Notes on the History of Federal Regulation of Airline Mergers

Lucie Sheppard Keyes
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LUCILE SHEPPARD KEYES*

The current "hard times" in the aviation industry have resulted in an increased interest in mergers as a solution to the economic difficulties facing air carriers. Prior experience with Federal regulation of mergers provides a measure to judge the effectivenness of CAB policies regulating this activity and points to certain improvements in the current procedures for evaluating merger proposals. Mrs. Keyes explores the history of CAB evaluation of merger proposals and concludes that current administrative policies and procedures are deficient in important respects. The author proposes alternative possibilities to the current regulatory procedures and discusses their impact on the existing regulatory framework.

THE current financial difficulties of the air transportation industry in the United States have created renewed interest in mergers as a remedy for losses, and several pending merger proposals have conferred practical urgency upon the policy problems involved in the regulation of these transactions. The following notes on the history of Federal regulation of airline mergers are offered in the hope that they may afford some useful guidance in the search for a solution for these problems. The scope of the discussion is limited to proposals involving domestic trunklines and local service carriers. Inclusion of other categories, such as those involving international or territorial carriers, would have necessitated extended treatment of topics only peripherally related to the main issues facing the regulators today.¹

¹ The treatment of merger proposals involving international carriers has been affected by such factors as the special position of Pan American Airways and, in one notable instance, by Presidential intervention. The regulation of mergers in Alaska, while affording a fruitful field for separate study, has been regarded by the Board as a special case outside the mainstream of regulatory policy. In an account of its policies prepared in 1952 for the Senate Small Business Committee, the Board stated:

A somewhat different situation has pertained in Alaska due to the fact that at the time the act was passed there were a great many carriers, many of them so small that they were unable to perform the services necessary to

The history of domestic airline merger regulation falls naturally into four successive periods: (1) from the beginning of regulation in 1938 to the late 1940's, during which time the Board adopted and held to a strongly pro-competitive policy and appears to have approved no mergers with appreciable anti-competitive effects other than those inevitably involved in extension of the acquiring carrier's protected access to traffic; (2) from the late 1940's to the mid-1950's, when airline financial reverses caused the Board actively to campaign for mergers and to approve some with apparently considerable anti-competitive impact; (3) from the mid-1950's to the latter part of the 1960's, when, despite the onset of "hard times" (in the early 1960's) and carrier proposals for anti-competitive mergers of major dimensions, only one domestic airline merger was approved, and that one was necessary for the rescue of a genuinely failing company; and (4) from the latter part of the 1960's to the present, when the need to reduce the cost of subsidizing the local service airlines and the desire to maintain service jeopardized by the serious and continuing financial problems of a small trunkline resulted in Board approval of four proposals for mergers (one of which was not consummated), at least one of which may have involved appreciable anti-competitive effects in addition to extended protected access to traffic.

I. THE FIRST PERIOD

The Board announced its pro-competitive approach to merger regulation in two well-known cases: United Air Lines Transport Corp., Acquisition of Western Air Express Corp. and American Airlines, Inc., Acquisition of Control of Mid-Continent Airlines, Inc. In each case, the large size of the would-be surviving carrier and its power to control connecting traffic played a leading part in bringing about Board disapproval of the proposed transaction. The two grounds for denial in United-Western were set forth as follows:

We find (1) that the predominance which approval of the application in this case would give to United in the West coast region would result in meet the needs of the Territory and that competition between these carriers existed over segments which lacked sufficient traffic potential to support competing services. As a result in Alaska the Board has approved a number of mergers and acquisitions of control that eliminated routes which at least on their face appeared to be competitive. A closer examination of the cases, however, discloses that in many instances this competition was illusory since the acquired carrier had ceased operations or that carrier would have been unable to continue to render service over both the competitive and noncompetitive portions of its route.


a 1 C.A.B. 739 (1940) [hereinafter cited United-Western].

b 7 C.A.B. 365 (1946) [hereinafter cited American-Mid-Continent].
a condition which would not be best suited to the encouragement and
development in that region of a system of air transportation 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, and (2) that the elimination of Western as the only independent
north-south air carrier in the territory west of the Rocky Mountains
would not be in accordance with the best interests of local business in
that territory and would not serve to maintain and encourage competi-
tion to the extent necessary to assure the development of a properly
balanced system of air transportation in that section of the country.4

The "predominance" referred to encompasses both relative size, as
measured by route miles and population served in the west coast region,
and control over transcontinental traffic originating in this region. In
particular, United would have obtained direct entry into Los Angeles
from the east, and would then have enjoyed access to all four major
west coast cities as compared with a maximum of two for each of its
competitors.5 Though the effect of the merger on the rank of United in
the industry is mentioned in the decision,6 the weight accorded to this
consideration, if any, is not evident.

While prospective elimination of competition between the participant
carriers was one of the two decisive factors in United-Western, this con-
sideration did not figure at all in American-Mid-Continent. Here the
"critical factors" were the "underlying circumstances of size and com-
petitive position": "at the time the subject agreement was executed," the
Board pointed out, "American exceeded any of the other certificated
domestic air carriers in route miles, population served, revenue plane
miles flown, revenue passenger-miles flown, total operating revenues,
and net operating income" and the proposed acquisition "would result
in a substantial enlargement of American's system and business."7 In view
of these circumstances, the Board found that the merger would be con-
trary to the public interest in two essential respects: (1) it would "pro-

4 United-Western at 750.
5 Id. at 745. United later obtained entry into Los Angeles from the east by the pur-
chase of Western's route from Denver. Competition from other through services and
Western's urgent need of funds made this move acceptable to the Board. United Air
Lines, Inc.—Western Air Lines, Inc., Acquisition of Air Carrier Property, 8 C.A.B. 298
(1947).
6 United-Western at 740: "The merger or purchase of assets for which approval is
sought in this proceeding would result in consolidating the fourth largest of the 17 do-
mestic air carriers with the eighth largest from the standpoint of route miles, United
being one of the three transcontinental operators and Western one of the major north-
south systems. The combined company would rank second in route miles."
7 American-Mid-Continent at 378 and 377.
8 Id. at 378. Here the Board quoted American's chairman: "Acquisition of Mid-
Continent would extend the American Airlines System to 3,156,290 additional persons
in 6 new States, 22 new communities, and over 2,400 new miles of route. By acquiring
Mid-Continent we would extend American's service to such important cities as New Or-
leans, Shreveport, Omaha, Des Moines, Kansas City, and Minneapolis-St. Paul, all major
United States cities."
duce so great a diversion of traffic from other air carriers as would be inconsistent with sound economic conditions . . . and would impair the competition we deem requisite to assure the development and maintenance of an adequate air transportation system; and (2) it would make it difficult or impossible for the Board subsequently to authorize new services needed to accommodate the demands of cities on the existing Mid-Continent system, because of the undesirability of increasing still further the size and competitive position of American. While these two factors were sufficient to cause disapproval, the Board also cited a third detrimental result to be expected from the merger, namely, that the development of Mid-Continent's connecting services would be impaired to the extent that American would be under "less economic pressure" to develop them and would "attempt primarily to work out complementary services within its combined system."

It is important to note that the Board did not object to the increase in the size of the American system because of possible diseconomies of scale, but rather because of the impact on its competitors resulting from greater public acceptance of a carrier with a wider scope of operations and greater control over "traffic originating at or destined to points to which [a competitor] does not have access." In this respect, the argument is similar to that in United-Western. Also in both decisions the Board generally accepted the contentions of the applicants that certain cost and service benefits could be expected to result from the proposed transaction, but did not attempt to make a definite evaluation of them. Except for the provision of through sleeper service at Salt Lake City, which was in fact accomplished by an interchange agreement approved at the same time the United-Western merger was disapproved, these benefits were found to be relatively unimportant.

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9 Id. at 379.

10 Id. at 380-81. These demands, the Board pointed out, would not be served by the proposed merger itself, since it "would establish no new service to accommodate the important traffic flows to and from the Mid-Continent communities and . . . those new single-carrier operations which are offered as conveniences to a few of the minor traffic potentials actually would be far from efficient as traffic patterns."

11 Id. at 381-2.

12 Id. at 379: "By these findings we mean to intimate no opinion that American is too big, in an absolute sense, nor to infer any predetermination not to permit, under appropriate circumstances, any further expansion or development of the American system. We make no attempt to calculate an optimum size for an air carrier, nor do we express a belief that such a fixed and invariable standard exists in so dynamic a field as air transportation."

13 Id. at 378-79.

14 Id. at 386: "In summary . . . while the applicant has been able to prove that some actual, tangible public benefits are attainable through the proposed acquisition, these benefits appear to be of relatively slight weight, and fall far short of offsetting the substantial injuries which the same transaction threatens to the public interest."

