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Notre Dame Law Review

Volume 34 | Issue 3 Article 7

5-1-1959

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Alfred A. Kaelin, *Legislation and Administration: Air Law -- Supplemental Air Carriers -- CAB Grants Certificates of Public Convenience and Necessity for Supplemental Air Service to 23 Applicants*, 34 Notre Dame L. Rev. 439 (1959).
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LEGISLATION AND ADMINISTRATION

AIR LAW — SUPPLEMENTAL AIR CARRIERS — CAB GRANTS CERTIFICATES OF PUBLIC CONVENIENCE AND NECESSITY FOR SUPPLEMENTAL AIR SERVICE TO 23 APPLICANTS. — A recent order of the Civil Aeronautics Board has granted certificates of public convenience and necessity to twenty-three applicants deemed by the Board to be qualified to engage in "supplemental" domestic carrier air service. The certificate authorizes unlimited planeload charter carriage and individual-sales service limited to ten directional flights per month between any two points within the United States. *Large Irregular Air Carrier Investigation,* CAB Order No. E-13436 (Jan. 28, 1959).

This decision has presumably culminated a general investigation begun in 1951[1] to ascertain the status of the so-called "Large Irregular Air Carriers" and the applicable policy relative to determining the class' proper position in the scheme of civil air regulation.[2] The history of the irregular carriers discloses a pattern of growth closely paralleling the remarkable development and ever-increasing utilization of route system carriers in this country since the passage of the Civil Aeronautics Act of 1938.[3] Unknown as a category of air transport at the time of the passage of the act,[4] it was soon apparent that to subject these carriers to the rigid certification requirements[5] of the route system would be both "impractical and inequitable."[6] Accordingly, they were exempted from certification under the statutory exemption authority,[7] and the exemption continues today under a regulation which emphasizes "services . . . of such infrequency as to preclude any implication of a uniform pattern or normal consistency of operation between, or within, such designated points"[8] as the essential element of definition.

World War II provided the impetus for the expansion of the irregular carrier services, as well as for the air-transportation industry as a whole. Military-trained aviators returning to civilian life found opportunity in the irregular carrier service to enter the air transport business with a relatively small capital outlay, utilizing their technical training and the surplus war aircraft available. The scope and variety of the services offered steadily expanded, until in 1955 some fifty irregular carriers were in operation and the service boasted a previous year's total of 1,252,680,000 revenue passenger miles and 54,249,000 cargo ton miles.[9]

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1 Large Irregular Air Carrier Investigation, CAB, Order No. E-5722 (Sept. 21, 1951). See Modern Air Transport Exemption, 14 C.A.B. 459, 480 (1951).

2 There seems to be dissatisfaction with the final disposition of the case on both sides with the authorized supplemental carriers claiming that the ten-trip proviso is "so limited that it isn't very economic," and the scheduled carriers and railroads presumably planning a court test of the Board's right to issue a limited certificate. Am. Aviation, Feb. 23, 1959, p. 42.

3 52 Stat. 973 (1938) (now Federal Aviation Act of 1958, 72 Stat. 731, 49 U.S.C.A. §§ 1301-1542 (Supp. 1958) [hereinafter cited as F.A.A.].

4 Craig, *A New Look at Section 416(b) of the Civil Aeronautics Act,* 21 J. AIR L. & COM. 127, 130 (1954).

5 Civil Aeronautics Act, § 401(a), 52 Stat. 987 (1938) (now substantially F.A.A., § 401(a), 49 U.S.C.A. § 1371(a) (Supp. 1958). "No air carrier shall engage in any air transportation unless there is in force a certificate issued by the Authority authorizing such air carrier to engage in such transportation. . . ."

6 See Netterville, *The Regulation of Irregular Air Carriers: A History,* 16 J. AIR L. & COM. 414 (1949).

7 Civil Aeronautics Act, §§ 416(a)-(b), 52 Stat. 1004-05 (1938) [hereinafter cited as C.A.A.].

8 14 C.F.R. § 291.1 (1957). For an excellent discussion of the concept "irregular" as used in the various regulations, see Netterville, *supra* note 6, at 419-23.

9 Large Irregular Air Carrier Investigation, CAB Order No. E-9744 (Nov. 15, 1955), 1955 U.S. & Can. Av. 559, 560-61.

Recognizing, perhaps, that the situation was becoming unstable,[10] the Board in 1955 undertook to define its policy in relation to the large irregular carriers in a proceeding which consolidated some sixty-six applications for continued, enlarged and original exemption authorizations.[11] Significantly, there were a large number of intervenors in the proceeding including the principal certificated domestic route carriers, civic and governmental bodies, railroads, and industry associations. The impetus of irregular carrier competition seemed to have had a substantial effect on the transportation industry. In what must be termed an all-important victory for the large irregular carriers, the Board, in a 3-2 decision, cited the accomplishments of the special service carriers, found a genuine public need for the continuation of this service, and adopted a policy "directed toward their survival and continued healthy growth, subject to the overall objectives of the Act and a proper relationship to our certificated air carrier system."[12] In furtherance of this policy, the carriers were designated as "Supplemental Air Carriers" since their former name was rendered inappropriate by the elimination of the existing restriction against regularity.[13] The Board granted interim authority to the supplemental carriers (pending final decision as to individual qualifications) to: 1) conduct unlimited charter operations on a full planeload basis for carriage of passengers and property in domestic, overseas, and territorial operations (Alaska excepted); 2) conduct a maximum of ten individual-sale flights in the same direction between any two points in any calendar month.

