

Fall 1949

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Recommended Citation

O'Connell, Joseph J. Jr. (1949) "Air Mail Pay Under the Civil Aeronautics Act," *Indiana Law Journal*: Vol. 25 : Iss. 1 , Article 2.

Available at: <https://www.repository.law.indiana.edu/ilj/vol25/iss1/2>

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AIR MAIL PAY UNDER THE CIVIL AERONAUTICS ACT

JOSEPH J. O'CONNELL, JR.*

The subsidization by the government of an industry is almost certain, under our present economic system, to create unusual legal and economic problems, both for the industry involved and for the government agency charged with carrying out the subsidy program. In the case of young industries, as aviation, subsidy is usually resorted to as a means of forcing the growth of the industry at a faster rate than could be expected on a strict commercial basis. In such cases it is important not only that the industry be rapidly expanded but also that it be brought to a stage of development where it can be weaned from the subsidy and made to stand on its own feet. The subsidy program must be set up and administered in such a way, therefore, that incentives are provided to the management groups within the industry to work towards self-sufficiency as rapidly as possible. This program is set forth in the Civil Aeronautics Act of 1938, as amended.¹ Many legal and economic problems face the Civil Aeronautics Board in administering government assistance to the airlines through the device of air mail pay.

In 1948 the federal government paid to the airlines through the Post Office Department approximately \$112,000,000 in the form of air mail pay.² It is not unlikely that mail pay during 1949 will run at an annual rate of \$125,000,000. This money covers the carriage of all mail which moves under rates fixed by the Civil Aeronautics Board, except for Alaska and territorial carriers.³ It goes to domestic feeder⁴ and trunk lines⁵ and to

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1. 52 STAT. 973 (1938), 49 U. S. C. §§401-681 (1946). The relevant section of the Civil Aeronautics Act of 1938 will be employed in subsequent statutory references.

2. These figures and others cited in this article may be found in CAB RECURRENT REPORTS, published monthly by the Board. In *Hearings before the Committee on Interstate and Foreign Commerce on S. RES. 50*, 81st Cong., 1st Sess. (1949), appendix 1, at 489, there is set forth U. S. mail revenues received by individual carriers for the years 1946-48.

3. Territorial carriers operate within a given territory or territories, as within Puerto Rico or between Puerto Rico and the Virgin Islands.

4. "Feeder" carriers are those designed to feed traffic from small points in a given area to the larger points served by the trunk lines.

5. The "trunk" lines are: American Airlines, Inc., Braniff Airways, Inc., Capital Airlines, Inc., Chicago and Southern Air Lines, Inc., Continental Air Lines, Inc., Colonial Airlines, Inc., Delta Air Lines, Inc., Eastern Air Lines, Inc., Inland Air Lines, Inc., Mid-Continent Airlines, Inc., National Airlines, Inc., Northeast Airlines, Inc., Northwest Airlines, Inc., Transcontinental & Western Air, Inc., United Air Lines, Inc. and Western Air Lines, Inc.

international carriers.⁶ It is difficult but nevertheless important to get this sum of money in its proper perspective. One hundred million dollars to one hundred twenty-five million dollars is not small change by any means. On the other hand it is considerably less than what the government is spending to support the price of Irish potatoes. Furthermore, a substantial proportion of the total cost of air mail is made up of reasonable compensation for the carriage of the mail, money that would have to be spent in any case despite the subsidy provisions of the Civil Aeronautics Act, in order to avoid confiscation of the air carriers' property. No one would maintain that the carriers should carry the mail for nothing. Nor does the total amount of mail pay represent a net drain on the taxpayers since a considerable portion of the total is made up to the Post Office through air mail postage sales, even after deducting the reasonable expense of handling air mail on the ground. No figures exist as to exactly what proportion of the total bill for air mail represents fair compensation and what represents subsidy as provided for in the Civil Aeronautics Act. Whether the subsidy element represents \$30, \$40, \$50 or \$60 million dollars is unknown. Any estimates of the subsidy element are highly tinged with the point of view of the estimator. If he is critical of airline operations, his estimate of the subsidy element is apt to be very high; if he is an airline man, he may tell you there is no subsidy involved at all, that actually the government is making money off the down-trodden airlines. Both positions should be taken with a considerable ration of salt.

