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THE AIRLINES: DESTINED TO FAIL?

RICHARD D. CUDAHY

I. INTRODUCTION

A KEY PIECE of wisdom about airline economics may be the thought that “no mass transportation system in the history of mankind has been profitable over time.”1 Perhaps part of the answer to the current financial crisis of the airline industry lies in pondering this historical circumstance. With deregulation, the airlines have been acquiring more and more of the attributes of mass transit.2 And as they have increasingly become a form of mass transportation—like Amtrak or the Greyhound bus—they have increasingly found it difficult to make ends meet. This Article will explore this interesting general observation at a later point, but first it must cover some specifics of airline economics.

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1 Kevin P. Mitchell, The U.S. Airline Industry Fate, 15 KNOWLEDGE, TECH. & POL’Y 3, 5 (2002). As Brian Cudahy notes, “[i]n recent years it has often been said that public ownership and operation of transit systems in North America came about after the Second World War because a downtown-oriented transit industry was no longer able to earn profits in the face of massive competition from private automobiles in an increasingly suburbanized environment.” BRIAN J. CUDAUBY, CASH, TOKENS AND TRANSFERS: A HISTORY OF URBAN MASS TRANSIT IN NORTH AMERICA 127 (1990). Today, it seems to be generally accepted that “[n]o mass transit system in the country earns a profit, and most transportation experts say that a system is successful if it reaches the 50 percent point.” Clifford J. Levy, The PATH War: Giuliani’s Call for a Fare Increase Provokes Anger and Veiled Threats, N.Y. TIMES, Aug. 27, 1995, § 1, at 34.

2 Comparing airlines to mass transit systems is not as peculiar as it may at first appear; many have urged, in fact, that federal subsidies for long-distance train travel should mirror those given in the airline industry. See, e.g., Editorial, Keep the Trains Running, N.Y. TIMES, Sept. 30, 2002, at A24.
The airline industry, deregulated in 1978, has been rewriting the laws of economics ever since its liberation from government control of entry, routes, rates, and other economic factors. Since deregulation, airlines have been free to serve whatever cities pleased them and to charge whatever fares seemed appropriate. Not only were the fares unrestrained both on the upside and on the downside, but their internal structure paid no heed to the principles of non-discrimination. It is a well-worn observation that passengers seated side-by-side in the tourist cabin could be paying fares that diverged by ten times or more in amount for essentially the same transportation.

There was a period, primarily in the 1990s, when business travelers were protesting bitterly about the high level of fares and complaining, probably correctly, that the high business fares were subsidizing the bargain prices available to vacationers. Whether an appropriate cost relationship existed between business and leisure uses to justify the fare differential is very doubtful since fare relationships resulted from a process called “yield management,” which essentially sought to charge not what was cost-justified but what the traffic would bear. Tickets sold immediately before flight time were presumably for business users, and their prices were set at estimated levels that businesses could absorb without extreme protest because it was assumed that business demand was quite inelastic. On the other hand, non-refundable tickets sold with advance purchase requirements and Saturday overnight stay requirements were presumed to be for planned leisure travel (where demand was very elastic). The price of these tickets was set with leisure travel use in mind and with the ultimate purpose of filling all the seats on the airplane. The yield management process may be viewed as a form of Ramsey pricing, where the very low marginal cost of air travel was reflected in the price of cheap tickets,

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3 Eric Torbenson, Travel Budgets Get Clipped: More Local and National Businesses are Spending Less on Travel—And That’s Bad News for the Airlines, ST. PAUL PIONEER PRESS, May 20, 1999, at 1B.


6 Id.
for which leisure-traveler demand was highly elastic, but total costs had to be recovered from the sale of higher-priced tickets to business travelers with inelastic demand.\(^7\)

One of the great innovations of the “legacy,” full-cost carriers to meet the competition of low-cost competitors, was to provide enough deeply discounted tickets to attract passengers who would otherwise be lost to low-cost competition, while providing enough full-price tickets for business passengers willing and able to pay the higher prices.\(^8\) Various large business customers, including the largest—the U.S. Government—were able to negotiate some concessions from absolutely top prices for themselves with different airlines.\(^9\) But essentially, the process of ratemaking amounted to charging at the top end what the traffic would bear and at the bottom end what would fill the aircraft’s seats. This process, as previously noted, is called “yield management.” The high-cost carriers could succeed in competition with the low-cost carriers because, although those airlines generally had uniformly low prices, business travelers did not use them much. This is how the system was supposed to work, but in the period after the September 11 terrorist attacks, the legacy carriers seem to have lost the power to price differentially in a way adequate to sustain revenues while filling all the available seats.\(^10\)

Business travelers, guided by their companies, began to desert the legacy carriers to take advantage of the uniformly low fares charged by the low-cost airlines and to use the discounted advance purchase and non-refundable fares offered by the legacy carriers.\(^11\) Video conferencing also played a role in corporate

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\(^7\) Brady & Cunningham, supra note 4, at 10–11 (“Ramsey pricing involves varying a rate or a fare charged for a ticket based on the elasticity of demand for that ticket in relation to the marginal cost of providing that ticket.”).

\(^8\)See Pitt & Norsworthy, supra note 4, at 86–88.


\(^10\)See Mitchell, supra note 1, at 6–8.

\(^11\)See, e.g., Mary Ellen Podmolik, United, American See Drop in Profits: Weaker Demand for Business Fares, Chi. Sun-Times, July 22, 1999, at 52 (observing that business travelers were switching to low-cost airlines and advance-purchase tickets); Chris Woodyard, More Companies Fly with Discount Airlines: Smaller Carriers Offer Incentives, Cheaper Fares, USA Today, July 19, 1999, at 1B; Sandra Jones, Business Travelers are Paying the Price, Chi. Sun-Times, Jan. 10, 1999, at 53 (noting that business travelers were switching to advance-purchase and non-refundable fares).
efforts to contain travel costs. These and other factors forced the legacies to reduce their business fares, thereby putting pressure on a major source of their revenues. As this Article is written, the financial condition of the well-established (legacy) airlines is dire, while that of several of the low-cost, start-up airlines is quite healthy. Four out of six of the largest airlines have recently sought bankruptcy protection, and it would be difficult to undertake much air travel without flying on a bankrupt line. Current commentary about the industry emphasizes the

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12 See, e.g., Torbenson, supra note 3 (explaining that businesses were pre-planning trips to take advantage of advance-purchase fares and replacing trips with video conferencing); Edwin McDowell, Companies Put Brakes on Their Travel Budgets, St. Louis Post-Dispatch, June 1, 1998, at 22 (observing that companies were replacing trips with video conferences).


cost advantage enjoyed by the low-cost airlines and ascribes their success to their cost structure, which enables them to offer inexpensive tickets that their more cost-burdened brethren have to match—usually at a loss.16

This Article, after dealing with some of the historical circumstances that have led the airlines to their current pass, will explore the dilemma of airline deregulation: on the one hand, there has been a plethora of charges of predatory conduct involving such matters as "fortress hubs," predatory pricing and capacity dumping, abuse of computerized reservations systems, exclusive dealing arrangements, abuse of travel agent commission overrides, abuse of code-sharing and megacarrier alliances, but, on the other, the industry as a whole has been unable to achieve a cumulative net profit over the entire period since the Wright brothers undertook the first flight at Kitty Hawk.17 On the one hand, there have been many serious accusations of efforts to improperly restrain competition, but, on the other, there has been evidence of what in a perhaps less enlightened age was called "excessive competition."18 Thus, the net earnings of the airlines, as adjusted for their accumulated deficits since they began to fly, are zero, or less than zero. There have been periods of prosperity, but these always have been offset by periods of loss. Still, at least during the long period of deregulation, the air has been filled with accusations of improper efforts to suppress competition and claims of excessive profits by the major carriers. This Article will attempt first to briefly sketch the history of regulation and deregulation of the airline industry and to suggest the concepts and expectations that were associated with both those regimes. Later, it will seek to answer the questions whether there is too little competition in the airline


industry or too much and whether the industry may ever look forward to sustained profitability. All this will lead to some observations about the general context within which, in a long historical perspective, mass transportation (perhaps including the airlines) may never have been profitable.