United-Western at 744: "Altogether, on the question of economies, we are in agreement with the examiner that, taken in the aggregate, the suggested economies have some
The three airline mergers approved\(^{14}\) in this early period entailed no elimination of parallel services and furthermore do not appear to have foreclosed any genuine potential competition. At the time of its acquisition by Northeast, Mayflower had not operated for about five years and had been adjudged bankrupt. Though both Marquette and Inland were operating at the time of their acquisition, the former had incurred operating deficits of more than $200,000 and was conducting service infrequently and with inferior equipment; and the latter, Inland, appears to have been equally unlikely to emerge as a viable potential competitor.\(^{16}\)

### Table I

**Operating Profit, Total Available Seat-Miles (Scheduled Service), and Total Revenue Passenger-Miles (Scheduled Service), Domestic Operations of the Domestic Trunkline Passenger/Cargo Carriers**

<table>
<thead>
<tr>
<th>Year</th>
<th>Operating Profit or (Loss) (All Services) (millions of dollars)</th>
<th>Total Available Seat-miles (Scheduled Service) (millions)</th>
<th>Total Revenue Passenger-miles (Scheduled Service) (millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1945</td>
<td>33.5</td>
<td>3,784.5</td>
<td>3,336.3</td>
</tr>
<tr>
<td>1946</td>
<td>(5.2)</td>
<td>7,490.4</td>
<td>5,903.1</td>
</tr>
<tr>
<td>1947</td>
<td>(20.9)</td>
<td>9,152.4</td>
<td>6,016.3</td>
</tr>
<tr>
<td>1948</td>
<td>2.1</td>
<td>9,980.2</td>
<td>5,840.2</td>
</tr>
<tr>
<td>1949</td>
<td>24.6</td>
<td>11,117.7</td>
<td>6,570.7</td>
</tr>
<tr>
<td>1950</td>
<td>62.6</td>
<td>12,385.6</td>
<td>7,766.0</td>
</tr>
</tbody>
</table>

Source: Civil Aeronautics Board, Handbook of Airline Statistics (1969 ed.).

### II. The Second Period

As the accompanying table shows, the latter part of the 1940's witnessed a sharp short-term reversal of the fortunes of the domestic trunk-

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\(^{16}\) Western-Inland at 661:

Evidence submitted in this proceeding shows that Inland's operations procedure and maintenance as well as operating personnel have on occasions failed to measure up to the standards required in the public interest. In addition, data incorporated in the record on the financial history of Inland shows [sic] that its management is largely responsible for the carrier's difficulties in that funds have been at times used for recoupment of the stockholders investment, rather than for the development of the system. On two occasions we have found it necessary to comment on Inland's management and financial policies which have been largely responsible for its financial impairment. We have heretofore recognized the superior quality of Western's operation and management over that of Inland.
lines, brought on by the failure of demand for air transportation to match the growth in capacity for carriage. Beginning in 1947, the Board was under heavy pressure to act to improve the industry’s finances, and initiated several investigations into the problems of particular air carriers. One such proceeding involved the possible dismemberment or other therapeutic restructuring of National Airlines. These efforts were largely without practical effect: the investigations became bogged down as the Board’s staff had to devote more of its attention to processing emergency mail rate orders, and National made a rapid recovery from its 1947 and 1948 low points, which had in fact stemmed in great degree from strikes and serious accidents. Nevertheless, both industry and official sources continued to suggest that carrier difficulties were attributable to unwise regulatory policies resulting in excessive competition, and proceedings looking toward elimination of competition in certain markets figured prominently in the Board’s Economic Program for 1949, issued in February of that year.

Of greater practical effect were the Board’s efforts to seek out opportunities for financial improvement through inter-carrier transactions such as mergers. In its statement of policy accompanying the Economic Program for 1949, the Board exhorted the industry to point out “uneconomic route pattern situations . . . which may be corrected by mergers, consolidations, interchanges, or suspensions.” In addition, the agency undertook a staff investigation of “the possibility, feasibility, and desirability of bringing about the merger of air carriers where such mergers would result in the improvement of the structure of the air transportation map of this country, and would result in substantial public benefits and lower mail rates.” In short, the Board adopted the view that airline financial difficulties had revealed inherent “deficiencies in the air-route pattern” which called for the formulation of “an over-all route

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17 These investigations are discussed in Investigation of Finances, Routes, and Operations of Capital Airlines, Inc., 11 C.A.B. 307 (1950).

18 National Airlines, Inc., Route Investigation, 12 C.A.B. 798 (1951). The investigation was instituted in September 1948.

19 See, for example, the following statement in the Annual Report of American Airlines for 1948, quoted in the Examiner’s Recommended Decision in American-Eastern Merger, Docket No. 13355 at 32n (November 27, 1962): “One of the basic economic problems of the industry for the past several years has been the willingness of the Civil Aeronautics Board to permit uneconomic paralleling of services operated, creating in the name of competition many elements of wasteful competition, with consequent ill effect on the industry and, in the long run, ill effect on the traveling public.”

20 See, Aviation Policy Board, National Aviation Policy, S. Rep. No. 949, 80th Cong., 2d Sess. 25 (1948) and Air Policy Comm’n, Survival in the Air Age 110-11 (1948). As late as May, 1954, the Air Coordinating Committee, in its report entitled Civil Air Policy, was recommending that the financial problems of “the smallest trunklines, and some of the medium-sized lines” could be alleviated by Board encouragement of “the development of suitable combinations of such carriers which would result in a smaller number of systems.” Air Coordinating Comm., Civil Air Policy 12 (1954).

plan to serve as the pattern for future development of the airline network”; and that this plan “must have as a vital ingredient, the possibility of mergers which will achieve a system of carriers whose size and other characteristics will permit more uniform cost levels; will avoid excessive competition detrimental to the system as a whole but at the same time preserve (non-"excessive"?) existing competition and increase the effectiveness of it; will improve service to the public through combinations of carriers whose routes logically integrate.”

In 1950 and 1951, individual Board members continued to urge the carriers to reduce “uneconomic competition” and achieve prosperity by means of mergers. The fate of these proposals is beyond the scope of the present study; however, it may be said with confidence that they were not what the Board had in mind when it made its statement of policy. Similarly unwelcome, presumably, was a proposal made somewhat later by the President of Eastern who, in a letter to the Chairman of the Senate Interstate and Foreign Commerce Committee, offered to take over all (or any one) of Capital, National, Delta, Chicago and Southern, and Colonial, and operate them without benefit of subsidy. The Senator's favorable response indicates the existence of strong Congressional support for drastic measures to improve carrier earnings.

The Role of Competition in Commercial Air Transportation, supra note 1, at 825-26.

See, e.g., the speech by Board Member Josh Lee reported in AVIATION WEEK, May 29, 1950, at 54; statements by Board Chairman Delos Rentzel, AVIATION WEEK, Jan. 22, 1951, at 45 and March 26, 1951, at 16; and a speech by Board Vice Chairman Oswald Ryan, AVIATION WEEK, June 18, 1951, at 86.

See AVIATION WEEK, March 7, 1949, at 16.

See AVIATION WEEK, April 4, 1949, at 14.

The acquisition of American Overseas was ultimately approved only because of the direct intervention of the President. See The Role of Competition in Commercial Air Transportation, supra, note 1, at 824.

"For the past ten years, the Board has been vigilant in preventing developments which would adversely affect the competitive balance in the United States-South America and New York-Miami markets. Thus, the Board has uniformly denied applications by Pan American for a domestic route, and has taken appropriate action to see that Pan American could not accomplish indirectly that which it has been denied by direct application." Pan American-National Agreement Investigation, Order No. E-15541, at 7-8 (Jul. 14, 1960).

AVIATION WEEK, June 6, 1949, at 47.

Id. The Senator is reported to have said that the proposal "looks good," and that his Committee would "examine the advisability of changing certain fundamental tenets of the 1938 Civil Aeronautics Act" to facilitate the plan. Later that year, the Senator urged airline managements to "consider carefully all merger possibilities," and put them on notice that "Congress as well as the C.A.B. may have to consider means to induce airlines to transfer routes and to merge or consolidate on reasonable terms in the best interests of the public." Cf. AVIATION WEEK, August 1, 1949, at 54.
From 1949 through 1956, three mergers of local service airlines,9 three of trunklines,9 and one combination of a local with a trunkline10 were authorized. At least one of the local service transactions and all four of the others involved one or more carriers which had been under specific pressure by the Board to seek merger partners, although the chosen partners were not necessarily those which the Board would have preferred. West Coast, which had previously sought unsuccessfully to obtain Board approval for its merger with Southwest Airways “in response to the Board’s repeated encouragement to air carriers to undertake route improvements through merger,”52 acted upon explicit Board suggestions that “there are other arrangements available to the applicant for exploring the possibilities for merger in contiguous areas” and that “West Coast and Empire present interesting possibilities for merger.”53

The Board had suggested a merger between Continental and Mid-Continent, and the Braniff-Mid-Continent transaction reportedly was undertaken after Mid-Continent’s negotiations with Continental had failed to bear fruit.44 At the time of the Braniff-Mid-Continent agreement, the Board’s staff was considering several possibilities for a match with Continental, though Pioneer did not figure among these candidates. Among the candidates under consideration for Chicago and Southern was the eventually successful Delta.46 The Board was also seeking a match for Colonial, which had been included, along with Northeast, National, and Delta, in a Board-instituted proceeding to investigate possible combinations between New England and southern carriers. Conspicuously not under consideration was Eastern, Colonial’s eventual purchaser, which “already [was] considered strong.”36

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52Braniff-Mid-Continent Merger Case, 15 C.A.B. 708 (1952) [hereinafter cited Braniff-Mid-Continent]; Delta-Chicago and Southern Merger Case, 16 C.A.B. 647 (1952) [hereinafter cited Delta-Chicago and Southern]; and Colonial-Eastern Acquisition Case, 23 C.A.B. 500 (1956) [hereinafter cited Colonial-Eastern]. The third of these mergers had been proposed as early as 1952. The Board then recommended approval but was reversed by the President on the ground that Eastern had illegally acquired control over Colonial prior to the execution of the acquisition agreement. Eastern-Colonial, Acquisition of Assets, National-Colonial Integration Investigation, 18 C.A.B. 453 (1954).