The exact amount of the subsidy payments to the air carriers is by no means the most important aspect of the air mail pay problem. Unquestionably we should know what that amount is; and the Board plans to find out what it is with the degree of precision which the present state of the accounting and cost allocation arts will permit. But if we are building up the type and the size of air transport system that we really want, if we know where we are going and are making progress toward our objective, the exact amount of the air mail pay bill is not of great significance. In terms of its potential contribution to our economy, our postal service and our defense, a well designed and properly functioning air transportation system would be worth many times the present level of mail pay.⁷ The significant problem is the

6. American Overseas Airlines, Inc., Pan American Airways, Inc., and Pan American-Grace Airways, Inc., are exclusively international carriers. In addition, nine of the trunk lines have international routes. See *Hearings before the Committee on Interstate and Foreign Commerce on S. RES. 50, 81st Cong., 1st Sess. (1949)*, appendix 1, at 489.

7. Section 2 of the Civil Aeronautics Act, which sets forth the Congressional declaration of policy for the administration of the statute, requires the Board to consider "(a) The encouragement and development of an air transportation system properly adapted to the present and future needs of the foreign and domestic commerce of the United States, of the Postal Service, and of the national defense." 52 STAT. 973 (1938) 49 U. S. C. § 402 (1946).

effect which subsidy, great or small, may have on the airlines and whether in using the device of mail pay we are working toward a sound air transportation system of the type and size that is needed. As the essence of our economic system lies in the freedom of large numbers of businessmen to make and execute sound economic decisions, the basic concern over mail pay is whether or not it leads airline management to behave like businessmen and to make their decisions as businessmen normally do.

The Civil Aeronautics Act of 1938 gives the Board the power to fix mail rates. It was passed at the end of four-year's of turmoil⁸ which had started with the cancellation of mail contracts and the start of competitive bidding for air mail routes. The Act concerns civil aviation in general and air transportation in particular, both the economic and safety phases of the problem. The Civil Aeronautics Act of 1938 is a very broad statute. Besides the usual regulatory provisions to be found in virtually every statute governing public utilities and transportation, the Act contains strong and unequivocal language to the effect that it is the policy of the government to promote and foster the rapid growth of civil aviation and air transportation.⁹ Such promotion is to be provided for through decisions of the government agencies concerned, through increased and more stringent safety controls, through regulated competition over routes, and last, but by no means least, by backing up air transportation with cash in the form of mail pay.

Section 406(b) of the Act provides specifically for paying the carriers mail pay in excess of the compensatory rates for mail carriage.¹⁰

Sec. 406(b) . . . In determining the rate in each case, the Authority shall take into consideration, among other factors, . . . the need of each such air carrier for compensation for the transportation of mail sufficient to insure the performance of such service, and, together with all other revenue of the air carrier, to enable such air carrier under honest, economical, and efficient management, to maintain and continue the development of air transportation to the extent and of the character and quality required for the commerce of the United States, the Postal Service, and the national defense.

8. More than 30 bills dealing with the subject of aviation regulation were introduced between 1934 and 1938. For example, see the testimony of the late Colonel Edgar S. Gorell, then president of the Air Transport Association of America, in *Hearings Before Subcommittee of the Committee on Interstate and Foreign Commerce on S. 2 and S. 1760*, 75th Cong., 1st Sess. 498 (1937).

9. This is especially illustrated by § 2 of the Act, which contains the declaration of policy. The declaration in effect directs the Board to promote a single type of transportation and as such is distinctive in the transportation field. This has been criticized by one of the leaders in railroad transportation. See Young, *A National Transportation Policy*, 12 LAW AND CONTEMP. PROB. 621, 631 (1947).

10. The administration of § 406(b) of the Act up to mid-1946 is extensively described in Burt and Highsaw, *Regulation of Rates in Air Transportation*, 7 LA. L. REV. 378, 393 (1947).

In effect, this section constitutes a directive to the Board to provide the carriers with the mail pay they *need* to maintain and develop an air transportation system, unless other circumstances or other considerations outweigh the policy as set forth. The Board has so interpreted the section and has acted accordingly. There does not appear to be any widely held view that the Board does not have to meet the carriers' needs. The Board has, however, frequently refused to underwrite with mail pay certain costs of the carriers, either because the costs were not reasonably incidental to air transportation or because they were higher than appeared reasonable. But these "disallowances" have not altered the basic approach of the Board to the "need" provisions of 406(b). The policy set forth in the first rate case, *Mid-Continent Airlines*,¹¹ in the first volume of *Civil Aeronautics Board Opinions* is in broad outline much the same policy that the Board is now pursuing.

