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Recasting the Air Route Pattern by Airline Consolidations and Mergers

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RECASTING THE AIR ROUTE PATTERN
BY AIRLINE CONSOLIDATIONS
AND MERGERS

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INTRODUCTION

M EASURED by its past, civil air transportation has made great strides in providing safe, efficient and economic service in the United States. A study of the present, however, provides no grounds for complacency. It reveals the need for persistent efforts if the improved service possibilities of a technologically young industry are to be realized in a dynamic market. Current analysis also discloses heavy continued reliance on financial support by the public treasury for some parts of the civil air transport system. While public financial support is not necessarily undesirable, the present degree of dependence is viewed critically by transportation authorities and has become a matter of concern for the Civil Aeronautics Board.

The Board itself has suggested that the civil air transport industry can be strengthened and the public financial support reduced through reshuffling the airlines' operating structures by consolidation and mergers. In its Statement of Policy relating to the Economic Program for 1949 it urged the industry to call "... to our attention uneconomic route pattern situations and possible corrective actions which may be corrected by mergers, consolidations, interchanges or suspensions." Later it proposed to study "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." While the agency has recently disapproved, at President Eisenhower's direction, of Eastern Air Line's acquisition of Colonial Airlines, it is unlikely that this will be the last development in the attempt to strengthen the air route pattern by consolidating airline facilities. In fact, steps have been taken to determine the public interest in the consolidation of other airline properties.

3 The Board has instituted investigations to determine whether Lake Central should be acquired by other airlines and whether Southwest and Bonanza should be merged. Annual Report of the Civil Aeronautics Board, 1953, pp. 3-4. Hearings were initiated in May on Pioneer's and Continental's proposal to consolidate their facilities. The Board has initiated an investigation to determine the public interest in integrating Braniff and Continental if the Pioneer-Continental pro-
It is the purpose of this paper to describe and analyze regulatory policy on mergers and acquisitions.\textsuperscript{3a}

\textbf{JURISDICTION OF THE CAB}

The Civil Aeronautics Act of 1938 gives jurisdiction over mergers of domestic airlines to the Civil Aeronautics Board.\textsuperscript{4} Where the proposed action involves an air carrier which is authorized to engage in overseas or foreign air transportation it is also subject to the approval of the President.\textsuperscript{5}

In the event that the proposal for a consolidation of facilities necessitates the transfer of a certificate of convenience and necessity, section 401 (1) of the Act applies. This section requires Board approval for a transfer. The agency is directed not to approve the transfer unless it is consistent with the public interest.

Section 408 invokes the jurisdiction of the Board where a consolidation or merger is involved. The appropriate provisions of the section read as follows:

\begin{enumerate}
\item It shall be unlawful unless approved by order of the Authority [Board] as provided in this section—
\begin{enumerate}
\item For two or more air carriers, or for any air carrier and any other common carrier or any person engaged in any other phase of aeronautics, to consolidate or merge their properties, or any part thereof, into one person for the ownership, management, or operation of the properties theretofore in separate ownerships;
\item For any air carrier or person controlling an air carrier, any other common carrier, or any person engaged in any other phase of aeronautics, to acquire control of any air carrier in any manner whatsoever;
\end{enumerate}
\end{enumerate}

Section 408 (b) requires the Board to give approval unless the proposed action is inconsistent with the public interest. Although the directives in Sections 401 and 408 are worded differently, the Board has held they are synonymous in their intent. The public interest is the important consideration and the proposal must contribute to the realization of this objective.\textsuperscript{6}

Congress has laid down the broad principle that the Board be guided in its actions by the public interest. In an attempt to partially delay its decision in the \textit{Reopened New York-Balboa Through Service Proceeding}, Order Serial No. E-7977 (1953). The CAB delayed its decision in the \textit{Reopened New York-Balboa Through Service Proceeding}, Order Serial No. E-5119 (1954), and has urged the carriers involved to explore the possibilities of creating one line to service Pangra's and Braniff's present international routes.

\textsuperscript{3a} For earlier articles relating to this subject see Bluestone, \textit{“The Problem of Competition Among Domestic Trunk Airlines,”} 20 \textit{JRL. OF AIR LAW & COM.} 379, and 21 \textit{JRL. OF AIR LAW & COM.} 50; Anderson, \textit{“Airline Self-Sufficiency and the Local Air Service Problem,”} 21 \textit{JRL. OF AIR LAW & COM.} 1; Goodrick, \textit{“Air Route Problem in the United States,”} 18 \textit{JRL. OF AIR LAW & COM.} 281; and Whitehead, \textit{“Effects of Competition and Changes in Route Structure on Growth of Domestic Air Travel,”} 18 \textit{JRL. OF AIR LAW & COM.} 78.


\textsuperscript{5} 52 Stat. 1014; 49 U.S.C. 601.

\textsuperscript{6} \textit{Acquisition of Mayflower by Northeast Airlines}, 4 C.A.B. 650, 651 (1944); \textit{Delta-Chicago & Southern Merger Case}, Initial Decision of the Examiner, Docket No. 5646 (1952).
RECASTING AIR ROUTE PATTERN

interpret this general concept it stated in section 408 (b) that a merger proposal shall not be approved if it would result in the creation of a monopoly which would restrain competition or jeopardize another carrier. Although not expressly referring to the question of mergers or acquisitions of control, section 2 of the Act provides additional statutory standards which the Board is to consider in determining the public interest. These include 1) the encouragement of an air transportation system adapted to the present and future needs of commerce, the postal service and national defense, 2) the preservation of the advantages of air transportation, the promotion of safety and sound economic conditions in such transportation, and the improvement of relations between, and coordination of transport by, air carriers, 3) the promotion of adequate, economical and efficient services at reasonable and nondiscriminatory charges and absent unfair and destructive competition, 4) the achievement of competition to the degree necessary to assure a sound air transportation system, and 5) the development of air commerce.

