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The Civil Aeronautics Board Policy Favoring Subsidy Reduction to Local Service Carriers: Its Role and Implementation in the Decisional Process

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THE CIVIL AERONAUTICS BOARD POLICY
FAVORING SUBSIDY REDUCTION TO LOCAL SERVICE
CARRIERS: ITS ROLE AND IMPLEMENTATION
IN THE DECISIONAL PROCESS*

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I. INTRODUCTION

A. Introduction To The Topic

Since its formation in 1946, the local service airline industry has experienced a rapid rate of growth, recently surpassing even that of the domestic trunkline industry, and showing large absolute increases in revenue passenger-miles flown since 1960. The continuation of this trend in recent years, with commensurate increases in gross revenue, has raised the hopes both of the Civil Aeronautics Board ("CAB" or "Board") and many local service carriers of eliminating the subsidy program which has characterized the industry since its inception. The industry paradox of sustained dynamic growth with continued subsidized operations spotlights the importance of future Board decisions in charting a course which will further encourage the growth and development of the local service industry but at the same time deal with the problem of subsidy payment.

1. Statement of Purpose

CAB policy is implemented, to a large degree, through the decisional process. The reason for this is that the authority to make a decision provides the Board with a unique opportunity to realize policy objectives. It is able to utilize this power to render a decision consistent with its policy objectives.

It will subsequently be demonstrated that the CAB has adopted a policy of reducing the subsidy requirements for local service carriers. The mere adoption of such a subsidy reduction policy, however, does not mean that the Board is necessarily effectuating it. This thesis will be concerned with determining the extent to which the Board is effectuating its policy of sub-

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1 Service in Rocky Mountain States Area, 6 C.A.B. 695, 741-42 (1946).
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sidy reduction through its decisional process. Or, stated another way, the object may be said to be to determine the extent and manner of policy guidance in resolving alternative possibilities in each proceeding. However stated, it is the effect of the Board's subsidy reduction policy upon the Board's decisional process which will be examined herein.

2. Theoretical Framework

The first requisite for the analysis herein is the detection and determination of the CAB policy favoring subsidy reduction for the local service carriers, as well as its approximate date of adoption by the Board. In satisfaction of this element the various media commonly used to express policy will be examined. Such sources as annual reports to Congress, other reports, speeches, hearings, press releases and regularized publications such as codified regulations will be relied upon.

Having detected and defined the requisite policy, attention will be directed to the decisional process. The decisional process of the Board encompasses such diverse areas as fares and fare structure, certification of carriers to provide service (i.e., entry, exit and points served), various business relationships including stock ownership, interlocking relationships, consolidation, mergers and acquisitions, and accounts, records and reports. The Board has, however, as will be demonstrated, selected primarily the areas of merger and route certification as the most useful areas for the effectuation of its policy of subsidy reduction. This selection appears to be quite sensible, on its face, since both areas present substantial opportunity for financial improvement of local carriers (and concomitant lessened subsidy requirements). Mergers are capable of increasing efficiency of local carriers and generating more traffic; route certifications can do likewise. Because the merger and route certification areas are the primary recipients of Board attention when it comes to the effectuation of subsidy reduction policy, it is these areas which will bear analysis in determining whether the Board is effectuating its policy of subsidy reduction through its decisional process. In this connection the following questions will be posed. Can it be shown that the subsidy reduction policy has been a material factor in the Board's decisions regarding merger application and route certification? If so, how? If not, why not?

In brief, this thesis will focus specifically on whether the Board is effectuating its policy of subsidy reduction for local carriers in its decisions regarding mergers and route certifications. In pursuing this objective pertinent local carrier merger decisions of the Board will be analyzed. Having established the adoption of a CAB policy favoring subsidy reduction for local service carriers, attention will be directed to those decisions rendered prior to the adoption by the Board of its subsidy reduction policy which will be examined first. Then, decisions rendered subsequent to the policy

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5 "Merger" as used here, refers also to acquisitions and consolidations. Essentially, these three forms of amalgamation of corporate enterprise will be treated in the same fashion in this analysis. However, it will be noted, where relevant, which form of amalgamation is being considered.
6 See Hearings on the Local Air Carrier Industry, supra note 3, at 35-36, 50.
will be examined to detect, through any shift in emphasis by the Board in its rationales, whether or not the subsidy reduction policy has served to shape the subsequent merger decisions, or whether or not it can in fact be concluded that the Board policy of subsidy reduction has had a discernible effect upon the Board’s decisional process.8

In the case of route certification it will be demonstrated that the Board has developed a comprehensive program termed “systems realignment” designed to implement its program of subsidy reduction in route certification cases. This program is composed of several component programs, the most significant of which is the “dense route certification” program. It is sufficient to note at this point that various approaches will be taken to all component programs to determine whether the Board is effectuating its policy of subsidy reduction through each particular program and thereby having an effect upon its decisional process. The dense route certification program will be the exception. To determine the effect of the policy of subsidy reduction on it, the Board dense route certification decision decided prior to the program will first be analyzed. In this connection decisions rendered both prior and subsequent to the Board’s adoption of its subsidy reduction policy will be examined. Then, Board decisions rendered subsequent to the dense route certification program will be analyzed. The object of these analyses will be to detect any shift in emphasis by the Board in its decisions, which would indicate that the policy of subsidy reduction has had a discernible effect upon the Board’s process with respect to dense route certification cases.

3. A Brief Consideration of the Nature and Significance of Board Policy

Several cogent reasons exist for briefly considering the nature and significance of Board policy. First, a basic understanding of the role of policy is useful as general background for the analysis attempted herein. Second, such an understanding will prove helpful in detecting and defining Board policy. Finally, it is important for the purpose of determining, with maximum accuracy, the effect of Board policy upon the decisional process.

Policy can be formulated both by Congress and by the various federal agencies such as the CAB. Policy formed by Congress can take two forms. The first is a general statement of policy intended to provide only general objectives and guidelines for the Board. Section 1302 of the Federal Aviation Act provides an example of such general policy. The second

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8 No merger applications were heard or decided by the Board in the period commencing with the adoption of the subsidy reduction policy by the Board, on or about 5 April 1962, and ending with the predisposition involving the favoring of local carrier mergers, on or about 28 Feb. 1966.

9 It can safely be stated that if the rationale of a merger decision, rendered by the Board (or route certification decision for that matter) is partially or totally based upon a desire by the Board to effectuate its own policy of subsidy reduction, then the Board has effectuated its policy of subsidy reduction through the decisional process. Only the occasional decision is based upon the consideration of one factor such as subsidy reduction. Most cases involve more. However, even where subsidy reduction is only one factor considered in a decision it can still be a material one, although, the actual weight accorded it will likely be difficult to determine unless the Board specifically comments in that regard.


10 In the exercise and performance of its powers and duties under this Act, the Board shall con-
form is a more specific, but not necessarily definitive, statement. An example is provided by the requirement of consistency with the "public interest," inter alia, for merger application approval as set out in Section 1378(b) of the Act.\footnote{12}

When policy is formulated at the agency level by the Board it is done so by agreement of at least a majority of Board members, usually at the conclusion of a thorough examination of the area involved. When formulating its own policy the Board will rely heavily upon the general objectives and guidelines set forth by Congress in the declaration of policy contained in section 1302 of the Federal Aviation Act. The general objectives and guidelines are thus instrumental in providing direction for Board policies.

On occasion the President brings the great weight and responsibility of his office to bear upon the Board in requesting the Board to adopt a particular policy. The Board need not comply with the request, but it may well choose to do so. This is a second method of Board policy formation. It has occurred in the last few years and will be the subject of some discussion at a later point in this analysis.

Policy formulated by the Board is not invariably obvious to all concerned. It may be expressed in at least three ways:\footnote{13} a) as principle to be extracted from decisions in a case by case approach, b) as a rule or regulation promulgated by the Board, and c) as an overt statement of policy appearing in a speech, hearing, annual report, or press release. The latter two methods of policy expression must be regarded as two variations on the same theme, namely, formal pronouncement of policy. The significant distinction between a rule or regulation and an overt statement of policy derives from the methods of publication employed, the former appearing in regularized publication such as the Federal Register and the Code of Federal Regulations, and the latter appearing more or less spontaneously, in speeches, press releases, hearings, and annual reports.

Consider the following, among other things, as being in the public interest, and in accordance with the public convenience and necessity:

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

(b) The regulation of air transportation in such a manner as to recognize and preserve the inherent advantages of, assure the highest degree of safety in, and foster sound economic conditions in, such transportation, and improve the relations between, and coordinate transportation by air carriers;

(c) The promotion of adequate, economical, and efficient service by air carriers at reasonable charges, without unjust discriminations, undue preferences or advantages, or unfair or destructive competitive practices;

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

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

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


\footnote{13} U.S. ATT'Y GENERAL'S COMM. ON ADMINISTRATIVE PROCEDURE, FINAL REPORT—ADMINISTRATIVE PROCEDURE IN GOVERNMENT AGENCIES, S. Doc. No. 8, 77th Cong., 1st Sess. 21 (1941).


See for example the Board regulation concerning names of air carriers and foreign air carriers set out in the Code of Federal Regulations, 14 C.F.R. § 215 (1967). Contrast this with the CAB's
No CAB policy of subsidy reduction for local service carriers has been announced in regularized publications. Therefore, to establish its adoption, resort will be necessary to annual reports, speeches, press releases, other reports, etc. for its detection and definition.

Policy plays an important role in the functioning of federal administrative agencies. This holds especially true in the case of the Civil Aeronautics Board. The importance of policy to the CAB becomes evident upon considering the problems which arise in the Board's adjudicative process in the absence of guiding policy.

Overt stated Board policy serves as a guide to the Board in pointing the general direction for it to aim in its decisions. Without developing its own policy it would be very difficult for the Board to define and clarify the very general policy dictated to it by Congress in the Federal Aviation Act. The absence of stated Board policy would likely cause a retrogression to the evolution of policy on a case by case basis as a result of the vacuum which the absence of stated policy creates in the policy development area. Historically, this was the main method of policy development. The case by case approach to policy formation would be a step backward since it is slow, accidental in character, permeated with potential hazards, and capable of maintaining conflicting standards.

On the positive side, Judge Friendly has prepared a "miscellany of intra-agency advantages" favoring the enunciation of policy by the Board. His list includes educating Board members, reducing the volume of cases, prevention of periods of drift by the Board, decreasing the number of appeals, facilitating delegation to subordinates, and reducing expenses and delay. Clearly, then, policy enunciation plays an important role in the Board's functioning and can have important and far-reaching advantages. The foregoing discussion of Board policy has similar application to other federal agencies.

The CAB makes use of a "hearing examiner" to hear various air carrier applications and make recommendations to the Board based upon its own objective findings in light of the statutory requirements. The use of an examiner can result in more efficient functioning by the Board. Efficiency improves when the examiner successfully "pre-digests" a case for the Board because a great deal of the Board's time is saved by the examiner's hearing and decision. However, to reach decisions acceptable to the Board the examiner must be attuned to the Board's general thinking on any particular matter. The best way to achieve this is by the enunciation of general policy by the Board. This would allow the examiner the correct frame of

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footnotes:

14 "The most important responsibility of an economic regulatory agency such as the CAB is the formulation of broad plans and general policies . . . . This is more important than the decision of specific litigated cases." Hector, Problems of the CAB and the Independent Regulatory Commissions, 69 Yale L.J. 931 (1960).


16 Id. at 143.

17 Id. at 143-45.

18 Id. at 23-27.
reference for his decision. Conversely, the absence of enunciated Board policy is likely to result in the examiner's being uninformed of Board thinking and therefore without meaningful guidance for reaching a decision acceptable to the Board. This unfortunate situation inevitably results in the Board reconsidering the whole case in depth with the wastage of the Board's very valuable time and energy. This is precisely the situation which prevailed in the Seven States Area Investigation case. Because of an absence of Board policy in that case the examiner was virtually without direction. As a result, his decision, which required two years to reach, was discarded and another year passed before the Board resolved the issue by its own decision. Time, energy, and patience of the Board, examiner, and parties to the proceeding had been wasted as a result of a lack of policy direction.

It is clear that the absence of enunciated guiding policy can result in serious deficiencies in the adjudicative process of federal administrative agencies such as the CAB. The utilization of a hearing examiner, to improve the efficiency of the Board's functioning, can have the opposite effect where no Board policy has been enunciated as the Board will have to rehear the matter in depth in more cases than would be necessary if policy were first enunciated.

B. The Evolution Of CAB Subsidy Policy For Local Service Carriers

1. A Brief History of Commercial Aviation and Regulatory Legislation

Air transport has progressed in giant strides from its origin 65 years ago. Today commercial air transport is unquestionably the dynamic growth leader of the transportation industry. For a time in 1903, when Langley's "aerodrome" was splashing into the Potomac River and taking a $50,000 hope of the United States Government with it, it looked as though mankind was destined to remain earthbound. The successful 284 yard, 59 second, flight by the Wright Brothers on December 17, 1903, at Kitty Hawk, North Carolina laid to rest forever the notion that man was not intended to fly and profoundly changed the course of history. World War I greatly accelerated progress in aviation, the United States alone training 10,000 men to fly and building 17,000 planes. During this period Congress appropriated $1.25 billion for the purchase of Army aircraft alone.

A desire on the part of the government for speedy carriage of airmail further hastened the development of air transport. Airmail service was

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19 Seven States Area Investigation, 28 C.A.B. 680 (1958).
20 Id.
21 Id.
23 See W. Jones, Cases and Materials on Regulated Industries 744 (1967).
26 D. Locklin, supra note 22, at 742.
initiated in 1918 by the government, and it was this service which was destined to evolve into passenger carriage. Although the government operated the early airmail routes, the Kelly Act of 1925 authorized the Post Office Department to contract with private companies to carry the mail. Government operation of mail routes ceased in 1927. Until this time air transportation had been virtually free of regulatory control.

