Interlocking Directorates under Section 409(a) of the Civil Aeronautics Act: Meaning of Representative

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SECTION 409(a) of the Civil Aeronautics Act of 1938 authorizes the Civil Aeronautics Board to prohibit interlocking directorate relationships which are detrimental to the public interest and to approve the relationships which are not detrimental to the public interest. Congress by enacting Section 409(a) has not only prescribed that one individual may not serve as an officer or director of two or more 409(a) companies but has also sought to prevent circumvention of its intent by prohibiting the use of a representative or nominee.

In Lehman v. Civil Aeronautics Board the question arose whether partners in an investment banking firm represent each other to the extent that this partner relationship alone can create an interlocking directorate subject to prohibition by the CAB. The court held that a prohibited relation

1 52 STAT. 1002 §409(a) (1938), 49 U.S.C. §489(a) (1946) which section is set out in full below:

Sec. 409 (a) After one hundred and eighty days after the effective date of this section, it shall be unlawful, unless such relationship shall have been approved by order of the Board upon due showing, in form and manner prescribed by the Board, that the public interest will not be adversely affected thereby —

(1) For any air carrier to have and retain an officer or director who is an officer, director, or member, or who as a stockholder holds a controlling interest, in any other person who is a common carrier or is engaged in any phase of aeronautics.

(2) For any air carrier, knowingly and willfully, to have and retain an officer or director who has a representative or nominee who represents such officer or director as an officer, director, or member, or as a stockholder holding a controlling interest, in any other person who is a common carrier or is engaged in any phase of aeronautics.

(3) For any person who is an officer or director of an air carrier to hold the position of officer, director, or member, or to be a stockholder holding a controlling interest, or to have a representative or nominee who represents such person as an officer, director, or member, or as a stockholder holding a controlling interest, in any other person who is a common carrier or is engaged in any phase of aeronautics.

(4) For any air carrier to have and retain an officer or director who is an officer, director, or member, or who as a stockholder holds a controlling interest, in any person whose principal business, in purpose or in fact, is the holding of stock in, or control of, any other person engaged in any phase of aeronautics.

(5) For any air carrier, knowingly and willfully, to have and retain an officer or director who has a representative or nominee who represents such officer or director as an officer, director, or member, or as a stockholder holding a controlling interest, in any person whose principal business, in purpose or in fact, is the holding of stock in, or control of, any other person engaged in any phase of aeronautics.

(6) For any person who is an officer or director of an air carrier to hold the position of officer, director, or member, or to be a stockholder holding a controlling interest, or to have a representative or nominee who represents such person as an officer, director, or member, or as a stockholder holding a controlling interest, in any person whose principal business, in purpose or in fact, is the holding of stock in, or control of, any other person engaged in any phase of aeronautics.

2 The term "409(a) company" as used herein includes: air carriers, common carriers, and any other person or persons engaged in any phase of aeronautics.

3 209 F.2d 289 (D.C. Cir. 1953); cert. denied 347 U.S. 916 (1954).
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existed; therefore, it affirmed the Board's disapproval of the interlocking directorate.

Both phases of the case concerned Mr. Robert Lehman, a partner in an investment banking firm which dealt in the financing of companies in the air transportation industry. Since Mr. Lehman desired to act as a director of two 409(a) companies he petitioned the CAB for the approval required by the Act. In this first phase of the case, the Board, noting that Mr. Lehman and other members of Lehman Brothers held directorships in various air carriers, instituted on its own initiative a separate proceeding to determine whether the interlocking relationship provisions of Section 409(a) were being violated by the Lehman Brothers partners. The CAB consolidated both proceedings and ruled that both situations gave rise to interlocking relationships which were not in the public interest and should not be approved. The Lehman partners appealed to the United States Court of Appeals and on appeal to the court affirmed the ruling of the CAB.

In considering the first phase of the case the court held that there was a sufficient present and potential conflict of interest between the two firms on which Mr. Lehman petitioned to serve, to support the Board's disapproval of the interlocking relationship. The opinion pointed out that no actual injury need be shown as the Civil Aeronautics Act is preventive in nature and the burden of proof is on the petitioner to show that the public interest will not be adversely effected by the proposed interlocking directorate. Since one of the purposes of the Act is to free the aeronautics industry from any interlocking relationships which might impede development and competition, even a slight or potential conflict could be termed adverse to the public interest and thereby violate the Act. The ruling is consistent with the prior policy of the CAB and the courts in regard to the first phase of the case. Assuming the competitive position of the two firms and the

4 Mr. Lehman was currently serving as a director of Pan American World Airways, an air carrier some of whose business is conducted in the Caribbean. He desired to become a director of United Fruit Company, a sea carrier approximately three (3) per cent of whose business consisted of passenger transportation in the Caribbean.