The instant decision dealt primarily with the form in which the final authorization should be granted. Confining its decision strictly to domestic service, the Board affirmed the unlimited charter service and the ten trip individual-sale provision[14] and ordered that final authorization be granted under certificates of public convenience and necessity. The Board found authority for its action by interpreting the broad policy of the Federal Aviation Act to reflect Congress' intent to develop the nation's air transport system primarily by certification.[15] Since the carriers had proven to be a significant part of the system, their "continued healthy growth" was an important objective in this scheme. The Board felt that this growth would best be "fostered by an authorization embodying the stability, dignity, and protection of a certificate, rather than an exemption."[16] Intervenors in the case were, for the most part, certificated route carriers and railroads, again reflecting the competitive pressures of the supplemental system.

In order to do justice to the order in the way of criticism, the entire setting must be analyzed in the light of relevant economic factors, since the avowed policy of both the Civil Aeronautics Act, and its successor, the Federal Aviation Act, for the purposes of this problem, is to encourage and develop an air transportation system properly adapted to the public need, to foster sound economic conditions in such transportation, and to regulate competition in the public interest to prevent destructive practices.[17] Since the specific situation was not contemplated when the original act was passed,[18] perhaps legal technicalities should give way to sound economic policy in this respect.

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10 "In recent years, this [exemption] section has reached a level of importance which, if left unchecked, could render all outstanding certificates of public convenience and necessity mere pieces of paper of no greater value than a World War II ration coupon." Craig, *supra* note 4, at 127.

11 Large Irregular Air Carrier Investigation, CAB Order No. E-9744 (Nov. 15, 1955), 1955 U.S. & Can. Av. 559.

12 *Id.* at 564.

13 The requirement that the carrier's services be kept on an irregular basis was somewhat nebulous and presented perplexing problems of administration. See generally Netterville, *supra* note 6, at 419-23. An attempt to define standards of irregularity to be used by the Board may be found in an interpretation of Part 291 of the Economic Regulations, 14 C.F.R. § 291 (1957).

14 The Board held that the replacement of three members of the CAB since the 1955 decision did not warrant reconsideration of that decision. 27 U.S.L. WEEK 2418 (CAB Jan. 28, 1959).

15 Large Irregular Air Carrier Investigation, CAB Order No. E-13436, at 4 (Jan. 28, 1959).

16 *Id.* at 5-6.

17 See C.A.A., § 2 (now substantially embodied in F.A.A., § 102, 49 U.S.C.A. § 1302 (Supp. 1958).

18 See note 4 *supra* and accompanying text.

Whether the recent Federal Aviation Act, the statute authorizing the instant decision, is adequate to cope with the problem is a question which will appear from the analysis.[19]

A. ECONOMIC FACTORS

1) *The Service To Be Rendered*

Due to their origin and the special nature of the services rendered, many of the irregular carriers are closed corporations or small company operations. Not limited to designated points or areas, they are free to move from place to place to meet peak periods in passenger and cargo transportation. They need not meet the high standards of management, organization and consistent service-potential required of a route carrier or prospective route carrier.[20] On the other hand, they are not eligible for federal subsidy and each is "a member of a class of mutually competing carriers who are subject to the forces of economic attrition."[21]

Public economic need is reflected, in part, in the benefits gained from past services. Free of the burdens of maintaining route service, this class of carrier has pioneered in special service development, such as coach-type and seasonal charter flights.[22] They have been able to aid in servicing movements between large metropolitan centers during peak load periods. They were immediately available for emergency military use in the Berlin airlift and the Korean conflict.[23] In its 1959 decision the Board competently summed up the nature of the service to be rendered:

> In the case at hand, the specialty is a service in large aircraft of a highly flexible, readily available, and generally nonluxury nature — roughly, a tramp ship service of the air — meeting the fluctuating needs of the nation's defense, commerce, and the the public at large wherever and whenever they arise. . . .[24]

It would appear that the economic function of the supplemental carriers is one of filling the gap in air transport service left by the imposition of consistent route service standards upon the previously certificated carriers.[25]

2) *The Evil To Be Avoided*

The other side of the economic coin is of no less vital public interest in this case. It concerns the harmful effect of increased competition on the certificated-route carriers

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19 The CAB itself was not sure of its authority to issue certificates for limited authority to supplemental carriers. See 1956 CAB ANN. REP. 21, recommending new legislation for such a purpose, and 1957 CAB ANN. REP. 31, expressing doubt and asking clarification to allow limited certification. The Board received no satisfaction from the recently-enacted Federal Aviation Act, 72 Stat. 731 (1958), 49 U.S.C.A. §§ 1301-1542. (Supp. 1958), within which the economic regulation provisions of the 1938 act were re-enacted virtually without change. The intention was clearly expressed that the re-enactment did not constitute legislative adoption of administrative interpretations and practices or of judicial decisions under the act. Admonition was given that the re-enactment was to be considered an "absolute neutral factor" in future questions of interpretation. H.R. REP. No. 2360, 85th Cong., 2d Sess. (1958); see 1958 U.S. CODE CONG. & AD. NEWS 3741, 3750. This was emphasized "particularly in view of the many legal controversies over the interpretation of the provisions of title IV." *Conference Report Statement of the Managers on the Part of the House,* 1958 U.S. CODE CONG. & AD. NEWS 3767, 3771-72.

20 Large Irregular Air Carrier Investigation, CAB Order No. E-13436, at 27-29 (Jan. 28, 1959).

21 *Id.* at 26.

22 Cherington, *The Essential Role of Large Irregular Air Carriers,* 19 J. AIR L. & COM. 411, 414 (1952).

23 *Id.* at 416-17.