The Air Commerce Act of 1926 changed that situation however, by, among other things, requiring the Secretary of Commerce to foster air commerce through the establishment of airports and air navigation facilities, by collecting and disseminating statistics, and by investigating and reporting air crashes and accidents.

The Lindbergh transatlantic flight of 1927 aroused substantial speculative interest in airline stocks in 1928. The airline industry boom led to the formation, by consolidation of regional operations of several airlines into three large airline combines, the forerunners of United Airlines, American Airlines, and Trans World Airlines.

The McNary-Watres Act of 1930 had a very significant impact upon the development of air passenger transportation. It provided for airmail contracts to be awarded to the lowest bidder at rates based on a space mileage basis regardless of the amount of mail actually carried. This, in effect, provided subsidy to the mail-carrying airlines since they were able to fly mail space empty thereby allowing passengers to be carried in the empty mail space portion of the aircraft. An unfortunate consequence of the McNary-Watres Act was its administration by the Postmaster General, who, contrary to law, awarded airmail contracts at secret meetings known as "spoils conferences" instead of by competitive bidding.

Because of the illegal aspects of such airmail contracts they were cancelled by President Roosevelt in 1934 and the Army was assigned the task of flying the mail. The results were disastrous. The Army was not up to the task, and 12 Army pilots lost their lives.

The Army failure led to a policy reversal and the passing of the Airmail Act of 1934. The Act was designed to prevent a repetition of previous abuses. Airmail contracts were to be replaced on a competitive bid basis, certain financial and corporate interrelationships were prohibited, and, individuals involved in the previous collusive contract bidding were pro-
scribed from holding managerial positions in bidding airlines. The Act still allowed unsubsidized airlines to establish routes anywhere, even in competition with the mail carriers. Only the mail carriers were regulated at this time.

The situation prevailing between 1934 and 1938 saw the mail carriers becoming increasingly anxious over competition and potential competition from the unsubsidized carriers. Competition in the airline industry at this period could only be described as excessive. An example of the degree of destructiveness of the “cut-throat competition” prevailing in 1937 was furnished by the airline industry’s representative, Colonel Gorrell, who asserted that at that time, as a result of operating losses, only $60 million remained of the original $120 million put into the airline industry by investors, and, that of 100 companies which had entered the airline business only 20 had survived. The extreme competition and the unfavorable economic conditions of the great depression combined to render the airline industry financially unstable.

During the 1934-1938 period two important factors became obvious. First, financial stability was vital to a safe air transport system and, second, a financially sound and safe air transport industry was necessary for national security and defense. The financial instability of the airline industry caused by destructive competition and the general ill-health of the economy in the 1930’s induced Congress to provide comprehensive regulation of the airline industry in the form of the Civil Aeronautics Act of 1938. Apprehensive over potential competition and concerned over possible economic collapse, the mail carriers had favored regulation of the industry even before the passage of the Act.

The Civil Aeronautics Act provided a comprehensive system of regulation as well as detailed safety controls for the airline industry. The Civil Aeronautics Authority, later the Civil Aeronautics Board (CAB), was empowered to regulate entry into air transport, to regulate rates, services and many inter- and intra-corporate transactions, and to control the subsidy payment to airlines. Inasmuch as the regulatory legislation was enacted to curb abusive and destructive practices, it is not surprising that the role of competition within that framework has been severely restricted. Nevertheless it is noteworthy that Congress in enacting the

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45 S. Richmond, supra note 40, at 6.
46 Id.
47 Id.
48 W. Jones, supra note 23, at 736.
50 See W. Jones, supra note 23, at 736.
52 See S. Richmond, supra note 40, at 6, 7; H.R. Rep. No. 1328 at 2.
54 Id.
55 The question regarding the necessity of regulation of the airline industry and the advantages and disadvantages of regulating this industry will not be discussed in this paper. Not only is that subject broad enough to be considered at length in a completely independent work, but also many fine treatises and periodical articles exploring it in depth have been published. See S. Richmond, supra note 40, at 10-217; Meyer, Competition in the Transportation Industries (1959); Gellman, supra note 49, at 414-34.
comprehensive airline regulatory legislation of 1938 adhered to its general policy of competition in the economy where feasible. The Federal Aviation Act was enacted in 1958 for the purpose of making more effective the regulation of air safety. However, no substantial change was made regarding the regulation of economic matters by the 1958 Act.

The Civil Aeronautics Board, established under the Civil Aeronautics Act and continued under the Federal Aviation Act, is an independent Federal agency made up of 5 members appointed by the President for 6 year terms. No more than three members can be appointed from the same political party. The Board is charged with carrying out the Congressional mandate, as expressed in the Federal Aviation Act. In that connection it exercises broad legislative, regulatory, and judicial functions.

Pursuant to its responsibility to regulate and control air transport the CAB found it necessary to classify the various air carriers into distinct groups. Apart from a general classification of air carriers into private, contract, and common carriers the CAB, pursuant to its statutory authority, has classified the air carriers into seven groups as follows: 1) domestic trunklines; 2) local service carriers; 3) helicopter carriers; 4) intra-Alaska carriers; 5) intra-Hawaii carriers; 6) domestic all-cargo carriers; and 7) international and territorial carriers.

2. The Creation and Nature of Local Service Carriers

In terms of revenue passenger-mileage flown, the local service industry is still standing in the shadow of its larger brothers, the domestic trunk carriers and the international and territorial carriers. Nevertheless, this "little brother" of the scheduled passenger airline industry forms an integral part of the national air transportation system. Broadly speaking, this segment of the industry is charged with the responsibility of providing "local service" between small communities and "feeder service" between small communities and the larger cities. Of a total of 23 local service carriers originally certificated by the CAB, only 13 remain presently, and

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58 Hale & Hale, supra note 52, at 312.
59 Id.
61 Id.
62 J. Frederick, Commercial Air Transportation 89 (3d ed. 1951).
64 "The Board may from time to time establish such just and reasonable classifications or groups of air carriers for the purposes of this subchapter as the nature of the services performed by such air carriers shall require; and such just and reasonable rules and regulations pursuant to and consistent with the provisions of this subchapter, to be observed by each such class or group, as the Board finds necessary in the public interest." Federal Aviation Act of 1958, § 416, 72 Stat. 771, 49 U.S.C. § 1386 (1964).
65 D. Locklin, supra note 22, at 770.
66 In the year ended 30 June 1966, the local service industry flew 2,966,293 revenue-passerger-miles; the international and territorial carriers flew 18,514,640 revenue-passenger-miles and the domestic trunk carriers flew 54,672,061 revenue-passenger-miles. 1966 C.A.B. Ann. Rep. at 77, 79, 81. Thus, the local service carriers' flew a scant 2.56% of total revenue-passenger-miles for the year ended 30 June 1966.
this number will soon be further reduced as consolidations are con-
sumated.67

The disinterest in providing service to the smaller communities of the
nation displayed by the domestic trunklines caused the CAB to reflect
upon finding an appropriate method to service these less populous areas.
Since the trunklines were preoccupied with the more profitable longhaul
traffic the Board was forced to give consideration to certificating a new
"feeder" level of air transport to furnish the necessary service.68

In 1944 the CAB announced as its local and feeder policy a program
designed to connect the small communities by air with the larger air
centers where there seemed to be "a justifiable expectation of success at a
reasonable cost to the government."69 The initial experiment of local and
feeder air transport had been commenced, subject to ultimate Board con-
firmation of policy, with a route award to Essair in the Continental Air
Lines, Inc. et al., Texas Air Service decision on November 5, 1943.70

Therein the Board stated:

[T]here appears to be a substantial need for local service performed with
equipment chosen with primary reference to the requirements of the Inter-
mediate points to be served, such as that proposed by Essair. We think that
this type of service should be inaugurated as a practical extension of needed
air transportation to the smaller Texas cities on Essair's proposed route. Since
the authorization can be a temporary one it need not be deemed to foreclose
any of the numerous questions of policy involved in the investigation of local,
feeder, and pick up air services.71

The first members of the group were admitted on an experimental
basis receiving only temporary certificates.72 The first permanent certifi-
cates were not granted until 1955.73 Since 1955 virtually all certificate
awards to local service carriers have been of the permanent variety.

The primary role of the local service carrier as originally conceived was
to provide air transport between the small communities and the large
urban centers,74 a market that the trunks had largely neglected and sought
to dispose of. A more detailed explanation of the local carriers' role was
provided by the Board's careful distinction between local and trunk
 carriers in the Piedmont Certificate Renewal Case:

67 The present carriers in the local service carrier classification are Allegheny Airlines, Bonanza
Air Lines, Central Airlines, Frontier Airlines, Lake Central Airlines, Mohawk Airlines, North Cen-
tral Airlines, Ozark Air Lines, Pacific Air Lines, Piedmont Aviation, Southern Airways, Trans-Texas
Airways, West Coast Airlines. D. Locklin, supra note 22, at 771. The existing local service carriers
now cover more route miles and fly many times more revenue-passenger-miles annually than did the
23 local service carriers originally certificated. See, e.g., 1966 C.A.B. Ann. Rep. 4, 81, 82; 1949
69 Investigation of Local, Feeder, and Pickup Air Service, 6 C.A.B. 1, 4 (1944).
71 Id. at 484.
72 Service in Rocky Mountain States Area, 6 C.A.B. 695 (1946).
operating prior to 1955 received grandfather operating rights. To establish grandfather rights a
carrier was required to show that it was an air carrier furnishing local or feeder service of persons,
property and mail under a temporary certificate from January 1, 1953 to the date of application.
74 H.R. REP. No. 1328 at 24.
These [local] carriers receive mail compensation at a much higher rate unrelated to the volume of mail they carry. When created, local carriers were initially identified as 'feeder' operators, indicative of their anticipated role of feeding traffic to the trunkline carriers for long-haul travel. The experience of the local service carriers indicates that the major traffic they serve is local in character between smaller points and their trade centers, and to a lesser degree between the smaller points themselves. The present line of demarcation between the services of local and trunkline carriers in some respects is not always clear. Many trunkline routes contain small cities between major points, comparable to local service routes. However, the principal distinction appears to be that local service carriers generally are required to serve each point in the order designated in their certificates in each flight over a particular route segment. On the other hand, trunkline carriers are free to schedule service to the smaller points on a skip stop or local basis as they see fit, subject only to the adequate service requirement of Section 404 of the Act.\(^7\)

The role of the local carriers, as described by the Board, resembles only generally the present role of the local carrier and less still its probable future role.\(^6\) However, the foregoing Board statement does serve to distinguish the character of the local and trunkline carriers adequately, although as stated by the Board, the line of demarcation between the two is not always clear.\(^7\) This is especially true today in view of the local carriers great growth from mergers and certification on to dense routes.\(^7\)

The provision of true local service, that is shorthaul service to small communities, is an expensive proposition since several factors militate

\(^7\) Piedmont Certificate Renewal Case, 15 C.A.B. 733, 810 (1952). Shortly after the local carriers received permanent certification in 1951, the Board offered the following definition of a local service carrier: "An air carrier authorized by certificate of public convenience and necessity to provide regularly scheduled services within the United States of a shorthaul, local, or feeder character." 1951 C.A.B. Ann. Rep. 24.

\(^6\) The local carriers today have expanded by merger and dense route awards. Whereas the trunklines once resembled them in providing local service, the local carriers now resemble the trunklines in providing dense route service. Though the line of demarcation has never been completely clear they are presently distinguished by relative size, preponderance of shorthaul, local and feeder traffic, and general confinement to one region of the country (although these distinguishing features seem to be rapidly disappearing).

\(^7\) In some cases it is very difficult to distinguish, on the basis of characteristics, a local service carrier from a trunkline carrier. As noted, the Board has classified the certificated air carriers into seven groups. D. Locklin, supra note 22, at 770. The domestic trunklines are: American Airlines, Braniff Airways, Continental Airlines, Delta Air Lines, Eastern Air Lines, National Airlines, Northwest Airlines, Trans World Airlines, United Airlines and, Western Air Lines, D. Locklin, supra note 22, at 771. The local carriers were enumerated in note 67, supra. The only certain method of identifying a local (or trunk) carrier is by making reference to the named carriers in the Board's own classification of local and trunk carriers.

\(^7\) One inevitable question of course was whether certification of the local service system was really necessary? This question in turn raises the more fundamental question of whether air transport service was necessary for the nation's smaller communities. Pursuant to the requirement of the Civil Aeronautics Act to encourage and develop air transport, the Board decided that it had a responsibility to promote the extension of air routes to those smaller communities of the nation not presently receiving air service. Zook, The Certification of Local and Feeder Air Carriers, 7 Sw. L.J. 183, 190 (1913). The trunk carriers were not interested in carrying the local traffic and it was theorized by the Board that, in any event, in developing the limited traffic potential local service market "the greater effort and the exercise of managerial ingenuity may be expected from an independent local operator whose continuation in the air transportation business will be dependent upon the successful development of traffic on the routes and the operation of the service on an adequate and an economical basis." Rocky Mountain States Case, 6 C.A.B. at 737. The Board opted for establishing a separate local service system where there was a "justifiable expectation of success at a reasonable cost to the government." Local Feeder and Pickup Case, 6 C.A.B. at 4. Since the Board was only proceeding experimentally, and at the same time attempting to balance fairly the interests of service against cost, the conclusion follows that the Board's course of action, establishing a secondary air transport system, was the proper one under the circumstances.
against profitability: i.e., the typically light traffic density,∗ the relatively short hauls involved,† the high variability in traffic volume carried,∗′ the intermodal competition with railroads and buses for traffic,∗∗ and the general obsolescence and unsuitability of the aircraft used for local service. Given the problems of cost and demand, local service requires the assistance of subsidy. The CAB developed a subsidy program to satisfy this local carrier requirement.*∗

Presently, the local carriers still require subsidy support. The origins and development of local carrier subsidization will be explored in the succeeding section.