5 Messrs. Lehman, Thomas, and Ehrman were directors of Pan American World Airways, National Air Lines, and Continental Air Lines respectively.

6 Lehman Brothers Interlocking Relationships Case, Docket No. 3605, including Docket Nos. 2678 and 4566, May 21, 1953, CAB E-6447.

7 Appeal from CAB ruling allowed §1006 CAA, 52 STAT. 1024, 49 U.S.C.A. §646 (1938).

8 See note 3 supra.

9 It is arguable that due to the nature of the service provided by the two concerns there is in fact no real conflict of interest or competition. United Fruit Company is primarily an importer with passenger accommodations on some of its vessels offering leisurely ocean cruises whereas, Pan American Airways provides rapid air travel. However, since both concerns actively solicit tourist traffic the position of the CAB and the court appears sound.

10 Ames—Continental Air Lines, Interlocking Relationships, 1 C.A.A. 498 (1939) (denial of petition for a common director of an air carrier and an aircraft manufacturer on the basis of potential interest conflict, i.e., possible interference with free choice of carrier when buying equipment).

Darling—Canadian Colonial Air Lines, Interlocking Relationships, 1 C.A.A. 641 (1940) (denial of petition for a common director of an air carrier and a company holding securities in various companies engaged in aeronautics wherein the CAB stated at page 647: "... the applicants have not sustained the burden, placed upon them by the statute, of showing that the public interest will not be adversely affected by the proposed interlocking relationship ...").

11 All American—Du Pont, Interlocking Relationships, 8 C.A.B. 672 (1947) (competition was between an air carrier and a common carrier serving the same general area; therefore, the interlocking relation was denied approval).

Pan American Airways—Hanes, Interlocking Relationships, 8 C.A.B. 617 (1947) (the CAB had previously approved the interlocking relationship but, be-
identity of the director, the situation falls squarely within the direct pro-
hibition of Section 409(a).

The second phase of the case presents a more interesting problem and
one which could have far reaching consequences. Here one man is not
serving as a director of two 409(a) companies; rather two 409(a) company
directors are associated by their membership in an investment banking
partnership, a non-409(a) company.15 The question that arises is whether
these partners are representatives of one another within the purview of
Section 409(a). The CAB concluded that there was representation, and
the court affirmed the Board’s finding.

Lehman Brothers is actively engaged in financial dealings with 409(a)
companies and through its investment banking business is closely associated
with the aeronautics industry as a whole.13 The court reasoned that various
Lehman partners when acting as directors cannot disassociate themselves
from their partnership interests or those of their fellow partners.14 Using
this analysis the court concluded that these partners in this firm are repre-
sentatives of one another when acting as 409(a) company directors and
thus fall within the “representative or nominee” clause of the Act. The
effect of this decision is that the determination of the question of whether
or not partners are representatives of one another will turn on the nature
of the partnership enterprise and its association with the air transportation
industry.15

Beside the approach adopted by the court the “representative or nominee”
clause of Section 409(a) permits two other approaches to this question:
(1) all partners are representatives of one another within the Act, and (2)
partners are never representatives of one another within the Act.

The court considered the first alternative that mere association of 409(a)
company directors in some non-409(a) enterprise would always make the
directors representatives of one another within the Act. However, it prop-
erly dismissed this alternative.16

cause of new passenger service offered, found an interest conflict at this later
date and struck down the relationship).

See also, 42 Geo. L. J. 140(1953); 39 VA. L. R. 975 (1953). Both publications
point out the consistency of the instant decision and the prior attitude of the CAB
in regard to the interlocking relationship between Pan American Airways and
United Fruit Company.

12 The Lehman Brothers case involved numerous situations wherein the CAB
found interlocking directorates. The final result was that all but the relations set
out in note 5 supra, were approved.

13 A substantial part of the Lehman Brothers business is the underwriting of
security issues for concerns in the air transportation industry.