In addition to knowing about the statutory authority to fix mail rates, the procedures used for fixing rates are also important. Down through the war, mail rates were set on the basis of what amounted to an adversary proceeding in which the Board's Public Counsel and the attorney for the air carrier went through all the steps of pre-hearing conference, hearing before an examiner, examiner's report and oral argument before the Board. Ultimately the Board issued its opinion. In recent months a new procedure known as the conference procedure has been developed.¹² Under the conference procedure, a group of Board analysts and a lawyer are assigned to the mail rate proceedings of a particular carrier. They make an analysis of the carrier's operations and costs on the basis of figures and reports—routine and special—which the carrier submits. After a period of study of this material, a tentative "case" is prepared and the staff and the management of the carrier sit down in a conference to discuss various aspects of the case. In the conference the reasons for apparently excessive costs are discussed in full. It may be that the carrier's management can provide the staff with valid reasons why its costs are so high, or they may only be able to justify a portion of the apparently excessive costs. Whatever the issues, the staff ultimately comes to the Board with a proposed tentative statement of findings and conclusions and an order which requires the carrier concerned to show cause why a given rate should not be prescribed by the Board for the period involved. After approval or modification by the Board, the statement and order are issued and the carrier then either accepts the rate—by not objecting to its establishment—or alternatively it objects to the rate or certain aspects of the rate. In the event of objection, the questions in issue are taken to a full

11. 1 CAA 45 (1938).

12. Revised procedures for the informal mail rate conference have just been promulgated as Amendment 4 to Part 302 of the CAB Procedural Regulations, Dec. 20, 1949.

hearing. If the carrier accepts the rate, there is a *pro forma* hearing for the purpose of permitting any interested outside party a chance to comment on the rate,¹³ following which the rate is made final.

Three other factors are requisite to an adequate appreciation of where the Board and the industry are going in the mail pay field: (1) the state of the Board's rate docket, (2) the availability to the carriers of the "protective" rate petition, (3) the nature and extent of cost disallowances in mail rate proceedings.

In early 1948 all but two of the domestic trunk-lines, all of the feeder lines, and all of the international carriers had applications before the Board for increased mail rates pending. This meant that from the date of each carrier's petition until the Board set a so-called final rate, the carrier was in a position to collect from the government all costs (less disallowances) plus a fair return on its used and useful investment, to the extent that this total amount was not covered by commercial revenue. It was on a cost-plus basis with respect to its mail pay, rather than a fixed price basis. Since that time the Board has made considerable progress in finalizing mail rates for past periods and in placing the domestic trunk and feeder carriers on so-called final rates for future periods. Show cause orders have been issued to seven of the sixteen trunk-lines and to six of the thirteen operating feeders.¹⁴ It is important that the carriers be placed on final rates, since a carrier has a mail rate case pending before the Board from the date that either it or the Board files a petition for an upward or downward adjustment in the rate. The Board's position is that it has no right to go into a rate behind the date of a petition. The Circuit Court of Appeals for the District of Columbia has upheld this view in both the *TWA* and *PCA* rate case and the *TWA* case has

13. Under § 302.4 of the Board's Procedural Regulation, it is not necessary to be a formal intervenor in order to appear and comment at the hearing.

14.	<i>Trunklines</i>	<i>Serial Number</i>	<i>Date</i>
	Continental	E-982	11-7-47
	Chicago & Southern	E-1740	7-1-48
	Delta	E-1959	9-7-48
	Braniff	E-1931	9-2-48
	Capital	E-2675	4-1-49
	Western	E-2333	12-31-48
	Inland	E-2334	12-31-48
	<i>Feeders</i>		
	Monarch	E-2628	3-25-49
	Challenger	E-2477	2-21-49
	Empire	E-1897	8-25-48
	Pioneer	E-528	5-5-47
	Southwest	E-1478	4-27-48
	West Coast	E-2492	2-17-49

been affirmed by the Supreme Court.¹⁵ When a final rate is established the carrier is placed on its own. It must operate within the mail rate fixed and has an incentive to make a profit on that rate through its own efforts. A current rate docket is thus of great importance to an adequate mail rate program which will furnish the necessary economic spurs to management.

Even if the docket were current, much of the force of the incentive provided by a final rate is removed by the device of the "protective" petition. The carrier is entitled to file a protective petition for a higher rate the day after the final rate is established, enabling it to sit back, secure in the knowledge that it can recoup its losses in mail pay except to the extent that such costs are reduced by disallowances. The only risk it faces is that the disallowances will be so large that it will end up with a rate lower than the one under which it is operating. The device of the protective petition coupled with the large backlog of mail rate proceedings makes it possible for a carrier to operate on a cost-plus basis. Obviously the Board must be able to deal with protective petitions promptly upon filing.