All of these, however, give no more than general direction to the Board's deliberation. It remains with the agency to exercise discretion in the individual cases before it within the framework of these broad statutory principles. It is also within the agency's province as stated in section 408 (b) to attach such terms and conditions to a proposed merger as it finds just and reasonable.

PUBLIC INTEREST

A review of its decisions in merger, consolidation and transfer cases reveals the specific factors which the Board has considered in determining the public interest in such actions. These factors are whether 1) the proposal will result in an integrated, rational and economical route pattern, 2) it will suppress competition and injure another air carrier, 3) the transfer price is satisfactory, and 4) the interests of labor are protected.

Integrated, Rational and Economical Route Patterns

There is public interest in a proposed merger if it will result in an integrated, rational and economical route pattern which will produce improved services and economies of operation. Improved service is anticipated if the merger creates the possibilities of through, one-carrier flights in lieu of two-carrier, connecting schedules. Historical inter-line traffic, the traffic exchanged by two lines, is studied to determine the extent to which passengers would be conveinced by one-carrier, improved service. If the inter-line traffic is substantial it is assumed there will be a significant value to the traveling public in the establishment of a consolidated company and the elimination of the need to exchange passengers. At the same time, it is also assumed that because of this convenience to passengers, traffic will increase to the extent that revenues of the surviving carrier will be improved.
The possibilities of achieving economies by consolidating the facilities of two airlines are also explored in determining the public interest in a proposed merger. Savings may result as facilities and personnel are jointly used and as direct operating economies result from more rational route structures. If the surviving carrier is strengthened financially by increased revenues or more economical performance the public interest is advanced. If the airlines are being subsidized the mail pay need may be lessened.

The Board approved United Air Lines' acquisition of Western's route No. 68 (Denver to Los Angeles) when it found the proposal would result in an integrated and rational route pattern which would promote the public interest.\(^7\) The finding was based on the record which showed a large number of passengers traveling between points on United's route east of Denver and Los Angeles, on Western's route, via the two systems with the passenger exchange effected at Denver. The Board referred to route No. 68 as a segment in the great circle transcontinental route from New York to Los Angeles. The passenger traffic over this route would be convenience by the establishment of one-carrier service in lieu of the existing two-carrier service of United and Western.

The dynamic nature of the advantage of integration, and the Board's adjustment of its policy to changed conditions, can be seen from an examination of the background of the above case. In 1940 the agency prevented United's direct entrance into Los Angeles (the feat accomplished in the 1947 case) by rejecting a request to approve that carrier's acquisition of Western.\(^8\) In 1944 United's bid for direct entry into Los Angeles was again rejected when Route No. 68 was certificated but was granted to Western rather than United.\(^9\) In both the 1940 and 1944 decisions the agency acknowledged the strong possibilities of creating an integrated and rational route by permitting United to provide through service from points on its system east of Denver to Los Angeles. This consideration was not strong enough, however, to overcome the public interest in maintaining Western as a strong regional carrier which would be seriously damaged by granting United direct access to the south California city.

Whereas the protection of Western had been the principal factor in the 1940 and 1944 cases, technological developments had changed the weight of the considerations involved by 1947 and route integration had become of greater importance.\(^10\) While two-carrier, DC-3 connecting service between the East and Los Angeles was adequate and, in fact, made Western's connecting service one of the strongest segments of its system in the early 1940's, the advent of new post-war air-

\(^7\) United-Western, Acquisition of Air Carrier Property, 8 C.A.B. 298 (1947).
\(^8\) United-Western, Interchange of Equipment, 1 C.A.A. 723, (1940); United-Acquisition of Western, 1 C.A.A. 739 (1940). In 1940 the entry of United into Los Angeles would have been achieved via Salt Lake City.
\(^9\) Western, Denver-Los Angeles Service, 6 C.A.B. 199 (1944). The examiner had recommended United for this route.
\(^10\) It is probable that Western's financial straits carried considerable weight with the Board in its 1947 decision. Note 38 infra.
craft had increased the value of one-carrier, through service by 1947. That is, nonstop flights utilizing the new equipment from Chicago and the East to the West Coast decreased the value of the connecting service and enhanced the public interest in one-carrier operations. In other words, technological developments had reduced the value to Western of Route No. 68 as through service became feasible. While the public interest in maintaining Western as a strong regional carrier continued, its retention of Route No. 68 would no longer make the same relative contribution to that end.

National's acquisition of Carribean-Atlantic failed to secure Board approval in 1946. It was pointed out that there was no possibility of physical fusion of the two systems which were separated by 1,000 miles of ocean and which served two different territories. This condition would prevent the realization of any significant economies of operation. It was also unlikely that a normal flow of traffic would be conveniently by the merging of two such physically non-integrated systems.11

The CAB denied American's request for approval of its proposal to acquire Mid-Continent. It was stated that the two systems it was proposed to merge were non-complementary and that therefore amalgamation would not contribute to a well coordinated air network. The tests applied were the amount of traffic which the two lines had exchanged in the past and the volume of traffic which moved between points on the two systems and which would be conveniently by one carrier service. While Mid-Continent did exchange much traffic with other lines, the exchange with American was relatively small.12

A proposed merger of Braniff and Mid-Continent was approved in 1952, however. The interline traffic of the two systems which would be provided one carrier service under the proposal was an important consideration in the decision. This improvement in air travel facilities, it was thought, would stimulate traffic and thus increase commercial revenues. This, together with the savings in ground and indirect operations which were expected from the elimination of duplicate facilities, should reduce the mail pay needs of the merged carriers.13