14 See note 6 supra, where the CAB characterized the representation among
the Lehman partners as follows:

“... The efforts of a Lehman partner who is a director of a section
409(a) enterprise to obtain for Lehman Brothers the underwriting busi-
ness of that enterprise would be a matter of financial interest to another
Lehman partner who is a director of an air carrier which may compete
for traffic with that enterprise. In such a situation it might well be that
the prospects for Lehman Brothers obtaining this underwriting business
could be materially enhanced if a Lehman partner could arrange for less
vigorous competition for the traffic by the air carrier. If the section
409(a) enterprise were a potential supplier air craft rather than a com-
petitor for traffic, efforts to obtain underwriting business from the sup-
plier might include efforts to facilitate sale of its products to the air
carrier. ...”

15 The Lehman Brothers case should be carefully restricted; it unquestionably
does not hold that partnership relation alone creates that kind of representation
which the language of the Act seeks to prohibit. See note 16 infra.

16 Lehman v. Civil Aeronautics Board, 209 F.2d 289, 293 (D.C. Cir. 1953):

“... Community of interest due to membership in a partnership is
not in and of itself sufficient to require approval of the relationship inci-
dent to partners being directors of Section 409(a) companies. ... For
The second alternative, that association of 409(a) company directors through membership in a non-409(a) company regardless of the nature of its business never creates representation within the meaning of the Act, seems to have considerable merit, although it was rejected by the majority of the court.

The legislative history of the Act supports the second alternative. First, the Senate version of the present Act contained, in addition to "representative or nominee," the words or otherwise. These latter words were dropped when the Act was passed. This would indicate that the present Act permits some relationships which the Senate version would have excluded—perhaps partnership association. Second, Congress declined to regulate all interlocking relationships between an air carrier and an investment banking concern. Congress indicated that investment banking concerns were not to be 409(a) companies. But the court by looking to the nature of this firm to determine whether the partners represented each other, in effect, erroneously put this investment banking firm in the class of a 409(a) company as soon as more than one of its partners served as an air carrier director. Third, the basic concept of Section 409(a) is expressed in subsection (1) which makes it unlawful for one person to act as a director of more than one company without first securing approval from the CAB. To prevent circumvention of the prohibition, subsection (2) makes it unlawful for the carrier and subsection (3) makes it unlawful for the person to avoid the prohibition of Section 409(a) (1) by the use of a representative or nominee. The comments of the draftman indicate that the purpose of this "representative or nominee" clause was to prevent evasion of the prohibition against one man holding a dual directorate through the use of a strawman.

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draftman, 22

17 SEN. 3845, 76th Cong., 3rd Sess. §410 (1938):

"... it shall be unlawful ... for any person who holds the position of ... director in any air carrier to hold the position of ... director ... either directly or through a representative or nominee or otherwise ... in any other air carrier ..." (Emphasis added.)

18 It could be argued that the elimination of "or otherwise" made the "representative or nominee" clause more all inclusive or that the words "or otherwise" were merely repetitious and therefore unnecessary.

19 In 1943, H.R. 3420, to amend the Civil Aeronautics Act, was reported out of the Committee on Interstate and Foreign Commerce. Section 409 (a) (B) of this bill made it unlawful "for any air carrier to have and retain an officer or director who is an officer, director, or member of, or who controls, any other person. ... (B) who is an underwriter. ..." The bill also made it unlawful for a director of an air carrier "to hold the position of officer, director, or member" of any person who is an underwriter. Commenting on this section of the bill the House Report states: "The principal change of substance is the inclusion within the scope of section 409 of interlocking relationships between ... air carriers and underwriters. ..." H.R. REP. No. 784, 78th Cong., 1st Sess. 27 (1943). The bill was committed to the Committee of the Whole House but was not accepted.

20 Since one of the primary functions of an investment banking concern is underwriting, it would seem that investment banking partners are not prohibited per se from serving as air carrier directors. See note 19 supra, where the proposed addition to §409(a) which would have included underwriting concerns within the category of 409(a) companies was not adopted.

21 Subsections (4), (5), and (6) extend the prohibition in a similar manner to holding companies in the aeronautical industry.

22 Mr. Clinton M. Hester, Assistant General Counsel for the Treasury Department, who appeared on behalf of the Interdepartmental Committee drawing the Civil Aeronautics Act of 1938 made the following comments which became part of the Congressional record.