3. The Origins and Development of Local Service Subsidization: 1944-1968

It had been demonstrated that the provision of inherently costly short haul local service is likely the most expensive form of air passenger transportation. As a consequence local service has been subsidized directly by the Federal Government since its inception in 1944.∗∗∗

Subsidy payment∗∗∗∗ was first received by the airlines in the form of compensation for transporting airmail. The Civil Aeronautics Act of 1938 provided that such compensation be based on the “need”∗∗∗∗′ of each carrier for compensation in addition to its other revenue, that would allow, under efficient management, the development of air transportation.∗∗∗∗ Congress clearly intended to subsidize the airlines to the level of adequate revenues.∗∗∗∗∗ In 1951 the CAB separated the fair-compensation and the subsidy elements

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79 J. Frederick, supra note 62, at 157.
80 Id. at 118.
81 Id. at 159.
82 Id. at 160.

* Although subsidy could have been made internal, by the CAB’s forcing the trunklines to provide local service with losses being borne by the profitable trunk routes, the CAB rejected this approach and accepted instead a direct government subsidy program. The approach appears sound as it allowed the development of the trunklines to proceed unimpeded. It was favored by the local carriers as a matter of necessity.


85 Subsidization of the local service carriers takes three forms: 1) the airlines are allowed to use without charge the airways maintained by the Federal Government; 2) they may make payment for the use of public airports that do not meet the full costs; and 3) mail transportation payments contain a substantial subsidy for local service carriers. D. Locklin, supra note 22, at 784. Only direct (mail) subsidy payments to the local carriers will be explored in this paper.

86 The Federal Aviation Act of 1958 § 406, 72 Stat. 763, as amended, 76 Stat. 141, 49 U.S.C.A. § 1376 (1966), 136 provides for airmail payments on the basis of the “need” of each carrier. This is the basis of the CAB’s authority to provide subsidy payments. The legality of resort to a class subsidy rate by the CAB rather than an individual subsidy rate, as prevailed prior to 1961, seems at least arguable. The CAB argues strenuously that a class rate can be fixed and still provide an individual carrier with its “need” under the statute. Local Service Class Subsidy Rate Investigation, 34 C.A.B. 416, 433-34 (1961). In any event it appears as though the Board’s authority to establish a class rate has not been successfully challenged, since the class rate is still in operation, in revised form in 1968. See AVIATION WEEK, Dec. 18, 1967 at 34.


88 The Civil Aeronautics Act has established the rule that where the other revenues of an air carrier do not suffice to meet the expenses of developing and maintaining air transportation as required in the national interest, the airmail compensation shall be given the marginal role, and shall be established at such a level as is necessary to build the total revenues up to the required level.” Pennsylvania-Central Airlines Corp., Mail Rates, 4 C.A.B. 22, 51 (1942).
in airmail payments. In 1953 President Eisenhower transferred the function of paying the airmail subsidy portion to the CAB while leaving the payment of service airmail pay with the Post Office Department. By 1966 the local service carriers were the only airlines within the 48 contiguous states receiving subsidy, with the exception of a New England trunkline which was also flying several local service routes.

As mentioned, the first subsidy payment by way of airmail was determined by a carrier's need. "Need" was calculated by first estimating the expenses to provide a reasonable amount of service, as well as return on investment, and then deducting all anticipated revenues. The balance represented "need" and would be paid as airmail pay by the Post Office Department. The individualized local service subsidy determination has two advantages: 1) it allows a subsidy to be tailored to the peculiar requirements of an individual carrier; and 2) it provides a precise method of controlling the earnings of each carrier. On the other hand, this method of subsidy is not without deficiencies: 1) when a subsidy rate is inadequate or excessive it results in extended open-rate periods requiring subsidy rates to be fixed retroactively, necessitating adjustments in reported earnings of the local carrier, and thereby adversely affecting the carrier's credit; 2) open rates discourage a carrier from maximizing efficiency as carriers are aware additional schedules will be underwritten with subsidy, provided general Board standards of economy and efficiency are met; and 3) when normal business incentive is lacking the Board's administrative burden becomes heavier as more careful scrutiny of the economy and efficiency aspects of local carrier operations is necessary.

Because the CAB believed that a class rate subsidy would have distinct advantages over the individualized subsidy, namely, the creation of stronger incentives to efficiency, the elimination of extended open rates, and, the lightening of the administrative burden of the Board, it established a class subsidy for the local service carriers. In 1963, after two

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89 D. Locklin, supra note 22, at 786.
92 D. Locklin, supra note 22, at 818. This method of subsidy became obsolete with the prosperity brought to many large airlines by World War II in 1942. Need was greatly reduced by the fact that many carriers' revenues frequently exceeded their estimated costs and by the "need" formula would not be entitled to receive mail payments for the mail that they carried. Consequently the CAB separated mail payment into that based on "need," as before, and that based on actual service. Prior to 1961 local service carrier subsidies were determined on the basis of need. Two variations of the need-based subsidy have been described by the Board:

"[T]he Board has always established subsidy rates on an individual carrier basis. Two types of subsidy rates have been employed: (1) a past period rate which is determined on the basis of actual results, and (2) a future rate which is based upon forecast operations. In either case, however, the same basic approach has been followed. The financial and traffic reports and forecasts are subject to audit and analysis, and adjustments are made to reflect more accurately the earnings of the period as well as to disallow expenses and investment found to be uneconomical or inefficient or not in accordance with statutory standards. After all adjustments, a carrier's subsidy rate is fixed in an amount sufficient to meet its break even need (the difference between expenses and other revenue) plus a reasonable return on investment after taxes." Local Service Class Subsidy Rate Investigation, 34 C.A.B. 416, 429 (1961).
93 The class rate subsidy program was described by the Board as follows:

The... class rate consists of a scale of rates based upon volume of operations per
years of operation of the 1961 class rate subsidy formula, the formula was revised. The Board hastened to indicate that the rationale supporting the original 1961 class rate formula was still totally applicable and that revision was sought only to eliminate adverse incentives and generally improve the original rate formula.4 The Board frankly stated that

[T]he class-rate concept in air transportation is still in its infancy, and even as revised the proposed rate will not solve all of its problems, whether foreseen or unforeseen. Undoubtedly problems will arise requiring additional amendments in the future, and consequently, the Board's staff will continue its study of the class rate with an eye to improvement through future amendments.46

The Board correctly defined the need for amendment of the class-rate subsidy formula in the interests of general improvement and solving new problems.46

There can be no question that the class-rate subsidy is a great improvement: as revenue plane-miles per station increase, the unit subsidy rate per available seat-mile flown is reduced. The monthly subsidy payable to each carrier under the class rate will be based upon (1) the carrier's available seat miles during the month times (2) a rate per seat-mile varying with the revenue plane miles per station per day for the particular carrier in the month given in accordance with the scale of rates contained in appendix I. No additional subsidy is paid for operations in excess of the 600 plane-miles per station per day. The proposed class rate also contains a profit sharing formula under which the carriers will refund to the Board (1) 50 percent of profits between a fair rate of return and a return of 15 percent on investment and (2) 75 percent of profits in excess of a return of 15 percent on investment. Earnings deficiencies will be permitted to be carried forward to 2 future years as an offset against any future excess earnings.

Local Service Class Subsidy Rate Investigation, 34 C.A.B. 416, 428 (1961). See also id. at 433-50.

4 The Board believed that its initial decision to scale the original rate to miles per station per day and applied to seat miles created a formula sensitive to changes in the number of stations but insensitive to the capacities of the aircraft employed. The revised formula provided for a local service carrier subsidy rate based upon seat miles flown per month, varying inversely with the traffic density as measured by the average number of plane departures per station per day. The revised formula also reflected Board interest in reducing subsidy payment to the local carriers by providing for exclusion of "non-subsidy" routes from subsidy and reducing payments on "subsidy-reduction" routes, both types of route being determined by the Board. The revised formula retained intact the profit-sharing aspect of the original class rate which provided for a recapture of a portion of a local carrier's earnings in excess of a prescribed fair rate of return. The recapture program was designed to prevent some carriers from receiving more subsidy than needed. Local Service Class Subsidy Rate, 39 C.A.B. 65, 72 (1963). Where a carrier's annual earnings exceeds its differentiated rate of return it is required to refund a portion of those profits to the government. The differentiated rate of return is a weighted average based on a rate of return of 5.5 percent on debt capital and 21.35 percent on common equity capital applied to the carriers' own capital structure. Maximum overall return is 12.75 percent, minimum is 9 percent. 50 percent of any profits above 12.75 percent but not exceeding 15 percent must be refunded and 75 percent on any additional profits must also be refunded. Rate of Return, Local Service Carriers Investigation, 31 C.A.B. 685 (1960); D. LOCKLIN, supra note 22, at 822.

46 While retaining the class-rate subsidy concept the Board has strived to refine it. 1966 C.A.B. Ann. Rep. 36. In April, 1967 sweeping changes in the class rate formula were proposed by the Board, the most significant of which was the implementation of a new class rate formula which would replace the profit sharing mechanism. AVIATION WEEK, April 10, 1967 at 36. This new tack by the Board again reflects its resolve to decrease overall subsidy payment (in this case by $3.1 million from the 1966 level) to the local carriers. Proposals also included: approved subsidy rates for general aviation-type aircraft used by local carriers; further encouragement of management efficiency incentive by using industry average cost, revenue, and investment data; limitation of the total amount of subsidy to be paid to any one carrier; limitation of subsidy to two round trips daily between two points served on routes eligible for subsidy; and finally, the relating of subsidy payments partially to service between city-pairs on a carrier's routes, as opposed to the overall system basis that prevailed before. AVIATION WEEK, April 10, 1967 at 36, 37. All proposals were put into operation by the Board the following month, completing a comprehensive revision of the class subsidy rate. AVIATION WEEK, May 29, 1967 at 75.
ment over the less sophisticated individual or "need" based subsidy. In providing local service the most efficient and economical methods must be employed in the public interest." Certainly a vital key to an efficient and economical operation is managerial incentive to efficiency. Therein lies the real strength of the class subsidy rate. As indicated previously, the class rate is designed to encourage managerial incentive, not discourage it. Various refinements have been made to the formula specifically for that purpose which make the rate even more effective in providing incentive. The main advantage of the formerly used individual rate, namely, that it could tailor a rate to an individual carrier, loses its significance when assayed as to its power to provide incentive to efficiency. More often than not it provides an incentive to inefficiency by encouraging open rates and retroactive subsidy which in turn allow the carrier to take uneconomic route and schedule risks which would ordinarily be declined.

The class rate subsidy also eases the administrative burden of the Board, thus increasing its efficiency. Attempts to "close" open rates and assess the efficiency of some local carriers done during an open rate period only robs the Board and its staff of their time. This increased efficiency reflects in smoother operation of the local carriers as a result of quicker hearings and reviews, and releases both the Board and its staff to deal with other responsibilities.

4. The Current Policy of Local Service Carrier Subsidy Reduction: Origins and Implementation

Other than the requirement that the cost to the government be reasonable, little consideration was accorded the possibility of subsidy reduction in the early CAB decisions establishing local service on an experimental basis. Perhaps this stemmed from the temporary certification of the local carriers, the rapid growth of these carriers, and concomitant subsidy requirements not being foreseen by the Board.

The principle of permanent subsidy for local carriers was soon attacked by Board member Jones in 1951, who vigorously urged that "[t]he establishment of a nationwide network of permanently subsidized local service airlines is unsound transportation policy." The possible growth of a permanent subsidy requirement for the local carriers was not mentioned by the CAB when the locals were granted permanent certificates in 1955 since no reference to subsidy growth or subsidy reduction appears in the CAB annual report for that year.

The CAB policy favoring subsidy reduction did not suddenly appear, but evolved gradually over a span of years. It was not formally published but appeared from time to time in annual reports of the Board, speeches of Board members, hearings before various Congressional committees and

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88 Trans-Texas Certificate Renewal Case, 12 C.A.B. 606, 621 (1951). Jones' grounds for opposing a permanently subsidized system of local service carriers were that "[t]he tends to perpetuate government financial support of air transport, and to extend such services into a field of least relative advantage, with a resulting impairment of surface transportation facilities contrary to the national interest." Id. at 623.
subcommittees, and in press releases.

As indicated previously, a policy, not formally published, can only be satisfactorily defined by reference to the original materials announcing it. In 1958 the Board held out little hope for any reduction of subsidy in the foreseeable future. The Board added that: "At best it is believed that . . . the subsidy bill for local service will increase for several years, but that then the trend may reverse." The Board's choice of the word "may" indicates its uncertainty as to whether the trend of rising subsidy actually would reverse. By 1959 the Board was cautiously optimistic in stating that "it is hoped that this trend will be reversed." By 1961 the CAB was taking steps on its own initiative designed to reduce subsidy. Foremost among these was the institution of a new method for determining subsidy known as the class rate. The Board had thus demonstrated its determination to "control . . . the total subsidy level, with a view towards reduction thereof in the long range future. . . ." In 1962 the Board predicted that the upward subsidy trend would peak in 1963, then reverse. The Board attributed the future reversal to its implementation of a class subsidy rate, a guaranteed loan program, final subsidy rates, and a relatively mild form of route strengthening.

New impetus was added to the Board's evolving policy of subsidy reduction by President Kennedy's Special Message to Congress on April 5, 1962. In it Kennedy declared:

I am asking the Board to develop by June 30, 1963, a step-by-step program with specific annual targets, to assure sharp reduction of operating subsidies to all [local service] airlines as well, within periods to be established by the Board. . . .

Kennedy suggested that rigorous enforcement of the "use-it-or-lose-it" policy, refinement of the class subsidy rate plan of 1961, and the establishment of single airports to serve adjacent cities would facilitate subsidy reduction to some extent.

Within the limits of protocol in dealing with the affairs of independent regulatory agencies, the President's special message can be interpreted as a direct command to the CAB to reduce the subsidy program. Whereas previously the Board had leaned toward subsidy reduction at some distant future time, now it had an Executive mandate which unequivocally dictated a policy of subsidy reduction.