Improvement which may occur in the service is not the only consideration in finding that an integrated, rational and economical route pattern will result from merging two systems. On numerous occasions the Board has pointed out that the action may cause substantial economies. When approval was given for the consolidation of Monarch and Challenger in 1949 it was indicated that the economies of the combined operations would be of even greater public interest than would the expedited traffic flow. Savings in both indirect and direct expenses were anticipated. Indirect accounts of the consolidated company would

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11 National-Carribean-Atlantic Control Case, 6 C.A.B. 671 (1946).
12 American Airlines, Acquisition of Control of Mid-Continent Airlines, 7 C.A.B. 365 (1946).
reflect the joint use of personnel and facilities. Direct accounts would benefit as dead ends, formerly existing for both companies at Denver and Salt Lake City, were eliminated and the more efficient use of persons and equipment was possible. The Board believed the mail pay requirement of the operations would be reduced as a result of the economies which were anticipated.14

When the Delta-Chicago & Southern merger was approved it was expected that the action would permit a more efficient utilization of equipment. It was thought probable that additional service could be offered without any increase in the number of aircraft because of improved use which could be made of existing planes. Again there was reference to an expected reduction in mail pay requirements as a result of these economies.15

Approval of American Airlines' acquisition of American Export Airlines was granted when it was thought integration of the two systems would produce economies which would contribute to the strength of the international carrier. Uniting the operating organizations and experience and the traffic generating facilities of American in the United States and the experience and organization of American Export in international service would permit the exploitation of the combined strength of the two companies. The CAB believed the result would be substantial economies of operation, maintenance, sales and advertising, more effective traffic generation and the promotion of international air transportation.16

Although savings in mail subsidy were expected as a result of economies of operation, the President, under section 801, directed the Board to disapprove Eastern’s acquisition of Colonial. The Board had determined that Eastern had unlawfully acquired control of Colonial, but had recommended approval of the merger on the basis of expected economies. The President recognized the possibilities of achieving a better integrated and more rational and economical route structure, but stated that these ends should not be achieved by unlawful means.17

While convenience to the traveling public and economies of operation have been major considerations in determining whether a proposed acquisition will result in an integrated, rational and economic route pattern, there have been other factors which have influenced the Board’s decisions. On several occasions it was pointed out that a proposal would probably strengthen the remaining carrier financially. Retention of Route No. 68 by Western would cause a further deterioration of the financial position of an already weak carrier. On the other

hand, relinquishing its role in the transcontinental market would strengthen Western as a regional operator.\textsuperscript{18}

The probability of improved management was given as an important consideration leading to the approval of Western's acquisition of Inland. There was little likelihood of substantial traffic interchange between the two systems. But the Board thought there was evidence that in the past Inland's operations procedure and maintenance as well as its operating personnel had not measured up to the standards which the public interest required. Further, there appeared reason to believe that Inland's management had been at least partially responsible for the carrier's financial difficulties. Western's acquisition of Inland would extend the benefits of its superior management, financial policy and its higher standards of operation to the acquired carrier.\textsuperscript{19}

\textit{Suppression of Competition to the Injury of Another Air Carrier}

The Act requires disapproval of a proposed merger if it would create a monopoly and "thereby restrain competition or jeopardize another air carrier." However, the Board has never interpreted the Act to require uncontrolled competition. To the contrary, its decisions indicate it has pursued a policy of controlled competition. By means of its certification powers it has restricted entry into the field of air transport. By its regulation of services it restrains competition among the existing companies. It appears that the agency has interpreted the Act to require the prevention of 1) uncontrolled competition which would jeopardize another company, and 2) "undesirable" domination of air commerce by a carrier. This was clearly stated when the Board said,

\begin{quote}
  The question of the effect that the transfer of a certificate will have on existing carriers has been and will continue to be an important issue in transfer cases and where the facts establish that approval of the agreement would unduly disturb the competitive balance the agreement will be disapproved.\textsuperscript{20}
\end{quote}

In those cases in which mergers were approved the Board has usually indicated that the diversionary impact of the consolidated company on other carriers would not be of serious proportions. Improved service, economies of operation and strengthened carriers were given as justification for the mergers. These developments were anticipated as a result of improved traffic facilities. They were not expected as a consequence of the elimination of competition. A merger was not permitted if it would provide uneconomic competition and weaken other carriers. It was not approved if the result would be undesirable domination of air transport by one company.

American was not allowed to acquire Mid-Continent. Not only

\textsuperscript{18} United-Western, Acquisition of Air Carrier Property, 8 C.A.B. 298 (1947). See also Northern Consolidated Airlines, Consolidation, 8 C.A.B. 110 (1947).
\textsuperscript{19} Western Air Lines, Acquisition of Inland Air Lines, 4 C.A.B. 654 (1944). See also Wien Alaska Air—Acquisition, Mirow Air, 3 C.A.B. 207 (1941).
\textsuperscript{20} Delta-Chicago & Southern Merger Case, Order Serial No. E-7052, p. 8 (1952).
were the two systems uncomplementary, but the proposal would have a deleterious effect on competition. American was already the largest domestic carrier. The acquisition of Mid-Continent would increase its size. Furthermore, American would acquire a competitive advantage in connecting traffic. Whereas, at the present Mid-Continent’s interline traffic was exchanged largely with other carriers because of greater convenience, the proposed consolidation would permit American to control this traffic, routing it over its own lines, to the disadvantage of other companies.\textsuperscript{21}

Alaska Airlines, largest carrier in Alaska, was not permitted to acquire Cordova. Its acquisition would have given Alaska an overwhelming competitive advantage over the remaining Alaskan lines. This would have precluded, it was thought, the development of the balanced competition which the public interest required.\textsuperscript{22}