8West Coast-Empire at 973.

55Southwest-West Coast Merger Case, 14 C.A.B. 356, 358 (1951) [hereinafter cited Southwest-West Coast].

54AVIATION WEEK, February 11, 1952, at 51.

55Id.

56Id.
agreement to merge was in fact arrived at by Colonial and National, and it was only after Colonial's stockholders had rejected this agreement that the Board, with apparent reluctance, turned its attention to the Eastern-Colonial proposal.

The three local service mergers entailed no elimination of parallel services; in two cases, new route segments were added to join the merging systems. Similarly, two of the trunkline mergers—Eastern-Colonial and Delta-Chicago and Southern—appear not to have eliminated any existing point-to-point competition. On the other hand, the Continental-Pioneer and Braniff-Mid-Continent combinations did have such an effect; in the latter case, at least, an important city-pair market was affected.

Probably of greater significance was the impact of these mergers on potential competition. While Arizona was literally a non-starter (in approving the merger, the Board's "principal motivation [appeared] to be a desire to see Arizona Airways airborne"), and Colonial was seemingly doomed to failure in its attempt to achieve a viable route system by means other than merger, the other carriers taken over

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37 AVIATION WEEK, February 18, 1952, at 53.
38 AVIATION WEEK, June 23, 1952, at 75.
39 After the Colonial stockholders rejected merger with National, Colonial's president solicited bids from other interested carriers, prominent among which was Eastern. The Chairman of the Civil Aeronautics Board thereupon directed a letter to the president of Colonial warning him that he could not "count on selling Colonial to the highest bidder." Id. According to the same source, Colonial's action had "disturbed" the Board, "especially since the National deal already had tacit approval" by that agency.
40 West Coast-Empire at 975-76; Arizona-Monarch at 261.
41 In Continental-Pioneer at 363, it is indicated that competition was to be eliminated in the following markets:

<table>
<thead>
<tr>
<th>Route</th>
<th>Average number of passengers per day</th>
</tr>
</thead>
<tbody>
<tr>
<td>Albuquerque-Houston</td>
<td>3.0</td>
</tr>
<tr>
<td>Albuquerque-Midland</td>
<td>1.5</td>
</tr>
<tr>
<td>Albuquerque-Santa Fe</td>
<td>2.6</td>
</tr>
<tr>
<td>Midland-San Angelo</td>
<td>2.7</td>
</tr>
</tbody>
</table>

Source: AIRLINE TRAFFIC SURVEY (March 1952).

42 Braniff-Mid-Continent at 734-35:

The only instance of significance in which competition will be removed as a result of the merger is with respect to service for passengers traveling between Kansas City and Houston. At the present time each company offers such a service and they have divided the bulk of this traffic between them. In March 1950, 457 passengers were ticketed between Kansas City and Houston, and Braniff carried 247, Mid-Continent 198, and 12 were moved over other combinations. In September 1950 the total was 434 passengers, 181 carried by Braniff, 226 by Mid-Continent, and 27 by other combinations.

43 Arizona-Monarch at 248: "Over a year and a half has elapsed since Arizona was awarded its certificate, and no service under that certificate has been afforded to the people in the Arizona area. On March 21, 1949, we revoked Arizona's authority to suspend service on its routes, and ordered that carrier to inaugurate service on or before July 1, 1949."

44 Id. at 254 (dissenting opinion of Board Member Jones).
45 Eastern-Colonial, Acquisition of Assets, National-Colonial Integration Investiga-
during this period appear to have been reasonably successful operations which could have provided new competition for other airlines, and were particularly well placed to offer such competition to the carriers with which they merged. For example, Braniff and Mid-Continent served five points in common; each was an obvious candidate for the provision of any new competitive services from these points to other points on the system of the other. Continental and Pioneer served eight points in common; Delta and Chicago and Southern served four; and Monarch and Challenger served two. The West Coast and Empire systems were joined at two points by Board action at the time of the merger.

Except (as noted) in Arizona-Monarch, the Board's principal motive in approving these combinations appears to have been a hope of improving the financial condition of one or more of the participants. Although generally avoiding endorsement of carrier estimates of financial benefits, the Board tended to accept in principle the contentions of the parties that such benefits would be of significant proportions. Even in Arizona-Monarch, the Board agreed with the view of the examiner that "the total overhead to be incurred under the consolidated operation should, with proper management, be less than the sum of such expenses of each carrier under independent operation." In Monarch-Challenger, while expressing general skepticism about prior estimates of savings through consolidation, the Board was "convinced that substantial savings can be obtained" by such means as better utilization of equipment, elimination of unnecessary personnel, and better utilization of the remaining personnel. In West Coast-Empire, the Board endorsed the examiner's estimate of total benefits, with certain specific deductions. The applicants' estimates of benefits in Braniff-Mid-Continent

It is evident that Colonial's difficulties, since they stem from infirmities inherent in its route structure, cannot be solved by measures short of a drastic revamping of Colonial's routes or by integration of its system with another carrier. Colonial has endeavored to secure authority to expand and to properly integrate its route structure but so far has been unable to secure route modifications or extensions which would, to any degree, solve its problems. It does not appear that there is any immediate prospect of a substantial improvement in Colonial's route structure through revision thereof or additions thereto.

Braniff-Mid-Continent at 728.
Continental-Pioneer at 377.
Delta-Chicago and Southern at 674.
Monarch-Challenger at 35.
West Coast-Empire at 975-76.
Arizona-Monarch at 247.
Monarch-Challenger at 36: "experience has demonstrated that estimates of this character are highly speculative."
Id. at 36-37.
West Coast-Empire at 976.
were deemed to enjoy "reasonable support" from the data submitted.\textsuperscript{55} The Board made no general finding regarding the magnitude of financial benefits in \textit{Delta-Chicago and Southern}, but expressed agreement with the examiner that "the savings to be achieved in ground and indirect expenses will be more in the vicinity of $250,000 as calculated by bureau counsel, rather than something less than 1 million dollars as predicted by the applicants."\textsuperscript{56} The leading financial consideration in connection with Eastern's acquisition of Colonial was the expected saving to the Federal Government of Colonial's subsidy of some $850,000 per annum.\textsuperscript{57} Similarly in \textit{Continental-Pioneer} the emphasis was on subsidy reduction: the Board found that "the acquisition will result in a saving in Federal mail-pay subsidy of at least $220,000 a year, and probably much more."\textsuperscript{58}

It is quite evident that in these cases (as in others) no serious attempt was made to estimate the net gain expected from the proposed transactions as a result of evaluating and comparing prospective benefits and detriments, and it is also evident that such estimates, if they had been arrived at, could not have been reliable. Apart from the exceedingly speculative nature of the predictions of specific savings usually offered by merger proponents, such predictions did not take into account what may be an extremely important part of the financial consequences of combination: namely, transitional difficulties and costs accompanying the consummation of the merger, and managerial diseconomies of scale. Thus limited, the information submitted by the participants to the Board almost necessarily demonstrates that any merger will be a financial success. But beyond this, it would have been a manifest waste of time for the Board to attempt evaluation of the anticompetitive impact of these mergers, especially since this impact consisted very largely of foregone opportunities for future competition.

In this second period of merger regulation, the Board turned down two proposals for domestic mergers, both involving local service carriers serving contiguous territories,\textsuperscript{59} even though these transactions, in the Board's view, would have produced significant financial benefits.\textsuperscript{60} The

\textsuperscript{55} Braniff-Mid-Continent at 734.
\textsuperscript{56} Delta-Chicago and Southern at 653.
\textsuperscript{57} Eastern-Colonial (supplemental opinion) at 782.
\textsuperscript{58} Continental-Pioneer at 333.
\textsuperscript{59} Southwest-West Coast Merger Case, 14 C.A.B. 356 (1951) [hereinafter cited Southwest-West Coast Merger Case] and North Central-Lake Central Acquisition Case, 25 C.A.B. 156 (1957) [hereinafter cited North Central-Lake Central]. A contract contemplating the latter transaction was entered into by North Central and the majority stockholders of Lake Central in October, 1952.
\textsuperscript{60} In Southwest-West Coast at 357, the Board expressed "general agreement" with the examiner's finding that the merger would bring about "reasonable probable savings in annual operating expenses of $211,586, and increased revenues of $35,000, for a total annual improvement of approximately $247,000 in applicants' present profit-and-loss
leading consideration in both instances was the fact that the merged company would no longer have conformed to the Board's conception of the proper nature of the local service carrier: a system serving a single "local trade area" and concentrating its efforts on building up local short-haul traffic. In both cases, the merger would have effected a particular extension of the system of a participant carrier which it had previously tried unsuccessfully to obtain by direct certification.

III. THE THIRD PERIOD

From 1956 until 1967, the Board approved only one merger of domestic trunklines and there were no mergers involving local service carriers. For the trunklines, these were generally prosperous years, interrupted by a lean period in the early 1960's when the rate of growth of traffic fell far short of the rate of growth of capacity (see Table II).