House Committee on Interstate and Foreign Commerce H.R. REP. No. 9738, 75th Cong. 3rd Sess. (1938) at page 45:

"15. Interlocking Directorates. H.R. 7273 prohibits any person from
The second alternative gains further support if the interlocking relationship provision of the Act is compared with the similar provision of the Public Utility Holding Company Act of 1935. The Holding Company Act declares that "... no registered holding company ... shall have, as a ... director ... any ... partner ... or representative of any ... investment banker. ..."23 If "representative" includes "partners" Congress would not have added the word "partner" in the Holding Company Act.

A literal interpretation of Section 409(a) also favors the second alternative. Such an approach would seem proper in view of the minute detail with which Congress expressed the interlocking directorate prohibitions.24

Analysis of the detailed language of Section 409(a) appears to require that present representation must be found to exist before the CAB has authority to determine whether or not the statutory relationship is detrimental to the public interest. The Act requires the having of a representative.25 In the instant case neither the CAB nor the court found present representation, only a possibility of future representation.26 Under the Civil Aeronautics Act the Board may disapprove a relationship solely because there is a possibility that in the future the relationship may adversely affect the public interest. However, before the CAB has authority to con-
sider the relationship's effect on the public interest the type of relationship set out in the Act must presently exist. It is submitted that the CAB confused the issue of relationship with that of adversity.

In the *Airlines Negotiating Conference Case* the CAB seemed to adopt the approach suggested by the second alternative. In this case various air carriers formed a non-profit organization headed by directors and executives of the carriers to act as the exclusive representative of the carriers in collective bargaining negotiations with pilots. When the CAB considered this situation it did not hold that a Section 409(a) interlocking relationship existed and thereupon approved the relationship on the basis it was not adverse to the public interest. Instead the Board held (1) that Conference members were not serving in a dual directorate because the Conference was not a Section 409(a) company, and (2) that Conference members did not represent other Conference members when serving as directors of their own air carriers.

The policy of the Civil Aeronautics Act is to prevent any type of interlocking relationship which might substantially impede competition in the air transportation industry. Another policy which should not be overlooked concerns the consideration of not unduly restricting the activities of experienced business executives. Courts have emphasized the policy of protecting competition at the expense of business freedom. The *Lehman Brothers* case is typical of this tendency. But under the circumstances of this case, and interpretation of Section 409(a) seems to justify giving more consideration to business realities.

an investment banker if he is not in any way under the control of such interest and answerable to it for his acts. Partners, since they are all principals, are never under the control of one another within the meaning of the above quotation.

Even taking the courts interpretation of representation, i.e., a partner-director represents his fellow partners when he acts in a manner beneficial to the partners, the court found no situation wherein the various directors were presently so acting.

28 Id. at 358, the CAB reasoned:
"The conference organization would not give rise to interlocking relationships within the purview of §409(a) of the C.A.A., unless the conference were found by the Board to be a person engaged in any phase of aeronautics within the meaning of that section . . . ."
"It does not appear that the conference has such a connection with the development of aviation per se as to give rise to the kind of situation contemplated by §409(a) . . . . Further, it does not appear that the conference gives rise to any interlocking relationship as between the member air carriers." (Emphasis added.)

29 See note 1 supra.

Sec. 401(d) Competition to the extent necessary to assure the sound development of an air transportation system properly adapted to the needs of the foreign and domestic commerce of the United States, of the Postal Service, and of the national defense.

Air carriers desire to obtain for their boards of directors, as do many large concerns, experienced business executives who lend their skill and advice to management. It is common knowledge, for instance, that successful banking officials are sought out for directorships of various businesses. Many examples of situations wherein bank officials (directors and officers) of the same banking institutions are also directors of various competing railroads can be found in Poor's Register of Directors and Executives, (1954).

31 Cf. The opinion of Mr. Justice Douglas in *Agnew v. Board of Governors*, 329 U.S. 441 (1947), construing the Banking Act of 1933. The language of the Act was subordinated to its broad overall policy. The court held that a firm twenty-six (26) per cent of whose gross income came from underwriting was primarily engaged as an underwriter and rejected the position that something in excess of fifty (50) per cent would be required for a holding that the concern was primarily an underwriter.