In compliance with the President's request and pursuant to its policy of subsidy reduction, the CAB tendered to the President a four-point program

101 Id.
104 The class rate is discussed at length in the previous section, supra.
107 Id. at 24.
108 KENNEDY, Special Message to the Congress on Transportation, Public Papers of the President, John F. Kennedy, 1962 (1962) at 292, 297.
109 Id. at 297.
designed to reduce local service subsidy and at the same time continue
the small-center air transport function of the locals and meet their opera-
tional and financial problems. The CAB Report to the President of July 3,
1963, predicted that subsidy could be reduced by $25 million from the
$81 million 1962 level, over a five year period, by four principal means. Subsidy savings would result from 1) airline revenues increasing at twice
the rate of increased costs; 2) gradual reduction of subsidy payment for
flights on high density routes; 3) consolidation of airports for two or more
cities; and 4) continued application of the "use-it-or-lose-it-policy." The Board specifically rejected the acquisition of more efficient equipment
as a method of subsidy reduction and deferred any consideration of route
strengthening by certification of local carriers on to dense traffic routes
until such time as hearings could be held. The CAB made no mention
whatever of potential subsidy reduction stemming from local service air-
line mergers in its Report to the President.

President Kennedy’s assassination occurred only months after the CAB
Report on Subsidy was tendered. While the Report was not specifically
endorsed by the Chief Executive, parts of it were already in use, or subse-
quently were put into effect by the Board. In 1964 the Board reported a
reversal of the upward subsidy trend with a $1.4 million saving in local
subsidy payment over fiscal year 1963. The Board attributed the favor-
able results to revenues increasing more quickly than costs, the implemen-
tation and refinement of a class rate subsidy, and the “strengthening of
the carriers’ route structures.”

The Board, having adopted as its own, and forcefully enunciated a
policy favoring subsidy reduction, was now forced to cast about for the
most effective method or methods of implementing its policy. Two
important questions arise at this point for consideration. The first ques-
tion, concerning the degree of subsidy reduction, is not capable of a final
answer, but even in 1961 Board member Gurney stated that “the ultimate
goal would be service without the need for subsidy.” Whether the ulti-
mate goal is total reduction of subsidy or only substantial reduction is not
of great significance at this moment. The significant point is that the
Board has committed itself to a policy of subsidy reduction. The methods
of effectuation of the policy will be much the same in either case regard-
less of the specific long term goal.

The second question of import concerns the reason for reducing subsidy.
A partial answer appears to be the conviction that an efficient system of
transportation can only be achieved through unsubsidized free enterprise, and this consideration outweighs other considerations, such as potentially

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10 CAB, REPORT TO THE PRESIDENT ON AIRLINE SUBSIDY REDUCTION PROGRAM PURSUANT TO
TRANSPORTATION MESSAGE OF 1962 (1963). [Hereinafter cited as CAB REPORT TO THE PRESIDENT
ON SUBSIDY.]
111 Id. at 1-3.
112 Id. at 3.
114 Id. at 31, 30.
115 Gurney, supra note 84, at 91.
116 KENNEDY, supra note 108, at 294.
deficient service, which favor subsidized local service.

In its search for effective methods of policy implementation the Board continued to refine its methods. In 1965 it described a four-point program for subsidy reduction adding the transfer of certain trunkline points to local carriers and a route realignment plan to "extend the operating authority of the local service carriers," to its existing use-it-or-lose-it and airport consolidation program.117 Much greater developments were not long in coming.

Hearings held in late February and early March, 1966, allowed CAB Chairman C. S. Murphy to announce and elaborate upon ambitious programs to reduce subsidy.118 Murphy asserted that the subsidy could only be reduced by increasing the earnings of the local carriers.119 As a first step toward this end he suggested "the introduction of the new, more efficient pure jet aircraft," hopefully to reduce unit costs and generate additional traffic and revenue.120

Far more significant than the introduction of new equipment was Murphy's indication that the Board favored route strengthening for local service carriers to the point of certificating them into shorter dense traffic routes in direct competition with trunkline carriers in an effort to increase their revenues:

The local carriers have requested that the Board strengthen their systems by relaxing present route and operating restrictions, by allowing them to compete with trunklines in denser markets, and by awarding them new operating authority over potentially profitable routes. This avenue for strengthening the local carriers, and hopefully deducing [sic] their dependence on subsidy support, is one which the Board views with favor and which it plans to pursue on a case-by-case basis.121

This announcement by the Board reversed its former position of avoiding direct local-trunk competition. The Board reasoned "that the relatively much larger size of the trunk carriers and their present favorable earnings position, will make it possible to strengthen the routes of the local carriers without significant impairment of the position of the trunks."122 This new program also overrides the original concept of the local carrier as a provider of air transport to small communities only. The Board did not elaborate at this point as to whether the role of the local carrier was being revised, but it is evident that the implementation of a program of such magnitude could have a great impact on the role of local carriers in the national transportation pattern.

Somewhat more subtly Chairman Murphy laid the foundation for a second far reaching program of subsidy reduction. Murphy indicated that mergers would be a useful means of reducing subsidy. When questioned by Senator Monroney concerning the desirability of local carrier mergers,
Murphy stated that he would look on such mergers with an open and sympathetic mind. He also suggested that there might very well be substantial economic advantages to such mergers.  

This statement was not part of any prepared text. It was an ad hoc, personal answer. As such it lacks any binding effect upon the Board. It does indicate, however, the then Board Chairman's predisposition toward the use of local carrier mergers where the resulting economic benefits will reduce subsidy, and where no curtailment of local small community service will result. Because there is no evidence indicating that the Board favors local carrier mergers as a means of subsidy reduction, it can be concluded that there exists no formal program to that effect. The most that can be said in this regard is, that all other factors being equal, it is probable that the Board would concur in these views of the chairman.  

On June 30, 1966, the Board outlined a comprehensive and coordinated five-point program designed to strengthen local carrier route structure and thereby reduced subsidy. Although an intensive route strengthening plan, the Board entitled its program "Realignment of System." The components of realignment were: granting more liberal operating authority; certificating local carriers on to dense routes; segment realignment; airport consolidation; and elimination of points through "use-it-or-lose-it" proceedings.  

With some exceptions the program above outlined indicates the most recent Board methods of reducing subsidy payment to local carriers. Recent press releases by the Board have added refinements to the programs. For example, the method of subsidy payment, the class-rate subsidy, has undergone several changes in attempts to reduce subsidy.  

No mention of merger appears in the CAB system realignment program. In the absence of any other stated modifications of the prior Board position regarding mergers as a means to subsidy reduction, that position must be presumed to continue in force.  

It must be concluded that the CAB has adopted a policy favoring subsidy reduction to local service carriers and pursuant thereto has determined to embark on the implementation of that policy. Some of the programs, such as system realignment, are stated with some degree of specificity. Others, such as merger encouragement, tend to be vague at best.  

It is one thing for the CAB to enunciate a policy of subsidy reduction with plans and programs of implementation pursuant to it. It is something else to effectuate that policy by means of its regular decisions. However, the fact remains that the decisional process is the only effective method available to the Board for implementing the Board policy.

123 Id. at 50.  
124 The various Board members, being exposed to the same pressures, economic realities, and evidence as the Chairman, would likely have a tendency to develop somewhat similar views.  
126 Id.  
II. THE DECISIONAL EFFECTUATION OF THE CAB POLICY OF SUBSIDY REDUCTION IN MERGERS OF LOCAL SERVICE CARRIERS

A. The Need For Decisional Effectuation Of The CAB Subsidy Reduction Policy

The Civil Aeronautics Board adopted a policy favoring subsidy reduction for the local service carriers on or about April 5, 1962. At that time the gradual evolution of this policy, under the Board's guidance was brought to fruition by President Kennedy's urging a policy of subsidy reduction upon the Board in unequivocal terms and requesting the Board to develop a program to reduce subsidy. The Board complied with the President's request and thereby adopted this policy as its own. The imposition of a general policy on a federal regulatory agency raises a critical question concerning the extent to which the agency will choose to effectuate such policy. More specifically, now that the CAB is totally committed to a policy favoring subsidy reduction to the local carriers, what will be its priority in regard to conflicting standards?

Whether the CAB carries out its enunciated policy of subsidy reduction is a matter of utmost moment to both the Board and parties affected by the policy. The reasons are not abstruse. First, it can safely be assumed that the policy exists for the purpose of realizing the combined objectives, of reducing subsidy to as low a level as possible, as quickly as possible. Secondly, the failure to effectuate such a clearly announced policy would be tantamount to perpetrating a fraud upon the parties affected since the Board would be guilty of deliberately misleading the parties. Clearly, it is deceitful to announce a policy with no intention whatever of implementing it, or even attempting to implement it, but knowing full well that parties will rely on it, in one way or another, in conducting their affairs in the future. Thirdly, such deliberate deceit would establish a "credibility gap" between Board and affected or potentially affected parties. The long-term effect of a credibility gap would be a general erosion of the relationship between regulator and regulated, and future Board policy would be received with skepticism. Fourthly, there are strong technical reasons for effectuating announced policy. Such policy serves to refine and clarify general legislative standards and is important in maintaining the efficiency of the Board decisional process. These later and related reasons for policy formation have been previously discussed.

The foregoing discussion rests upon the premise that the effectuation of the Board policy was realizable and not an impossibility. Some policy is as difficult to implement as some law is difficult to enforce. However, in view of the facts that the trunkline carriers were able to be weaned almost completely from subsidy as far back as 1959, and that the local service

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128 See Section I, infra.
129 Id.
130 H. FRIENDLY, supra note 15.
132 See Section I, infra.
carriers are experiencing much the same growth pattern and development characteristics as the trunklines did before them, the conclusion follows that the Board policy of subsidy reduction for local carriers is realizable, at least to a very large extent. Therefore, having announced the policy, the possible excuse of impossibility of implementation is not available to the Board to meet allegations of deliberate non-effectuation.

Perhaps even more disastrous than deliberate non-implementation of policy is the prospect of selective implementation. Unless the reasons for selectivity were logical, clear, and consistent, such an approach by the Board would likely induce a form of schizophrenia in the parties forced to live under the policy. Decisions pursuant to it would seem to provide an additional source of concern rather than guidance. Such a situation is likely to prevail, to some extent, when Board policy is not considered a significant factor in Board decisions.

The conclusion follows that once announced, barring reversal, it is obligatory upon the Board, for many reasons, to seek full effectuation of the policy favoring subsidy reduction to local service carriers.

The Board should implement its own policy of subsidy reduction, but does it do so in practice? That is the central question which we shall seek to answer. Stated more precisely the question is three-pronged: Having stated a policy of subsidy reduction, does the CAB effectuate it? And, how? That is, by what means? And, to what extent? The satisfactory answering of these questions raises interesting questions concerning the effect of the policy implementation upon the local carriers and the airline industry as a whole.

Any consideration of policy effectuation compels a consideration of means or methods. The process of actual implementation of policy involves three steps. First, the policy must be formulated. Second, a plan or program designed to implement the policy must be adopted. Such programs as route realignment, sometimes known as route strengthening, and merger encouragement, exemplify means of policy implementation. Finally the plan or program itself must be put into operation through the Board’s subsequent decisions. It is instructive to note that the existence and content of some implementation programs are more readily detected than others. For example, the route realignment program was specifically set out in detail by the CAB, as was its purpose, but any “program” of merger encouragement is much more difficult to detect and define, as will be seen. The degree of implementation of policy by means of a special program is another question requiring an answer. It is answerable only after a careful analysis of decisions reached before and after the policy was implemented. This method of analysis, explained in more detail subsequently, will be used to determine whether or not the CAB policy of subsidy reduction is being effectuated in local service merger decisions heard by the Board.

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185 The question of whether CAB encouragement of local carrier mergers is a program for implementing the subsidy reduction program is discussed infra.
B. The Statutory Basis For Local Service Carrier Merger Applications

No mergers may occur between air carriers, between an air carrier and a common carrier, or between an air carrier and one engaged in any other phase of aeronautics without authorization by the CAB. The pertinent section provides in part:

It shall be unlawful unless approved by order of the Board as provided in this section

(1) For two or more carriers, or for any air carrier and any other common carrier or any person engaged in any other phase of aeronautics, to consolidate or merge their properties, or any part thereof, into one person for the ownership, management, or operation of the properties theretofore in separate ownerships.

With regard to the statutory standard applicable to merger applications before the Board the Federal Aviation Act provides:

Any person seeking approval of a . . . merger . . . shall present an application to the Board. . . . Unless . . . the Board finds that the . . . merger . . . will not be consistent with the public interest or that the conditions of this section will not be fulfilled, it shall by order approve such . . . merger . . . upon such terms and conditions as it shall find to be just and reasonable and with such modifications as it shall prescribe: Provided, that the Board shall not approve any . . . merger . . . which would result in creating a monopoly or monopolies and thereby restrain competition or jeopardize another air carrier not a party to the . . . merger.

Since several Board decisions examined hereunder were handed down prior to the enactment of the Federal Aviation Act of 1958, it is important to note that the above cited legislation was originally enacted in the Civil Aeronautics Act of 1938 and was reenacted without substantial change in the Federal Aviation Act of 1958.

As indicated above the Act furnishes the Board with two standards for testing merger applications. The first standard—the "public interest"—is a vague test composed of many elements necessarily allowing the Board a fairly wide discretion. The Board is directed by Section 102 of the Federal Aviation Act to consider among other things, the encouragement and development of an appropriate air transport system, the preservation of the inherent advantages of air transport, the promotion of adequate, economical, and efficient service with competition to the extent necessary, as being in the "public interest." The second standard, the antimonopoly proviso, is even more elusive than the public interest standard. Neverthe-
less the Board is charged with the responsibility of measuring all merger applications by these two standards in the hope of establishing a consistent pattern of rational decision.

In examining the Board approach to merger applications of local service carriers, the initial point of inquiry will be the Board treatment of the earliest merger application pursuant to the public interest and antimonopoly standards outlined in the substantially identical predecessor Civil Aeronautics Act.\textsuperscript{142} The earliest merger applications involved only trunklines as the local carriers were not conceived until the mid-forties. The public interest standard will be considered first.