As in the earlier period of "hard times" in the late 1940's, there was no lack of weighty voices calling for airline mergers as a means of reviving profits. Thus, in the Report of the Task Force on National Aviation Goals (Project Horizon), issued in September 1961, we find the following passages:

"Despite recent fare increases . . . the domestic trunk airlines have found themselves in a constant squeeze on earnings. The causes of this profit squeeze are numerous, but many can be essentially traced to excess capacity generated by the jets. . . . Much of [the excess capacity] may stem from the fact that levels of competition, which were perhaps economical with the smaller piston equipment, cannot be profitably maintained with large equipment."

.. . . .

"In the light of the growing size and cost of new aircraft, considera-

_61_ Southwest-West Coast at 357-58; North Central-Lake Central at 157-58.


_63_ REPORT OF THE TASK FORCE ON NATIONAL AVIATION GOALS 158-59 (1961). This task force was appointed by the head of the Federal Aviation Administration at the request of the President to draw up a set of "national aviation goals" for 1961-1970. It was made up of non-governmental persons with experience in civil aviation and related matters.
tion should be given to the possibility of further mergers among both trunkline and local service carriers to achieve sound economic conditions. . . . The introduction of numerous jets, and the foreseeable introduction of supersonic aircraft, indicate the need for an examination of future requirements and the creation of some standards for mergers. . . . The study should determine the minimum number of carriers required to achieve desirable service quality and rate standards; the maximum number of carriers which can economically subsist; and the optimum number of combination of carriers.

The task force believes the CAB now has statutory authority to undertake such a survey. If it does not, appropriate legislation should confer it.65

TABLE II
OPERATING PROFIT, OVER-ALL AVAILABLE TON-MILES, AND OVER-ALL REVENUE TON-MILES, DOMESTIC OPERATIONS OF THE DOMESTIC TRUNKLINE PASSENGER-CARGO CARRIERS

<table>
<thead>
<tr>
<th>Year</th>
<th>Operating Profit or (Loss) (All Services) (millions of dollars)</th>
<th>Over-all Available Ton-miles (All Services) (millions)</th>
<th>Over-all Revenue Ton-miles (All Services) (millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1958</td>
<td>95.1</td>
<td>5,190</td>
<td>2,751</td>
</tr>
<tr>
<td>1959</td>
<td>105.2</td>
<td>5,949</td>
<td>3,167</td>
</tr>
<tr>
<td>1960</td>
<td>34.9</td>
<td>6,583</td>
<td>3,332</td>
</tr>
<tr>
<td>1961</td>
<td>(11.1)</td>
<td>7,176</td>
<td>3,435</td>
</tr>
<tr>
<td>1962</td>
<td>74.9</td>
<td>8,114</td>
<td>3,771</td>
</tr>
<tr>
<td>1963</td>
<td>129.2</td>
<td>9,223</td>
<td>4,258</td>
</tr>
</tbody>
</table>

Source: CIVIL AERONAUTICS BOARD, HANDBOOK OF AIRLINE STATISTICS (1969 ed.).

For its part, the Board "publicly indicated its willingness to consider promptly any merger agreements presented, and . . . sought to encourage carriers to arrive at voluntary arrangements."66 In 1962 and again in 1963, it noted with apparent satisfaction that "airline interest in mergers as an avenue of meeting increasing costs and reducing uneconomic [sic] competition" had been running high during the preceding fiscal year.67 Board Chairman Alan S. Boyd voiced publicly his individual support for mergers to solve airline financial problems.68 The agency also undertook an investigation (in the end without practical result) evaluating "the air services authorized and operated between the northeastern and southern areas of the United States" in order to determine whether any should be modified, suspended, or eliminated.69

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65 Id. at 181-82.
66 CIVIL AERONAUTICS BOARD, ANNUAL REPORT 26 (1962).
67 Id. and CIVIL AERONAUTICS BOARD, ANNUAL REPORT 14 (1963).
68 For example, in a speech before the Society of American Travel Writers reported in AVIATION WEEK, June 18, 1962, at 41.
In this apparently favorable regulatory atmosphere, two agreements were reached which contemplated the merger of large airlines: one between American and Eastern, the other between Pan American and TWA. Here again, these proposals were not of the type which the Board had wished to encourage: the former was withdrawn after the Board had given tentative assent to the examiner's recommendation for disapproval, and the latter was "indefinitely deferred" by the Board "because of existing substantial uncertainties surrounding the stock ownership and control of TWA."

The one merger actually consummated—that between United and Capital—was caused directly by the extremely serious financial plight in which Capital found itself in 1961. An almost unbroken series of losses in the preceding five years had left Capital unable to finance the purchase of modern jet airplanes; as a result, its service had been curtailed and its share of total industry traffic had fallen from 6.3 percent in January, 1958 to 4.9 percent in January, 1960. The carrier was faced with immediate extinction in the absence of a very large injection of capital and there was no private source other than United from which these funds could be obtained. The only other possible avenue for saving the carrier,—large-scale subsidization by the Federal Government—would not have been available in time to be effective and quite possibly would not have been forthcoming at all.

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71 Id.
72 United-Capital at 309.
73 Id. at 311:

Although the record was not fully developed on the subsidy issue, related proceedings such as Capital's petition for a subsidy mail rate, and the Board order instituting an investigation of Capital, indicate the Board's view that there is 'serious question . . . whether the carrier would be entitled ultimately to any subsidy whatsoever . . . .' We note that Capital's requests on two occasions for temporary subsidy were both denied. In rejecting one of these petitions the Board observed that (1) none of the 12 U. S. domestic trunkline air carriers is receiving subsidy; (2) with minor exceptions all of the domestic trunklines have been operating without subsidy for over 8 years; and (3) no other domestic trunkline has pending before the Board a claim for subsidy for any current period. Moreover, even were subsidy available . . . we seriously doubt that it would be in an amount sufficient to rehabilitate Capital as a viable company, especially in view of the carrier's requirement for new equipment estimated to cost $100 million . . . . In point of fact, this Board would not, in the absence of legal compulsion, favor underwriting Capital's operations with the enormous amount of subsidy that would probably be required to insure its survival, and certainly would not award temporary mail pay in advance of hearing.

The legal status of Capital's claim for support was far from clear, but Chairman Boyd, at least, expressed "grave doubts that the Civil Aeronautics Board can, today, properly provide direct subsidy to any trunk airline where, over a major portion of its system, competing nonsubsidized trunk airline service is readily available, and where in regard to other parts, nonsubsidized trunk airline service could be made available in the event of the demise of the corporation, or existing subsidized local-service operations could be made available." Id. at 335.
In view of these circumstances, the Board invoked the "failing business" doctrine in support of its approval of the merger, and declared that this doctrine enabled it to avoid the need for evaluating the transaction in terms of the anti-monopoly proviso of section 408(b). Without this argument, the agency would have found it difficult if not impossible to justify the United-Capital merger, which eliminated competition in nineteen city-pair markets accounting for almost one million passengers a year and including four major city pairs: New York-Cleveland, Cleveland-Chicago, Philadelphia-Detroit, and Philadelphia-Cleveland. In addition, as Board Member Minetti pointed out, "this merger of the Nation's second and fifth largest airlines . . . create[d] a system between 15 and 30 percent larger than the then biggest carrier, and was contrary to the Board's long-standing efforts to effect a more equitable distribution of traffic among the trunklines", it also enabled United to acquire "routes from the Great Lakes to Florida that it ha[d] no prospect of receiving under established decisions governing route awards."

It is understandable that an agency charged with maintaining "sound economic conditions" in air transportation and setting mail rates on a "need" basis would have been extraordinarily reluctant to permit the demise through bankruptcy of one of the carriers committed to its care. But it should be emphasized that the purchase of a failing certificated air carrier is not so innocent of anti-competitive consequences as is a similar transaction in an ordinary unregulated industry. First, the airline transaction enables the acquiring carrier to enter new markets without the competition offered by other applicants when a route is awarded by the certification process. The actual importance of this consideration, which is of course also relevant to mergers involving carriers which are not in extremis, depends on whether and to what extent the acquiring

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74 Id. 308-09. The Board here cited the Supreme Court's decision under Section 7 of the Clayton Act in International Shoe Co. v. Federal Trade Comm'n, 280 U.S. 291, 302 (1930):

In the light of the case just disclosed of a corporation with resources so depleted and the prospect of rehabilitation so remote that it faced the grave probability of a business failure with resulting loss to its stockholders and injury to the communities where its plants were operated, we hold that the purchase of its stock by a competitor (there being no other prospective purchaser), not with a purpose to lessen competition, but to facilitate the accumulated business of the purchaser and with the effect of mitigating seriously injurious consequences otherwise probable, is not in contemplation of law prejudicial to the public and does not substantially lessen competition or restrain commerce within the intent of the Clayton Act.

75 United-Capital at 397. Competition was later restored in the four major markets by means of proceedings initiated by the Board. CIVIL AERONAUTICS BOARD, HANDBOOK OF AIRLINE STATISTICS 469 (1969).

76 United-Capital at 337.

77 Id. at 340.
airline would in fact have had to face competition in seeking direct certification. In cases such as TWA-Marquette, Western-Inland, and Northeast-Mayflower, this consideration appears to be of negligible weight, while in connection with such transactions as those between United and Capital, Eastern and Colonial, and Northwest and Northeast (to be discussed below), it is much more important. Second, the extension of the acquiring carrier's system strengthens its ability to channel traffic to and from newly acquired points to its own system, and to this extent affords some shelter from existing competition. Neither of these consequences would be significant if competing airlines were free similarly to extend their own systems; under the present regime of protective certification, however, this freedom does not exist.