II. HOW DID THINGS GET THE WAY THEY ARE?

From 1938 to 1978, the airlines were heavily regulated. The principal rationale for regulation was the belief that the industry was wracked by excessive and destructive competition. So the regulatory regime, although it permitted some competition in strictly limited circumstances, relied heavily on administrative measures in preference to market forces. Entry, routes, and fares were the principal subjects of regulation. Routes between city pairs were awarded by the Civil Aeronautics Board ("CAB") based on many criteria including, of course, the expected demand for service. An effort was made by the CAB in some cases to award routes to regional and other secondary carriers to strengthen their systems and improve their financial health. Healthy airlines were also expected to provide service on unprofitable routes. There was a fair amount of direct competition, because more than one airline would have rights to fly on more heavily traveled routes. Ten "trunk" airlines were certificated (authorized) to fly on major routes, and no new airline was admitted to this group during the period of regulation. A number of regional airlines, as feeders to the trunk lines, were also authorized by the CAB. In addition, commuter lines with smaller planes also provided service to less traveled destinations.

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20 Meyer & Menzies, supra note 18, at 24; see also Pitt & Norsworthy, supra note 4, at 67–96.
21 From 1938 to 1940, the Civil Aeronautics Authority regulated the airline industry; the Civil Aeronautics Board assumed oversight in 1940. STEVEN A. MORRISON & CLIFFORD WINSTON, THE EVOLUTION OF THE AIRLINE INDUSTRY 4 (1995).
22 E.g., New York-Chicago Serv. Case, 22 C.A.B. 973 (1955) (granting Capital Airlines application to extend certain routes and to remove operating restrictions on others because the CAB concluded that Capital could viably compete and would better serve the public). See also Paul Stephen Dempsey, The Rise and Fall of the Civil Aeronautics Board—Opening Wide the Floodgates of Entry, 11 TRANSP. L.J. 91, 112–13 (1979) [hereinafter Dempsey, Rise and Fall].
23 Brady & Cunningham, supra note 4, at 5–6.
Fares were regulated by the CAB, with the amounts of fares varying generally in line with distance flown. The regulation of fares meant generally that competition had to take the form of efforts at better service. Frequency of flights between various city pairs was the most significant dimension of service, which meant that, as competition mounted, airlines would fly more flights with lighter passenger loads—and thus lower load factors. A load factor is the percentage of a full load carried on a particular flight, and the lower the load factor, the less remunerative the flight. Thus, competition sometimes tended to reduce efficiency.

Competition also took the form of more comfortable seating or dining service featuring richer and more delicious food. Competition, however, could not be reflected in lower fares, and the CAB made every effort to keep fares remunerative and the airlines profitable (although, as industries go, airline profits were not extraordinarily high). Meanwhile, safety standards were enforced by the Federal Aviation Administration, and this regulation was unaffected by the later discontinuance of entry, route, and fare regulation.

Economic regulation came to an end with the passage of the Airline Deregulation Act of 1978. Deregulation of the economic aspects of airline operation (public control of entry, routes, rates, etc.) was complete, and these dimensions of air travel were left entirely to the market. The transition was so sweeping that the economic regulatory agency, the CAB, ceased to exist as of 1985. The move to deregulation was facilitated by intense academic criticism of regulation primarily on ground of inefficiency and wastefulness of resources. Also, unregulated intrastate airline service could be furnished at much lower cost for the same quality of service as federally regulated airline service.

The entry of the industry into deregulation was turbulent with numerous start-up airlines making their appearance, usually offering cheaper prices than the legacy carriers and often chal-

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24 Pitt & Norsworthy, supra note 4, at 73–74; Morrison & Winston, supra note 21, at 25–27.
25 Pitt & Norsworthy, supra note 4, at 69–70.
26 Id. at 72–73.
lenging them directly along popular routes. During the 1980s and shortly thereafter, many new airlines (and a few old ones) bit the dust. Air Florida, Midway, People Express and Frontier—all showing promise at the outset—were unable to sustain operations. Some more established carriers, like Eastern (originally one of the so-called Big Four) and Braniff, also went out of business. But stalwarts like United, American, and Delta seemed to be doing reasonably well despite their high cost structures.

The question therefore occurs why, during this earlier period of deregulation, it was primarily the start-up, low-cost carriers that were the victims of financial failure. An answer is, of course, that these airlines had no “franchise” carried over from the days of regulation and did not operate on a broad geographic scale. Their business was almost wholly noncommercial travel, and they had few business travelers paying much higher business fares. Unlike the “legacies,” where the cheap fares were targeted at only a limited category of vacationers, the fares of start-ups were uniformly low. Most of them had no first-class service, which appealed to many business travelers. Their financial resources were limited, and frequently, when they undertook to extend their service to new areas, they were unable to compete effectively.

Part of the reason for the high casualty rate for new airlines during this period was the successful efforts of the established carriers to score competitive points by establishing “fortress hubs” impervious to incursions by new entrants, by making selective price cuts and expanding service to meet competition, by establishing and making available to travel agents proprietary computerized reservations systems (“CRSs”) (purportedly favoring the offerings of the owner of the system), by code-

30 Id. at 76–77.
31 DOGANIS, supra note 28, at 71.
32 Id. at 72.
33 CRSs are “computer systems that contain and provide information about airline schedules, availability, fares, and other services.” Cindy R. Alexander & Yoon-Ho Alex Lee, The Economics of Regulating Reform: Termination of Airline Computer Reservation System Rules, 21 YALE J. ON REG. 369, 371 (2004).
34 MORRISON & WINSTON, supra note 21, at 62 (stating that CRSs can be biased in two ways, through “display bias,” when “the host’s flights are listed more prominently than those of other carriers,” and “architecture bias,” which “often makes
sharing and megacarrier alliances, and by other techniques (some allegedly predatory). Accusations of predation against the legacy airlines relied on the theory that they were undercutting the start-ups to put them out of business with a later opportunity for the big airlines to charge monopoly prices. Efforts to invoke the antitrust laws against the legacies were generally unsuccessful. And complaints about the permissive attitude of the Department of Transportation toward airline mergers probably came too late. In 1987, however, there was a shift of antitrust enforcement to the Department of Justice.

After the September 11 attacks, the casualty epidemic among airlines seemed to shift from the start-ups to the legacies. As indicated earlier, as business fares continued to rise, corporations rebelled and guided employees to the use of low-cost airlines or of non-refundable tickets on the legacies, so that the revenues of legacy carriers, heavily dependent on elevated business fares, began to decline. U.S. Airways entered bankruptcy twice, while United sought protection once. Delta and Northwest entered recently. Even American seemed shaky (although at this writing it remains solvent). It suddenly became crystal clear that the lower costs of the start-ups (based in large part on their less onerous labor contracts) gave them an inherent advan-

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37 Id. at 1195–96. Antitrust liability against the legacy carriers on the theory of predatory pricing is rarely established because of the difficulty of proving a carrier practiced below-cost pricing and recoupment. The district court granted AMR Corp.'s motion for summary judgment because the government could not establish that AMR's alleged predatory pricing was below cost or that American was able to recoup any of there short-term losses.

38 Nancy S. Abramowitz, Flying on Empty?: Airlines, Pensions, and Disappointments, 1 BUS. L. BRIEF (Am. U.) 21, 21 (2005) (stating that legacy carriers, as opposed to low-cost carriers, have been dissolved or absorbed by others in bankruptcy or “merely flirted off and on” with bankruptcy).

39 See supra note 15. Continental, which has fallen into bankruptcy twice in its history, has managed to survive thus far.

40 Abramowitz, supra note 38, at 21.

41 Mark Skertic, Flight Paths Diverge: United and American Take Sharply Different Tacks as They Try to Return to Profitability, Chi. TRIB., June 26, 2005, at C1.
tage that threatened to push the established part of the industry into bankruptcy. The industry solvency problems were greatly exacerbated by the dizzying rise in the price of oil and correspondingly of aviation fuel and by the imposition of heavy security costs after September 11. Fuel is a cost input even exceeding labor in impact, and bankruptcy provides no escape from this category of cost nor from the elements of security costs not assumed by the government. Nevertheless, operating successfully in this season of adversity was the former intrastate carrier, Southwest, which had union contracts but apparently not onerous work rules. Southwest could, therefore, claim low labor costs and had apparently hedged against rising fuel costs.