The problem is brought into sharper focus when the type of cost disallowances that are typically made as a result of Board action are considered. These disallowances may be classified roughly into four categories. There are, first of all, disallowances of cost on the basis that they should have been capitalized. The Board recently announced, for example, that the costs incidental to the grounding of new type aircraft were properly capitalizable

15. TWA filed a petition on March 14, 1947, requesting that a rate be fixed back to January 1, 1946. PCA's petition, filed on January 14, 1947, requested a rate back to June 1, 1942. In both cases, final rates had previously been established and were in effect at the time the petitions were filed. The Board, with one member dissenting, held that it had no authority to fix a new rate for an operation during a period in which a final rate previously fixed by the Board was in effect and unchallenged by the initiation of a mail rate proceeding, and dismissed the petitions insofar as they requested rates for a period prior to filing. 8 CAB 685 (1947). (The writer was not a member at the time.) The Circuit Court of Appeals for the District of Columbia unanimously upheld the Board's decision in both cases. *Transcontinental & Western Air, Inc. v. Civil Aeronautics Board*, 169 F. 2d 893 (App. D. C. 1948), *Capital Airlines, Inc. v. Civil Aeronautics Board*, 171 F. 2d 339 (App. D. C. 1948). After affirming the decision below in the TWA case, 336 U. S. 601 (1949), the Supreme Court denied *certiorari* in PCA. 69 Sup. Ct. 890 (1949). Justice Douglas, writing for the majority, agreed with the court below and the Board that the language of § 406 of the Civil Aeronautics Act was similar to that normally used in granting authority to make public utility rates, which are essentially prospective in nature, and never made effective for a period prior to inauguration of proceedings. The Court further found from the legislative history of the Act that the provision in § 406 giving the Board authority ". . . to make such rates effective from such date as it shall determine to be proper . . .", was inserted only to make clear that the rates could be made retroactive to the date of the inauguration of a rate proceeding, there having existed some doubt at the time whether even that much was permissible. Justices Jackson and Frankfurter, dissenting, felt since mail rates contain an element of subsidy, the rate-making by the Board is not analogous to rate-making for a railroad or a public utility, and found in an ordinary reading of the "make effective" clause of § 406 an intention by Congress to give the Board the flexibility needed to aid the development of air transportation.

to be amortized over a five-year period.¹⁶ This type of disallowance does not affect, of course, the eventual mail pay income of the carrier. There are, secondly, certain disallowances made because the costs or the capital item are not used or reasonably connected with air transportation service. For example, the Board has been fairly stringent in disallowing for rate making purposes costs of entertainment and contributions. Third, there are disallowances because of excess capacity. Until recently the Board has been fairly liberal with regard to this type of disallowance, but there may well be a tightening up in this area as load factors¹⁷ decline and more and more excess capacity appears in the industry. Finally, there are disallowances made on the basis that the particular costs of the carrier are so far out of line with the costs of comparable carriers that they can only be ascribed to poor or inefficient management and management techniques. A number of recent cases show substantial disallowances of this type.¹⁸

In dealing with rates for a past period, the Board and its staff are under a serious handicap in making disallowances from airline costs and capital structures. As a practical matter the burden of proof is on the regulatory agency to prove the disallowance rather than on the utility to justify the

16. This originally was announced on February 21, 1949, in a special policy statement of the Board entitled *Economic Program for 1949*.

17. Load factor refers to the proportion of the seating or over-all weight capacity of an aircraft which is utilized by traffic—number of passengers, or the weight of passengers, cargo or mail. For example, if a plane has a pay load of 10,000 pounds and there are 6,000 pounds of traffic on board it is said that the plane has a 60 per cent load factor, or a DC-3 having 21 seats and 14 passengers aboard would be said to have a 66 2/3 per cent load factor.

18. See Northeast Airlines, Inc., Mail Rates, Dockets Nos. 1932 and 1890 Order Serial No. E-1230, Feb. 26, 1949. The Board compared Northeast's DC-3 maintenance costs with a group of eight representative carriers, and after taking into consideration various differences, disallowed \$8.59 per hour flown. After discussing in detail the more important factors, the Board concluded:

The disallowances in the reported maintenance costs are made with full recognition of the importance of proper maintenance to the safety of air transportation. However, in the instant case we have allowed Northeast a unit maintenance cost for DC-3 operations approximately 30 per cent higher than the experienced unit cost of a representative group of carriers and we believe that the excess costs reported by Northeast over and above the reasonable level of \$32.75 per hour allowed herein result from the failure of Northeast to establish more effective cost controls. We are of the further opinion that the excessive costs have not resulted from special maintenance techniques directed at improving safety and have made no additional contributions toward greater safety which, under cost controls, consistent with minimum standards of economical and efficient management, are not herein adequately provided for by the allowance of \$32.75 per hour flown.