The first merger application was received by the Board (then the Civil Aeronautics Authority) in 1939 and involved the proposed acquisition of Western Air Express by United Airlines.\textsuperscript{145} United at the time flew primarily east-west routes from New York to California and was the fourth largest domestic air carrier.\textsuperscript{146} Western was the eighth largest carrier in terms of route miles and flew primarily north-south routes along the west coast of the United States.\textsuperscript{147} The Authority, after first stating that Section 408 (b) governed the case,\textsuperscript{148} added that the public interest "is not a mere general reference to public welfare but has a direct relation to definite statutory objectives. Thus Section 2 of the act directs the authority to consider certain specific objectives as being in the public interest."\textsuperscript{149} To determine the public interest, therefore, the Board must make reference to the statutory guidelines set out in Section 2 of the Civil Aeronautics Act.\textsuperscript{150} These standards, as previously noted, are so general that the Board is allowed wide discretion in its assessment of the public interest.\textsuperscript{151} Furthermore, the nature of a merger proceeding is such that the great quantities of specialized technical evidence that are presented to the Board are related directly only to the parties involved.\textsuperscript{152} Hence each case is considered to a large degree in an ad hoc manner with precedent playing only an auxiliary role and the statutory standards of Section 2 of the Act being relied on only for guidance in determining public interest.

Nevertheless, in determining whether a proposed trunkline merger would be inconsistent with the public interest the Board has, over a period of time, evolved certain factors which will bear consideration in its determination. Most factors are common to many trunkline merger proceedings but receive varying emphasis and weight from case to case. These factors will be mentioned only briefly in this context, a more thorough examination being undertaken subsequently in considering the application of such

\textsuperscript{142} Civil Aeronautics Act of 1938, ch. 601, § 408(b), 52 Stat. 1001.
\textsuperscript{145} United Airlines Transport Corporation-Acquisition of Western Air Express, 1 C.A.A. 739 (1940).
\textsuperscript{146} \textit{Id.} at 740.
\textsuperscript{147} \textit{Id.}
\textsuperscript{148} \textit{Id.} at 741.
\textsuperscript{149} \textit{Id.} at 739.
\textsuperscript{150} \textit{Id.} at 740.
\textsuperscript{151} \textit{Id.} at 739.
\textsuperscript{152} \textit{Civil Aeronautics Act of 1938, ch. 601, § 2, 52 Stat. 980.}
\textsuperscript{153} \textit{Civil Aeronautics Act of 1938, ch. 601, § 2, 52 Stat. 980. Section 2 is substantially the same as Section 102 of the Federal Aviation Act of 1958, § 102, 72 Stat. 740, 49 U.S.C. § 1302 (1964), set out in pertinent part in Chapter I supra.}
\textsuperscript{154} \textit{See 1 C.A.A. 739 (1940).}
factors to the local carriers merger determinations.

The Board has devoted much time to achieving competitive balance
between trunkline carriers. A proposed merger which would, in the Board’s
opinion, unbalance competition is considered contrary to public interest.\textsuperscript{101} It was primarily for this reason that the United-Western merger proposal
was rejected by the Board.\textsuperscript{102} The Board also gives consideration to rea-
sonableness of purchase price as a condition of approval.\textsuperscript{103} Route integration
potential economies and potential diversion of traffic from competing
carriers round out the factors considered by the Board in determining
violations of the public interest.

Some transference of these factors to local service carriers is observable.
Since the local carriers were conceived to provide primarily local and
feeder service between the smaller communities and medium-sized com-
unities, and were not intended to be competitive with either the trunks
or each other as a result of their very high operational costs, the emphasis
on factors relating to public interest is likely to be somewhat different for
them.\textsuperscript{104} In fact this is precisely the case. Certain factors determinative of
public interest recur with frequency. Other factors, though important
to the public interest in trunkline merger applications, are rarely con-
sidered by the Board in local carrier merger cases.

As in the case of the trunks, and for the same reasons, the weight of
precedent of the public interest factors is mitigated by the highly specific
factual context of each merger proposal. The local carrier merger applica-
tions do, however, tend to fall into a more stable pattern than do the
trunks regarding the factors determinative of public interest.\textsuperscript{105}

The first local service carrier merger application to be heard by the
Board was the \textit{Monarch-Challenger Merger Case}.\textsuperscript{106} This proposed merger
involved two small, western, local carriers operating route systems con-
tiguous at Salt Lake City and Denver. The Board stated, in reaching a
decision, that the principal factors considered in determining public inter-
est were a) whether an integrated route system would result from the
merger and b) whether more economical and efficient services would also
result.\textsuperscript{107} The Board also noted later in its opinion that the proposed merger
lacked potential diversionary effect upon traffic of intervenors Inland and
Continental.\textsuperscript{108} The Board’s statements concerning factors determinative
of public interest are almost as significant for what they do not say as for
what they do. The Board made no mention of the effect upon balanced
competition, probably because the locals are not substantially competitive

\begin{footnotes}
\item[101] Id.
\item[102] Id.
\item[103] Acquisition of Marquette by TWA, 2 C.A.B. 1 \textsuperscript{1} (1940). The acquisition was approved when
the price was reduced. Acquisition of Marquette by TWA, 2 C.A.B. 409 \textsuperscript{2} (1940) (Supplemental
Opinion).
\item[104] Ibid. at 35.
\item[105] Id. at 37.
\item[106] Id. at 35.
\item[107] Id. at 37.
\item[108] Id. at 37.
\end{footnotes}
with trunks or each other, and other than affecting competition through diversion of traffic, are not directly concerned with competition or a balanced system of competition. (It is noteworthy that potential local competition does become a consideration in more recent merger and certification cases.) The controlling factors of the Board decision were clearly stated to be prospective economies and efficiencies of service, a better integrated route system, and lack of any real diversionary consequences. The Board did not mention whether the merger would result in a survivor of trunkline character, or whether the trade areas being connected were related.

In the second local service merger, the Arizona-Monarch Merger Case, the Board premised its approval of the proposed merger primarily upon expected economies but also mentioned a lack of traffic diversion. Of peripheral interest in this decision was the vigorous dissent advanced by Board member Jones who opined that the combination of three local carriers (Monarch, Challenger and Arizona) into one created a carrier which was no longer "local" in nature and which therefore tended to defeat the purpose of the local service experiment. The remaining four Board members did not find that argument persuasive. It is instructive to note that, here also, with the exception of Jones' dissent, the Board did not even give passing mention to whether the merger would result in a survivor of trunkline character or whether the trade areas being connected were related.

Several conclusions emerge from the matter heretofore considered. The Board makes reference to the general guidelines of Section 2 of the Civil Aeronautics Act in its consideration of the public interest. Since the guidance provided by the Act is general and equivocal at best, the Board has evolved more specific details relating to the public interest on which it relies. The final Board determination of public interest is achieved by a weighing of the factors determinative of public interest. The earliest local service merger cases indicate that economy of operation, efficiency of service, integration of route structure, and potential traffic diversion are the public interest factors which most concern the Board.

The second standard which the Board must apply in deciding a merger application is the antimonopoly proviso. It provides that no merger is to be approved by the Board "which would result in creating a monopoly or monopolies and thereby restrain competition or jeopardize another air carrier not a party to the . . . merger." The very general nature of the proviso makes its clarification by the enunciation of Board policy imperative. Although the Board could have facilitated clarification either by articulating an opinion explaining its understanding of the proviso, or by

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159 Absence of monopoly discussed infra.
161 Id. at 247.
162 Id. at 247-48.
163 Id. at 247-48.
164 Id. at 214-16.
proceeding on a case by case process to isolate various factors pertinent to a determination of monopoly, it made little effort to accomplish either.\textsuperscript{160} The Board offered its only attempt at interpreting the proper construction of the antimonopoly proviso in the \textit{United-Western Interchange Case}.\textsuperscript{167} Therein the Board perceived two distinct problems: "(1) Whether or not any restraint of competition would prevent approval by the Authority; and (2) whether or not jeopardy to another air carrier would prevent such approval without regard to the existence of a monopoly."\textsuperscript{168} Essential to solution of the problems was a clear idea of the word "monopoly" in the Act. The Board proceeded in its analysis:

In modern usage, most of the definitions suggested by the Courts fall into two general categories, one of which defines the term "monopoly" as embracing any combination the tendency of which is to prevent competition in its broad and general sense, and to control prices to the detriment of the public, and the other holding that the word "monopoly" means the control of a particular business or article of trade, without regard to the results which may flow therefrom. . . . If the first definition of the word "monopoly" which is essentially descriptive of a result, is applied to the proviso in section 408 (b), the words immediately following, "and thereby restrain competition", would be repetitious and of no effect since the definition by its terms includes the factor of restraint of competition. On the other hand, if the second definition, which treats "monopoly" as a condition embodying a particular degree of control, is applied, the remaining words of the proviso would have a definite meaning and effect, since it would not be a foregone conclusion that such a condition would restrain competition. It is a generally accepted rule of statutory construction that every word of a statute is to be given meaning, for it cannot be assumed that particular words were used without some purpose. It is concluded, therefore, that the word "monopoly" as used in the first proviso of section 408 (b), refers to a particular degree of control of air transportation, or any phase thereof, in any territory or section of the country. It follows that restraint of competition is a factor, insofar as the application of the proviso is concerned, only if it results from the degree of control which the Authority decides constitutes a monopoly of air transportation.\textsuperscript{169}

The Board thus decided that the absence of punctuation in the proviso compelled the conclusion that jeopardy to an air carrier, like restraint of competition, is a factor to be considered only if brought about by monopoly.\textsuperscript{170} The Board concluded its analysis by saying: "In deciding upon the application of the proviso in section 408 (b) to the agreement, therefore, it is necessary to determine whether it will result in giving one of the parties the degree of control of air transportation, or some phase thereof, within a particular section of the country, necessary to constitute a monopoly therein."\textsuperscript{171}

The foregoing analysis has become somewhat academic in light of the fact that the Board has never found that a proposed merger would violate

\begin{footnotes}
\item[160] Travers, \textit{An Examination of the CAB's Merger Policy}, 15 \textit{KAN. L. REV.} 228, 247 (1967).
\item[167] United Air Lines Transport Corporation and Western Air Express Corporation—Interchange of Equipment, 1 C.A.A. 721, 732-34 (1940).
\item[168] \textit{Id.} at 732.
\item[169] \textit{Id.} at 733-34.
\item[170] \textit{Id.} at 734.
\item[171] \textit{Id.}
\end{footnotes}
the antimonopoly proviso. Furthermore, the CAB has failed to elaborate upon what type of merger violates the antimonopoly proviso and has thereby failed to develop standards to aid in the application of the proviso. Consequently, the Board has tossing off the antimonopoly proviso in a somewhat perfunctory manner, in local service merger cases, seeming to treat it as some vague form of overall or partial monopoly. In the Monarch-Challenge Merger Case the Board merely noted that there was no evidence that the proposed merger would result in a monopoly. In the Arizona-Monarch Merger Case the Board adopted the examiner’s opinion that the acquisition would not result in the elimination of any competing carrier and therefore the issue of monopoly was not present. In the West-Coast-Empire Merger Case the Board again noted only that the merger would not result in a monopoly. The Board did not attempt to further refine the meaning of the word monopoly and nowhere did it attempt to decide what percentage share of a city pair market or series of markets would constitute a monopoly by the local carrier involved. The very nature of the local service operation seems to favor route monopolies due to the high costs involved in providing service on the local, typically low density, routes. Therefore, it would seem to follow, that a consideration of route monopoly is much less important in local service mergers than it is in trunkline mergers since the Board would likely tolerate a high degree of monopoly on a typical local carrier system.

The conclusion follows that regarding proposed local service mergers the Board pays lip service only to the antimonopoly proviso. Without a cursory reference to even the vaguest of standards the Board will determine that the merger will not result in a monopoly. It must follow that little significance attaches to the antimonopoly proviso’s role in Board decisions of local service mergers. Hence it can be seen that the antimonopoly proviso is much broader than its language would seem to suggest. It is capable of being sensitive to monopoly in trunkline cases but tolerant of monopoly in local service carrier cases.

Having set out the statutory basis for local service carrier merger decisions, attention can now be focused upon policy implementation in the decisional process.

C. The Proposed Decisional Effectuation Of The CAB Policy Of Subsidy Reduction Through Local Service Carrier Mergers

Two programs have been devised to implement the Board policy of subsidy reduction of which the least precise, undoubtedly, is the program of encouraging local service carrier mergers. Although lacking in precision by contrast with the carefully articulated system realignment program,
it nonetheless appears to be a general program designed to implement the Board policy. The following treatment will advance the position that such a program has indeed been developed. It will also explain its supporting rationale.

A brief consideration of the rationale promising the local carrier merger encouragement program reveals the impact of such a program upon the subsidy reduction policy. The purpose of subsidy reduction is clearly to lessen the amount of subsidy required by local carriers. As stated by the Board, the best way to reduce subsidy is by increasing earnings of the carriers.\textsuperscript{177} The encouragement of local carrier mergers, within the broad purview of the Federal Aviation Act,\textsuperscript{178} will both increase earnings and decrease expenses of the local carriers. Economies which the carriers achieve upon merging arise both from increasing earnings, as a result of decreasing expenses, and from increasing revenues per se. The decrease in expenses and consequent increase in earnings results in the main from the realization of economies of scale upon the consolidation of two or more airlines and their facilities. The principal economies of scale realized are: economies stemming from the establishment of longer stage lengths by the merged airline which is then able to employ the more efficient turbofan jets to provide service;\textsuperscript{179} economies arising from the general efficiency of a larger, better integrated route structure;\textsuperscript{180} and, economies resulting from the combined financial and physical resources of the merger carrier which bring about a financially stronger carrier in turn more able to compete effectively with both trunkline carriers and other local carriers, hopefully preventing losses due to strong and resourceful competition.\textsuperscript{181} Increases in revenue of the per se variety, that is, occasioned by a direct gain in revenue and not derived from a cost saving, generally result from gains in passenger traffic facilitated by increased generation of passenger traffic in general as well as through passenger traffic upon a larger route system.\textsuperscript{182}

Since increased earnings can normally be expected to result in a direct reduction of subsidy, it follows that an implementation program of encouraging local carrier mergers would assist in effectuating the policy of subsidy reduction to the extent that increased revenues result.