Although the economic aspects of airline activity are no longer regulated, the cost environment within which various airlines operate is subject to modification under the Bankruptcy Code. As the financial condition of an airline deteriorates, it becomes a candidate for reorganization under Chapter 11 of the Bankruptcy Code. Once in Chapter 11, the airline may take advantage of various provisions of the Code permitting rejection of certain executory contracts that impose financial obligations. The most significant of these contracts are collective bargaining agreements with the unions representing its employees. United Airlines, which was in bankruptcy for several years, took the opportunity to renegotiate on several occasions wage and benefit concessions with various groups of employees, like pilots, mechanics, and flight attendants. United has also been

42 Id. (noting that 162 domestic carriers declared bankruptcy since airline deregulation; nearly all failed).
44 Id. at §§ 1101-74. Chapter 11 permits airlines, like other businesses in financial turmoil, to restructure their finances while continuing to operate. CHARLES JORDAN TABB, THE LAW OF BANKRUPTCY § 5-6 (1997).
46 Id. at 273 (“Generally, labor costs are both the single largest variable cost (between airlines) and the largest cost factor.”) (footnote omitted). On labor issues, airlines are subject to 11 U.S.C. § 1113, allowing a debtor to secure the bankruptcy court’s approval for an interim or permanent rejection of CBAs.
47 See Micheline Maynard, Agreements Reached With United, Averting a Strike, N.Y. Times, June 1, 2005, at C2 (stating that United reached agreement with International Association of Machinists and Aerospace Workers; other unions, including the machinists, pilots, and flight attendants, had previously granted the airline $1.5 billion in concessions so that it could emerge from Chapter 11); Micheline Maynard, For Airlines, A Long Argumentative Summer, N.Y. Times, June 30, 2004, at
successful in shedding its pension liabilities through securing their takeover by the Pension Benefit Guaranty Corporation (PBGC).\footnote{See, e.g., Micheline Maynard, United Air Wins Right to Default on Its Pensions, N.Y. TIMES, May 11, 2005, at A1.} Other airlines have also succeeded in eliminating their obligations either while in bankruptcy\footnote{See, e.g., Micheline Maynard, US Airways and Unions Agree on Cuts, N.Y. TIMES, Dec. 21, 2002, at C1 (stating that US Airways successfully shed obligations while in bankruptcy).} or through negotiations to avoid bankruptcy.\footnote{See, e.g., Micheline Maynard, Delta Reaches Deal With Pilots, Averting Chapter 11 Filing, N.Y. TIMES, Oct. 8, 2004, at C1 (stating that Delta’s agreement with pilots’ union cut wage and benefit costs but enabled it to avoid bankruptcy); Maynard, Northwest Chief, supra note 47 (stating that American received concessions from its unions by threatening to declare bankruptcy).} As indicated, wage and benefit concessions by labor constitute the largest items of relief available to bankrupt airlines. These concessions, by extending the life of the failing airlines, tend to perpetuate excess capacity, and, while serving to rescue the airline and many of its employees, do little to correct the conditions leading to financial failure, except to reduce or eliminate the claims against the enterprise.\footnote{See John J. Gallagher, Jon A. Geier & Margaret H. Spurlin, An Unhappy Crossroads: The Interplay of Bankruptcy and Airline Labor Law, SK007 ALI-ABA 679, 708-09 (2004).} Of course, labor contracts are the prime targets for rejection in bankruptcy.\footnote{The Bankruptcy Code prescribes the standards under which a bankrupt airline may reject a collective bargaining agreement. 11 U.S.C. § 1113.} To the extent that employee benefits, including wages, are reduced, employees are being called on to subsidize the carriers.\footnote{Labor has attempted to extract promises by airlines to give back these concessions if the airline is ever profitable. To date, these attempts have been unsuccessful. But see Mark Skertic, IRS Ruling Taxes Plan for United, Airline Fighting Tax on Notes to Workers CHI. TRIB., Aug. 25, 2005, at C1.} Governmental subsidies and loan guarantees have also been provided to needy airlines through legislation enacted after September 11.\footnote{Air Transportation & System Stabilization Act, Pub. L. No. 107-42, 115 Stat. 230 (2001). See also Tara Branum & Susanna Dokupil, Security Takeovers and Bailouts: Aviation and the Return of Big Government, 6 TEX. REV. L. & POL., 431, 475-86 (providing a general discussion of the 2001 government bailout).} These developments are consistent with viewing the airlines as a species of mass transit because subsidization is common practice in connection with
the latter. Subsidies are made available to various species of mass transportation, including airlines, because of the essential nature of these services and the dire consequences of their interruption. In its early years, the airline industry was subsidized through contracts for the carriage of air mail.\textsuperscript{55} Bankruptcy proceedings and how they relate to subsidies will be discussed further, later in this Article.

III. AN EVALUATION OF DEREGULATION

At this point, it may be appropriate to examine the advantages and disadvantages of deregulation. There is general agreement that deregulation has lowered average fares and, through discounted fares made available to bargain-seeking travelers, made it possible for a much broader segment of the public to take advantage of air travel than under regulation.\textsuperscript{56} These changes, of course, have moved air travel closer to mass transportation. From another perspective, there has been a greater opportunity under deregulation for airlines to engage in what are arguably predatory practices (some of which have been noted) such as discriminatory pricing and the exercise of dominance at hub airports.\textsuperscript{57} Deregulation has also stimulated merger activity, which, at least to some degree, has had a depressing effect on competition.\textsuperscript{58} But an obvious and troubling consequence of deregulation has also been the seeming inability of the industry to maintain profitable operations on a sustained basis. Even


\textsuperscript{56} Brady & Cunningham, \textit{supra} note 4, at 10 ("Despite many press reports critical of airline behavior under deregulation, the Department of Transportation believes that consumers have received much benefit from the advent of deregulation . . . . consumers can save on an average fare anywhere from 35 to 40 percent in markets where low-cost carriers operate.").

\textsuperscript{57} \textit{See}, e.g., United States v. AMR Corp., 140 F. Supp. 2d 1141, 1152-54, (D. Kan. 2001) (discussing American Airlines' observation that Delta Airlines lost $232 million in annual revenue by passively allowing Valujet, a low cost carrier, to make inroads in its Atlanta hub. An American internal memo proclaimed "[c]learly we don't want this to happen to AA at DFW [American's main hub]." American believed that its long-term viability required protecting its DFW hub and its network out of DFW against low cost carriers, and its fare matching and increased capacity against a low cost carrier's entry was one tactic in maintaining its hold on DFW).

\textsuperscript{58} Carstensen, \textit{supra} note 55, at 135 ("The most important change in airline structure since 'decontrol' has been the wave of mergers that has increased the level of concentration in the industry as a whole and created regional monopoly problems.").
though the absence of regulation has apparently provided an opportunity for certain airlines to take undue advantage of a monopoly position on certain routes, the industry as a whole and over time has not been able to make money. The only airline to succeed financially on an extended basis has been Southwest, which has enjoyed low costs, has grown gradually and prudently, and is now the shining example of what a successful airline ought to be.

A preliminary question here should be: does it make any difference that the airline industry has been chronically unprofitable for as long as memory stretches? The consumer certainly has not suffered from the low prices that have brought on airline deficits. And investment capital has continued to be forthcoming for airline projects no matter how discouraging the realistic prospects for making money. Somehow, those who would put their money in airlines have not been discouraged by the dismal financial history of the industry. Perhaps airline investors are like people who put money into Broadway shows—lots of excitement but little financial payoff. This generosity of investors seems to contradict the laws of economics; under the generally understood rules of capitalism, a record of profits, or at least some expectation of them, is a necessary condition to eliciting investment. But perhaps there is something about the airlines that has repealed those rules. Perhaps we need not be concerned, and all the money required to keep potential passengers content will be forthcoming as a result of some investment impulse unrelated to the prospect of gain. If this is indeed the case, a study of airline economics becomes even more enlightening because it presents a completely new set of principles, never before encountered.

59 Since price competition was unleashed by deregulation, the industry has lost all of the $5.4 billion in cumulative profits it had made prior to 1978 and then some. Daniel P. Rollman, Comment, Flying Low: Chapter 11’s Contribution to the Self-Destructive Nature of Airline Industry Economics, 21 EMORY BANKR. DEV. J. 381, 383 n.16 (2004) (citing Edward Wong, Airline Economics: Fasten Your Seat Belt, N.Y. TIMES, Dec. 9, 2003, at G6).

60 See, e.g., Wong, supra note 59.

61 Scott McCartney, The Middle Seat: It Could Get Even Worse for Airlines, WALL ST. J., May 17, 2005, at D4 (stating that, despite concessions among airline executives, the airline industry is "as bad as it ever has been right now," investors, backed by hedge-fund money, continue to invest in the industry at prices which analysts consider inflated). Industry analysts’ cool reception to the recent US Airways-American West merger echoes this concern. See Jerry Knight, US Airways Investors Live in a Fantasy World, WASH. POST, May 30, 2005, at E1.
Much as one would like to believe that the airlines do not share the usual obligations of business enterprises and the paramount requirement to show a profit, one should assume that a failure to return something to their investors will in due course end unhappily, if not disastrously. Perhaps, this assumption is slavish adherence to the conventional economic wisdom, but it seems more reasonable to try to explain why airlines are the way they are while subject to the usual conventions, than attempt to formulate an entirely new set of conventions. Observing that money continues to flow to the airlines, one is struck by the almost pathetic credulity of investors that can keep hope alive in the face of an almost universal experience of ultimate failure. But beyond that, one simply must assume that perpetually losing money is a bad thing with some unfortunate consequences.