24 Large Irregular Air Carrier Investigation, CAB Order No. E-13436, at 12-13 (Jan. 28, 1959).

25 If a route carrier were required to provide extra service to handle adequately a peak period on its route (as conceivably could be ordered under the F.A.A., § 404(a), 49 U.S.C.A. § 1374(a) (Supp. 1958), it would in most cases be required to purchase additional aircraft and equipment, and hire temporary pilots in order to accommodate the traffic. This equipment in all probability would lie unused during most of the year, thereby creating a highly undesirable situation since the costs of such uneconomical ventures by route carriers would eventually be passed to the public treasury in the form of increased subsidy demands. See Cherington, *supra* note 22, at 418-19.

resulting from the authorization of supplemental carriers.[26] It would indeed be an ideal situation if, for example, the supplemental service between Chicago and Miami were available during the peak of the tourist season in Florida, to carry those charter and individual-sale flights which the route carrier could not handle, and then were seen no more until the following year. The underlying rationale of the Board's authorization of supplemental carriers certainly presupposes such a concept of mobility, *i.e.*, that greener pastures will ever beckon the "Supps" when the temporary rush is over. However, this may prove to be empty optimism. Armed now with the advantage of offering prescheduled, regular flights to the public,[27] the supplemental carrier may remain in Chicago the year around, offering the public reliable advance-scheduling which, due to the low cost of operation, will considerably undersell the flights of the route carriers operating there.[28] There will be seasons when the ten flights per month of the supplemental carrier will harmfully infringe upon the business of the route carrier bound ever to service properly and adequately the route assigned in its certificate.[29] The financial loss to the route carriers would eventually result in an increase in federal subsidy necessary to insure reliable and efficient route service, since "costs once made up by subsidy are now being made up by fare-paying passengers who find aviation meets their transportation needs."[30] In brief, if the route carriers suffer from supplemental duplication of services, the public will indirectly bear the expense.

Whether, and to what extent, route carriers will be affected is at this time largely conjectural, with convincing argumentation on both sides.[31] The Board is not insensitive to the probability of harm to the business of the route carriers. With a view to keeping the authorized services supplemental, it has embodied in certificates to be issued pursuant to its final order in the instant decision, detailed controls against direct or indirect pooling of services and mergers of operators.[32] Also, included is a provision for reducing to a lesser number, the permissible monthly individual-sales flights after notice and opportunity for oral argument, whenever the reduction is found "necessary to confine the operations of supplemental air carriers to the rendition of services of a

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26 The adequacy of existing facilities is a factor to be considered where there will be a paralleling or duplication of services. See note 58 *infra* and accompanying text. *But see* Continental Airlines Case, 4 C.A.B. 215, 239-40 (1943), supplemental opinion, 4 C.A.B. 478 (1943). Here, where existing services were claimed to be inadequate, the Board nevertheless denied a route extension, pointing to its complete power to correct inadequate services under § 404 of the Civil Aeronautics Act.

27 To come within the exemption class as a large irregular air carrier, the carrier was forbidden to "hold out to the public expressly or by course of conduct that it operates one or more aircraft between designated points, or within a designated point, regularly or with a reasonable degree of regularity. . . ." 14 C.F.R. § 291.1(a)(4) (1957). The requirement now is that it shall not advertise more than ten flights per month as per individual-sales authority and must include in any advertising the words "Supplemental Air Carrier," while omitting thereform statements which may be readily construed to offer unlimited scheduled service. *Cf.* Temporary Certificate of Public Convenience and Necessity for Supplemental Air Service (to be issued pursuant to CAB Order No. E-13436), pt. I(1)(i), (v), (vi).

28 See Pacific No. Airlines, Inc. v. Alaska Airlines, Inc., 80 F. Supp. 592, 600 (D. Alaska 1948).

29 F.A.A., § 404(a), 49 U.S.C.A. § 1374(a) (Supp. 1958).

30 Rizley, *Some Personal Reflections After Eight Months As Chairman of the Civil Aeronautics Board*, 22 J. AIR L. & COM. 445, 447 (1955).

31 *Compare* Cherington, *supra* note 22, at 418-20 *with* the dissent in Large Irregular Air Carrier Investigation, CAB Order No. E-9744 (Nov. 15, 1955), 1955 U.S. & Can. Av. 559, 582-91. The dissenters maintain that the individual-sales service is a duplication of, rather than supplemental to, route carrier service. This particular problem was well-anticipated by Cherington, *supra*, at 420:

> What is needed is a line of public policy which will avoid deciding either entirely for the regular scheduled lines or, on the other hand, permitting unbridled operations on the part of the large irregulars. In economic terms what is necessary here in the public interest is to so shape public policy that the large irregulars, in their operations, will support and complement regular scheduled carriers and will have a sufficient scope within regulatory policy to fulfill to the greatest possible extent their true role of economic usefulness in an expanding industry.

32 Temporary Certificate of Public Convenience and Necessity for Supplemental Air Service (issued pursuant to Order No. E-13436), pt. I(1)(ii), (iii), (iv), (ix); pt. II(2).

supplemental nature and to remove any substantial threat to the stability and soundness of the certificated route carrier system posed by the operations of supplemental air carriers."[33] It is submitted that the provision against merger will not prevent several of the supplemental carriers from competing independently for traffic at a given place during a peak period. Since they are not limited to any particular points by their certificates, they may operate anywhere in the United States.[34] Heavy supplemental competition at a given point cannot help but have an adverse effect upon the business of carriers serving routes to and from the point. The provision for lowering the number of individual-sale trips may prove burdensome to administer, and again, since the supplemental carriers are not limited in operation to any given point, the Board may be faced with the unenviable alternative of either apportioning numerous *ad hoc* reductions or instigating another copious and lengthy "blanket" reduction hearing.