Potentially uneconomic competition was the consideration when a proposal to unify Southwest and West Coast, two local service lines operating on the Pacific Coast, was rejected. Trunk lines flying in the area had expressed a strong distaste for the proposal on the grounds it would divert traffic from them. The agency found ample justification for these fears and refused its approval for the move.\textsuperscript{23}

Other local service lines were permitted to merge notwithstanding the fears of the trunk lines. In these cases the Board thought trunk line traffic would not be diverted but would continue to move as it had in the past because of the established position of the major lines. The local lines were required to stop at intermediate points, while the trunk lines could offer faster service by minimizing their stops. Furthermore, the major airlines had greater advertising, stronger sales facilities and superior equipment. In other words, the local service lines were expected to remain fundamentally local lines while the trunk lines would continue to carry the trunk line traffic.\textsuperscript{24}

\textit{Purchase Price}

The price at which it is proposed to transfer assets has been an additional consideration in airline merger cases. Terms of the agreement must be reasonable and must not impair the capacity of the acquiring company to provide efficient service. The Board has maintained that reasonableness of purchase price depends not only upon the ability of the purchaser to pay the price, but also upon the value of the property to be acquired. The agency must be satisfied that the carriers’ financial condition will permit it to meet the terms of the proposal. It must

\textsuperscript{21} American Airlines, Acquisition of Control of Mid-Continent Airlines, 7 C.A.B. 365 (1946).

\textsuperscript{22} Acquisition of Cordova by Alaska Airlines, 4 C.A.B. 708 (1944). See also Alaska Air, Service to Anchorage, 3 C.A.B. 522 (1942). For decisions approving mergers on the ground that the competitive balance would not be destroyed see Marina Airways, Alaska Air Transport—Consolidation, 3 C.A.B. 315 (1942); Wien Alaska Air—Acquisition, Mirow Air, 3 C.A.B. 207 (1941).

\textsuperscript{23} Southwest-West Coast Merger Case, Order Serial No. E-5594 (1951).

\textsuperscript{24} Monarch-Challenger Merger Case, 11 C.A.B. 33 (1949); Arizona-Monarch Merger Case, 11 C.A.B. 245 (1950); West Coast Empire Merger Case, Order Serial No. E-6650 (1962).
also be convinced that the value of assets transferred has not been inflated to the extent that a weakened carrier will not be able to offer efficient service without additional financial support from the government.

Braniff Airways' proposed acquisition of Aerovias Braniff was not approved. The estimated plans for operation of Aerovias were inadequate, vague and indefinite. For this reason it was impossible to ascertain the financial effects of the proposal on Braniff Airways. There was a distinct possibility, indeed a probability, the new company would prove to be a financial drain on Braniff Airways. This would impair Braniff's ability to raise needed capital and endangered its capacity to respond to the future needs of air transportation without prolonged financial assistance in the form of public subsidy.25

Although the impossibility of achieving an integrated system was an important consideration leading to disapproval of National's acquisition of Carribean-Atlantic, the Board was also influenced by what it thought were the inequities of the purchase arrangement. The majority stockholder in Carribean-Atlantic was to receive 1 share of National stock for 1.26 shares of his present stock. Minority stockholders were to receive only 1 share for 5 shares of Carribean-Atlantic. The CAB was not satisfied with the proceedings which had led to this arrangement and stated that such apparent inequities would inevitably have an adverse effect on airline investments.26

It has been the Board's policy in acquisition cases to distinguish between two sets of values—market value for transfer purposes and book value for rate-making purposes. It has generally insisted that value for rate-making not be increased as a result of consolidations. The Board said,

We are . . . of the opinion that for rate-making purposes the proper valuation . . . should be related to the original cost . . . less allowable depreciation rather than to the fair market value. . .

The agency has permitted, however, assets to be transferred at prices which exceed book value. It has reasoned that profits realized from such transactions will induce a seller to dispose of its properties to another carrier in a position to operate them with greater advantage to the public. In the absence of this incentive one of two alternatives would result, it is said. First, the air network would be frozen. Secondly, the Board could pressure the carriers by its airmail or certificate suspension powers into redrawing the network. This it has been reluctant to do, concluding it has no power to achieve indirectly what it has no power to accomplish directly—requiring the carriers to transfer their property.

A market value above book value is reached by a write-up of tan-

25 Braniff Airways, Acquisition of Aerovias Braniff, 6 C.A.B. 947 (1946).
26 National-Carribean-Atlantic Control Case, 6 C.A.B. 671 (1946).
27 United-Western, Acquisition of Air Carrier Property, 8 C.A.B. 298, 312 (1947).
gible assets and by the inclusion of intangibles. Justification for a write-up is found where market conditions have caused the value of the assets to exceed their original cost less depreciation or where the assets will have greater value in the hands of the acquiring carrier than they would in other uses. The inclusion of intangibles, including goodwill and going concern value, is permitted on the grounds that an improvement in the earning power of the acquiring carrier will follow from the transfer and, thus, warrants this action.

The Board is inclined to accept an exchange price above book value where it has been arrived at as a result of arms-length bargaining (no compulsion being involved) by two parties represented by competent and able individuals who are experienced in business and cognizant of the problems of air transportation. The alternative to this, if the transfer is permitted above book value, would require the Board itself to accept the responsibility of fixing the price. The agency has considered this "...not only contrary to the intent of the Act, but outside the competence of the Board."

Adherence to this policy has raised the problem of preventing a market value in excess of book value from becoming a part of the latter. In the United-Western case the Board attempted to achieve this by requiring that the excess be charged to surplus. In the Monarch-Challenger case the payment was made between individuals and was not reflected in the accounts of the carriers. In the more recent Braniff-Mid-Continent and Delta-Chicago & Southern cases the exchanges were effectuated by transfers of securities with no change in the book values of the assets.