IV. THE FOURTH PERIOD

In the fourth period in the history of domestic airline merger regulation, from 1967 to the present day, the Board has approved three combinations of local service carriers and one (not ultimately consummated) of trunklines. In all these cases, the Board saw the proposed transaction as a means of filling a pressing need for improvement in the financial position of one or more of the participant carriers. The period was also marked by a recurrence of general "hard times" in the industry caused by failure of traffic growth to keep up with an increase in capacity for carriage; a revival of familiar arguments for mergers as a remedy for this general decline in earnings; and an airing of certain merger proposals which were not likely to be suggested in normal times because of the practical certainty that they would be turned down by the Board.

As the accompanying table shows, Federal support of the local service carriers became increasingly costly in the early 1960's; in 1962, the subsidy bill exceeded that for 1959 by approximately 54 percent. In April 1962, President Kennedy sent to the Congress a special message

<table>
<thead>
<tr>
<th>Year</th>
<th>Subsidy Revenues (Thousands of dollars)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1959</td>
<td>43,252</td>
</tr>
<tr>
<td>1960</td>
<td>54,837</td>
</tr>
<tr>
<td>1961</td>
<td>61,920</td>
</tr>
<tr>
<td>1962</td>
<td>66,776</td>
</tr>
<tr>
<td>1963</td>
<td>67,043</td>
</tr>
<tr>
<td>1964</td>
<td>63,559</td>
</tr>
<tr>
<td>1965</td>
<td>62,618</td>
</tr>
<tr>
<td>1966</td>
<td>56,439</td>
</tr>
<tr>
<td>1967</td>
<td>52,180</td>
</tr>
<tr>
<td>1968</td>
<td>44,508</td>
</tr>
</tbody>
</table>

Source: Civil Aeronautics Board, Handbook of Airline Statistics (1969 ed.).
(1) endorsing proposed legislation making the domestic trunklines ineligible for subsidy, (2) approving termination of subsidies for helicopter services, and (3) "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 other domestic airlines as well, within periods to be established by the Board for each type of service or carrier." Approximately 80 percent of these subsidies were accounted for by the local service airlines.\(^7\)

In accordance with this request, the Board prepared a report to the President which indicated its belief that substantial savings in the subsidy bill would be forthcoming from several sources, including an expected increase in commercial revenues, reduction of the standard of flight frequencies for which subsidy was forthcoming on high-density routes, consolidation of airports, and continuation of the "use-it-or-lose-it" program.\(^6\) In subsequent years, the Board also sought to improve the earnings of the local service carriers by such measures as granting "more liberal operating authority through the removal of outdated operating restrictions" and giving the carriers "more access to higher density, short, and medium-haul markets, on a subsidy-ineligible basis, even in instances where such an award may involve competition with trunkline services."\(^8\)

Although the local service subsidy bill did decline appreciably in each year after 1963, in 1966 it was still above the 1960 level and not far below it in 1967 (see Table III). Again in 1968, while a much better showing was made than in the preceding year, the cost was still in excess of the 1959 level. It was the desire further to reduce the subsidy burden which appears to have been the Board's chief motive for approval, in 1967 and 1968, of the mergers of Frontier and Central;\(^9\) Pacific, West Coast, and Bonanza;\(^8\) and Allegheny and Lake Central.\(^4\) These transactions figured prominently in the Board's Annual Report for fiscal 1968, where it was noted that the agency had "determined that the ... first-year subsidy need reductions" produced by the mergers would be $503,000, $676,000, and $902,000, respectively.\(^5\) The need

\(^7\) Special Message to the Congress on Transportation, April 5, 1962, reprinted in Public Papers of the Presidents of the United States, John F. Kennedy, January 1 to December 31, 1962 at 297 (1963).

\(^8\) Civil Aeronautics Board, Annual Report 16 (1963).

\(^9\) Id.

\(^10\) Id.

\(^11\) Frontier-Central Merger, Order No. E-25626 (September 1, 1967) [hereinafter cited Frontier-Central].

\(^12\) Bonanza-Pacific-West Coast Merger Case, Orders Nos. E-26625 and E-26626 (April 9, 1968) [hereinafter cited Air West].

\(^13\) Allegheny-Lake Central Merger Case, Order No. E-26968 (June 24, 1968) [hereinafter cited Allegheny-Lake Central].

for subsidy reduction was evidently considered to be sufficiently great to outweigh the fact that these mergers marked the effective demise of the "local trade area" concept which had been a foundation of the Board's original approach to the "local service experiment."

None of these transactions caused the elimination of any significant point-to-point competition; however, the contiguous position of the participants did make them outstanding potential competitors with one another for any newly authorized services. Indeed, the examiner's recommended decision in *Air West* explicitly took account of this fact, and thus elicited the first recognition by the Board (as far as this writer has been able to determine) of the elimination of potential competition as a factor to be weighed in connection with mergers. The sort of potential competition which the examiner had in mind was not directly competitive service by the participants, but competition for certification of new route extensions. The actual importance of this sort of consideration in connection with these local service cases, as with others, depends, of course, on the probability that such route extensions will in fact be

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81 In *Air West* at 10-11, the examiner remarked: "The Board is here asked to permit a long step towards changing the local service airline industry from one of relatively small localized carriers which would concentrate on the local service needs of limited areas to an industry made up of a few carriers serving large areas of the nation. *Air West* would serve an area bounded in the north by Port Angeles, Seattle, and Calgary, in the south by San Diego and Yuma and Phoenix and extending from the west coast to Great Falls, Idaho Falls, and Salt Lake City." The extent of the combined system resulting from *Allegheny-Lake Central* is indicated as follows (at 9-10): "Allegheny schedules service in 12 states, the District of Columbia, and Canada (Toronto) over a network reaching from Boston, Mass., in the northeast, southward along the Atlantic Coast to Norfolk, Va., and as far west as Memphis, Tenn. . . . Lake Central's operations cover 10 states and the District of Columbia, within the area of Chicago, Ill., and St. Louis, Mo., on the west, Baltimore, Md., and Washington, D. C., on the east, Buffalo, N. Y., on the north, and Evansville, Ind., on the south . . . ." *Frontier-Central* represented yet another substantial extension of the Arizona-Monarch-Challenger (Frontier) system which had already transcended the outer limits of the "local trade area" concept. On this point, see the dissent of Board Member Jones in *Arizona-Monarch* at 254.

82 *Allegheny-Lake Central* at 40; *Frontier-Central* at 16; *Air West* at 11.

83 *Air West* at 11:

The three component carriers have not been in competition with each other in the same city pair markets in any significant degree. However, in another sense they have competed. Their systems meet each other at a number of cities and their individual operations enable the comparisons as to equipment, costs, personnel, methods of operation, solicitation of traffic, and the like, which the Board from an early point in its regulatory history has recognized as tending to assure the 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 American Export Airlines, Trans-Atlantic Service, 2 C.A.B. 16, 31 (1940). In route licensing cases they have completed with each other in seeking extension of their systems into new markets. Thus, a certain lessening of competition in the section of the country that they serve is inherent in the merger . . . . It is obviously not in the public interest to give up advantages of the foregoing type unless corresponding advantages to the public are received in return.

84 *Id.* at 3n. of the opinion of the Board.
made; at this stage of the local service experiment, this probability is especially difficult to evaluate. The recommended decision also took note of the value of the existence of more than one carrier in comparable circumstances for purposes of comparison and evaluation of performance (the "yardstick" principle)—a factor which had played a major role in the Board's policy towards international route awards to U. S.-flag carriers. The late 1960's witnessed a decline in the fortunes of the trunklines from the relatively high prosperity of the middle of the decade. Table IV outlines this development and the underlying unfavorable relationship between the growth of traffic and that of capacity. Some governmental and much industrial support was again evidenced for the consummation of trunkline mergers to improve their earnings. The new Chairman of the Board put the industry on notice that "Mergers that offer advantages to the public and the industry would be acceptable to him." "Considerable industry discussion about mergers" prompted the Department of Transportation to undertake formulation of guidelines to "provide management with a checklist for assessing the probability of department opposition to any planned amalgamation." At hearings held by the Aviation Subcommittee of the Senate Interstate and Foreign Commerce Committee, "Merger as a means of eliminating excessive competition was urged by a majority of airline presidents testifying. . . ."

Pan American reportedly "held preliminary discussions" concerning combination with American, Continental, and Eastern; and after the bankruptcy of Rolls Royce was announced, with serious implications for the future of TWA, representatives of this carrier also discussed merger with Pan American. In the domestic sphere, a proposed merger between American and Western received stockholder approval and was submitted to the Civil Aeronautics Board. Because of the probable long-run independent viability of all these would-be partners, and in view of the fact that the Board has never approved merger of a viable trunkline with one of the industry's giants, it is doubtful that these proposals would have seen the light if the proponents had not sensed the possibility of an extraordinarily favorable regulatory environment.