It well may be that a continued expansion of the industry will provide enough business to maintain route system levels and also create a need great enough to satisfy the potential competitive threat of the supplemental carriers. In the alternative, the Board may be able to prevent harm to the route system through devices reserved for this purpose. Only time will tell.

B. Legal Factors

Essentially, the legal problem confronting the Board in the instant case was the extension of its authority under a statutory scheme which did not contemplate the situation, in order to effectuate properly its economic policy determination of strengthening supplemental service without thereby harming route-system transportation. Two alternatives presented themselves: the final authorization could be by exemption[35] or by certification.[36] In practical effect there may be little or no difference in the selection;[37] in legal effect, however, judicial review may hold the ultimate choice to be outside the scope of the existing law.

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33 *Id.* pt. II(3)(b).

34 See note 53 *infra* and accompanying text.

35 F.A.A., § 416(b), 49 U.S.C.A. § 1386(b) (Supp. 1958), provides that the Board may exempt from the provisions of title IV:

> any air carrier or class of air carriers, if it finds that the enforcement of this title or such provision, or such rule, regulation, term, condition, or limitation is or would be an undue burden on such air carrier or class of air carriers by reason of the limited extent of, or unusual circumstances affecting, the operations of such air carrier or class of air carriers and is not in the public interest.

Under the regulations, individual applications must be made for exemptions by the members of the Large Irregular Carrier class. 14 C.F.R. § 291.16 (1957).

36 F.A.A. § 401, 49 U.S.C.A. § 1371 (Supp. 1958), provides for certification of all "air carriers" as a prerequisite of the right to engage in air transportation. After application and opportunity for public hearing with intervention of interested parties, § 401(d) provides:

> The Board shall issue a certificate authorizing the whole or any part of the transportation covered by the application, if it finds that the applicant is fit, willing, and able to perform such transportation properly, and to conform to the provisions of this Act and the rules, regulations, and requirements of the Board hereunder, and that such transportation is required by the public convenience and necessity; otherwise such application shall be denied.

37 The opinion stresses the element of "permanency" of certification as compared to exemption. Such a notion may be illusory in view of the fact that only temporary (2 and 5 year) certificates were granted, and the Board, on its own motion or upon petition or complaint, may, after notice and hearing, "alter, amend, modify, or suspend any certificate, in whole or in part, if the public convenience and necessity so require. . . ." F.A.A. § 401(g), 49 U.S.C.A. § 1371(g) (Supp. 1958). Furthermore, it has been held that notice and hearing are similarly required to satisfy due process of law in a proceeding to suspend letters of registration issued to an irregular carrier pursuant to the exemption authority of the Board. Standard Airlines, Inc. v. CAB, 177 F.2d 18 (D.C. Cir. 1949). In neither case will the supplemental carriers receive any government subsidy, although the right to carry mail conceivably exists under exemption, as well as certificated authority. American Airlines v. CAB, 231 F.2d 483 (D.C. Cir. 1956); Mail Transportation by Noncertificated Carriers Case, 18 C.A.B. 201 (1953).

1) *The Possibility of Exemption*

The probability that the requirements of certification would be an onerous burden to certain small-plane or fixed-base operators, prompted Congress to include section 416(b) providing for a carrier's exemption from any or all of the economic requirements of Title IV upon a finding that their enforcement would be an undue burden on the carrier or class of carriers and would not be in the public interest.[38] As the self-sufficiency of the large irregular carriers became established, the concept that any requirement of conformity to various statutory economic standards would prove to be unduly burdensome narrowed considerably. Consequently, compliance with some of these provisions was ordered in 1947.[39] They included, among others, the tariff-filing provisions,[40] the anti-discrimination provision,[41] and the provision for disclosure of stock ownership.[42] In 1949, the regulations were amended[43] to require compliance with all provisions of the act except the following: certification;[44] the duty to provide adequate service as per certificate, and through service upon reasonable request;[45] and the requirement of filing detailed schedules with the Postmaster General to facilitate mail carriage distribution.[46] This was the status of the carriers involved prior to their re-classification as supplemental carriers by the 1955 Board decision.[47]

The Board's exemption power as exercised in the 1955 decision was challenged in a petition for review of the order in the District of Columbia Circuit on the ground, *inter alia,* that the Board had failed to make the indispensable finding of "undue burden."[48] The court sustained this contention of the certificated petitioners, recognizing that the demise of the requirement of irregularity brought the supplemental carriers "much closer to the certificated carriers" and that the "burden of certification is no longer obvious."[49] Accordingly, the case was remanded to the Board to make basic findings to support its conclusion that the enforcement of the exempted provisions would constitute an "undue burden" upon the applicants.

The court undoubtedly struck at the nerve center of the legal fault in the Board's attempt to exempt these carriers from the provisions of Title IV. The "burden" involved in obtaining a certificate of public convenience and necessity would seem no more onerous than conforming to the requirements of an exemption.[50] Exemption of the carriers from sections 404(a) and 405(b) of the act is premised on the particular applicability of these sections to route system carriers; it is incongruous, rather than "burdensome," to apply them to the supplemental carriers, who are not bound to service designated route points.