Although it has accepted exchange prices above the recorded values of the assets this policy of the Board has been vigorously challenged. Chairman James M. Landis in a strong dissent stated his belief that the excess would necessarily affect rates paid by the consumer or the government, even though charged to surplus and not entered in the rate base. Landis argued the credit position of the acquiring carrier would be weakened as the stockholders' claims, represented by the surplus account, were dissipated. Increased rates either on mail or commercial traffic would necessarily be required to avoid this.

The same reasoning could be applied to the recent cases in which

28 Delta-Chicago & Southern Merger Case, Initial Decision of the Examiner, Docket No. 5546 (1952); Acquisition of Mayflower by Northeast Airlines, 4 C.A.B. 680 (1944).
29 United-Western, Acquisition of Air Carrier Property, 8 C.A.B. 298 (1947).
30 Ibid., p. 314.
31 Ibid., p. 318.
34 United-Western, Acquisition of Air Carrier Property, 8 C.A.B. 298, 325-345 (1947). On an earlier occasion Board member Edward Warner objected to the assignment of an exchange value to a certificate Marquette Airlines proposed to transfer to TWA. Acquisition of Marquette by TWA, Supplemental Opinions, 2 C.A.B. 409 (1940). The decision in this case was interesting in that it represented a clear-cut reversal of an earlier opinion in which the Board had stated that the inclusion of a value for a certificate above its developmental costs was not in the public interest. Acquisition of Marquette by TWA, 2 C.A.B. 1 (1940).
mergers have been effectuated by an exchange of securities. On these occasions the rates at which the securities of two carriers were exchanged reflected the excess of transfer price over recorded value. Thus, Chicago & Southern shareholders were to be given $10,000,000 Delta debentures for assets with a book value of $7,000,000. Mid-Continent stockholders were offered Braniff stock at a ratio of 1 share of Braniff to 1.5 shares of Mid-Continent. A comparison of book values revealed a ratio of approximately 1 to 1.72.

Has this policy of the Board resulted in increased rates as Landis feared? An examination of the record does not provide a definitive answer, but some general observations are in order. Mail rates for the airlines industry were raised in 1948, following United's acquisition of Route No. 68 at a price above book value. The Board, however, has declared these increases were necessitated by an overexpansion of the industry induced by over-optimism in the immediate post-war period.

If uniform mail and commercial rates are applied to a group of carriers, as the Big 4, it is impossible to assert that an equal increase for all is a result of the dissipation of the shareholders' equity in one company. It would appear that where these uniform rates exist, and where no special action favoring a particular company is taken, the impact of such a charge to surplus will be on the stockholders, not on the shippers and public treasury. If the acquisition of assets improves the earning capacity of the company the shareholders will benefit, partially or wholly offsetting the excess of price above book value. If the earning capacity is worsened, the shareholders will lose. The ability to continue to meet the increasing capital needs in an industry characterized by rapid growth without special government financial support indicates no calamitous impairment of the stockholders' equity.

Furthermore, as long as the CAB pursues the policy of applying uniform rates to a group of carriers, it is academic to pursue the notion that an improved earning position from a route adjustment should be reflected in lower rates for the particular airline. Industry competition requires that charges for similar commercial services must be practically uniform. Uniform mail rates are sound regulatory policy where they are service (nonsubsidy) rates.

If the danger of increased costs to shippers or the public is not present it would appear the policy of permitting an exchange price in excess of book value is justified. This leaves the initiative for recasting the air network with the airlines where, under the present philosophy of negative regulation or "umpiring," it was probably intended it should be. An incentive is provided for an airline to dispose of its routes, or segments of routes, to carriers willing to pay the price because of the greater earning value which the property will have for the acquiring company. The Board correctly expects the profit incentive

will provide a more reliable standard, under its supervision, for modifying the network in the public interest than would the standards it might apply.\textsuperscript{88}

Acceptance of this principle, however, provides no argument for permitting an exchange price based on speculation in the subsidy value of airline property. Since consolidation is viewed as a method of strengthening the commercial air transport industry, it is probable that at least some actions will involve the weaker airlines, those presently being supported by the government. If airline assets requiring subsidy are involved, the payment of a price in excess of the book value of the assets is based solely on speculation on the CAB's mail pay policy. This undesirable development could be avoided by the adoption of a clearly defined policy eliminating the subsidy element in mail pay. If this were done, an exchange price above net book value could be based only on the commercial value to the acquiring company of the route or route segment to be acquired.

It is presumed here, however, that the public interest may require the government to support certain airline operations, e.g., those of some international carriers. When the properties of these airlines are involved in a merger proposal an intangible value, assignable to the certificate of convenience and necessity, will appear if the total income is capitalized. It appears impossible to prevent this, assuming permanent certification of the route, under present legislation which circumscribes the authority of the CAB to revoke certificate rights. In these circumstances, however, the intangible value could be minimized if the Board would provide only the minimum support required to maintain the essential operations. This support should be so limited as to provide an incentive for the present company to dispose of its properties to a carrier if this carrier could operate a better integrated, more rational and economic route structure, one which could be maintained profitably at the rate of minimum financial support provided.