See also Chicago and Southern Airlines, Inc., Mail Rates, Dockets Nos. 1335 and 1897 Order Serial No. E-1825, July 28, 1948. The Board compared C. & S. unit costs with a group of five representative carriers, and after considering in detail, and adjusting for, recognizable differences, arrived at an allowable unit cost of 30 cents per available ton-mile, before depreciation, which resulted in a disallowance of a little over \$1,000,000 for a 12-month past period.

cost. Patently the management of a carrier is in a much more favorable position to defend its past actions than is the Board's staff to attack the level and nature of costs. Even a poor lawyer could come up with a long list of reasons showing why his client's apparently high maintenance costs were not really excessive. He would point out that the carrier operated over rough terrain, necessitating the use of extra power, the weather was bad, labor in the particular section of the country was high priced and of poor quality, the airports were rough and hard on the tires, there was an unusual amount of taxiing involved which was hard on the engines, and so on. Most of the carrier's contentions have some basis in fact, but the total aggregate weight of these arguments is difficult to appraise. This is particularly true because disallowances which are too large tend to defeat the purposes of the Act in that they may so weaken the carriers that they no longer are in a financial position to develop their routes and services in the most sound and expeditious manner.

The Board has met with criticism for not establishing apparently desirable objective standards of airline costs. The critics, however, undoubtedly underestimate the difficulty of establishing useful standards and overestimate the benefits which would be derived therefrom. The Board already has the standard of comparative costs. In all probability, objective standards would tend to be set in accordance with current average levels of managerial proficiency in the industry and would perhaps not establish permissible cost levels appreciably below the present comparative level. So it is probable that the results in terms of disallowances would not be substantially different from the current method of disallowing costs unexplainable in comparison with other carriers. It is hoped that the Board can establish reasonable objective standards for station costs, for maintenance, for traffic and sales, for passenger service and other items, particularly overhead items. But it would be wrong to suppose that their presence will cut our air mail pay bill appreciably. The total of the disallowances which have been made in recent rate cases is relatively small and those which have been made have had to do more with the economics of the carrier rather than with its efficiency. This is not surprising, for while there is undoubtedly some inefficiency and waste in the airlines today, in their failure to cooperate more actively in establishing joint terminal and ticket facilities, it is doubtful if it can be demonstrated that the carriers are really inefficient in the orthodox meaning of the term.

The words "honest, economical and efficient" as used in Section 406(b)¹⁹ are usually spoken in one breath and it is a little difficult to differentiate between at least the last two. The word "efficiency" seems to represent a concept of output relative to input. This would be judged primarily by the amount of transportation produced by a given number of employees, the

19. For pertinent portions of § 406 (b) see *supra* at 29.

amount of transportation which can be generated by a given amount of capital applied to the business, etc. On the other hand, "economical" connotes such questions as whether or not the carrier and the carrier's management arrive at decisions which make reasonable economic sense. For example, are they offering an amount of capacity which is based on reasonable levels of demand or are they offering capacity which is far in excess of that demand? Is their pricing, that is, their rates and fares for the carriage of passengers and property, so designed as to maximize their revenues and their profits or are they established with no clear objective in mind and allowed to drift along as best they may? The word "economical" implies an ability to plan sufficiently far in advance as to be prepared to meet the contingencies of both operations and traffic at the time that they may arise, granted, of course, that no forecasting or planning can be perfect. An economical management is one which would exercise a reasonable care and prudence in terms of the financial plans that it worked out. These plans should take into consideration the basic nature of air transportation and the possibility, if not probability, that the industry and the particular carrier concerned will be faced sooner or later with difficult periods during which the impact of a heavy debt structure and related fixed charges will be particularly onerous, perhaps crushing.

It is not clear that all of our air carriers have an economic management in the above sense, and a very definite relationship appears between what has been here termed a lack of economic management and the various aspects of air mail pay and subsidies. The question of capacity is illustrative. Airline load factors since the war have dropped steadily and are now at a point below that attained prior to the war.²⁰ While the Board can make disallowances for excessive capacity operated, the amount of schedule analysis necessary to determine the disallowance is tremendous and can only be undertaken in the most flagrant cases. Further, a disallowance after the fact is not the ideal solution to the problem. In recent rate cases involving the future period the Board has adopted a sliding scale formula which provides for higher rates of return on the carrier's investment at higher load factors. Some incentive is provided to management by this formula to control excess capacity, but it is greatly weakened by the ability of the carriers to file protective rate petitions. The usual economic consequences of over-production in industry and in other public utilities thus do not impinge on airline managements. The inevitable result has been, is, and promises to be, the operation of excess capacity, the costs of which are borne by the government.