2) *The Problem of Certification*

The Board's attempt to certificate the supplemental carriers and still maintain their complementary position to the route-carrier system accentuated the inadequacies of

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38 See note 35 *supra.*
39 12 Fed. Reg. 3076 (1947).
40 C.A.A., § 403, 52 Stat. 992 (1938) (now F.A.A., § 403, 49 U.S.C.A. § 1373 (Supp. 1958)).
41 *Id.* at § 404(b) (now F.A.A., § 404(b), 49 U.S.C.A. § 1374(b) (Supp. 1958)).
42 *Id.* at § 407(b), (c) (now F.A.A., § 407(b), (c), 49 U.S.C.A. § 1377(b), (c) (Supp. 1958)).
43 14 Fed. Reg. 1879, 1883 (1949).
44 F.A.A., § 401(a), 49 U.S.C.A. § 1371 (a) (Supp. 1958).
45 F.A.A., § 404(a), 49 U.S.C.A. § 1374(a) (Supp. 1958).
46 F.A.A., § 405(b), 49 U.S.C.A. § 1375(b) (Supp. 1958).
47 However, the large irregular class remained after this decision. See 14 C.F.R. § 291.15 (1957).
48 American Airlines, Inc. v. CAB, 235 F.2d 845 (D.C. Cir. 1956).
49 *Id.* at 853.
50 *But see* American Airlines, Inc. v. CAB, 231 F.2d 483 (D.C. Cir. 1956), in which the protracted waiting period pending certification hearings was held to support a finding of "undue burden" in the exemption proceedings. The irregular carrier investigation continued eight years before a final order was entered and this situation would have obtained whether the final authorization was through exemption or certification because of the large number of applicants in the consolidated proceeding and the scope of the controversy. A formal hearing is not customary in an exemption proceeding, but it may be ordered in the Board's discretion, presumably if the scope of the proceedings so warrants. 14 C.F.R. § 302.408 (1957).

the twenty-one year old Civil Aeronautics Act, which have persisted in the Federal Aviation Act. Under the 1959 decision,[51] the Board granted the supplemental air carriers certificates of public convenience and necessity which include unlimited planeload charter authority and individual-sales flight authority limited to ten trips per month between any two points. The intervenors contended, and certainly not without merit, that the Board's action was devoid of legal authority, primarily because 1) the ten-trip limitation violated section 401(e) of the act, which prohibits certificate limitations restricting "the right of an air carrier to add to or change schedules . . . as the development of the business and the demands of the public shall require;"[52] and 2) the failure to designate base points of operation also violated section 401(e), which states that "each certificate issued under this section shall specify the terminal points and intermediate points, if any, between which the air carrier is authorized to engage in air transportation and the service to be rendered. . . ."[53]

The Board's attempts to answer these objections were understandably weak, since the provisions utilized by the intervenors again peculiarly contemplate route system transportation, the primary objective of the Civil Aeronautics Act of 1938. As for the first contention, it is, of course, incongruous for the route carriers to complain of the limited grant of authority in these certificates when they are primarily concerned with limiting the competitive scope of supplemental activities. However, as holders of certificates themselves, they might understandably complain of a breach of this protective provision since the absence of a legal differentiation between classes of certificates might conceivably subject them to a similar interpretation limiting the scope of their activities in the future. The Board answered this contention by pointing to its authority to "reasonably define in a certificate the scope of the services that are required. . . ."[54] It concluded that this limitation is a reasonable "definition" of supplemental service. The Board referred to several cases imposing a certificate limitation on the type of service to be rendered but cited none which imposed a numerical limitation on the number of flights which could be made.[55]

The Board adverted to several prior decisions to support its failure to require a specification of points of travel.[56] These decisions are pertinent in that they set up an irregular route under a certificate which essentially defined *an area* in which the carrier may provide services. However, it should be noted that all three of the cases cited imposed the limitation that the service over an irregular route *would not, except on a casual or infrequent basis, be rendered between points within the area authorized in any certificate for a regular route.*[57] A similar limitation in the authorization of the supplemental carriers operating exclusively in the United States would again reduce them to the status of irregular carriers. In addition, since these cases dealt with air transportation in Alaska and Samoa, they would seem to be of little precedent value for the proposition that terminal points need not be designated for supplemental carriers operating in the United States, where the route system scope and complexities are infinitely greater, and where any supplemental service at other than a peak period is bound to conflict to some degree with a route-system carrier.

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51 Large Irregular Air Carrier Investigation, CAB Order No. E-13436 (Jan. 28, 1959).

52 F.A.A., § 401(e), 49 U.S.C.A. § 1371(e)(Supp. 1958).

53 *Ibid.*

54 Large Irregular Air Carrier Investigation, CAB Order No. E-13436, at 12 (Jan. 28, 1959).

55 Furthermore, in referring to the certificates issued helicopters, local service carriers, and all-cargo carriers as authority for supplemental definition, the Board fails to recognize that these are *by their nature,* supplemental to trunkline route service. In failing to distinguish these cases, the Board ignored the reason which prompted the division between large and small irregular carriers and increased the regulation of the large — namely, that aircraft of substantially the same size as, and capable of performing all services performed by, the domestic route carriers pose a greater competitive threat to route carriers than competitors limited by their very nature. See 12 Fed. Reg. 3077 (1947).

56 Samoan Airlines Case, Reopened, 18 C.A.B. 533 (1954); Alaska Route Modification Case, 17 C.A.B. 943 (1953); Alaska Air Transport Investigation, 3 C.A.B. 804 (1942).

57 18 C.A.B. at 535 (1954); 17 C.A.B. at 951 (1953); 3 C.A.B. at 820-21 (1942).