If mergers of local carriers contribute to the financial improvements necessary for subsidy reduction, has the CAB developed a program of encouraging these mergers? The answer is in the affirmative. The founda-

\textsuperscript{177} Hearings on the Local Air Carrier Industry, supra note 3, at 33.
\textsuperscript{178} The Federal Aviation Act allows the CAB fairly broad discretion in deciding merger applications. The statutory requirements are examined in greater depth in Section IIB, supra.
\textsuperscript{179} Aviation Week, Oct. 23, 1967, at 39.
\textsuperscript{180} American Aviation, Dec., 1967, at 45.
\textsuperscript{181} Aviation Week, supra note 179, at 39.
\textsuperscript{182} Naturally the proportionate improvement in earnings position resulting from each of the various economies or revenue gains effected in a merger of two (or more) local service carriers will vary somewhat from merger to merger. Every type of economy and revenue gain is likely to be effected in a merger to some degree because these are the only economies and revenue gains possible and tend to be present in any given merger. The degree of realization of each varies from merger to merger as factual situations are never identical. Therefore, different types of unification of local service carrier systems, whether "parallel" or "end-to-end," accomplished by merger, consolidation, or acquisition, will have the same sources of economies and financial benefits although the degree of realization of each will vary.
tion for the CAB program of encouraging mergers was laid by Board Chairman, C. S. Murphy, when testifying before the Aviation Subcommittee of the Committee on Commerce on February 28, 1966. After first answering a question concerning the desirability of mergers, by stating that local carrier mergers would be viewed with an open and sympathetic mind, he added that the problems facing a particular area would also carry much weight. The Chairman also elaborated upon the circumstances calling for mergers:

In theory and in general terms it seems to me there might very well be substantial economic advantages [to mergers]. But here again we need to keep always before us the primary purpose of establishing this class of carriers to provide local service to small- and medium-sized cities. And if mergers should occur we would need to make sure it didn't take us away from that.

To date no contrary opinions of the Board or others have been expressed although some opinions have appeared which would support a conclusion that the Board has a program favoring mergers. A recent comment by A. M. Andrews, director of the CAB's Bureau of Operating Rights, expressed the view that of all actions affecting local carriers then before the Board, "in significance [he] would place mergers at the head of the list" because "of the reasonably available courses of action mergers seem to contain some of the greatest long-term potentials for subsidy reduction and improved public service." The director's statement can reasonably be regarded as indicating the Board's position on mergers.

The foregoing statements are strongly suggestive of a general CAB policy favoring local carrier mergers in the interest of subsidy reduction. What remains is the determination of whether this policy has been a significant factor in the decisional process, or whether it has been forced into the role of merely one of several competing considerations.

D. The Extent And Manner Of Decisional Effectuation Of The CAB Policy Of Subsidy Reduction Through Local Service Carrier Mergers

1. The Method of Analysis

It has been demonstrated previously that the Board has adopted a policy of subsidy reduction for local service carriers and appears to have adopted a general program favoring local carrier mergers in order to carry out its policy. The question must now be asked as to whether the proposed means of effectuation has been applied in practice.

The method of analysis to be used in the determination of CAB policy effectuation rests heavily upon a comparison of CAB decisions rendered prior and subsequent to its policy and program of implementation. There-

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183 Hearings on the Local Air Carrier Industry, supra note 3, at 27-68.
184 Id. at 50.
185 Id.
186 Aviation Week, supra note 179, at 39.
187 Id.
188 At the very least it can be said that the Board is predisposed in favor of local carrier mergers as a means of effectuating the CAB subsidy reduction policy. See Section IIC, supra.
fore it is necessary to determine the date of adoption of the CAB policy and the date of formation of the program of policy implementation.

It was indicated previously that, although the Board had harbored a vague notion that subsidy should somehow be reduced, it was not until President Kennedy's Message to Congress that the CAB unequivocally adopted a policy of subsidy reduction. The date was April 5, 1962.

The general program of implementation of the CAB policy, that is, favoring local carrier mergers, is not as easy to tie down. Its basic foundation appears to have been expounded by Board Chairman C. S. Murphy on February 28, 1966. No prior mention of this general program appears in CAB annual reports or elsewhere. In any event, no local carrier merger applications were heard by the Board in the period extending from the Board's adoption of a subsidy reduction policy on April 5, 1962, until Chairman Murphy's reference to favoring local carrier mergers on February 28, 1966. There were, however, merger applications decided by the Board prior to its adoption of a subsidy reduction policy in April, 1962. Thus, the actual date of the general program's nascence is not particularly significant since it can be seen that no merger decisions were rendered by the Board prior to that general program yet subsequent to the Board policy of subsidy reduction. February 28, 1966 would seem a reasonable peg for the implementation program's appearance.

Having determined the dates of adoption of the Board subsidy reduction policy and general implementation program the emphasis shifts to the method of analysis to be applied to the Board's decisions prior and subsequent to both policy and program. The analysis will be restricted for the most part to local service merger decisions which will be grouped and examined on the basis of similarity of geographical situation. Conveniently each "prior" case has a recent analogue in the "subsequent" category. At least one very recent application which the Board has not yet decided will also bear analysis.

The analysis will focus upon the various factors, or "variables," determinative of the consistency of merger applications with the public interest, and, of less importance, the monopoly proviso. Critical to the analysis will be the detection of an expected shift in emphasis from such factors originally determinative of Board local service merger decisions as potential traffic diversion, trunkline character of the resulting system and relationship, or lack of it, between the areas served by the applicants, to other factors relating to economy and efficiency as a necessary basis for implementing the Board policy and program. An examination in depth of the Board's articulated reasons as well as any unarticulated premises will be necessary in analysing the relevant decisions.

189 See Section I, supra.
190 Id.
191 Hearings on the Local Air Carrier Industry, supra note 3, at 27-68.
2. The Analysis

Three separate merger applications of local carriers providing air transport on various parts of the west coast of the United States will be considered first. Two of the merger decisions were rendered prior to the adoption of the subsidy reduction policy and the remaining one is yet to be decided by the CAB although the hearing examiner has recommended its approval to the Board.

The first significant local carrier merger application before the Board was the Southwest-West Coast Merger Case. It also had trunkline overtones. The applicant Southwest flew three routes connecting Los Angeles, San Francisco and Medford, Oregon. The applicant West Coast flew five routes involving Portland, Seattle, Port Angeles, Bellingham and Medford. The applicants' routes were contiguous at Medford.

In reaching its decision the Board weighed factors determinative of the public interest but did not refer to the antimonopoly proviso. On the favorable side the Board noted that the proposed merger would result in an integration of physical properties and operations of the applicants (although noting that little integration of traffic could result); that annual savings and increased revenues would likely total $247,000; and, that neither United nor Western, being the competitive trunk carriers on the Pacific coast, would suffer serious traffic diversion as a result of the merger. In spite of the potential advantages, the Board denied the proposed merger as adverse to the public interest. Instrumental in the Board's evaluation of the public interest were the factors that: the proposed merger...
would tie together the San Francisco-Los Angeles and Seattle-Portland areas which are not essentially related trade areas; the routes of the applicants would be fused into a huge single system running the length of the Pacific coast in the trunkline tradition (as did United's and Western's systems) and, though not penetrating the United and Western long haul market, would still pose a competitive threat to the trunks by virtue of its availability to transport passengers for practically any length along the Pacific coast. This potential competition was especially threatening to Western, by far the weaker of the two trunk carriers, whose Pacific coast routes constituted the backbone of its system. The Board added that: "[w]hile we do not share the concern of [United and Western] with the possibility of the merged carrier assuming trunkline characteristics, yet by retaining the Board's original policy of confining local carriers to particular areas, the Board will not only maintain its own policy but will remove the fear expressed by the trunks in this case."

In reaching its decision the Board weighed all factors deemed consistent and inconsistent with the public interest and decided that the merger would result in an "undesirable change in the air route pattern." The Board did not discuss the question of potential subsidy reduction resulting from the merger. It did, however, note that the unification would improve the profit and loss position of the merged carrier by $247,000. However, it is not possible to determine what portion of this gain, if any, the Board expected to flow through to reduce subsidy. Although the Board noted that the merged carrier would have a trunkline character and would compete to some extent with the existing trunkline carriers in the area, it did not elaborate on the degree of competition which would be provided. The Board did not comment upon the significance of the resulting trunkline character of the merged carrier other than to note that it could result in some competition for the existing trunks and that it was the Board's original policy to confine local carriers to particular areas. This is not sufficient commentary to determine the precise role which resulting trunkline character played in the Board decision.

In the Southwest-West Coast decision it appears that when faced with a choice between the realization of a financial improvement of the order of $247,000 annually and the degree of resulting new trunkline competition (however intense it might be) as well as the connection of essentially unrelated trade areas, the resulting trunkline character, and the poor traffic integration, the Board gave precedence to the latter considerations. The latter factors are the controlling variables in the Board's decision. Subsidy reduction does not appear to have a controlling variable in the

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190 Id. at 358. The Board did not say that it was unconcerned with the trunkline character of the survivor which would result from the merger, however. It said: "we cannot lose sight of the fact that the merger would convert the routes of the two local service carriers into a single system extending over substantially the entire length of the Pacific Coast. It would enable the merged company to provide one carrier, one plane service between the large traffic centers, Seattle-Portland, San Francisco and Los Angeles." Id. at 357.

200 It appears that the connection of unrelated trade areas, is for the most part, not bad per se but simply represents an absence of affirmative benefit.

201 Diversion and monopoly likewise do not appear to be controlling variables in the Board's
decision since the Board did not mention it, or examine it, which it surely would have done had it been a significant consideration. Nor can the examination by the Board of potential financial improvement be presumed to refer directly to subsidy reduction. Therefore, it can be concluded that potential subsidy reduction has not played a significant role in Southwest-West Coast, other variables controlling the Board’s decision.

The Board did not enunciate any guidelines for determining an “essential relationship” between trade areas. It did, however, set forth some criteria for assessing the trunkline character of an air carrier, notably, whether the merged carrier possessed a large route system covering a large geographic area and provided one carrier-one plant service between the large traffic centers. The precise evaluation of trunkline character, as will subsequently be seen, is rarely possible upon resort to Board criteria.

The Board suggested as well in the Southwest-West Coast Merger Case, that contiguous trade areas might provide a more fertile field for mergers than areas of only scant relationship. While expressly denying that this fact premised the decision in any way, the Board suggested that such potential unifications as West Coast-Empire and Southwest-Bonanza presented interesting possibilities. This statement by the Board appears to be a significant policy revelation indicating that (apart from subsidy reduction) the Board favors only the connection of contiguous trade areas in local carrier mergers. The context of the statement and the very nature of the route systems which would result from the suggested mergers, however, are strongly suggestive that while the Board was interested in improving local carriers’ economies and earnings through mergers (and potentially subsidy reduction as well), it was only interested if a carrier of trunkline character did not result and contiguous trade areas were connected. While the Board did not mention diversion, monopoly, or quality of route integration, it would seem reasonable that the Board would consider such factors, especially if present in adverse capacity, in local carrier merger applications. It can be concluded, then, that at this time the Board was not opposed to local carrier mergers per se but was interested in using them to improve the financial position of local carriers if circumstances were favorable.

Less than one year from its denial of the Southwest-West Coast merger the Board considered the West Coast-Empire Merger Case which had been so intriguing the previous year. West Coast, as already noted, flew routes in western Washington and Oregon. Empire serviced eastern Washington and Oregon, and northern Idaho.

The former was not present in sufficient force to block the merger, the latter was not even mentioned by the Board.

The Board stated: “Although we do not rest our decision upon this fact, it should be noted that there are other areas available to the applicants for exploring the possibility of mergers in contiguous trade areas. For example, West Coast and Empire present interesting possibilities for merger. Similarly, Southwest and Bonanza may find it to their advantage to consider a merger, and it might well be that such mergers would result in equivalent if not greater savings than appear possible in the proposed West Coast-Southwest merger.” 14 C.A.B. at 358.

West Coast-Empire Merger Case, 15 C.A.B. 971 (1952). All relevant factual statements recited in the text of this paper pursuant to this case are drawn from discussion in the case itself at 972-92.
CAB AND SUBSIDY REDUCTION

In reaching its decision the Board noted several factors determinative of the public interest, almost all of them favorable to a merger of the applicants. The Board, while not mentioning subsidy reduction, observed that the merger would result in annual savings of $164,000, and would also generate approximately 2 million more passenger miles annually. The proposed purchase price was found reasonable. No monopoly would result. The only negative factor was the possibility of slight diversion of traffic from United. The Board did not mention that the merged carrier would a) join continuous trade areas in the Pacific northwest (favored by the Board in the Southwest-West Coast Merger Case) and, b) that the new carrier would not have the character of a trunkline but would remain a local carrier in form and function serving a fairly small area of the country. The Board approved the merger on June 27, 1952.

The significance of the West Coast-Empire decision lies principally in its material differences with the Southwest-West Coast decision. There were two related significant differences: the West Coast-Empire merger connected contiguous trade areas and did not give rise to a system of trunkline character. It follows that the West Coast-Empire merger was approved because of its potential financial benefits, its resulting connection of two contiguous related trade areas, and its retention of a local service character. Therefore, the significant differences which led to the approval of the West Coast-Empire application and denial of the Southwest-West Coast application must have been the resulting trunkline character and connection of unrelated trade areas in the Southwest-West Coast merger application.