One of these consequences will probably be a decline in levels of service: the substitution of a pack of pretzels for a decent meal. Additionally, a decline in the quality of equipment will result: airplanes will be expected to fly longer and farther than would be the case in more prosperous circumstances. Of course, less profitable service to smaller centers of population is bound to be reduced in the interest of reducing costs. However, the availability of subsidies can cushion these impacts on the level of service.

Another consequence of straightened financial circumstances might be the impairment of airline safety. The fact that no fatal accident has occurred during these years when bankruptcy has been a common airline condition lends credence to the no-

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62 Mark Skertic, Fliers Share Stress of a Weary Airline: Traveler’s Five-day, 7,836-mile Odyssey Finds Passengers Adjusting But Missing Way Flying Used to Be, CHI. TRIB., July 31, 2005, at C1; Joe Sharkey, In a Sign of Desperate Times, Many Airlines on Many of Their Flights Will Serve No Meals, N.Y. TIMES, OCT. 24, 2001, at C6. But see Keith L. Alexander, As Amenities Disappear, United Bucks Trend, WASH. POST, June 14, 2005, at D1 (stating that John P. Tague, United’s head of marketing, noted that the airline is “not pulling pillows and blankets off because we’re still here to provide value-added service to the customers” and predicts that “there is a large segment of customers who value and will pay for what we produce”); Andrea Bennett, Travel: Loo Skies; Planes Add Bidets, Flowers, But Will Flyers Notice? The No-Thud Toilet Seat, WALL ST. J., May 13, 2005, at W1 (stating that some airlines are sprucing up their bathrooms while cutting back on other services).

63 See, e.g., Micheline Maynard, Fears of Isolation as US Airways Cuts Flights, N.Y. TIMES, Aug. 13, 2004, at C1; Micheline Maynard, A Nation of Airport Haves and Have-Not’s, N.Y. TIMES, Sept. 26, 2004, § 3 at 31 [hereinafter Maynard, Airport Haves and Have-Not’s].

64 Sara Kehaulani Goo, Airline Inspections Called Inadequate; FAA Hasn’t Kept Up with Risks Posed by Industry Cost-Cutting, Reports Says, WASH. POST, June 9, 2005, at
tion that the Federal Aviation Administration ("FAA") regulates safety with the same ardor in the face of bankruptcy that it displays when cash flows are satisfactory. However, it hardly seems likely that safety is not somewhat undermined by the decline in employee morale inevitably associated with major give-backs and even loss of company pensions. In addition, financial stringency has led to increased farming out of maintenance to contractors (including contractors in foreign countries). This is not necessarily a bad practice leading to a decline in quality of maintenance, but the diffusion of control, inherent in the use of contractors, may create a potential for problems. Certainly, a pervasive need to save money is not compatible with an increased emphasis on safety. At the time of the ValuJet crash in the Florida Everglades, there was a concern that low-cost operations implied cutting corners on safety. Frankly, the ability of the airlines to lose money wholesale while maintaining excellent safety records is amazing, but one should remain skeptical that this state of affairs can be maintained fully intact over the long run. Efforts to economize must tend to impair safety in the long run.

In any event, is it not axiomatic that in a capitalist economy, net earnings are essential to survival and that the adequacy of earnings has something to do with the quality of the product or service provided? If aircraft are to be replaced when worn out, new employees recruited to replace old ones and an income stream generated to support the value of equity, the airlines


67 See Carstensen, supra note 55, at 128 ("After decontrol of fares and profits, there were two pressures on investments in safety. First, the funds used for excess safety investment now could be diverted into profits . . . . Second, competitive pressures might well drive down total earnings, which would in turn create added incentives to postpone or minimize any avoidable investment."). But see Bahram Adrangi, Garland Chow & Kambiz Raffiee, Airline Deregulation, Safety, and Profitability in the U.S., 36 TRANSP. J. 4, 50 (1997) (concluding that the authors' study showed "[t]he increased financial riskiness of the business has evidently had no effect on airline safety").

must have earnings. So, it may be unnecessary to demonstrate why losing operations cannot rationally be accepted over the long haul. Agreeing with this premise, one can attempt to analyze why losses seem so inescapable. And history suggests that they may be unavoidable. Regulation was introduced in 1938 in the belief that, without it, excessive and destructive competition would destroy the potential for successful operations.\(^6\) Of course, in those days the airlines were an infant industry, and there was a general belief that protection was no longer needed in 1978, when the regulatory shield was removed.\(^7\) But, since 1978, there have been clear signs that the airline competitors have encountered great difficulty in dealing with unrestrained competition. Despite proper and improper efforts to win a degree of control over pricing\(^7\) (that have succeeded in some instances but not enough to swing the balance toward profitable operations overall), clear symptoms of overcapacity\(^7\) or underpricing\(^7\) continue to be the rule rather than the exception.

IV. THE DILEMMA

After deregulation, the airline industry has faced the twin problems of, on the one hand, anticompetitive abuses and, on the other, competition that may be too vigorous or too destructive, causing almost the entire cadre of legacy airlines to plead for relief. Of course, the orthodox comment on such a disorderly scene is that there is no such thing as excessive competition. Yes, abuses can impair competition, but there is no such thing as too much competition. The concept of excessive compe-

\(^{6}\) Meyer & Menzies, supra note 18, at 24 ("The airline industry was originally regulated out of concern that carriers, left to their own devices, would compete so intensely that they would set fares too low to generate the profits to reinvest in new equipment and other capital.").

\(^{7}\) Vowles, Effect of Low Fare Carriers, supra note 16, at 121 ("The supporters of the [Airline Deregulation Act of 1978] believed that market forces would create competition between the airlines, which in turn would create lower fares for consumers and a more efficient industry as a whole.").

\(^{71}\) Brady & Cunningham, supra note 4, at 9 ("The high ratio of fixed costs to variable costs, and the potential for excess capacity, create a situation in which airlines are willing to sacrifice long-term stability for near-term income. Such a situation creates a ruinous pricing environment for the airlines.").

\(^{72}\) Id. at 8 ("[A]irlines find themselves in a situation that, when the price is equal to the minimum average cost, the capacity is greater than the demand.").

\(^{73}\) Id. at 13 ("[I]t has been documented that major carriers do in fact match lower fares [of new entrants]," citing study showing that "United Airlines set their fares to match those of Frontier Airlines, and that price put them 30 percent below their costs ... ").
tition has not been widely credited since the 1930s. This orthodoxy leaves the generally accepted explanation of red ink in air carrier operations: the failure of most, if not all, airlines can be attributed to their unwillingness or inability to cut costs to a level where they can compete with Southwest, Jet Blue, or whoever else may come along. Certainly, cost-cutting is an obvious response to the sort of financial embarrassment that has driven several leading carriers into the bankruptcy court. The main consequence of this has been the effort to squeeze labor costs—obviously at the expense of employees, whose standard of living has been substantially undercut. Quite apart from issues of fairness, there are real questions whether this kind of draconian solution can in the long run be in the best interest of the industry. Some observers, of course, see the whole bankruptcy process as merely taking back what should never have been given to labor in the first place. What are being scrapped, however, are agreements on which both sides thought they could rely. We do not really know specifically what will be the ultimate outcome of the industry’s “perils of Pauline” existence, but the dangers to reliable service seem significant, if not dire. Therefore, there must be questions about the success of free competition in the airline industry.

The obvious alternative to an uncritical faith in the market is recourse to heavy-handed regulation to restrain some of the excesses of competition. At some point, re-regulation may indeed be sought by the airline industry as the only proven way to rid it of deficits. Recourse to earlier forms of regulation, however, raises the specter of all the inefficiencies and misallocations which characterized the regime in force before 1978.\textsuperscript{74} It is hard to imagine that regime, or any close variant of it, not resulting in prices far above present discounted levels and far in excess of what bargain-hunters may have learned to expect in current circumstances. Regulation, as practiced before 1978, essentially involved government management of an airline cartel with the allowance of competition only on a carefully measured basis. One does not have to be a market fanatic to see the problems with such an inflexible brand of regulation.\textsuperscript{75}

\textsuperscript{74} See Carstensen, \textit{supra} note 55, at 112 (stating that, by the 1950s, the CAB had “become a protector of existing airlines by blocking entry, frustrating price competition, and generally setting rates that allowed airlines very good returns”).