The general considerations which should govern the issuance of a certificate of public convenience and necessity are:

> [1] whether the new service will serve a useful public purpose, responsive to a public need;
> [2] whether this purpose can and will be served as well by existing lines or carriers;
> [3] whether it can be served by the applicant with the new service without impairing the operations of existing carriers contrary to the public interest; and
> [4] whether any cost of the proposed service to the Government will be outweighed by the benefit which will accrue to the public from the new service.[58]

With these criteria in mind, the instant decision may raise the same objections that warranted the previous judicial remand of the 1955 decision, *i.e.*, failure to make the required findings.[59] That there is public need for these services is again incontrovertible, but there is little concrete support for the conclusion that the authority granted will not impair the operations of route carriers to such an extent as to be contrary to the public interest, or that the ten trip individual-sale limitation with the additional reservation of adjusting the number of trips, will insure that the services will remain supplemental to the route system. It is submitted that these findings are no less essential to effectuate the policies of the act than is the finding of a general public need for the service. As long as supplemental services are permitted to move haphazardly from point to point for virtually any purpose, there can never be an adequate basis for making the requisite findings.[60]

Conclusion

The realities of the air-traffic situation disclose a continuing public need for supplemental services. At the same time, some control is necessary to insure the perpetuation of their supplemental character, since competitive harm to the route carriers must indirectly be borne by the public treasury in the form of increased subsidy to them. The final position taken by the Board in its 1959 decision is legally weak due to the fact that it was dealing with a statute which had no provision for the resolution of the problem. The Board attempted to follow the broad policy of the act to provide an adequate and proper overall system of air transportation. This, however, requires the prohibition of destructive competitive practices as well as meeting public need.

It is the function of an administrative agency to operate within the statutory scheme creating it. If the scheme does not encompass a particular problem, it is for the legislature to modify it to conform to existing needs. The instant decision has done much to strengthen the position of the supplemental carriers and little to protect route carriers against resulting destructive competition. The Board has repeatedly stressed that the need shown for supplemental service is not the same as that for route service, and yet the authorization granted will enable the "Supps," in many instances, to complete for traffic where there is actually no necessity for supplemental service. Presumably, such competition will be profitable because of a lower cost of operation and the public

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58 United Air Lines Transp. Corp., 1 C.A.B. 778, 779-80 (1940).

59 See note 48 *supra* and accompanying text.

60 See SEC v. Chenery Corp., 318 U.S. 80, 94 (1943): "[T]he orderly functioning of the process of review requires that the grounds upon which the administrative agency acted be clearly disclosed and adequately sustained." *But see* FCC v. RCA Communications, Inc., 346 U.S. 86, 96-97 (1953):

> In reaching a conclusion that duplicating authorizations are in the public interest wherever competition is reasonably feasible, the Commission is not required to make specific findings of tangible benefit. It is not required to grant authorizations only if there is a demonstration of facts indicating immediate benefit to the public. To restrict the Commission's action to cases in which tangible evidence appropriate for judicial determination is available would disregard a major reason for the creation of administrative agencies, better equipped as they are for weighing intangibles "by specialization, by insight gained through experience, and by more flexible procedure. . . ." In the nature of things, the possible benefits of competition do not lend themselves to detailed forecast, . . . but the Commission must at least warrant, as it were, that competition would serve some beneficial purposes such as maintaining good service and improving it.

relations advantage of pre-scheduled regular flights. There is nothing to prevent the independent clogging of given points by these carriers during peak periods. Although this practice may be limited by the mutual competition factor, the resulting "economic attrition" cannot help but have an adverse effect upon carriers servicing routes over these points.

It is submitted that what is needed here is not such a "blanket" authorization but permanent authority to engage in service *only* of a supplemental nature. This would require: 1) a finding that service between given points or within a small geographic area is inadequate, and in what respect such is inadequate; *e.g.*, passenger transport service is inadequate to meet the public convenience and necessity betwen Chicago and Miami during the period of November through March of each year; 2) a finding that supplemental service is required; *e.g.*, this need is sporadic and temporary and the public convenience and necessity would not be served by ordering the route carriers servicing the area to increase service for such a temporary period; 3) an *ad hoc* authorization to one or more supplemental carriers to take up the slack in this traffic; *e.g.*, accordingly, the Board finds that the public convenience and necessity requires, and it so authorizes, certificates be issued to X, Y and Z supplemental carriers to engage in X number of individual-sale passenger flights per month between Chicago, Miami, and connecting points during the peak passenger season of November through March during any fiscal year.

Under this system, the supplemental carriers would still regularly schedule, would still hold "permanent" certificates, and would be fairly assured of revenue. However, the Board would have the control necessary to insure the supplemental character of the service because of the availability of criteria for evaluating the resultant effect on route-system traffic. The supplemental carriers would also benefit since they would be protected from destructive infringement by other supplemental carriers.

Perhaps, a preferable solution would be for Congress to create a "supplemental certificate" system in an amendment to the Federal Aviation Act. There is something inherently repugnant in placing the supplemental carriers, who are bound to no minimum standards of flight consistency or service, on an equal basis with route-system carriers. Their small organization and less complex financial and management structures, coupled with the essential nature of the services they perform, strongly suggest a separate legislative approach.