Such factors as reasonable price, minimal diversion of traffic, and no

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505 Purchase price refers to the price of acquired assets in an acquisition. In the case of a conventional merger, "price" becomes a formula to determine relative ownership participation by the two groups of shareholders in the merged enterprise. Southwest-West Coast Merger Case, 14 C.A.B. 356, 373 (1951). In the West Coast-Empire Case, West Coast sought to unite with Empire by a purchase of all outstanding Empire stock. The Board termed this a merger. West Coast-Empire Merger Case, 15 C.A.B. 971 at 971 (1952).

506 15 C.A.B. at 992.

507 By the Board's own criteria (as set out in the Southwest-West Coast Merger Case) the surviving carrier would not cover a large geographical area, at least not nearly as large as the proposed Southwest-West Coast merged system. It would not provide one-plane-one-carrier service between any large traffic centers except perhaps Seattle and Spokane. 1952 C.A.B. Ann. Rep., Appendix III. Therefore the West Coast-Empire merger should not result in a surviving system of trunkline character. However, the Board has not developed entirely satisfactory criteria for determining resulting trunkline character when local carriers merge. (The basic criteria of local carrier character, set out in the Piedmont Certificate Renewal Case, 15 C.A.B. 736, 810 (1952), are helpful in stressing the short-haul, multistop, compulsory stop nature of a local carrier system. West Coast-Empire retains this nature. Like other local carriers it is confined to one particular region of the country—the Pacific Northwest. Thus the merged carrier appears much less a trunk and much more a local carrier.). (Note: The merged carrier, West Coast-Empire, would also be unlikely to satisfy the trunkline criteria later set out in North Central-Lake Central, namely: substantial route mileage; large number of cities served; density of population and substantial geographical area covered. North Central-Lake Central, 25 C.A.B. at 159.). The Board has not clarified the meaning of "contiguous trade area" but a reasonable interpretation would seem to rely heavily upon geographical proximity of population and trade centers. On this basis, a West Coast-Empire merger would connect areas in western and eastern Washington which appear to be the most proximate, populated areas. [Furthermore, the Board stated that these areas were contiguous in the Southwest-West Coast Case, 14 C.A.B. 356, 358 (1951).] It appears then, that the areas are contiguous.

508 See supra note 207. The estimated financial improvement in each merger was of approximately the same order.
resulting monopoly, though stated as reasons for decision must be discounted as true premises of decision because they are essentially negative factors. If present in an adverse capacity, for example, unreasonable price, resulting monopoly, or substantial diversion of traffic, they will likely compel a denial of merger application. But if present in a favorable capacity, the effect is only to turn the Board’s attention to more crucial issues.

The point of the above analysis is that in the West Coast-Empire merger the controlling variable was potential financial improvement, a positive factor, with no significant adverse negative factors being present. Conversely, in the Southwest-West Coast merger a positive factor, financial improvement, was outweighed by the negative factors of resulting trunkline character of the unified carrier, connection of unrelated trade areas, poor route integration, and resulting new trunkline competition. It follows that local mergers were not used at this time permanently as a source of subsidy reduction. The overriding consideration was the maintenance of the locals’ character and not their need for financial improvement.209

The foregoing analysis suggests that, barring any change in Board policy, a merger resulting in local carrier financial improvement would be denied if it resulted in the surviving carrier’s assumption of a trunkline character and connection of unrelated trade areas. However, as previously indicated, the Board did change policy by adopting a policy of subsidy reduction for local carriers in April 1962 and developed a general program of policy implementation by encouraging mergers of local service carriers. If the Board really sought to effectuate its policy of subsidy reduction it would be expected that when faced with an application for merger in which the primary considerations were a substantial financial improvement (and potential subsidy reduction) versus an assumption of trunkline character and connection of unrelated trade areas by the surviving carrier, the Board would approve the merger in order to realize a subsidy reduction. The Board has recently decided just such an application by three west coast local carriers.

A merger application which would merge Pacific, West Coast and Bonanza into one huge western system known as Air West has been approved by the Board. The proposed merger is very similar to the Southwest-West Coast merger denied by the CAB in 1951, Southwest having changed its name to Pacific210 in the interim. One substantial difference, however, is the inclusion of Bonanza.

Pacific and West Coast still fly routes in the Los Angeles-San Francisco and Seattle-Portland-Spokane areas respectively.211 Bonanza’s routes are contiguous with Pacific at Los Angeles and Las Vegas, with West Coast at Salt Lake City. The Air West system will serve an area bounded by Canada, the Pacific Ocean, Mexico, and Salt Lake City. If the proposed Southwest-West Coast merger would result in a trunkline character for

209 Cases to the contrary are examined infra.
210 See Hearings on the Local Air Carrier Industry, supra note 3, at 300.
211 Id. See map between pages 126-27.
the survivor, the *Bonanza-Pacific-West Coast* merger would result in a trunkline character to an even greater degree. Similarly, if the proposed *Southwest-West Coast* merger would have connected unrelated trade areas, so would the proposed *Bonanza-Pacific-West Coast* merger since the same areas, as well as some new ones, have been connected.

Despite the trunkline character of Air West and its connection of unrelated trade areas, the merger application was approved by CAB examiner Ralph Wiser on the ground that new service, substantial economies and subsidy reduction (of the order of $400,000 annually) would result. The examiner also noted that no monopoly and only slight diversion would result. The Board in approving the application found itself in substantial agreement with its examiner. It reconsidered in depth only the use of the name “Air West” and the total amount of anticipated subsidy reduction.

In reaching its decision the Board found that the merger would improve service, not create a monopoly, have no substantial adverse effect on other carriers, and reduce subsidy, not by the $396,000 estimated by the examiner, but by $676,000 per annum. The Board concluded: “In light of the immediate subsidy reduction of $676,000 per annum, the additional long term economies . . . and the other substantial benefits of the merger enumerated in the recommended decision, the proposed merger is clearly consistent with the public interest.” It seems clear that the controlling variables in the decision were subsidy reduction and improvement of service by the merged carrier.

The decision was based partly upon anticipated new service resulting from the unification. New service, however, is bound to result from any merger of carriers with contiguous route systems since one carrier-one plane service becomes possible over longer route segments. More efficient scheduling and plane utilization is possible. Subsidy reduction, on the other hand, is not the inevitable consequence of a merger because a merger does not automatically improve earnings. Of direct significance, however, the Board did not note the extent of service improvement but saw fit to specify, in some detail, the extent of potential subsidy reduction. It follows that the Board regarded subsidy reduction as the most important consideration in its decision.

Subsidy reduction was the most important controlling variable in the *Bonanza-Pacific-West Coast* decision. It is clear, therefore, that subsidy reduction has had a significant impact upon the Board’s decision.

Because the Board did not indicate the role of its subsidy reduction

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212 *Bonanza, Pacific*, *Pacific*, *West Coast*, *Merger Agreement*, Docket No. 18996 (C.A.B. Examiner’s Decision, 4 Jan. 1968). The examiner stated: “The matters set forth above lead to the conclusion that approval of the proposed merger, subject to appropriate conditions, will be in the public interest. A considerable amount of new and improved service and substantial economies and reduction in subsidy can be expected. No substantial adverse effects on other carriers are involved . . . .” *Id.* at 19.

213 *Id.* at 6, 7.


215 *Id.*

216 *Id.*
policy in this decision, and because subsidy reduction was not the only controlling variable in the decision, it cannot be definitely concluded that the Board’s subsidy reduction policy was a material influence in this decision. The Bonanza-Pacific-West Coast decision was very similar to the Southwest-West Coast application in that both mergers would connect unrelated trade areas and result in a merged carrier of trunkline character. However, these decisions differed in that subsidy reduction and improvement of service were controlling variables in the Bonanza-Pacific-West Coast decision but were not in the Southwest-West Coast decision.

Because subsidy reduction was the major controlling variable in the Bonanza-Pacific-West Coast case, because resulting trunkline character and the connection of unrelated trade areas were not controlling variables as they were in the very similar Southwest-West Coast decision (and might well have been in this decision) and because this case was decided subsequent to the Board’s adoption of its subsidy reduction policy, the conclusion is strongly suggested that the Board’s subsidy reduction policy did have a material effect upon the Board’s decision in the Bonanza-Pacific-West Coast case. For the reasons previously noted, however, the suggested materiality cannot be said to be conclusive.

The second group of local carrier mergers to be considered comprises three similar merger applications between inland carriers of the western, central and eastern United States. Only one merger decision in this group of applications was rendered prior to the adoption of the Board policy of subsidy reduction in April, 1962. That decision was given in the North Central-Lake Central Acquisition Case of 1957 and involved local carriers in the central states.

North Central, the proposed acquirer, provided service primarily north of Chicago in Michigan, Illinois, Wisconsin, Minnesota, and North Dakota. Its system was contiguous with Lake Central’s at Chicago. Lake Central provided service south of Chicago primarily in Ohio and Indiana.

In reaching a decision the Board found that approval would result in substantial subsidy savings from elimination of duplicating facilities, operations, and personnel. The examiner had estimated subsidy savings at $400,000 annually, but the Board would only indicate that such saving would be "sizeable." However, the Board also found that the merger would result in the connection of trade areas which were substantially unrelated, making for poor integration, and also give rise to a system of trunkline character as measured by route mileage, cities served, popula-

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27 It is difficult to compare the estimated financial benefit of $247,000 in the Southwest-West Coast case to the estimated annual subsidy reduction of $676,000 in the Bonanza-Pacific-West Coast because there is no way of determining what portion of the $247,000 financial benefit would flow through to subsidy reduction. However the Board did not deal at length with the amount of financial benefit in the former case whereas it did deal at some length with the quantum of subsidy reduction in the latter case. This is suggestive, but not conclusive, that quantum of subsidy reduction was somewhat material in the latter decision.

28 North Central-Lake Central Acquisition Case, 25 C.A.B. 156 (1957), aff'd sub nom. North Central Airlines v. CAB, 261 F.2d 181 (D.C. Cir.), cert. denied, 360 U.S. 903 (1959). All relevant factual statements recited in the text of this paper pursuant to this decision are drawn from the discussion in the case itself at 159-69. Although referred to as a "merger" this proposed unification was actually an acquisition wherein North Central sought to acquire Lake Central. Id. at 156.
tion density and geographical area covered, thereby posing the kind of competitive threat to trunklines which concerned the Board in the Southwest-West Coast decision. The Board in denying the application stated that subsidy reduction is only one factor to be considered in assessing the effect on the public interest of the proposed merger and on balance it is outweighed by the adverse factors present in the case.

The stated considerations supporting the merger denial are very similar to those expressed in the Southwest-West Coast merger decision previously examined. In the North Central-Lake Central case, when faced with a choice between "substantial" subsidy reduction (not mere financial improvement as in Southwest-West Coast) and resulting trunkline character of the merged carrier with concomitant potential new trunkline competition, the connection of substantially unrelated trade areas and poor route integration, the Board gave precedence to the latter considerations. They were the controlling variables in the decision. Therefore, it can be concluded that, prior to the Board's adoption of its subsidy reduction policy, the goal of subsidy reduction was not sufficient to offset the disadvantages of creating a merged carrier of trunkline character, which connected unrelated trade areas, and resulted in poor route integration. Because subsidy reduction was not a controlling variable it appears that it did not exert a material influence upon the Board's decision even though it was of a substantial nature.

In contrast to the North Central-Lake Central merger decision is a very recent Board merger decision, the Frontier-Central Merger decided September 1, 1967. Frontier provides local service in the west and midwest, primarily in Colorado, Wyoming, Montana, New Mexico, and Nebraska. Central flies routes in the southwest, primarily in Kansas, Oklahoma, and Texas. Their routes are contiguous at both Denver and Kansas City. On its face, the merger is very similar to the North Central-Lake Central application denied previously by the Board, in that the surviving carrier would possess the character of a trunkline by the Board's own criteria.

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219 Id. at 159.
220 Id. at 162.
221 The Board adopted the examiner's $400,000 per annum figure, arguendo, in its consideration. (Neither monopoly nor diversion were mentioned by the Board in this decision.)
222 Frontier-Central Merger, Docket No. 18117 (Order No. E-25626) (1 Sept. 1957); 2 Av. L. Rep. ¶ 21,741.01. Unlike the geographical group of Pacific coast carriers which flew primarily North and South, the carriers in the "inland" geographical group operated "net" type systems which, although contiguous in the various applications, provided service in practically every direction. The distinction between the geographical groups is not of great significance but facilitates a consideration of the various merger applications. (Pacific group carriers: West Coast, Pacific neo Southwest, Bonanza, Empire; inland group carriers: North Central, Lake Central, Central, Frontier, Allegheny.)
223 Hearings on the Local Air Carrier Industry, supra note 3, at 126-27.
224 Id.
225 Id.
226 The Board criteria were set out in the North Central-Lake Central Acquisition, 25 C.A.B. at 159. The factors which the Board assesses in determining whether a merged carrier (from two or more local carriers) has a trunkline character are: route mileage, number of cities served, density of population and geographical area covered. The proposed new Frontier-Central system would have combined route mileage of approximately 14,000 miles, serve 100 points and cover a 14 state area. 1966 C.A.B. Ann. Rep. at 82; 1967 C.A.B. Ann. Rep. at Map No. 2. By contrast, the North Central-Lake Central proposed merger of 1957 would have a combined route mileage of approximately 9,000, serve 93 points, and cover a 12 state area. 1959 C.A.B. Ann. Rep. at 53 and Map No. 2.
Also, it is difficult to see how the trade areas connected would be more than distantly related when considering the Board's own vague pronounce-
ments on that subject. The Board requires a showing that substantial traffic
will flow beyond the connecting point of the merger applicants' route
systems to demonstrate a relationship between trade areas. In the North
Central-Lake Central case the Board found that it was "clear from the
record" that little traffic could be expected to flow between points on the
systems east and west of Chicago but "as experience shows" traffic would
tend to stop in Chicago.\textsuperscript{227} The situation in the Frontier-Central case seems
similar. Traffic would seem much more likely to stop in Denver or Kansas
City, the connecting points of the route systems, than flow through these
points between the western Colorado, Montana, Wyoming, Nebraska
system and the southwestern Kansas, Oklahoma, and Texas system. It
follows that the degree of relationship between the connecting trade areas
would likely be slight.