In an obviously different category was the proposed takeover of

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90 See note 88 supra.
92 AVIATION WEEK, December 22, 1969, at 27.
93 AVIATION WEEK, February 15, 1971, at 36.
94 AVIATION WEEK, November 17, 1969, at 33.
95 THE ECONOMIST, July 17, 1971. Later reports indicate abandonment of the Pan American-TWA project, and continued negotiations between Pan American and Eastern and TWA and Braniff. AVIATION WEEK, October 11, 1971, at 23.
### TABLE IV

**Operating Profit, Over-all Available Ton-miles, and Over-all Revenue Ton-miles**

**Domestic Operations of the Trunkline Passenger/Cargo Carriers**

<table>
<thead>
<tr>
<th></th>
<th>Operating Profit (All Services) (millions of dollars)</th>
<th>Over-all Available Ton-miles (All Services) (millions)</th>
<th>Over-all Revenue Ton-miles (All Services) (millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1966</td>
<td>453.7</td>
<td>14,404</td>
<td>7,083</td>
</tr>
<tr>
<td>1967</td>
<td>410.1</td>
<td>18,769</td>
<td>8,969</td>
</tr>
<tr>
<td>1968</td>
<td>320.1</td>
<td>23,098</td>
<td>10,321</td>
</tr>
<tr>
<td>1969</td>
<td>344.9</td>
<td>29,165</td>
<td>12,647</td>
</tr>
<tr>
<td>1970</td>
<td>16.7</td>
<td>29,622</td>
<td>12,589</td>
</tr>
</tbody>
</table>

*1966-1968: Domestic operations of the domestic trunkline passenger/cargo carriers. 

**Sources:**

Northeast by Northwest, which received Board approval in December 1970. As the examiner wrote:

The fact is that despite the Board’s efforts to preserve Northeast as an independent entity and those of successive carrier managements to carry out that mandate, Northeast has been unable to make its own way as a viable airline. It has been plagued by chronic losses, a large and growing negative net worth, and is operating today only by grace of its major lenders. Moreover, looking to the future, Northeast lacks the flight equipment and other resources necessary to remain competitive over the major segments of its route system and is without the means to acquire them. While there is no contention that Northeast is in extremis in the legal sense, its outlook is bleak, absent merger or a similar resolution of its problems. Left to its own devices Northeast’s most likely fate would be a sort of hand-to-mouth existence, with its public services performed on a skeleton basis. There is no reasonable probability that the Storer interests [in control of Northeast] could be any more successful at this point . . . than were the Atlas Corporation and the Hughes Tool Company, both former backers of Northeast, in years past during periods of acute financial distress.*

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*Northwest-Northeast Merger Case, Orders Nos. 70-12-162, 70-12-163 (1970), [hereinafter cited Northwest-Northeast].

*Northwest-Northeast Merger Case at 54-55 (recommended Decision of Examiner Robert L. Park). The evidence left no doubt that Northeast’s troubles were chronic, not temporary, and that, as the examiner noted, “[a]bsent the merger, Northeast sees no opportunity for overall profitable operations but only a reduction in the amount of loss through retrenchment.” *Id.* at 8.
With the major exception of the recommendation concerning transfer of Northeast's new route from Miami to Los Angeles, the Board expressed general agreement with the examiner, and there is no doubt that the service benefits to be derived from substitution of a prosperous carrier for the chronically impecunious Northeast played a major role in bringing about Board approval.99 The agency also agreed with the examiner's apparently justified finding that "the resulting route integration, which is virtually all of the end-on variety, will not create any monopoly markets or even significantly reduce competition"; that "Northwest's relative ranking in the industry will remain essentially unchanged";100 and that the merged company would obtain no "undue competitive advantage" as a result of "sheer size."101

Though the shaky financial condition of Northeast might seem likely to render it ineffective as a potential competitor on new routes, this had not in fact been the case as late as July 1969: at this time, the Board had awarded Northeast a certificate to operate between Miami and Los Angeles, and had done this precisely because the carrier was in need of strengthening.102 Because the award had been made solely for this purpose, Northeast's decision to merge—made on the day following the effective grant of the route—"radically changed the circumstances upon which the Board's award was predicated."103 For this reason, and because

99 The Board's discussion of the benefits to be derived from the merger is as follows (Northwest-Northeast Merger Case at 3):
If subject to the Board's conditions, the merger will clearly be in the public interest. Although the examiner may have overstated Northeast's dependence upon the merger, he correctly concluded that the merger will enable the carriers to gain significant economies, to integrate their operations, and to provide improved air service. With Northwest's backing, Northeast can reactivate dormant and semi-dormant routes; it can operate more modern, competitive equipment; and it can upgrade its New England and other services. Northwest has the ability to turn Northeast's chronic losses into profits and to eliminate any future subsidy need for Northeast to operate its New England intraregional routes. And the merged carrier can offer the public new service opportunities in the form of through-plane and one-carrier services.

100 Id. In the recommended decision, it is pointed out that the two applicants served "only seven markets in common as independent airlines" and did not "compete effectively" in any of these; moreover, all seven would "retain the services of two or more air carriers" after the merger. Id. at 57.

101 Id. at 57-58.

102 Southern Tier Case, Order No. 69-7-135, at 17-19 (1969):
The larger Miami-Los Angeles market we are awarding to Northeast for route strengthening purposes . . . . It is beyond dispute that Northeast, by any standard, has the weakest route structure of any trunk carrier . . . . The Miami-Los Angeles route is ideal for counterbalancing each of [the] limitations in Northeast's system . . . . Thus, by this award, Northeast will gain access to a large, long-haul market not subject to the same seasonal fluctuations of its current market. It will again another long jet route to allow it to use more effectively, not only the jets it needs today to compete in its East Coast markets, but the larger, more efficient jets of tomorrow.

103 Northwest-Northeast at 5.
transfer of this route to Northeast could "only encourage the formulation of merger plans . . . based upon the outcome of pending route proceedings," the Board decided not to permit immediate transfer but to reconsider the award in a separate proceeding. At this point Northwest, in accordance with its announced intent, withdrew from the merger agreement and the project was abandoned.

Several carriers reportedly offered to combine with Northeast in the aftermath, and a merger agreement between Delta and Northeast was submitted for consideration by the Board. Delta had sought unsuccessfully to obtain the Miami-Los Angeles route, and was also especially interested in securing entry into the New York-Miami market. On its part, Northwest developed a plan to merge with National, a transaction calculated to accomplish much the same route extensions as it had desired to obtain by combining with Northeast.

V. ECONOMIC BENEFITS

In any evaluation of past regulatory policy, as well as in attempting to formulate policy for the future, it would be of great value to know whether and to what extent past mergers have produced the economic benefits expected of them. As for the activation, revival, and rescue operations (Arizona-Monarch, TWA-Marquette, Northeast-Mayflower, Western-Inland, and United Capital), the verdict is favorable: these mergers produced the desired effect of starting up or continuing services which could not have been afforded (or at best could have been poorly maintained) under the auspices of existing managements. The takeover of Pioneer and Colonial by the relatively prosperous Continental and Eastern may also be regarded as successful in that the acquired operations were shortly thereafter permanently removed from the category of the subsidized. Acquisition of Colonial by the much larger Eastern brought about this effect at once; Continental, which was about four times as large as Pioneer (in terms of revenue ton-miles) in 1954, the last pre-merger year, received some subsidy until 1958. A similar lasting result can probably be expected from the Allegheny-Lake Central combination. In 1967, the last pre-merger year, Allegheny was over four times as large as Lake Central (in terms of revenue ton-miles) and

104 Id. at 5-6.
105 Aviation Week July 19, 1971.
107 Northwest would thereby obtain "rights to most of the key East Coast-Florida routes it would have obtained in the Northeast merger [and] . . . a Miami-Los Angeles route, plus other important southern transcontinental routes to California from Florida, Louisiana and Texas." Aviation Week September 13, 1971.
was rapidly working itself towards self-support, and its condition improved still further in the immediate post-merger period. A merger of Allegheny with Mohawk, which is at present under consideration by the Board, might well be expected to produce a similar result.

With respect to the remaining two trunkline and four local service mergers, it is in most cases far more difficult to judge the results. Publicly available accounting data reflect, of course, the impact of many other factors besides the mergers, and the participant managements, which are presumably in a position to judge the separate impact of these transactions, are inevitably inclined to defend their own actions. In addition, these statistics reflect not only those cost reductions and service improvements (if any) to accomplish which the mergers were actually necessary, but also those which could have been brought about by means short of merger, and any financial gain resulting from anti-competitive effects, neither of which should be regarded as an economic benefit from the point of view of public policy. It is significant here that most if not all of such widely claimed benefits as provision of new through services, fuller utilization of equipment through offsetting seasonal traffic variations, and consolidation of traffic and maintenance facilities appear to be attainable by means of inter-firm arrangements short of merger. While a thorough study of available data would probably be of value, and might produce more favorable conclusions, it is perhaps worth recording that a preliminary look at some readily available data does not suggest that these transactions were spectacularly successful, and reveals one genuine disaster.