Another instance of the effect of subsidy on airline management concerns route patterns. Under the Act and the present concept of establishing mail rates a carrier is virtually assured that the government will make up any losses

20. CAB RECURRENT REPORTS.

involved in operating a given route pattern, provided there is not flagrant overscheduling. The question arises: What incentives are provided either in the Act or by our mail rate action which would lead the carriers now and in the future to be sure that its routes were laid out in the best possible manner, that highly uneconomical points were eliminated and that its operations over a given route made good economic or business sense? There are no such incentives. In the last year there have been no instances where a carrier has come to the Board and said, "Look, this route is uneconomic and we believe that you should allow us to give it up." Indeed there have been only three instances of where carriers have urged the abandonment of points on a route.²¹ Of course, the responsibility is on the Board to lay out and maintain a sound and economic route pattern, but it is unlikely that the carriers will give the necessary assistance to the Board unless they have an economic incentive. What has been said with respect to routes and points on routes applies with equal force to questions such as interchange.²² Most of these that have been presented to the Board are based not upon a series of economic decisions but rather as defensive actions in an adversary proceeding, as in *Delta-American*,²³ *Delta-Chicago and Southern*,²⁴ *Capital-National*,²⁵ *National-Panagra*.²⁶ The extent to which these proposals make economic sense is purely incidental because the incentives to management are essentially non-economic.

Next consider the question of airline financing, over which the Board has no jurisdiction. Few incentives exist in either the Act or in Board mail

21. Instances where carriers have urged abandonment of points on a route include Chicago and Southern at Peoria, Bloomington and Urbana; American Airlines at Abilene and Big Springs; Northeast Airlines at Riverhead and Islip.

22. The question of the extent to which carriers shall be permitted to interchange equipment is of particular difficulty. A recent decision of the Board is *Capital-National Interchange Agreement*, Docket No. 3291, adopted April 28, 1949. Supplemental Opinion and order adopted July 28, 1949, deals with this problem. See also Westwood & James, *Compulsory Interchange of Aircraft Between Connecting Air Carriers*, 34 VA. L. REV. 1 (1948).

23. *Delta-American Interchange Agreement Case (Temporary)*, Docket No. 3609. Decided August 30, 1949—Permanent authorizations pending decision in Southern Service to the West Case, Docket No. 1102 *et al.* The agreement calls for the interchange of DC-6 equipment between the carriers so as to provide single plane service between points on Delta's routes such as Miami, Atlanta, Birmingham and New Orleans and points west of Dallas, particularly Los Angeles and San Francisco. This interchange is now in operation.

24. *Delta-Chicago and Southern Interchange Agreement*, Docket 3644, Consolidated with Through Flight Investigation, Docket No. 3426—pending examiner's report. The agreement contemplates an interchange of equipment at Memphis on condition that Delta is awarded a route between Birmingham and Memphis.

25. *Capital-National Interchange Agreement*, Docket No. 3291, decided April 28, 1949. Supplemental Opinion & Order adopted July 28, 1949. The agreement calls for an interchange of equipment at Washington to provide one plane service between such Capital points as Pittsburgh, Buffalo, Detroit, etc., and National points such as Miami, Jacksonville, Tampa, etc. Interchange not yet in operation.

26. *National-Panagra-National Route Transfer Case*, Docket No. 3500 *et al.*—further rehearing conference assigned for Oct. 7, 1949. The agreement calls for "trackage" rights for Panagra and Pan American aircraft over the routes of National to New York.

rate action, which make it imperative and compelling upon the carriers to finance themselves in the soundest conceivable way so that they will not only have adequate funds to meet their capital obligations, but also so that their capital structures may be reasonably depression-proof. The record of the growth of airline debt since the war is almost irrefutable evidence of the lack of such incentives. In large part this incentive has been removed as the present Act tends to operate as a shield between the air carriers, and the ultimate in economic penalties—bankruptcy. Bankruptcy is, after all, in private enterprise the principal astringent for washing away uneconomic operations. In the air transportation business, as it is conducted today, this astringent is no stronger than water. Because of this factor, and perhaps also because the Board has no power to regulate the airlines' security issues, the financial structures of many of the air carriers have deteriorated to a remarkable extent.