Under a congressional enactment, the element of "permanency of certificate" could be maintained, the primary prerequisite being a finding of capability to perform supplemental services in general. A procedure could be established to process expeditiously applications for supplemental authority subordinate to general certification. Under such a procedure, each supplemental carrier could collect several or numerous authorizations based upon capability and the public need for the particular service involved. Separate findings might be required for the "peak period" and "other special service" authorizations. A "grandfather" clause similar to that contained in the old Civil Aeronautics Act[61] might be inserted to aid in accommodating existing supplemental carriers. The overall statutory policy should be directed to the increased healthy growth of the carriers, the satisfaction of particular public need, and the prevention of undue interference with the soundness, and self-sufficiency of the basic route system.[62]

F. James Kane

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61 C.A.A., § 401(e), 52 Stat. 988 (1938). This provision has been omitted from the F.A.A. of 1958, as was the proviso to the certification requirement regarding existing carriers. C.A.A., § 401(a).

62 Were it not for the objectionable practice of certifying route carriers and supplemental carriers under the same statutory provision because of the wide variance in the applicable findings and policy considerations, authority for issuing temporary certificates could conceivably be found under § 401(d)(2) of the F.A.A. of 1958, 49 U.S.C.A. § 1371(d)(2)(Supp. 1958), which permits the issuance of a certificate authorizing all or any part of such temporary transportation "for such limited periods as may be required by the public convenience and necessity. . . ."

GIFT TAX — SPECIFIC EXEMPTION — FAILURE OF FAMILY PARTNERSHIP FOR INCOME TAX PURPOSES DOES NOT RESTORE EXEMPTION TAKEN FOR GIFT TO CHILDREN. — Petitioner reported ten gifts in 1951 totaling $61,767.04, from which he deducted multiple exclusions of $30,000[1] and the specific exemption of $30,000.[2] The Commissioner determined that the total amount of exemptions claimed and allowed for prior years, namely $8,080.04 in 1941, and $3,960 for 1946, was to be subtracted from the specific exemption. Petitioner conceded the 1946 reduction but contended that his specific exemption should not be reduced by the 1941 gifts since the Commissioner had refused to recognize those gifts for income tax purposes, and consequently petitioner had been taxed on the income of the property, namely, interests in a partnership given to his wife and three sons.[3] *Held,* as petitioner was granted exemptions on the 1941 transfers, the specific exemptions must be reduced by that amount, despite the fact that petitioner was taxed on the income from the partnership because it was dependent on an incompleted gift. *Camiel Thorrez,* 31 T.C. No. 70 (Dec. 31, 1958).

Petitioner's argument represents another of the many attempts to reconcile a provision of the income tax system with a seemingly inconsistent gift tax provision. Since the contention centers on the fact that one of the elements of the prior decision[4] was a finding of a failure of the gifts, an examination of the conditions necessary for the recognition of a new partner in the family partnership intended in 1941 must be made to resolve the issue.

On numerous occasions husbands and wives have established partnerships and have split the income derived therefrom between them for income tax purposes. The Tax Court and its predecessor, the Board of Tax Appeals, have frequently held that there is nothing in the revenue acts to prevent members of a partnership from including their wives and other members of their families as partners.[5] However, it was not a simple task to enumerate the composite parts of a valid partnership at the time of the original *Thorrez* decision. The issue often stated was whether a bona fide partnership had been formed or existed,[6] or even more dimly, whether the husband was taxable on the wife's share of partnership earnings.[7] These do little to clarify the problem involved. Restatement requires recapitulation of the established principles under which the family partnership cases were formulated and within which they had their existence.

The cardinal rule for purposes of decision in 1945 was that income was taxable to the person who earned it.[8] It was sufficiently clear that for tax purposes a wife could be a partner in a business wholly engaged in personal services only if she actually rendered services; if she rendered no services, her share of the income from the partnership was taxable to the husband.[9] In such cases it was held that the husband had done no more than assign his income to her,[10] retaining control of the income because it was earned only through his continued efforts.[11] Through his power to command the income, the assignor enjoyed the benefits of the income upon which the tax was laid.[12]

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1 INT. REV. CODE OF 1954, § 2503(b).

2 INT. REV. CODE OF 1954, § 2521.

3 The earlier decision is reported in 5 T.C. 60 (1945), *aff'd,* 155 F.2d 791 (6th Cir. 1946).

4 Camiel Thorrez, 31 T.C. No. 70, at 395 (Dec. 31, 1958).

5 Felix Zukaitis, 3 T.C. 814 (1944); Justin Potter, 47 B.T.A. 607 (1942); Alfred T. Wagner, 17 B.T.A. 1030 (1929); Arthur Stryker, 17 B.T.A. 1033 (1929).

6 See Frank J. Lorenz, 3 T.C. 746 (1944); Felix Zukaitis, 3 T.C. 814 (1944); M. W. Smith, Jr., 3 T.C. 894 (1944); Walter W. Moyer, 35 B.T.A. 1155, 1169 (1937).

7 Francis E. Tower, 3 T.C. 396 (1944); Robert P. Scherer, 3 T.C. 776 (1944).

8 See Lucas v. Earl, 281 U.S. 111 (1930); Schroder v. Commissioner, 134 F.2d 346 (5th Cir. 1943).

9 Earp v. Jones, 131 F.2d 292 (10th Cir.), *cert. denied,* 318 U.S. 764 (1942) (insurance business); Mead v. Commissioner, 131 F.2d 323 (5th Cir.), *cert. denied,* 318 U.S. 777 (1942) (insurance and real estate business).