On September 1, 1967 the Board approved the Frontier-Central Mer-
ger.\textsuperscript{228} In so doing the Board did not mention the resulting trunkline
character of the merged carrier, Frontier, and offered no comment upon
the degree of relationship of the trade areas connected by the merger,\textsuperscript{229}
both factors important to the Board in the North Central-Lake Central
application.\textsuperscript{230} It seems likely that the Board chose to de-emphasize the
importance of these factors by remaining silent in that regard. The only
factor potentially negative to the public interest which the Board did
mention in the decision was possible traffic diversion from the Braniff, a
nearby trunk.\textsuperscript{231} The Board held that the prime factors bearing upon the
public interest were the resulting additional through service and financial
improvement with corresponding decrease in subsidy requirements (or
lower fares, or both) which would result from the merger.\textsuperscript{232} The Board
did not discuss the quantum of subsidy reduction which could be expected
to result. The Board did note that no restraint of competition or jeopar-
dizing of another air carrier would result.

The controlling variables in the Frontier-Central decision were the
additional through service which would be provided and financial im-
provement in the merged carrier's position which, the Board noted, would

\textsuperscript{227} 25 C.A.B. at 158. Airline traffic of the local and feeder variety has a strong tendency to
leave the local carriers at larger centers as it is either being "fed" to the trunk carriers or is reaching
the terminus of its journey.

\textsuperscript{228} Frontier-Central Merger, \textit{supra} note 222.

\textsuperscript{229} The Board did not mention potential trunkline character for the merged carrier nor directly
the connection of unrelated trade areas. However, the Board statement that the public would be
benefited by the resulting through service would seem to imply that the Board believed the trade
areas were related to some degree.

\textsuperscript{230} Frontier-Central Merger, \textit{supra} note 222.

\textsuperscript{231} \textit{Id.} The Board stated: "[T]here cannot be concluded that any traffic diversion resulting from
the merger will have any substantial effect upon any other carrier . . . ." Braniff had indicated it
would suffer diversion but nevertheless did not object to the merger.

\textsuperscript{232} Frontier-Central Merger, \textit{supra} note 222.
“in the long run decrease the subsidy burden, or lower commercial fares, or both.” Like the Southwest-West Coast and the North Central-Lake Central proposed unifications, Frontier-Central would connect unrelated trade areas and result in a carrier of trunkline character. However, these factors were not mentioned in the Frontier-Central decision and therefore were not controlling variables in the decision.

In seeking to determine whether the Board policy of subsidy reduction has had any effect in the Frontier-Central decision, several observations are required. In the first place it is not clear as to whether subsidy reduction was even a controlling variable in this decision. Because subsidy reduction logically accompanies an improvement in financial position, and because it was specifically mentioned by the Board as a likely result of the financial improvement, it is likely that it was considered by the Board when it considered financial improvement. It is suggested, then, that subsidy reduction was likely a controlling variable in the Board’s decision. If it was not, however, then it is clear that the subsidy reduction policy could not have had any effect upon the decision. Second, the Board did not elaborate upon the role played by the improved service controlling variables, or its relation to financial benefit (and subsidy reduction) in the decision. Thus it is not possible to know precisely what role financial benefit (and subsidy reduction) played in the decision. Third, there were various other controlling variables present in the Southwest-West Coast and North Central-Lake Central decisions, such as potential trunkline competition and poor route integration, which were not discussed in Frontier-Central, so a direct comparison with these decisions and the Frontier-Central decision is difficult. However, the Frontier-Central decision was rendered subsequent to the Board’s subsidy reduction policy and would result in financial benefit for the merged carrier and very likely potential subsidy reduction as well. Furthermore, the merged carrier would acquire a trunkline character and connect unrelated trade areas. The latter variables were found controlling in merger decisions rendered prior to the Board’s adoption of a subsidy reduction policy but were not controlling in the Frontier-Central decision. Taken together these considerations suggest that the Board subsidy reduction policy was in some way instrumental in the Board’s decision.

Because the merger decisions have not involved identical factors, and for the reasons above stated, however, it can only be suggested that the subsidy reduction policy had some effect upon the Frontier-Central decision. For the reasons noted the suggested materiality cannot be said to be conclusive.

The third merger application in this second group of cases involved Allegheny and Lake Central. Allegheny services northeastern states, primarily New York and Pennsylvania. Lake Central’s system is contiguous.
at Pittsburgh and Detroit and services the area southwest of the Great Lakes, primarily Ohio, Indiana, southern Michigan, and western Pennsylvania. No decision has yet been rendered by the hearing examiner on this application although this will be necessary before the Board hears and decides the application. At present, the Allegheny-Lake Central merger application has been approved by the shareholders of each carrier and the Board’s Bureau of Operating Rights. The examiner’s decision is pending.

On the surface the Allegheny-Lake Central application appears to encompass many of the considerations of the various local carrier merger decisions rendered previously. The various route systems involved suggest strongly that, by the Board’s own criteria, the merged carrier would take on the character of a trunkline. The geographical characteristics of the route systems involved suggest the possibility that unrelated trade areas might be connected. It is likely that some form of financial benefits, possibly leading to subsidy reduction, and some form of improved services, will also be involved in this application. Because the Allegheny-Lake Central application will in all likelihood involve many of the significant considerations of the Southwest-West Coast, North Central-Lake Central, Frontier-Central and the Bonanza-Pacific-West Coast, its decision by the Board will be of great importance. The Board decision will be able to confirm the material effect of subsidy reduction in the Board’s local carrier merger decisions and either strengthen or weaken the suggested materiality of the Board’s subsidy reduction policy in those decisions.

E. Conclusions

In the first significant local carrier merger considered, the 1951 Southwest-West Coast decision, it was demonstrated that when faced with a choice between a potential financial improvement of $247,000 annually and the resulting trunkline character of the merged carrier, the degree of resulting new trunkline competition, the connecting of unrelated trade areas and poor traffic integration, the Board gave precedence to the latter four factors. These factors were the controlling variables of the decision. Subsidy reduction was not mentioned and the extent of potential new trunkline competition was not examined by the Board. Because subsidy reduction was not a controlling variable, it can fairly be said that it has not had a discernible material effect upon the Board’s decisions. The Board

236 Id.
238 Wall Street Journal, Mar. 15, 1968, at 13, Col. 8. The function of the Bureau of Operating Rights has varied over the years. Originally it was known as “public counsel” and its principal responsibility was to represent the public interest in proceedings before the Board. Subsequently it acquired the job of preparing an adequate record for Board decisions and to this end the Bureau requests evidence from the various parties to a proceeding. Lately the Bureau has concerned itself deeply with the question of subsidy. When local service carrier proceedings involving merger, or route certification applications arise, the Bureau almost invariably recommends action to the hearing examiner and to the Board itself. The Bureau will favor action leading to subsidy reduction where all factors are equal. Interview with Mr. S. Stroud of Mayer, Friedlich and Co., Attorneys At Law, Chicago, 26 Apr. 1968.
239 See North Central-Lake Central Acquisition Case, 21 C.A.B. at 159.
offered a policy revelation in the *Southwest-West Coast* case indicating that it favored connecting only contiguous trade areas in local carrier mergers and suggesting that West Coast-Empire and Southwest-Bonanza presented interesting possibilities for merger. The import of this statement, gathered from its context and the nature of the resulting merged system, appeared to be that the Board was interested in improving local carriers' economies and efficiencies through financial benefits resulting from local carrier mergers—but only if a merged carrier of trunkline character did not result and contiguous, related trade areas were connected. (And, of course, where no other factors such as diversion, integration, and monopoly were significantly adverse.)

In 1952 the Board approved the *West Coast-Empire* merger which differed significantly from the *Southwest-West Coast* application only in that the merged carrier lacked a trunkline character and it connected contiguous trade areas. The merged carrier, therefore, would not be capable of supplying additional trunkline competition for the existing trunk carriers. The Board did not specifically mention route integration. The Board found that the merged carrier would realize financial benefits totalling $164,000 annually. Although the estimated financial improvement in *West Coast-Empire* was only about two-thirds as large as that in *Southwest-West Coast*, the Board nevertheless approved the merger. In the absence of the resulting trunkline character and connection of unrelated trade areas factors (and seemingly in the absence of poor route integration), potential financial benefit had become the controlling variable in the Board's decision. It can be concluded that the Board favored local carrier mergers which would materially improve the financial position of the merged carriers.

The important role played by the factors of resulting trunkline character and the connection of unrelated trade areas in local carrier mergers can be seen in considering the *Southwest-West Coast* and *West Coast-Empire* decisions. Their absence from the favorable decision and presence in the unfavorable one suggests that, at this time, they would be the controlling variables of almost any decision in which they were significant factors. Although financial benefit could lead to subsidy reduction, subsidy reduction was not discussed in *West Coast-Empire* and was not a controlling variable of the decision.

In 1957 the Board denied the *North Central-Lake Central* merger application. The stated considerations of the Board decision did not differ greatly from those of the *Southwest-West Coast* decision. The Board decided against a merger which although it would reduce subsidy by $400,000 annually would also result in a merged carrier of trunkline character, connect unrelated trade areas and poorly integrate the applicants' routes. Substantial subsidy reduction had failed to become a controlling variable in the decision in the presence of resulting trunkline character, connection of unrelated trade areas, and poor route integration which were controlling variables of the decision.
Upon considering the three early merger decisions, *Southwest-West Coast*, *West Coast-Empire* and *North Central-Lake Central*, two conclusions emerge. Prior to the Board’s adoption of its subsidy reduction policy the Board favored financial improvement (and potential subsidy reduction) through local carrier mergers in the absence of such significant factors as resulting trunkline character, connection of unrelated trade areas, and sometimes poor integration of applicants’ routes. However, when faced with a choice between financial improvement, or even substantial subsidy reduction, and resulting trunkline character, connection of unrelated trade areas, and poor route integration in a local carrier merger application, the latter three variables were found by the Board to be controlling. It can be concluded that substantial subsidy reduction, of the order of $400,000 annually, did not have a material effect on the Board’s decision in the presence of the above controlling variables. It would seem, then, that even substantial size of potential subsidy reduction would not result in its having a material effect upon the Board’s decision under such circumstances.

In 1967 the Board approved the *Frontier-Central* merger application, a very important decision. The factual contexts of *Frontier-Central* and *Southwest-West Coast* and *North Central-Lake Central* were very similar. A significant difference was that the former application was decided subsequent to the Board’s adoption of its subsidy reduction policy while the latter two applications were decided prior to it. Although the prior analysis demonstrated that the merged carrier would connect unrelated trade areas, and result in a merger carrier of trunkline character, the controlling variables in the Board’s decision were additional through service and financial improvement leading to subsidy reduction or lower fares or both. Neither subsidy reduction, nor its quantum, were further discussed, so it is not absolutely clear that subsidy reduction was a controlling variable in the Board’s decision, although this conclusion is suggested. Hence, the materiality of size of subsidy reduction cannot be determined. Because it appears likely that subsidy reduction had some effect in the Board’s decision (or could have as a result of the anticipated financial improvement) and because resulting trunkline character and the connection of unrelated trade areas were not controlling variables, as they well might have been had the application been decided prior to the Board’s adoption of its subsidy reduction policy, the conclusion is suggested that the subsidy reduction policy had some effect upon the *Frontier-Central* decision. However, the presence of additional service as the other controlling variable in the decision, and the presence of other factors in the pre-policy decisions, militate somewhat against the suggested conclusion.

In 1968 the Board approved the *Bonanza-Pacific-West Coast* merger. The controlling variables of the decision were an estimated subsidy reduction of $676,000 annually, and improved service. Subsidy reduction was the dominant controlling variable. Although the factors of resulting trunkline character and the connection of unrelated trade areas were demonstrated by the analysis to be present, they were not controlling
variables. Because substantial subsidy reduction was the dominant controlling variable it is clear that it had a discernible effect upon the Board's decision. By contrast, in the very similar *North Central-Lake Central* application, very substantial potential subsidy reduction (of the order of $400,000 annually) did not have an effect upon the Board's decision. Resulting trunkline character, connection of unrelated trade areas, and poor route integration were the controlling variables. The only significant difference between the decisions was the existence of the Board's subsidy reduction policy prior to *Bonanza-Pacific-West Coast* but subsequent to *North Central-Lake Central*. Thus, in a situation in which the only significant variable was the subsidy reduction policy, the variable resulted in a decision change. Because of the effect of subsidy reduction on the Board's decision and because the existence of the Board's subsidy reduction policy was the only significant variable in *Bonanza-Pacific-West Coast* and *North Central-Lake Central*, the conclusion is strongly suggested that the Board's subsidy reduction policy has had a material effect upon the Board's decisional process. The materiality of the size of the potential subsidy reduction in the decision is very difficult to assess because the Board did not discuss this aspect of its decision. However, it would seem likely that the dominance of subsidy reduction as a controlling variable would decline with the size of the potential subsidy reduction.

A final merger application requesting the unification of Allegheny and Lake Central has yet to be decided. This application will likely involve many of the significant considerations examined previously in the prior local carrier merger decisions. Its resolution by the Board will provide an opportunity to confirm the material effect of subsidy reduction in the Board's local carrier merger decisions and either strengthen or weaken the suggested materiality of the Board's subsidy reduction policy in those decisions.

The analysis of local carrier merger decisions, and conclusions drawn therefrom, strongly suggests that the CAB policy of subsidy reduction has had a discernible material effect upon CAB decisions in the merger field. Thus far, however, the Board has acted subsequent to its policy of subsidy reduction only in the *Frontier-Central* and *Bonanza-Pacific-West Coast* mergers. Whether such materiality will continue may be known when the Board decision in *Allegheny-Lake Central* is handed down.