\textsuperscript{75} See id. at 111 (“[CAB regulation] created the functional equivalent of a powerful and protected industry cartel . . . [p]rices, routes, and other aspects of competition within the CAB’s jurisdiction were controlled . . . .”).
Are there any measures short of the old style of regulation that would help to avoid the current problems of the industry? One can start with what might be the crudest approach: the establishment of a ceiling on the total number of aircraft in commercial use at any particular time. Such a limitation on supply, if feasible, would, of course, violate a basic principle of antitrust, but could help to maintain a more realistic balance between supply and demand. However, this approach would obviously run up against the problem of determining how the permissible aircraft should be allocated among the various carriers and what provisions should be made for new entrants. In fact, the problems might be very similar to those encountered in a supply management program in agriculture, with quotas to determine how much each farmer can place under cultivation.\(^7\)

This approach, when fully elaborated, might not be much different from the arrangements formerly in effect under the CAB. However, during the period of regulation, one measure for reducing overcapacity was to allow agreements among airlines to limit capacity.\(^7\)\(^7\) If subject to regulatory surveillance, this might provide an approach to the overcapacity problem. But before attempting full, or even partial re-regulation, it might be worthwhile to explore how the apparently destructive impact of naked price competition could be moderated without recourse to something encumbered with all the accumulated baggage of "regulation." After all, price competition in the airline industry has been so intense that it has persistently driven the industry into deficit operations, and an attempt might be made to "moderate" competition short of comprehensive regulation.

\(^{76}\) U.S. agricultural economic policies and programs have historically consisted of supply management programs. See generally Allen H. Olson, *Federal Farm Programs—Past, Present, and Future—Will We Learn From Our Mistakes?*, 6 Great Plains Nat. Resources J. 1 (2001). Such an agenda creates certain problems. See *The McGraw-Hill Encyclopedia of Economics* 21-22 (Douglas Greenwald ed., 2d ed. 1994) ("It is also generally agreed that the [U.S. agricultural economic] policies and programs in the 1950s and 1960s and again in the 1980s held farm prices and incomes higher than they otherwise would have been in a short-run context . . . . [T]he policies and programs were beneficial to the farming sector in the short run, but the implications for the long run are questionable . . . . [T]he general agricultural economic policy of the nation has contributed, and continues to contribute, to a changed structure of American farming—a structure in which there are fewer and fewer and larger and larger farms.").

V. CAN COMPETITION BE TEMPERED IN THE INTEREST OF STABILITY?

Certain markets characterized by pure price competition may be plagued by a problem of competitive intensity,\textsuperscript{78} in which sellers find it difficult to maintain their financial viability. This may not be fully true of commodity businesses generally although it is usually the case that people in these businesses are struggling on a continual basis to differentiate their products in order to escape the commodity classification, and the airlines' product is not only a commodity, but a \textit{perishable} commodity.\textsuperscript{79} Some of the factors that seem to bear on the financial viability of commodity producers involve the ease of entry into their businesses, the transparency of competitive prices, and the apparent urgency of meeting competitive prices. Entry into the airline industry, although not almost costless as was argued in connection with the application of contestability theories, is still thought to be relatively easy.\textsuperscript{80} And price transparency has been strongly fortified by competitive information easily accessible on the Internet, which is increasingly the vehicle for obtaining air reservations in lieu of recourse to travel agents.\textsuperscript{81} Airlines and some similar businesses, where entry is relatively cheap, where there is apparently nothing unique or recognizably different about the

\textsuperscript{78} Brady & Cunningham, \textit{supra} note 4, at 8 ("It is argued that the airline industry can be seen as having an empty core, where there are no core customers who cannot be taken away by a price competition rival.").

\textsuperscript{79} Id. at 10 ("Airlines treat their seats as a perishable commodity . . . . The [seats] are differentiated by service levels received in flight, and by the willingness of a customer to accept certain restrictions.").

\textsuperscript{80} There seems to be a lack of consensus as to whether the airline industry is characterized by ease of entry. Vietor argues that entry was easier after deregulation, with low sunk costs enhancing contestability, but concludes that the advantages of incumbency, specialized assets, and strategic choices prevailed. Richard H. K. Vietor, \textit{Contrived Competition: Airline Regulation and Deregulation, 1925-1988}, 64 BUS. HIST. REV. 1 (1990). Levine notes that early deregulation literature hypothesized that entry and exit into the airline industry would be possible without substantial sunk costs because aircraft were leased, and maintenance and reservation systems were contracted, while airports and airways were already public. Levine, \textit{supra} note 27, at 400. \textit{But see} Andrew R. Goetz, \textit{Deregulation, Competition, and Antitrust Implications in the U.S. Airline Industry}, 10 J. OF TRANSPORT GEOGRAPHY 1, 4 (2002) (citing study identifying five significant "barriers" new airline entrants face); Carstensen, \textit{supra} note 55, at 141 (stating that "new entrants faced substantial costs in making entry into a market, and that existing airlines had many inherent advantages over new entrants").

\textsuperscript{81} Rubin & Joy, \textit{supra} note 5, at 222 (stating that "the advent of competitive direct airline ticket sales, on both individual airline and discount travel Web sites, has revolutionized the marketing and selling of tickets").
product, and where prices throughout the industry are extremely transparent, seem to have an urgency about meeting competition that may lead to prices falling below what is required to recover costs.\textsuperscript{82} This is a phenomenon that is not part of the body of orthodox economics but is one that occasionally pops up where, as indicated, entry is relatively costless, where the product is purely a commodity and undiluted price competition is the rule, where prices are wholly transparent, and where there is an urgency to meet competition, as, for example, in the airlines and in agriculture. Seventy years of experience with the airlines, during which there have been no net cumulative earnings, suggest that something is at work beyond poor management (although that may be a factor).\textsuperscript{83}

Currently, there is nothing about an airline flight that raises it above the level of generic rapid transportation between Point A and Point B.\textsuperscript{84} It is, of course, easier to distinguish service between Point A and Point B (as opposed to individual flights) from the generic on grounds of frequency or of superior timing. It is also possible to distinguish service based on a number of factors, such as type of aircraft used, amount of space between seats, food and drink provided during flight, and so forth, but the commercial reality seems to be that price will trump any of these factors as a basis for choice—in part because these factors are rarely so telling as to override price. Travel in the coach section of airplanes is uncomfortable, and the fact that it may be slightly more uncomfortable on some airlines than in others is rarely decisive.

One of the marketing devices developed by the industry to overcome the consequences of its commodity character is the frequent flier program. This program provides that the more miles are flown on a particular airline, the more free additional miles of flight on that airline will be earned. Thus, particularly for business travelers, who cover tens or hundreds of thousands of miles annually, there is an opportunity to accumulate enough

\textsuperscript{82} See Brady & Cunningham, supra note 4, at 8, 10.

\textsuperscript{83} See Rubin & Joy, supra note 5, at 219 ("The market power characteristics of price determination, product differentiation, economies of scale, and contestability with low-cost competitors indicate that airlines are an inherently unstable industry—a problem typical of industries with high capital costs.").

\textsuperscript{84} As Brady and Cunningham state, "[i]t is argued that the airline industry can be seen as having an empty core, where there are no core customers who cannot be taken away by a price competitive rival." Brady & Cunningham, supra note 4, at 8.
free mileage to enable the traveler to fly domestic and even international routes on vacation without cost.\textsuperscript{85} This is certainly an incentive to stick with one airline with a generous frequent flier program and to accumulate free mileage at a relatively high rate. It may have been frequent flier programs that for a long time kept business customers of the legacy airlines loyal in spite of prohibitively high fares. Sometimes, the employers of these travelers arrogated the bonus miles to themselves—thus providing the employers with a significant benefit and a good reason (at least in their own mind) to remain loyal to their chosen legacy carrier.\textsuperscript{86} But gradually the incentive of bonus miles was overborne by simple considerations of price, and business users began to abandon the high fares of the legacies in favor of tickets on the low-cost carriers or non-refundable tickets on the legacy carriers.\textsuperscript{87} Businesses began to decide that they simply could no longer afford a high level of air travel. In fact, they began to promote video conferencing and other electronic substitutes for travel itself.\textsuperscript{88} As a result, frequent flier plans lost much of the effectiveness as a means of stimulating repeat business.\textsuperscript{89} But in

\textsuperscript{85} One might even say that frequent flier programs were designed to lure business travelers away from discount travel. See Paul Grimes, \textit{What's New in the Travel Industry, Wooing the Corporate Traveler}, N.Y. TIMES, Dec. 25, 1983, § 3, at 9 ("Apparently acknowledging that most business travelers (or their companies) care more about basic transportation than frills, American Airlines recently announced that it was discontinuing extra-fare 'business class' from most domestic flights. The big pitch, instead, is to entice [business] travelers through frequent-flier bonuses—principally in the form of free travel—for choosing one carrier over another.")