Although the Board generally prohibits an inflation of the rate base, a write-up in the investment for rate-making purposes occurred when West Coast acquired Empire. Under the terms of the proposed arrangement the price of $525,000, claimed as the fair market value of the assets, was $338,000 in excess of the book value, $187,000, of Empire's properties. The Board's decision approving the merger required that this fair market value be reduced by the amount of depreciation for which Empire had already been reimbursed in mail payments. However, a write-up of the undepreciated assets was permitted. This had the effect of increasing the net book value for rate-making purposes by approximately $106,000.\textsuperscript{89}

\textsuperscript{88} It is not implied that the Board accepts this standard solely on grounds of principle. The atmosphere in which the agency approved an intangible exchange value of Western's Route 68 is a case in point. The financial position of Western was weak. "Board approval of the transfer was a condition precedent to an RFC loan." Edward C. Sweeney, "Staff Report on the Civil Aeronautics Board," included in \textit{Air-Line Industry Investigation}, 81st Cong., 1st and 2nd Sess., p. 2218. See also pp. 2329-2331.

\textsuperscript{89} \textit{West Coast-Empire Merger Case}, Order Serial No. E-6550 (1952).
In approving the write-up the Board recognized that this represented a departure from its policy of insisting that investment for determining rates not be increased by consolidations. Reference was made to the "special circumstances" in this case, and a warning was issued that this was not to be accepted as a precedent for future cases. The "special circumstances" resulted from the difficulties with which negotiations had proceeded (several earlier attempts had failed) after the Board itself had urged that the possibilities of a West Coast-Empire merger be explored. In an admitted effort to induce the two parties to accept the final plan, Empire was permitted a profit and West Coast was allowed to increase the investment base by the write-up.

This deviation from accepted policy did not go unchallenged, however. Vice Chairman Oswald Ryan pointed out the inconsistency of the action when judged by past decisions and stated the opinion might have broad significance for future consolidation cases. Ryan said:

This is a compromise of principle which is likely to have a profound effect on all mergers and acquisitions in the future. It can become the entering wedge by which the existing assets of numerous companies can be inflated, the return to stockholders substantially increased, and the cost to the government, and ultimately the consumer raised.\(^40\)

It is possible that the action in this case may prove to be only a transitory lapse from a policy of preventing any inflation of the rate based by merger. The Board itself betokened this at the time it set the mail rate for the merged company. It confirmed its acceptance of the write-up, but in doing so said,

... we do so with the explicit reservation that absent the special circumstances present here, we will continue to apply the general principle ... that equipment ordinarily ... shall be recorded for rate purposes on the basis of the net book value as shown on the books of the transferor.\(^41\)

**Protective Labor Conditions**

Consolidating the facilities of two airlines may affect the interests of several groups. Reference has already been made to the possibilities of convenience to the traveling public, through improved travel facilities, and benefit to the government and investors, as a result of greater earning potential. Employees may be adversely affected by the termination of employment or the transfer to positions of less remuneration through displacement by a senior employee. That labor has been aware of this is evidenced by its requests that provisions designed to protect its interests be included when the Board approves a merger.

There is no express statutory authority for imposing such provisions. Implicit power, however, exists in section 408 (b) which permits the imposition of such terms and conditions as are in the public interest. In recent cases the CAB has found the public interest requires


\(^{41}\) *West Coast Airlines, Mail Rates*, Order Serial No. E-7412, pp. 7-8 (1953).
that benefits for the traveling public, the stockholders and the government should not be achieved at the expense of the employees. Furthermore, it is thought the national interest is protected if labor difficulties arising out of hardships incident to a merger are not allowed to become the basis for delaying or preventing the unification of facilities for the interruption of service. \(^\text{42}\) The Board has found support for this position not only in other regulatory legislation, \(^\text{43}\) but also in judicial decisions upholding the legislation. \(^\text{44}\) As a result, the agency has endeavored in recent years to anticipate the labor problems which may arise when airlines merge and has taken steps to provide for their amicable settlement.

In the earlier cases the Board refused to attach protective labor conditions to its approval of mergers notwithstanding the Air Line Pilots Association's requests for action of this type. This position was taken on the grounds that the interests of labor appeared adequately protected without intervention. In 1947 when United was permitted to acquire Western's Route No. 68 this policy was continued. Western had testified that on the basis of its expansion plans none of its employees would be unfavorably affected. \(^\text{45}\) These optimistic expectations of Western were not realized, however. An appeal by various labor groups induced the Board in 1950 to reexamine its policy of non-interference and retroactively to require provisions for the employees' protection. \(^\text{46}\)

In this 1950 case there was no precedent in air transport regulation to guide the Board. Consequently, while it provided a plan to meet the specific problems presently before it, it was unwilling to adopt a general formula for future cases. It turned for guidance to the field of railroad regulation and the Burlington Formula applied by the I. C. C. in 1944. \(^\text{47}\) The Board strongly urged airline labor and man-

\(^{42}\) United-Western, Acquisition of Air Carrier Property, 11 C.A.B. 701 (1950); North Atlantic Route Transfer Case, 12 C.A.B. 124 (1950).

\(^{43}\) The Transportation Act of 1940, 54 STAT. 905; The Communications Act, 57 STAT. 5.


\(^{45}\) United-Western, Acquisition of Air Carrier Property, 8 C.A.B. 298 (1947); see also Western Air, Acquisition of Inland Air, 4 C.A.B. 654 (1944); American Airlines, Control of American Export Airlines, 6 C.A.B. 371 (1946); Monarch-Challenger Merger Case, 11 C.A.B. 33 (1949).

\(^{46}\) United-Western, Acquisition of Air Carrier Property, 11 C.A.B. 701 (1950).