In none of these cases, because of the existence of subsidy on a virtually cost-plus basis, do such over-all measures as rate of return on investment or net operating profit constitute reliable indicators of economic performance. In four cases out of six, the merger occurred before 1954, the first year in which service mail pay was reported separately from subsidy; in these instances, therefore, it is not possible to rely on break-even need as an inverse measure of performance. For these four, a possible rough substitute index is the total dependence of the carrier upon mail revenue or “mail pay need,” that is, the excess of operating expenses over non-mail commercial revenues. Assuming that the proportion of mail revenues attributable to subsidy remained fairly constant from year to year for any given carrier, the resulting index would reflect

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110 Allegheny's break-even need had been declining in the years preceding the merger, and in 1967 amounted to only $1.7 million. In 1968 and 1969, it declined still further and in 1970 reached a negative figure of $7.9 million. Civil Aeronautics Board, Comparative Selected Data for Local Service Air Carriers, 12 Months Ended December 31, 1967, 1968, 1969, and 1970. Break-even need is the excess of operating expenses over non-mail commercial revenues, including service mail pay but not subsidy.
the course of break-even need from year to year even though not indicating its real magnitude.

The combined mail pay need of Monarch and Challenger was $2,020 thousand in 1948 and $2,099 thousand in 1949, the last two pre-merger years. (The merger was approved in December 1949.) In 1950, the figure for the merged carrier amounted to $2,379 thousand, and further relatively sharp increases, to $2,564 and $2,757 thousand respectively, were recorded in 1951 and 1952. Results for the later years of course reflect also the taking over of the Arizona system by Monarch, which was approved in April 1950. In the case of West Coast-Empire, which received approval in June 1952, combined mail pay need showed a decrease in 1951 as compared with 1950 ($1,040 thousand for 1951 as compared with $1,166 thousand for 1950). In 1952, the comparable figure increased to $1,203 thousand; in 1953, rose to $1,801 thousand; and in 1954, stood at $1,639 thousand, still far above the pre-merger level. The two years preceding the merger of Braniff and Mid-Continent (approved in May 1952) saw a sharp decline in the combined mail pay need of the two carriers: from $1,151 thousand in 1950 to $169 thousand in 1951. In 1952, there was a larger positive need, amounting to $793 thousand, and this figure rose to $1,801 thousand in 1953. (Thereafter, however, the fortunes of the carrier changed: in 1954, net operating income exceeded mail payments by $1,294 thousand.) Similarly, Delta and Chicago and Southern had experienced improved conditions in the pre-merger period. In 1951 and 1952, the combined net operating income of these carriers exceeded their mail payments by $3,353 thousand and $2,833 thousand, respectively, as compared with a positive mail pay need of $661 thousand in 1950. Merger was approved in December 1952. The first post-merger year, 1953, saw a sharp decline in the excess of net operating income over mail pay, to a level of $284 thousand, and in 1954 this excess, at $3,039 thousand, was still not up to its 1951 level. (By 1955, however, it had grown to $6,143 thousand.)

The two remaining mergers, Frontier-Central and Air West, were also seemingly unproductive of impressive success. The former merger was approved in September, 1967. In 1966, the combined break-even need of Frontier and Central stood at $5,329 thousand, representing a marked decline from $8,352 thousand in 1965. The comparable figure for 1967 was $6,764 thousand, and in 1968 there was a pronounced rise to $9,472 thousand. For 1969, break-even need stood at $6,251

111 The basic sources of the statistics from which the figures in this paragraph are calculated are Civil Aeronautics Board, Annual Airline Statistics, United States Certified Air Carriers (1948) and Civil Aeronautics Board, Handbook of Airline Statistics, United States Certified Air Carriers, Calendar Years 1949-1956 (1957). Figures for Braniff and Mid-Continent include local-service operations.
thousand, still substantially higher than in 1966. The combined break-even need of Bonanza, Pacific, and West Coast had jumped from $8,773 thousand in 1966 to $15,443 thousand in 1967; 1968, the year of the merger (approved in April), saw a relatively moderate rise to $18,860 thousand. In the two subsequent years, 1969 and 1970, break-even need rose to $24,608 thousand and $28,345 thousand respectively, the latter figure representing a level some 84 percent above that in the last full pre-merger year.\(^1\)

As has been said, these figures in all cases reflect many other causes besides the mergers themselves, and merely offer some evidence that these transactions did not produce great improvements in the fortunes of the participants. A more ambitious conclusion would require a far more detailed picture of the consequences of each merger. In the case of Air West, such a picture exists, owing to the fact that by March 1969, it had become evident that the combined carrier was in desperate straits and could be rescued only by the good offices of the Hughes Tool Company (Toolco).\(^1\) Since this assistance involved acquisition of Air West by Toolco, and this acquisition had to be passed on by the Board, the story of the previous merger and its consequences is plainly set down in the examiner's recommended decision favoring approval of the proposed purchase. This decision, as well as the corresponding opinion in Air West, which also was generally agreed to by the Board, should be read by all students of economic regulation, particularly those who believe that the regulators can and should perform a super-managerial function. Here only two passages will be quoted. In the first instance, the examiner in *Air West* noted the applicants' estimate that the first year of merged operations would result in a net financial improvement of $400,000, and recorded his belief that much larger benefits could be expected:

A saving of $400,000 on Air West business bringing revenues totalling almost $70 million, of which almost $11 million is subsidy, is not inconsequential, but it is only about one-half of one percent of the revenue—a small start towards subsidy elimination. It is not nearly the amount that should be expected to accompany the expansion of size and service opportunities inherent in this merger. The obvious reason for the failure to show greater savings lies in the fact that the estimates are based primarily on adding the three operations together rather than actually merging them and accomplishing the economics that could be effected by an efficient central management. An example of dramatic savings that can be produced if the three-carrier operation is integrated into one is

\(^1\) The basic sources of the statistics in this paragraph are *Civil Aeronautics Board, Comparative Selected Data for Local Service Air Carriers, 12 Months Ended December 31, 1966, 1967, 1968, 1969 and 1970.*

\(^1\) Acquisition of Air West, Inc. by Hughes Tool Company, Orders Nos. 69-7-102 and 69-7-103, at 30 (July 22, 1969) [hereinafter cited Air West-Hughes].
supplied by computer savings. . . . costs for the merged carrier for a completely mechanized system with growth possibilities will be $25,491 monthly, a saving of . . . 15 percent. Unfortunately, there is a paucity of such examples in the record. The carrier on brief points out one of the primary reasons for this, which is that there is at this time no dominant carrier who can speak with assurance in advance of the merger as to decisions which will be taken afterward. . . . Mr. Bez, the prospective chief executive of the surviving carrier, is well known as an experienced and successful entrepreneur. In running the merged business he can be expected to see that a fully-integrated business is established. He will undoubtedly require a plan of operation that will result in lower unit costs as an outgrowth of the expanded operations.\textsuperscript{14}

On the recommendation of the examiner, the Board instituted a separate proceeding to determine probable savings, and the appropriate subsidy reduction, for the first post-merger year, and came up with the above-mentioned figure of $676,000.

In \textit{Air West-Hughes}, the actual result of the merger is described in part as follows:

Since the beginning of the merged operations . . . Air West has experienced heavy financial losses. . . . The absence of a unifying force impeded the amalgamation of the three managements into an effective working team that could respond objectively and expeditiously to the developing problems of a complex merger.

The magnitude and shape of the problems of the merged company were not fully anticipated. Consequently, on July 1 when the merged schedule was inaugurated, Air West got off to a start that was virtually disastrous, and this happened at the beginning of the peak traffic season of the year. Many things failed to mesh and a number failed to function properly. Adaptation to the new scope and concept of the operation was entirely inadequate. The transition problems led to a level of efficiency far below normal and this extremely bad performance led to a terrible public image of Air West.

The biggest single and identifiable problem in terms of completion and on-time performance of flight schedules was the inability of the maintenance department to support the operation. The aircraft simply were not available to maintain the schedules.

At the time of the merger the three companies employed approximately 3,100 people. Today Air West employs over 3,800.\textsuperscript{15}

\textbf{CONCLUSION}

Though far from exhaustive, the foregoing survey suffices to suggest that the present method of regulating airline mergers in this country is defective in at least two important respects. First, there has been some

\textsuperscript{14} Air West at 12-13.

\textsuperscript{15} Air West-Hughes at 21, 22, 23, 25.
tendency on the part of regulators to favor, and on occasion to promote, mergers for an inappropriate purpose, that is, as a remedy for temporary financial reverses unrelated to the structure of the industry. Second, in attempting to judge the effects of each merger on a case-by-case basis the Board has set itself an impossible task. For example, only by virtually ignoring the question of potential competition has the Board been able to deal in a plausible, if not convincing, manner with assessing the results of eliminating competition between the participant carriers. In most of the approved cases, this factor has been found insignificant because there has been little or no duplication in the two firms’ existing services, even though each participant was often among the likeliest candidates for competing with the other for new route awards or for receiving route awards competitive with the other’s existing services. Though a calculation of the discounted value of such new competition would form a necessary part of an assessment of total economic effect, the Board was undoubtedly wise in not undertaking such a speculative enterprise. Similarly, the Board has been able to appear to deal with the question of effects on costs and revenues only by confining itself to examining carrier claims connected with such proposals as eliminating duplicate facilities and improving through services. Little attention has been devoted to transitional difficulties and managerial diseconomies which are certain not to figure prominently in the presentations of the applicants. The case of Air West is sufficient to show that this omission can be of crucial importance.