\textsuperscript{86} When frequent flier programs were first instituted, many corporations did not like this bonus since its benefits were designed to accrue to individual travelers, not their employers. See Grimes, supra note 85. But employers first had to force employees to disclose these details, which proved difficult. Frequent flier programs were so successful that business travelers often kept mum about travel plans so as to conceal accumulated perks from their employers. See Agis Salpukas, \textit{Companies Battle Airlines on Bonuses}, N.Y. TIMES, Dec. 19, 1983, at D1 (stating that corporate travel departments had difficulty persuading employees to turn in bonus travel points from frequent flier programs).

\textsuperscript{87} See Torbenson, supra note 3.

\textsuperscript{88} See McDowell, supra note 12.

\textsuperscript{89} But see Kimon Proussaloglou & Frank Koppelman, \textit{Air Carrier Demand}, 22 TRANSP. 371 (1995) (finding that air carrier choice was a product of market presence, schedule convenience, low fare, on time reliability, and frequent flier programs; in their study, however, frequent flier programs had one of the strongest impacts on carrier selection).
their heyday, frequent flier programs were criticized as being anticompetitive.\textsuperscript{90}

Another marketing device aimed at tying potential customers to one of the legacy carriers and also suspected of anticompetitive potential was the computerized reservations system ("CRS"), which was widely furnished to travel agents. American Airlines first entered this field with its Sabre system,\textsuperscript{91} which provided travel agents computer listings of flight schedules and fare information relating to almost all airlines.\textsuperscript{92} American Airlines flights, however, were given prominent treatment, with the expectation that they would frequently be the choice of the travel agents on whose premises the CRS was installed.\textsuperscript{93} United Airlines soon followed with its Apollo system,\textsuperscript{94} which provided a similar service with similar expectations of providing a boost for United's business.\textsuperscript{95} A growing number of other airlines also undertook to establish CRSs. This approach was effective enough

\textsuperscript{90} See Mark N. Cooper, Freeing Public Policy from the Deregulation Debate: The Airline Industry Comes of Age (And Should Be Held Accountable for Its Anticompetitive Behavior), 13 AIR & SPACE LAW. 1, 24 (1999); see also MORRISON & WINSTON, supra note 21, at 57.

\textsuperscript{91} Sabre was created in 1962 by IBM. See Thomas Petzinger, Jr., Hard Landing: The Epic Contest for Power and Profits That Plunged the Airlines into Chaos 54 (1995).

\textsuperscript{92} For a detailed discussion of Sabre's history and formulation, see Robert V. Head, Getting Sabre off the Ground, 24 IEEE ANNALS OF THE HIST. OF COMPUTING 32 (2002).

\textsuperscript{93} See Douglas B. Feaver, American Airlines Defends Computer System, Wash. Post, June 3, 1982, at E1 ("However, American builds what Crandall calls a 'bias' into the computer program" in which the first set of listed flights on the terminal will include those with best service, regardless of airline, but American flights that are within thirty minutes of the desired time will be listed first, even if another flight is closer in time).

\textsuperscript{94} Apollo was created in 1971. See Stanley Ziemba, Feds Wonder If All's Fair in the Air, Critics See Bias in How the Airlines Take Reservations, Chi. Trib., Mar. 29, 1992, at C1.

\textsuperscript{95} See John H. Cushman, Jr., The High-Stakes Battle for Airline Reservations, N.Y. Times, June 18, 1989, § 3, at 7 (describing architectural bias in Apollo; a travel agent using Apollo can see up-to-date information on the availability of United seats and fares but not necessarily for other airlines, and will issue more United tickets because the Apollo system is designed to make transactions involving United flights easier than for those of other airlines--a factor known as the "halo effect"); Dempsey, Predation, supra note 35, at 812 (stating with respect to "upstart airlines" that "Apollo's display bias against non-code-sharing connecting flights . . . coupled with United's refusal to code-share with upstart airlines, gives their product offerings inferior shelf space in the vertically integrated market which United controls").
to evoke criticism as being anticompetitive, and in due course some regulatory measures were adopted to eliminate the presumed discriminatory effect of the CRSs. The CRSs, however, did not seem to be a significant factor when, after September 11, the legacy airlines were sorely battered by competition from the low-cost operators. The bottom line is that none of the various marketing devices employed by the legacy airlines to enable them to compete successfully in the face of substantially lower prices has proven to be very effective. In the end, price always seems to be the dominant consideration. According to mainstream economists, this is as it should be. But the unalloyed dominance of price, in conjunction with the other factors discussed, has not only driven the airlines toward efficiency but also in many cases toward bankruptcy. There seems to have been too much of a good thing — competition.

What may have been needed, and what has always been missing in the airline industry to help keep financial disaster at bay, is a strong enough sense of brand preference and brand loyalty to dilute the impact of persistent and radical price cutting as the only marketing strategy. The essence of the airlines' competitive problem has been the need to follow the low-price leader instantaneously or even anticipatorily, with nothing to sustain sales even in the face of a minor and transitory price disadvantage. A genuine and widely recognized advantage in quality would, of course, seem to be exactly what is required, but this is a situation that has rarely prevailed in the airline industry. One instance of where it has prevailed involves Midwest Express, which has its hub in Milwaukee and which flies to various important destinations throughout the country. This airline has provided two-abreast seating, with wider seats than are available in

\[\text{See, e.g., Scott McCartney, American Airlines is Accused of Bias With Sabre System, WALL ST. J., Oct. 29, 1996, at A8.}\]
\[\text{See, e.g., id. The CAB began to investigate the CRS industry, in particular those systems owned by American and United, as early as 1982. Alexander & Lee, supra note 33, at 381. In the summer of 1982, the Department of Justice empaneled a grand jury in Fort Worth to investigate American Airlines' Sabre system and found that the system produced anticompetitive conditions; it later opened a similar probe to inquire into United's Apollo system. Douglas B. Feaver, Justice Steps Up Probe of Airline Ticketing Systems, WASH. POST, Mar. 13, 1983, at F1. This led to overlapping investigations and conflicts of authority, which were ultimately resolved in favor of the Department of Justice. Douglas B. Feaver, Baxter Asks CAB to Drop Own Air Ticketing Probe, WASH. POST, Apr. 21, 1983, at D17. The CAB, however, outlawed display bias in CRSs in 1984. MORRISON & WINSTON, supra note 21, at 62.}\]
\[\text{See Torbenson, supra note 3.}\]
the normal three-abreast situation.\textsuperscript{99} This was a feature widely known to potential passengers and widely commented on as an important benefit by people acquainted with the airline. But recently, when the whole industry has faltered in the wake of September 11 and in the face of competition from the low-cost carriers, even a well-developed and well-known quality advantage like this one, has apparently not been able to offset price as a determinant of consumer behavior.\textsuperscript{100} Of course, low prices are what competition is supposed to produce, so there may be impatience with the view that this can be a "problem." The current view of the airlines' situation is simply that the legacies must get their costs down to match the low-cost carriers or go out of business. Several of the legacy carriers are now in bankruptcy, and several more threaten bankruptcy. Bankruptcy is now a sort of Purgatory—a waypoint on the road to Heaven, where petitions of all sorts can relieve aspiring debtors of their burdens. In the case of the airlines particularly, bankruptcy affords an opportunity to shed bothersome obligations in the interest of becoming competitive. And the obligations to one's labor force are the most vulnerable, apparently because there are no alternative bidders for the services of pilots and flight attendants. There, of course, have been precedents in other industries for the use of bankruptcy as a weapon against labor. Meatpacking comes immediately to mind.\textsuperscript{101} In 1984, Wilson and Company (a large meatpacker) entered bankruptcy and rejected its collective bargaining agreement, which purported to incorporate a wage scale following the industry pattern—that is, the scale of compensation imposed by the Food and Commercial Workers international union on all, or almost all, significant members of the industry. The Wilson company then adopted a wage scale drastically reduced from what had existed before.