These three instances (capacity, routes and financing) are perhaps sufficient to indicate the lack of economic incentives in the present Act, particularly in Section 406(b), and the way mail pay is now administered under that section.

The year 1949 constitutes a kind of crossroads in the development and evolution of air transportation. In the first place, the carriers will probably end the year in a much stronger position than at any time since the end of the war, due partly to increased mail pay and the establishment of final mail rates and partly because of the installation of new and more efficient equipment and a general shaking down of post-war problems.

In the second place, partly because the post-war crisis appears to be under control, we appear to have reached the point where serious consideration must be given to the question of how to provide the economic incentives to air carrier management which appear to be lacking now. If exploration as to the ways in which these incentives may be provided is not started promptly, our air mail pay bill can be expected to continue to rise. More important, the economic soundness of our air transportation system may be seriously and permanently undermined because of the atrophy of the ability of airline management to behave like businessmen. Accordingly, we should consider the steps which must be taken before we will be in a position to say whether, and if so, how, Section 406(b) must be amended.

Some action along these lines has already been taken by the Board in connection with its recently issued *Economic Program for 1949*.²⁷ A start has been made in the direction at least of arranging for the collection of the necessary factual material upon which an ultimate decision can be made, but this is barely more than statement of good intentions. In the *Economic Pro-*

27. A mimeographed copy of this statement, dated February 21, 1949, may be secured from the Secretary, Civil Aeronautics Board.

gram for 1949 there is first of all the investigation into the economy and efficiency of the so-called "Big Four."²⁸ These are the three largest trans-continental systems²⁹ and Eastern Air Lines. Together these four carriers provide about seventy-five per cent of the domestic trunk-line scheduled air transportation and receive approximately forty-seven per cent of the mail pay to domestic trunk-lines.³⁰ Without a thorough investigation into the economy and efficiency of the operations of these carriers, it is difficult to approach the problem of air mail pay and impossible to make serious efforts toward the establishment of cost standards. This group of carriers, incidentally, is the one which the Board has maintained should be able to operate without subsidy and with mail pay only sufficient to provide them fair compensation for the carriage of the mail on a cost basis. In other words, these carriers are not supposed to be in the "need" class. With the exception of Eastern, however, these carriers have each shown large losses in 1947 and 1948 at rates of mail pay which were at least tentatively computed by the Board to represent the fair compensation for the carriage of the mail. The purpose of the investigation and the related mail rate proceedings for these carriers³¹ is to determine to what extent lack of economy and efficiency may have had a part in these losses or whether in the alternative they must be regarded as "need" carriers and receive subsidy under Section 406(b) of the Act.

A second investigation which is getting under way and which was announced in the Board's program is an investigation into the cost of carrying the mail.³² The purpose of this study is to determine a reasonable and fair basis on which to allocate to mail that portion of direct and indirect costs which it should bear. The Board is fully aware that in an industry which involves extensive joint costs, no mathematically precise and unassailable formula of the cost of mail carriage is possible. On the other hand, a reasonable guess is not now possible as to mail costs. Nor is there even an approximate notion of the cost of the various special services involved in the handling of mail available. To consider one instance, mail has priority over passengers, although it cannot off-load passengers at intermediate points. The Board, the Post Office and the general public are entitled to know the extent that this priority impinges on the over-all costs of the carrier. Perhaps the cost is negligible, perhaps substantial. We do not now know, although with study at least a reasonably approximate answer appears possible. There is little

28. Order Serial No. E-2483, February 21, 1949.

29. American Airlines, Inc., Transcontinental & Western Air, Inc., and United Air Lines, Inc.

30. CAB RECURRENT REPORTS.

31. Order Serial Nos. E-1351, 1352, 1353, 1354 and 1355, March 29, 1949, also E-1517, E-1518, E-1519, E-1520 and E-1524, May 7, 1948, also E-2484, February 21, 1948 and E-2862, May 25, 1949.

32. Order Serial No. E-2487, February 21, 1949.

doubt that the cost of mail study will result in an answer that the cost of handling mail is substantially different for various classes of routes and operations. It would seem likely that the ton-mile cost of transcontinental mail is substantially less than the carriage of mail between, say, New York and Washington. This is, of course, true for all classes of traffic and is recognized by the Board in, for example, various freight tariffs and minimum levels of rates.³³ The Board must have a far better understanding of other aspects of the cost of carrying the mail. For example, is mail easy or hard to handle? Is the volume of mail relatively stable and are the peak loads predictable? What proportion of the ground-handling, which in the case of express and freight must be performed by the carrier, is performed by the Post Office in the case of mail? It is this kind of question in which the Board is interested. By the time that the cost of mail service investigation is completed, some of the answers should be available.