\(^{47}\) The Burlington Formula, applied in a railroad abandonment case, contained the following conditions: 1) an employee placed in a worse position with respect to compensation and working conditions should be paid a monthly displacement allowance equal to the difference between his current employment and that from which he was displaced; 2) a monthly allowance equal to the average monthly pay of his prior employment should be paid an employee who was dismissed; 3) an employee affected by the abandonment should not be deprived of the fringe benefits attached to his prior employment; 4) moving expenses were to be paid to an employee who was required to move as a result of the abandonment; 5) an employee should be reimbursed for the loss from a sale of his house at less than fair value or the termination of a lease when the loss resulted from a required change in the location of employment; and 6) any dispute arising out of the interpretation of the formula was to be submitted to arbitration. Chicago, Burlington & Quincy Abandonment, 257 I.C.C. 700 (1944).
RECASTING AIR ROUTE PATTERN

agement to follow the example set in the railroad industry and to work out a general program to mitigate the hardships to labor incident to mergers.

In the absence of successful collective bargaining in the United-Western case, conditions providing for compensation for employees' losses of the following type were imposed: 1) loss of salary attributable to furlough or termination of employment, 2) loss of salary resulting from transfer to a position of lower pay, and 3) moving and transportation expenses incident to a transfer to a new location. If the carrier (Western) and employees were unable to arrive at a satisfactory agreement regarding the problems of compensation, arbitration was to be employed. The jurisdiction of the arbitration tribunal was to include not only the question of which employees were adversely affected, but also the questions of what compensation should be paid these employees and the period of time for which compensation should be granted.\footnote{United-Western, Acquisition of Air Carrier Property, 11 C.A.B. 701 (1950). The court upheld the Board's power to retroactively impose protective labor conditions in this case. \textit{Western Air v. C.A.B.}, 194 F. 2d. 211 (1952).}

The integration of seniority lists has posed a particularly thorny problem in airline mergers. The serious nature of the question became evident when Pan American was permitted to acquire American Overseas Airlines. Although the order approving the merger had specifically required arbitration in the event of failure to successfully negotiate an agreement,\footnote{North Atlantic Route Transfer Case, 12 C.A.B. 422 (1951).} four groups of Pan American employees refused either to negotiate or to arbitrate until an order stipulated an agreement must be reached or the Board itself would integrate the employee lists.\footnote{North Atlantic Route Transfer Case, 12 C.A.B. 124 (1950).} Even this failed to conclude the dispute between several labor groups. Pan American pilots challenged the jurisdiction and questioned the procedure of an arbitration tribunal to which they had been a party but which had produced an award to which they objected. The questions were carried to the court where the award was upheld.\footnote{O'Donnell v. Pan American, 200 F. 2d. 929 (1953).} Pan American flight engineers refused not only to negotiate and submit to arbitration, but denied the authority of the Board to integrate the seniority lists. This question also was carried to the court where the CAB's decision was affirmed.\footnote{Kent v. C.A.B., 204 F. 2d. 263 (1953).}

In 1952 the Braniff-Mid-Continent opinion produced what may prove to be a general formula for protecting employees adversely affected by airline mergers. The Board stated carefully that its decision was not to be considered as a prejudgment of future cases; each would be decided in the light of conditions peculiar to it. Nevertheless, since its adoption the Braniff-Mid-Continent formula has been applied, with modifications to fit the circumstances, on the three occasions that mergers have been approved. The main clauses of the formula provide for, 1) the integration of seniority lists, 2) the payment of displace-
ment allowances, 3) the payment of dismissal allowances, and 4) compensation for loss and expenses incident to changing locations.

The Board prefers that seniority lists be integrated by negotiation between the parties concerned. In its original United-Western decision it had expected that negotiated settlements of this and other problems would be reached. Since this expectation was not fulfilled and since it had to impose retroactively protective labor conditions, the Board has been unwilling to restrict itself to urging an amicable settlement of problems and then confine itself to retaining jurisdiction until satisfactory solutions are reached. The Braniff-Mid-Continent formula requires that arbitration be used when negotiation breaks down.

The Board's preference for negotiation followed by arbitration was spelled out clearly when it approved the merger of Flying Tiger and Slick. Slick pilots had opposed on legal grounds the provision for arbitration, and had favored a Board order integrating the seniority lists, if negotiations failed. The agency said,

We find no reason to depart from our view that seniority disputes arising from airline mergers are best settled by negotiated agreement, and that the other methods — arbitration, integration by Board action, and leaving the dispute to be resolved by economic pressure — descend in desirability in the order stated.

In refusing to accept responsibility for performing the task, the Board referred to the prolonged proceedings, involving both arbitration and adjudication, which followed its efforts when Pan American acquired American Overseas Airlines.

Although it refused to require arbitration of all questions of assignment of personnel in the Braniff-Mid-Continent formula, the Board reversed this policy when Delta acquired Chicago & Southern. On that occasion Delta employees, excepting the pilots, were unorganized. To provide this group additional protection, arbitration was required if there was no agreement reached on "rearrangement" of employees.

The Braniff-Mid-Continent formula provides that displacement allowances be paid employees who are placed in positions offering lower compensation than the employees received prior to the merger. The claim for this allowance must be presented within three years of the effective date of the merger. The protection is afforded for a period of four years.

53 Braniff-Mid-Continent Merger Case, Order Serial No. E-6459 (1962). The three later cases in which the formula was applied are West Coast Empire Merger Case, Order Serial No. E-6550 (1952); Delta-Chicago & Southern Merger Case, Order Serial No. E-7052 (1952); Flying Tiger-Slick Merger Case, Order Serial No. E-8022 (1954).