\textsuperscript{99} See Associated Press, \textit{Midwest Airlines Aims to Please Thrifty Fliers}, CHI. TRIB., May 29, 2003, at C10 (commenting on the "signature service's more spacious two-by-two leather seats").

\textsuperscript{100} See Melissa Allison, \textit{Leisure Suits Midwest Fine in Turnaround; Milwaukee-based Airline Renowned for Its First-class Treatment of Business Travelers Takes Drastic Steps to Cope With Big Losses}, CHI. TRIB., Mar. 22, 2004, at C1N.

\textsuperscript{101} Oklahoma-based Wilson Foods, Inc. was financially solvent, with $67 million in assets, when it filed for Chapter 11 in 1983, but was losing $1 million each week largely because of noncompetitive union contracts. In bankruptcy, the corporation unilaterally abrogated union contracts and sharply reduced wages for union workers before emerging from bankruptcy in 1984. See Warren Brown, \textit{Surviving "Creative" Bankruptcy; As a Business Strategy, Firms Find That It Exacts a Heavy Price}, WASH. POST, Nov. 6, 1988, at H1.
This shattered the industry pattern, and from then on members of the industry negotiated their own contracts establishing levels of compensation applicable only to them. This was a precedent for much that has followed in the airline industry.

And nowhere has bankruptcy been used with such persistence, determination, and, flair as in the airlines to change rather fundamentally the terms under which employees undertake to render service. The shift of the United Air Lines pension plan to the back of the government (under much more modest terms) is the most conspicuous example. The underlying principle of international unionism—that competition should not be carried on in the terms under which labor is rendered—has been abandoned. That principle was the basis of the unions' efforts to establish an industry pattern that could be enforced uniformly in bargaining with all employers in a given industry. On that basis, all the competitors in an industry would be faced with the same labor costs, and competition would be carried on otherwise than at the expense of labor. Of course, that principle has currently lost much of its significance in the face of the growing importance of competition's going forward on a global basis, where there is no wage "pattern." But even in strictly domestic terms, the Bankruptcy Code has presented a golden opportunity to employers to carry on competition primarily in the terms that they offer to their employees and to engage in a running revision of their labor agreements (and "a race to the bottom"). This process has met with no expressions of outrage outside of labor circles except for a newspaper column written by a Catholic priest, who has equated the dumping of pensions to the theft of a worker's wages and as a sin calling out to Heaven for vengeance. Without pursuing the morality of these matters, it is still the case that the bankruptcy process may amount to a subsidy to the airlines by their labor force.

Whether the downward revision of the benefits provided by a collective bargaining agreement is a true "subsidy" is more than

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104 Andrew Greeley, Editorial, A Society That Permits Such Abuse is a Sick Society, CHI. SUN-TIMES, May 27, 2005, at 47.
a matter of semantics. Because the terms to be revised had once been voluntarily agreed upon by the parties, they seem to represent a proper baseline for evaluating the nature of a change under the duress of the Bankruptcy Code (even though the latter may only have recognized the realities of the need for corporate survival). A subsidy to facilitate corporate survival is nonetheless a subsidy. There may be objection to use of the word "subsidy" on the ground that the benefits under the labor contract were purportedly too generous and agreed to by the airline under some kind of unspecified duress. The fact is, however, that the collective bargaining agreement was enforceable as a contract absent the coercive impact of the Bankruptcy Code. Under the law, it was a voluntary agreement, and properly establishes the baseline against which to measure the changes demanded by the Bankruptcy Code.

VI. ARE THERE SOLUTIONS?

The airlines face a situation where they have been deregulated and committed to the tender mercies of competition. They have operated in a more or less freely competitive mode for more than twenty-five years. The competitive regime has been successful in substantially lowering fares and in opening the airways to use by much broader segments of the general public than was formerly the case. There would be little support for returning to the former regulated regime. There have been periodic concerns that the legacy airlines have engaged in anticompetitive practices at the expense of the "low-cost" airlines. On the other hand, at this point the legacies are, without exception, suffering severe financial problems and seem to be incapable of competing successfully with the low-cost airlines, at least without severe reductions in costs mostly achieved under the Bankruptcy Code. Labor concessions achieved under the Bankruptcy Code are, in effect, subsidies by labor to the airlines, hopefully enabling them to recover financial stability.

The airlines have attempted, for the most part unsuccessfully, to differentiate their product so as to build brand loyalty and to insulate themselves to a degree from pure price competition. But air travel seems to be a commodity with unusual price transparency provided by the Internet, which furnishes immediate price comparisons of the cost of requested air travel between specified points. Whether, for some reason, this, coupled with comparative ease of entry, leads to "excessive competition" is the question raised by some observers, even though the concept of
“excessive competition” is not recognized by mainstream economists today. In addition, antitrust theory regards competition as an unqualified good—always to be sought after and never to be undermined. There is no escaping the fact, however, that, taken collectively, the airlines have not shown a profit over their entire history—that is, the profits from the beginning have been offset by the losses. This is a stubborn fact that must be recognized and addressed.

Perhaps, there is something about the process of establishing airline prices and of responding to prices set by competitors that leads to ill-considered pricing below cost. The fixed costs of an airline flight are so great in relation to the total cost that pricing at marginal cost, without adequate adjustments to capture total cost, will bring eventual disaster. In addition, passenger transportation, by air or otherwise, is a perishable commodity. There is great pressure to earn something for empty seats before their value disappears on take-off roll. It might be useful to conduct experiments in pricing procedure to obtain clues about any changes that might improve the rationality of pricing. One approach that might conceivably be helpful and might bring more deliberation to pricing would be to establish a requirement that public notice of price changes must be filed with a government agency a specified time before the proposed fare’s effective date. This procedure might have some impact in making pricing more deliberate and more rational although there is no present evidence that this is necessarily the case. In any event, this sort of procedural requirement, or something like it, would presumably have no fundamental or long-term effect on the price-setting function of competition but might tend to restrain whatever it is that leads to underpricing in the competitive maelstrom of airline yield management. Whether this kind of provision, or some other similar procedural requirement, would be helpful can, of course, be determined only by trial and error.¹⁰⁵

The more fundamental problem—that mass transportation is intrinsically incapable of yielding a long-term profit—is obviously more resistant to solutions.¹⁰⁶ If this dictum is in fact valid

¹⁰⁵ See Carstensen, supra note 55, at 143.

¹⁰⁶ Indeed, at times, the potential for mass transit to be profitable was sacrificed for the “public good.” New York, for instance, debated in the early years of the twentieth century whether considerations of profit would triumph over those of loss; in 1906, as the New York state assembly was confronting this very issue, the New York Times argued that the “truest test” of any new subway line was “the reasonable certainty of profit,” while the Hearst papers contended that “only
(and history seems to validate it), its cause may be the force of the consumer demand for transportation service below cost. Currently, almost all forms of mass transit are subsidized, from Amtrak\textsuperscript{107} to municipal bus service.\textsuperscript{108} Greyhound continues to operate an intercity bus service on a for-profit basis.\textsuperscript{109} Whether this can be done successfully remains to be seen, and Greyhound continues to retrench its service. Greyhound certainly provides mass transportation, although its customers are drawn heavily from the lower-income fringe of the population. The airlines serve a broader spectrum of incomes and, with time, seem to penetrate lower and lower on the income scale. Another indicator of the demand for subsidies in mass travel was the practice, in socialist economies, to offer mass transportation at prices far below cost. The author shall always remember paying three kopecks to ride the Moscow subway in its Red period.

\textsuperscript{107} Amtrak is the popular term for the National Railroad Passenger Corporation, a private, for-profit company created by the Rail Passenger Service Act that in 1971 took over virtually all intercity passenger trains. \textsuperscript{108} Subsidization is actually built into the structure of publicly managed mass transit. From the end of the Second World War, mass transit under public management "was able to distinguish operating expenses (i.e., salaries, fuel, routine maintenance) from capital expenses (i.e., replacement of rolling stock, construction of maintenance facilities)." \textsuperscript{109} Tim Jones, \textit{Greyhound Cuts Leave Many Adrift}, CHI. TRIB., Oct. 30, 2005, at C27.


\textsuperscript{108} Subsidization is actually built into the structure of publicly managed mass transit. From the end of the Second World War, mass transit under public management "was able to distinguish operating expenses (i.e., salaries, fuel, routine maintenance) from capital expenses (i.e., replacement of rolling stock, construction of maintenance facilities)."}
Obviously, socialist practice should not dictate capitalist policy, but the socialist procedure is some indicator of the force of public demand for cheap transportation.