Two other investigations which were ordered as part of the Board's program for 1949 deserve mention at this point. One concerns the feasibility of having the carriers enter into a larger number of joint facility agreements at airports and city ticket offices,³⁴ the other is an investigation into freight rates.³⁵ With respect to the freight rate investigation, the Board's objective is to establish a pattern of rates in this youngest branch of air transportation which will permit the maximum development of the market and at the same time provide fair compensation for the carriers. A growing volume of evidence indicates that this cannot be successfully done under the present tariff structure pieced out here and there by commodity and so-called back-haul rates. The Board is not wedded to the idea of a class rate structure. On the other hand, it is convinced that the freight business should be entirely self-supporting to the end that it may decrease and not increase the level of subsidy required.

These investigations will be of value in solving immediate mail rate cases and problems and in establishing objective cost standards. If properly and vigorously conducted, they will be of even greater value in that they will provide the necessary basis upon which to make future decisions concerning the use of mail pay. They should point the direction in which we must move if we are to provide the necessary economic incentives which are essential to the maintenance and development of a sound air transportation system. In the first place, the availability of the data contained in these investigations

33. The *Air Freight Rate Investigation*, Order Serial No. E-1639, June 2, 1948, established minimum freight rates of 16 cents per ton-mile on the first 1,000 ton-miles of any shipment, and 13 cents per ton-mile for ton-miles in excess of 1,000 ton-miles in any one shipment.

34. Order Serial No. E-2485, February 21, 1949.

35. *Class Rate Investigation*, Order Serial No. E-2486, February 21, 1949.

will put the Board in a position to tell with some degree of accuracy what portion of total mail pay can be regarded as subsidy and what portion represents fair compensation for the carriage of the mail. The necessity of having this breakdown is becoming increasingly apparent; its need by the Post Office Department is pointed out in the recent Hoover Commission Report.³⁶ Congress and the people need it to tell the cost of supporting the air transport system.³⁷ The airlines must have it in order to keep them under constant pressure to achieve self-sufficiency. Finally, it is needed by the Board in order to permit it to appraise its regulatory and developmental actions in route and commercial rate fields in terms of cost to the government.

Various objections have been raised in the past to breaking down mail pay into fair compensation and subsidy. The carriers have opposed it, presumably because there is considerable opprobrium attached to the word "subsidy" in polite business circles. Another argument is that if the subsidy element were separated, it would tend to become a political football. The advantages of separating the subsidy appear to outweigh the disadvantages and dangers. From the standpoint of a sound air transportation system these advantages would be to hold constantly before the carriers and the Board the dollar amount of the subsidy. This would provide a considerable incentive to the carriers to put themselves in a sound economic position and it would make it far easier for the Board to determine those areas where service being performed by the carriers was uneconomic.

The investigations which the Board recently inaugurated should also provide it with the data needed to appraise other aspects of Section 406(b) as presently written. Some of the other changes necessary to this section, such as the elimination, or at least control, of protective petitions now appear obvious. On the other hand, it may be that this and other shortcomings of the section can be corrected within the present legislative framework. Although certain shortcomings in Section 406(b) as presently written and administered undoubtedly exist, before saying that it must be abandoned or radically altered, it is desirable to have a carefully thought out alternative. In the year ahead the Board, the carriers, the Congress and others interested in air transportation will have an opportunity to appraise critically this important segment of our aviation statutory framework. If this opportunity is not grasped and made the most of, we will have seriously shirked our responsibilities.

There is little doubt that we can and will succeed in recreating an atmosphere and a legislative framework in which air transportation can move

36. Task Force Report on Regulatory Commissions [Appendix N], prepared for the Commission on Organization of the Executive Branch of the Government (1949) at 75-77.

37. A number of bills have recently been introduced in the Congress which are directed toward this end. See, for example, S. J. RES. 92, H. J. RES. 331, S. 1431, H. R. 2908 and S. 2437, all 81st Cong., 1st Sess. (1949).

forward on sound economic lines. This does not mean that a meat-ax approach to the problem of subsidy must be taken, throwing the industry into the kind of turmoil in which it found itself preceding the passage of the Civil Aeronautics Act of 1938. Nor does it mean that the government and the industry can continue along the lines followed since the war, no matter how comforting to the airlines that course of action might be. Between these extremities lies the road to be followed if the development of an air transportation system which is privately owned and managed and which rests on a sound economic foundation is to continue.