54 United-Western, Acquisition of Air Carrier Property, 8 C.A.B. 298 (1947).

55 Flying Tiger-Slick Merger Case, Order Serial No. E-8022, p. 6 (1954).


57 The Delta-Chicago & Southern case appeared at first glance to produce a modification of the formula when the Board stated that employees who refused to change their residence should not be provided the protection of displacement allowances. Mr. Jay M. Jackson, Legal Counsel, Braniff Airways, Inc., has called the author's attention to the fact that although its decision in the Braniff-Mid-Continent case did not specifically exclude personnel who refused to change their residence.
The formula provides that an employee deprived of employment as a result of the merger shall be accorded a dismissal allowance equivalent to 60% of his average monthly pay for a period which varies with the length of employment to a maximum of five years. The employee may elect to take in lieu of a dismissal allowance a lump sum separation payment determined by the length of his employment and his average monthly rate of pay. The company's liability, however, is reduced by earnings which may be received from other employment.

Payment of travel and moving expenses for employees who are required as a result of the merger to change their place of employment is called for by the Braniff-Mid-Continent formula. If as a result of the move the employee experiences a loss on the sale of his home, he shall be reimbursed by the carrier for the loss. The loss for which reimbursement is required is that which arises from a sale at less than fair market value, i.e., it is a result of a "distress" sale.

In addition to the above protection provided employees adversely affected by a merger, provisions of the Braniff-Mid-Continent formula also require disputes arising in the administration of the protective labor conditions to be resolved by arbitration. The Board specifically stated its preference for this procedure in lieu of one which would require a Board order for settlement. Employees earning in excess of $6,500 per year, excepting flight personnel, dispatchers and meteorologists are excluded from the protection. In the Delta-Chicago & Southern Merger Case the carriers expressed a willingness to eliminate this provision. This modification the Board accepted.58

SUMMARY AND CONCLUSION

Two conditions point inevitably to the need for a survey of the national air network with a view to the elimination of deficiencies which may be discovered. First, the readily apparent existence of public financial support for some airlines clearly indicates a public stake in the air route pattern. Secondly, the dynamic character of both the air transport industry and the market in which it is offered indicates an evolving public interest in air transportation facilities. The survey may reveal inadequate routes. It may disclose uneconomic route patterns. These defects may be adjusted with public advantage by a certification of additional routes.59 They may be adjusted by the elimination of existing routes or route segments under temporary certifi-

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Finally, they may be adjusted by consolidating the present facilities of operating airlines.

The consolidation of airline properties is subject to the approval of the CAB. The agency has granted or withheld its approval on the basis of public interest in such action. Public interest is conceived to be a function of several factors. First, the proposal should result in an integrated, rational and economic route pattern. It will do this if it will convenience the traveling public because of improved service, if it will produce economies of operation with benefit to the stockholders and with reduced cost to the government and, finally, if it will strengthen the carrier financially or provide it with improved management. Secondly, the proposal should not result in uncontrolled competition which would endanger another carrier, nor should it permit an undesirable domination of air commerce by one company. Thirdly, the proposed transfer of assets must be on terms which neither impair the ability of the acquiring line to provide efficient service nor create a need for higher commercial or mail revenues by an inflation of the rate base. Finally, the advantages to be gained by the traveling public, the carrier and the government must not be at the expense of the employees. For this reason the Board considers conditions designed to protect the interests of labor to be in the public interest.

While consolidation proposals may originate either with the Board or the airlines, those raised by the latter have been most productive of results. The agency's investigation into the public interest in transferring National's routes and property to other carriers was dismissed in 1951 after the company's financial condition had improved. The investigation into the public interest in a modification of the route patterns of Western and Northeast came to nothing. In 1952 the Board instituted an investigation into the public interest in mergers or combinations of air carriers in the eastern part of the United States. The procedural steps were indefinitely postponed, however, after an investigation into the desirability of consolidating the facilities of National and Colonial was undertaken. The outcome was still pending following the rejection of an Eastern-Colonial Merger. However,
the Board’s suggestion that West Coast and Empire explore the possibilities of combining their facilities did lead the two carriers to merge.65

Generally, it has been the position of the Board that it should not formulate the plan for combining the facilities of two airlines. One member has expressed doubt whether the agency has the authority to require the airlines to conform to a plan even if the Board was inclined to draw one.66 Given this attitude of the Board, it would appear that a recasting of the present route pattern by consolidation or merger must await voluntary action by the airlines.

However, a study of railroad consolidation leads to the conclusion that without strong incentives, reliance on voluntary action cannot be expected to produce the desired results — the creation of an economically strong transportation system.67 Adequate incentive might be found not in the highest, but in the most “steady” human motive, to use Alfred Marshall’s expression. In other words, voluntary airline consolidation and merger can be expected not as a result of a public interest in such action, but in response to the possibilities of an economic advantage for the parties to the consolidation. In the case of non-subsidized carriers, the economic advantage must be found in the improved earning position expected as a result of consolidation. In the case of subsidized carriers, the Board’s power over airmail payments provides an opportunity to offer this economic advantage to the airlines.

It is suggested here that a CAB policy which is openly designed to eliminate or reduce the subsidy element in airmail payments might convince the weak airlines there is an economic advantage to be gained in strengthening the air route pattern by consolidation and merger. The airlines have less incentive for this, the advantage in doing so is not as apparent, under the Board’s policy of supporting the present operating structure with mail pay. The agency has been reluctant to pressure one airline into transferring its property to another by a reduction of its mail pay. There should be no hesitation, however, about adopting a general policy designed to achieve an orderly withdrawal of federal support. (The support should be reduced to a minimum where, as in the case of international air transportation, continued operations are clearly warranted on non-economic grounds.) Such a program might induce the airlines to explore more actively the possibilities for reshuffling the present commercial airline system by consolidations and mergers. The Board is not legally bound to provide mail support for the existing structure of the industry. It is legally bound to provide the mail payments required to sustain an air transportation system adapted to the present and future needs of commerce, the postal service and national defense. It is legally required to foster sound economic conditions in such an air transportation system.

65 Southwest-West Coast Merger Case, Order Serial No. E-5594 (1951).