The strength of consumer or public demand can powerfully affect the pricing of such crucial necessities as mass transportation. Similarly, resistance to high business fares in recent years has broken the airlines' favorite fare structure. As the public develops a sense of entitlement to transportation as essential to survival in a modern economy, it acquires a resistance to prices that are beyond the reach of the most disadvantaged and impu-
cunious.\textsuperscript{110} Call this resistance political, if you will;\textsuperscript{111} it is a resistance that can powerfully affect commercial relations.\textsuperscript{112} The airline entrepreneurs of today may be like the street railway and interurban tycoons of a bygone era, who were able to extract a profit from their transportation enterprises for a while but who eventually succumbed to public ownership or its equivalent.\textsuperscript{113} To the extent that airline travel becomes democratized—that is, available to almost the entire population regardless of income or status—the more likely it is to follow in the path of other forms of mass transit.

Of course, air travel has not for the last twenty-six years been price-controlled like most of the earlier forms of mass transit, and this fact may suggest a different adjustment to deficits. The earlier types of mass transportation passed out of private ownership when public authority would not allow fares to be maintained at, or raised to, a compensatory level. Airline fares are unregulated, so they presumably will follow a variant of this scenario. The likely path of the airlines is for them to receive periodic public subsidies under various guises as red ink proliferates rather than to descend at an early point into public ownership (although that may be their eventual fate). Once the public is addicted to bargain fares (and this is the case today) it seems unlikely that the industry will seek or the government permit necessary increases. Subsidies like the ones instituted after Sep-

\textsuperscript{110} See Randy Kennedy, The Nation: On New York's Mass Transit, Pay More as You Go, N.Y. Times, Dec. 15, 2002, § 4, at 3 (stating that when mass transit systems were taken over by cities, "fares often held steady for decades" because "mass transit was an efficient way to move people around and that making it affordable was good public policy").

\textsuperscript{111} See id. (stating that raising mass transit fares could be "political suicide").

\textsuperscript{112} See Air Transport Ass'n Statement, supra note 17, at 22.

\textsuperscript{113} The transfer of public mass transportation was effected only when private owners could not afford to bear the costs of replacing old and outmoded equipment. See Cudahy, supra note 1, at 181.
tember 11 (with some regulatory surveillance) are more likely, and this will be the end of airlines as ordinary commercial enterprises (although, of course, hidden subsidies abound in other sectors of the economy). The pressure for subsidized fares (in some form) will prevail in the long run. This, of course, would be a reversion to the early days of aviation when subsidies related to carriage of mail were a major source of revenue to airlines. Nor would subsidization (hidden or overt) put an end to competition, which would continue, though with a less likely culmination in bankruptcy.

The most obvious objection to this line of argument is to cite the example of Southwest and ask, "Why can’t all the other airlines do what Southwest has done and operate profitably over time?" There is little doubt that the management of Southwest has outshone all of its competition over a very extended period, and the policies of Southwest would be models for others to emulate. But can the entire airline system of the country successfully follow the Southwest pattern? This is doubtful because one of Southwest’s most important policies has been to be very careful where and how it undertakes service. It has undertaken service only on those routes where, for one reason or another, it thought that it could compete successfully.\(^\text{114}\) And it has been careful about the number of flights it has undertaken in servicing a particular route.\(^\text{115}\) It has essentially been a cream-skimmer or cherry-picker, not offering universal service, and this has been fundamental to its success. To serve the entire country—good routes and bad, like United, American and Delta—is not nearly as likely to be as profitable. A closely related consideration involves the use of hub-and-spoke routing as opposed to Southwest’s point-to-point scheme. Hub-and-spoke is a more efficient way of providing universal service, but Southwest’s approach works very well for its more limited purposes. Thus, the example of Southwest—heartening as it has been (and a model to be emulated)—cannot serve as a paradigm for an airline sys-

\(^{114}\) As Herb Kelleher has remarked, “We have a limited number of planes and we can make X number of dollars in one city and Y in another . . . . We have a formula for that . . . . usually accurate to 5 percent. If the formula says we will do substantially better here than there, we select that city.” Richard M. Weintraub, \textit{Herb Kelleher Has Done It His Way: For Southwest’s Flamboyant Chief, Success Brings Satisfaction, Wealth}, \textit{Wash. Post}, Sept. 12, 1993, at H16.

\(^{115}\) See Maynard, \textit{Airport Haves and Have-Nots}, supra note 63 (“But even Southwest has to be careful in choosing new destinations, and in deciding how many flights to offer, because it must fill 15 to 25 flights a day to and from any destination for the route to make money.”).
tem purporting to provide something resembling universal service.

Nor does the anticipation of noncompensatory operations and subsidies eliminate the prospect of more entrepreneurial airlines—innovative and highly profitable—like Southwest, Jet Blue and Ryanair (in Europe). There will always be room for “niche” airlines, providing good service at low prices and earning profits better than the industry average. These will always be characterized by “cream-skimming” and will not be paradigms for the system as a whole—just as charter operators make money while the bus business in general is either a drain on the public treasury or ekes out a bare living. So there will always be room for the exceptional and for the highly focused, but this prospect does not essentially alter what may lie ahead for the bulk of the airlines.

VII. CONCLUSION

Currently there seems to be more concern about whether the airline industry as a whole can return to profitable operation and remain generally profitable in the future than about the many other problems relating to airlines that have arisen from time to time. The author belongs to the school that believes the present structure of the industry cannot survive unless profitable operation can be restored. Given the belief that private companies surviving on earned revenue must provide the service, a failure to return the air travel system to profitable operation will deal a fatal blow to the public interest in an efficient air transportation system.

An exploration of the economics of the industry reveals a belief that competition there tends to be so vigorous that some observers have described it as “excessive”—that is, tending to drive prices below costs, resulting in deficit operations. The main support for this view, which, of course, finds no foundation in orthodox economic analysis, is in the history of the industry. Before the institution of federal regulation in 1938, there was a continuing record of loss by air carriers, and, at that time, the idea of excessive competition was widely accepted. Of course, air travel was then in its infancy, so the financial record may not have relevance to current conditions. However, the financial record since deregulation in 1978 again shows a cumulative deficit of airline operations over the years. Sometimes the industry showed good profits, but these were offset by losses at other times. The only airline to prove consistently profitable
over the years has been Southwest, whose management has been unmatched but whose strategy involves cream-skimming—making Southwest a questionable model for emulation by the system as a whole.

As a remedy for whatever ails the system, some observers have advocated imposition of a full-blown pattern of regulation like that in place from 1938 to 1978. But this would probably result in significantly higher fares and in an inflexible fare structure and, as a remedy, might be worse than whatever ails the system now. A less comprehensive scheme of regulation might seek to limit the total number of aircraft in use at any particular time (a limitation on the supply of air travel). One question would be whether this approach could be confined in a practical way to overall supply. It is possible that such a limitation could be established by agreement (with antitrust exemption) as during the era of regulation. Experience during the period of regulation with agreements among airlines, subject to regulatory approval, to limit capacity might provide a basis for this approach.

If excessive competition is at the root of the problem, this Article suggests, as a lesser intervention in the market, experimentation with procedures for setting and announcing fares. There might be a requirement that changes in fares be filed publicly with a government agency and not put into effect for a period of time (perhaps, thirty days). Whether this would have a significant effect in causing prices to remain at or above costs is unknown, but only experience would provide an answer. Such a procedure might encourage more rational pricing, which would not detract from efficient results in the long run but might avoid underpricing as a short-term response to competition.

Another approach to the problem of persistent deficits is simply to recognize that air travel as a form of mass transportation is not destined to be profitable in the long run. Deregulation, with its introduction of heavily discounted fares, has helped to make travel by air a mass phenomenon, available to the public without distinction as to class or level of income. As a form of mass transportation, air travel will feel the powerful public resistance to fare increases in the interest of profitability. Like bus, train, and other mass transit before it, air travel will be increasingly unlikely to yield a profit. Like these other forms of mass transportation, air travel on the whole may survive only with public support and subsidies of a nature yet to be determined. The essential fact is that air travel over the years has been unable to produce a consistent profit. The burden is on those who
would continue with the present system unmodified to show how the consistent problem of unprofitability can be overcome.

The basic problem is a refusal to recognize the fundamental nature of the forces operating to deny profitability. Now that air travel has been made available to almost all of society at bargain prices, will society permit the sort of pricing needed to eliminate deficits? Or will society permit the persistent lowering of labor standards (in bankruptcy) in pursuit of solvency? Both of these possible avenues are blind alleys, and public subsidy is a more likely remedy for losses.