Could these defects be remedied by the adoption, either by legislation or regulatory action, of a more definite general rule which would resist stretching in “hard times” and at the same time avoid the attempt at case-by-case evaluation of detriments and benefits? To fill these requirements, this rule would have to offer far more definite guidance than is afforded by such criteria as the Department of Transportation’s recently issued guidelines, which amount in essence to a list of for the most part well-known pros and cons which can be added to, subtracted from, and differentially weighted each time they are applied.16

16 U. S. Dep’t of Transportation, Executive Branch Criteria for Domestic Airline Merger Proposals (1971). These criteria were prepared “to assist Executive Branch agencies in deciding whether to intervene in an airline merger case before the Civil Aeronautics Board . . . . and in deciding what recommendation, if any, should be made to the Board concerning the merger.” They are summarized as follows:

A. A merger should not result in either the elimination of effective competition, or an excessive market share for the surviving firm, in significant city-pair, regional or national markets for airline services.

B. A merger should not result in undue concentration within the air carrier industry.

C. A merger should not be likely to lead to extensive reactions and defensive merger proposals by competitive carriers so that the end result will be a restructuring of the industry and excessive concentration in a few firms.
Two familiar possibilities suggest themselves: (1) a rule which would permit merger of two airlines only when one appears to be incapable of maintaining satisfactory service as an independent entity under its existing management (on a self-supporting basis or on the level of subsidization accepted as satisfactory at the time of merger) and other means of independent viability do not exist; and (2) a rule which, in addition to mergers permitted under (1), would allow such transactions up to the point where the merged carrier achieves a size determined, after a general study of the industry, to be the minimum scale for maximum operating efficiency.

Rule (1) and, of course rule (2), would presumably have permitted United-Capital, Eastern-Colonial, TWA-Marquette, Western-Inland, Northwest-Northeast, and, of course, Northeast-Mayflower. Application of this rule to the other approved mergers is complicated by the difficulty of interpreting what would have been the satisfactory level of subsidization at the time of the various transactions; however, a reasonable interpretation would surely include permission of takeover by any carrier firmly offering to operate a local service airline on an unsubsidized basis, after the time had passed when the latter had demonstrated its inability to achieve self-sufficiency in a relatively short period of years (i.e., this particular local service experiment had manifestly failed). Of course, no such firm offer was made in any of these cases; however, Allegheny-Lake Central and Continental-Pioneer might well have qualified under this interpretation, though perhaps not at the time when they were actually approved. In addition, Arizona-Monarch might well have passed muster under a plausible interpretation of the acceptable standard of support. In short, it may be tentatively concluded that this rule would have permitted all those mergers which have or would have produced evident public benefits (though further investigation may conceivably show that others have been beneficial as well), and would

D. A merger should not result in substantial foreclosure of competition for interchange traffic or other excessive injury to other carriers.

E. A merger should bring about substantial operational, service, or organizational benefits for the surviving firm so that the public will receive significant benefits such as greater efficiency and better service, and the size of the airline resulting from the merger should not be such as to produce significant diseconomies.

F. In the case of a merger of a relatively effective carrier and one that is marginal, or in the case of two marginal carriers, the resulting benefits of the surviving firm should be corrective of the original difficulty of the weaker merger partner. Alternative solutions should be shown to be considerably less effective than merger.

G. The protection afforded labor in the merging firms should be in accordance with the present policies of the Board.

The accompanying statement reads in part as follows: "There will be instances where certain criteria are not applicable, or where a criterion must be extended or refined, or where additional data are applicable. At the same time, the criteria are meant to be looked at as a whole. There is not any one criterion of overriding significance."
have prevented at least the one obvious disaster (on the extremely plausible assumption that none of the applicants in Air West would have committed itself to subsidy-free operation of the others).

On the other hand, as has been pointed out, the acquisition of even a non-viable certificated airline by another air carrier is not so devoid of anti-competitive consequences as an acquisition of a “failing company” in an unregulated field, since the former type of transaction permits the acquiring carrier to enter new markets without competing with others for certification and provides the acquiring carrier with a regulatorily protected superior access to connecting traffic originating in or destined for points on the acquired route system. Because of these effects, it cannot be assumed that the acquisition by another air carrier of even a non-viable airline is not on balance contrary to the public interest: the carrier proposing to take over the operation (which may mean, in effect, the carrier able to submit the most satisfactory bid to the management of the acquired company) may be willing to do so simply because of these anti-competitive effects. Indeed, the acquisition of new route authority has evidently played a very important role in motivating many of the merger proposals dealt with here: for example, Northwest-Northwest (abandoned because of the Board's refusal to approve automatic transfer of the Miami-Los Angeles route); the successor proposals, Northwest-National and Delta-Northeast; American-Western (where the president of American has stated that the deal would be off if the California-Hawaii route previously denied to American were not included in the acquisition\textsuperscript{17}); TWA-Marquette, where the price paid by the acquiring carrier is explicable only in terms of payment for entry into such important centers as Detroit; Northeast-Mayflower; American-Mid-Continent, which would have brought American into many new city-pair markets in the central United States; United-Capital; Eastern-Colonial; Allegheny-Lake Central, which brought Allegheny into St. Louis and Chicago; United-Western; and Continental-Pioneer (where the former gained entry into Fort Worth-Dallas, previously denied).

These anti-competitive effects stem directly from the certification requirement, and can be avoided only if protective certification is abandoned. In its absence, all carriers would have equally free access to connecting routes and these would tend to be served by those companies able most efficiently to perform the service.

There is some rather convincing evidence, with respect to the domestic trunklines, that there is some scale beyond which average costs tend to rise,\textsuperscript{18} and a study of the (until recently) relatively unregulated Cali-

\textsuperscript{17} Wall Street Journal, March 22, 1971, at 2, col. 3.

\textsuperscript{18} See, e.g., American-Western Merger Case, Docket No. 22916 (Rebuttal Exhibits of the Bureau of Operating Rights), at 10 (May 28, 1971):

Turning to the 1969 cost curves for each carrier, we find that United,
fornia intrastate carriers has concluded "that the airline industry is characterized by few, if any, economies of scale beyond those achievable with four or five aircraft." Nonetheless, the heterogeneity of the industry and its managements makes it doubtful that a reliable general rule permitting mergers up to a minimum efficient scale could be formulated. After considering the higher cost levels and smaller return on capital experienced by the "Big Four" as compared with the smaller domestic trunklines, a British committee recently concluded that there was no evidence of either economies or diseconomies of scale of any great magnitude. The report of this committee (the so-called "Edwards Report"), which is worth the attention of all who are interested in air transport economics, finds that the relatively poor showing of the "Big Four" may well be due to factors other than scale, and attributes the superior performance of the leading intrastate California carrier to specialization of function, the advantages of which, according to the committee, "are much more significant in airline operations than the economies of overall airline size." While expressing skepticism as to "sweeping statements about the relationship of efficiency to size . . . especially as the quality of the management itself will so often prove of over-riding importance", the committee was convinced that, in general, "very large size does increase the unit cost of management", and that "there are positive merits in having as many different approaches to the

American, and TWA are already experiencing diseconomies of scale. Each of these carriers has exceeded its optimal size both in terms of total annual departures and ATM's [available ton-miles] per departure. Their unit cost levels will decrease if their size is reduced. Thus, under free market conditions these carriers would have to operate at a reduced size in order to remain cost and price competitive with smaller and more efficient carriers. Delta and Eastern, like the 'Big Three,' have already exceeded their optimal size in terms of total annual departures. However, Eastern and particularly Delta are smaller than the optimally sized carriers in terms of the number of ATM's per departure.


119 Id. at 63-65.


121 Id. at 74.

122 Id. at 61.

123 Id. at 61.

124 Id. at 76, where the following passage also occurs:

We were impressed by the technical ingenuity of the management information systems in use and under development by some of the largest airlines, but could not escape the conclusion that these are bound to be less effective than on-the-spot knowledge of what is happening in the airline, which we found in smaller companies. A senior executive of one of the largest United States airlines told us frankly that he thought his company was less 'nimble' than smaller airlines and that this was a burden which it carried for the other advantages of being large. This seems to us to be the essence of the problem.
management problems of the airline industry as [is] possible without losses of scale economy.\footnote{\textit{Id.} at 61.}

Accepting the desirability of preserving multiple centers of initiative and innovation without sacrificing any important economies of scale, and accepting also the fact that optimum scale for a particular airline may depend very largely on the quality of its particular management, how is it possible to avoid the need for a case-by-case evaluation of benefits and detriments of mergers and at the same time permit growth of efficient companies to the extent required to make full use of their management capabilities? One answer is to rely on the process of internal growth, that is, to allow each management to achieve a larger market wherever it can out-perform its competitors. This course, as has often been pointed out, has the virtue of increasing the probability that expansion is actually accompanied by superior performance. Here again, the protective certification requirement stands in the way of reaping the maximum benefit from such a policy: where the incumbent carriers are protected from serious diversion of their revenues by new competition, the only way to replace the inefficient may be to buy them out.

Thus, though a ban on virtually all inter-airline mergers, modified by a failing-business rule in the sense indicated above, has much to recommend it, the adoption of such a ban would not, under the present regulatory regime, avoid anti-competitive consequences, and might result in undue rigidity in the structure of the industry. In addition, though such a ban would presumably ameliorate to some extent the long-run tendency towards shrinkage in the number of domestic trunklines, it would not entirely eliminate it. The exit door would still be open, while the entrance (certification of newcomers) would still be closed. The correction of these defects would require abandonment of protective certification.