10 Schroder v. Commissioner, 134 F.2d 346 (5th Cir. 1943); Luce v. Burnet, 55 F.2d 751 (D.C. Cir. 1932).

11 Rossmore v. Commissioner, 76 F.2d 520 (2d Cir. 1935).

12 See Harrison v. Shaffner, 312 U.S. 579, 582 (1941); Helvering v. Horst, 311 U.S. 112 (1940).

Where the partnership was engaged in mercantile, manufacturing, or other business in which capital is an important, if not the principal, income-producing factor, the contribution of services by the wife appears not to have been necessary.[13] However, since the contribution by the wife usually consisted of capital she received from her husband as a gift, the courts required that there be a complete transfer of the interest, divesting the assignor of all substantial attributes of ownership — domination and control — as well as the mere technical forms of ownership.[14] A transfer which was not complete in this sense would leave unchanged the transferor's tax obligation, however effective the transfer might have been under local law.[15] The test of completeness was actual command and control[16] and not refinements of title or elusive concepts of property law.[17] In examining this control, the courts required that the wife have some measure of control over, or voice in, the partnership business.[18] In terms of these fundamental principals, the deciding factor in the family partnership cases appears to have been the character of the property transferred. The contrast is between an assignment of capital from which income is derived and an assignment merely of income itself — the tree, or only its fruit.[19]

In light of this consideration, the opinion of the Tax Court in the 1945 decision may be examined more intelligently. In this decision, the court was concerned first with ascertaining the character of the interest assigned to the wives and sons, whether income-producing capital or income attributable to the personal efforts of the petitioner; and secondly, the completeness of the gift for income tax purposes. The subject of the proposed gift was a percentage interest in a metal plating business, of which Thorrez was an inactive partner. The assets of the company included a plant and the usual machinery used in that line of business. Though a large measure of control was retained by the original partners, the partnership agreement itself was amended to include the names of the proposed new partners; it would thereby seem that it was the intent of the parties that there be transferred an interest in the very properties of the partnership. Many businesses present close questions of fact as to the source of their income; it is often difficult to determine whether profits are from capital or the special skill, acumen and knowledge of the husband-partner. More often than not there is a mixture of the two factors.[20] The majority of the court in the 1945 decision failed to state its interpretation of the character of the interest transferred. By virtue of the authority cited, it may have likened the situation to one in which the income was earned through the personal efforts of the donor,[21] despite the fact that less than a year earlier the court decided a very similar transfer in *Robert P. Scherer*[22] as one of income-producing capital. The majority opinion failed to mention this latter decision. If this interpretation were adopted it would appear the court could have avoided the question of a completed gift by deciding the case upon the principle that he who earns the income shall be taxed for it. It might well have been held that because of his control over the income, the husband enjoyed its benefits.

However, this is precisely the approach advocated by Judge Mellott in his concurring opinion. He maintained the court ought to look beyond the gift and determine whether there was an actual combination of capital and labor with other members of the firm. But the majority refused to adopt this approach, and, as a result, based the

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13 J. D. Johnson, Jr., 3 T.C. 799, 809 (1944).

14 Robert P. Scherer, 3 T.C. 776 (1944); Millard D. Olds, 15 B.T.A. 560 (1929), *aff'd*, 60 F.2d 252 (6th Cir. 1932).

15 Helvering v. Clifford, 309 U.S. 331 (1940).

16 Burnet v. Guggenheim, 288 U.S. 280 (1933); Corliss v. Bowers, 281 U.S. 376 (1930).

17 *Cf.* Helvering v. Hallock, 309 U.S. 106, 118 (1940).

18 Robert P. Scherer, 3 T.C. 776 (1944); Millard D. Olds, 15 B.T.A. 560 (1929), *aff'd*, 60 F.2d 252 (6th Cir. 1932).

19 Humphreys v. Commissioner, 88 F.2d 430 (2d Cir. 1937).

20 See Humphreys v. Commissioner, *supra* note 19.

21 The opinion cites Burnet v. Leninger, 285 U.S. 136 (1932), and other similar decisions.

22 3 T.C. 776 (1944).

decision on the finding that the taxpaper had not made a completed gift. The opinion continually discussed the lack of donative intent or divestment of control; at no place is it argued that the partnership must fail because the income is derived from the personal efforts of the donor. The majority opinion seemed to say that there was no transfer of the corpus of the partnership property to a new firm with a consequent readjustment of rights in that property and management. It was with this conclusion that the three separate dissenting opinions took issue.[23] They evidently assumed also that the majority opinion relied on the failure of the gift since they went to such lengths to criticize the majority on this issue.

Between the time of the 1945 Tax Court decision and its review by the appellate court, the Supreme Court in *Commissioner v. Tower*[24] attempted to postulate definitively the requisite criterion for the family partnership. The Court stated that the intent of the parties to carry on a partnership determines the validity of the partnership; the words "really and truly"[25] were used to characterize the required intent. The Court did not negate the importance of a completed gift, but rather, considered the gift and other circumstances as important indicia of the required intent. In reviewing the 1945 *Thorrez* decision,[26] the Sixth Circuit found the parties lacking in this required intent, but in its opinion, the court seems to have relied on the Tax Court finding that there was no gift. Relative to *Thorrez*, the court did not deem it necessary to consider any of the other factors to which the Court in *Tower* looked for the required intent. It simply stated that there was ample evidence for the Tax Court to find as it did.

In light of this, it would appear that the court now assumes a contradictory posture in holding that the previous exemption must stand, even though it was taken for a gift that failed for income tax purposes. Analytically, this action leaves much to be desired, since it cannot be doubted that the Tax Court rested its 1945 decision on the failure of a completed gift to the members of petitioner's family. The language of the 1945 decision was too sweeping under the circumstances, and one in petitioner's position might have concluded in good faith that, in addition to finding him taxable on the income from the interests transferred, the court also purported to pass upon the substantive validity of the gift. If it had done so (and a literal reading of the unguarded language would suggest this), then the court's subsequent finding in 1958 would be clearly inconsistent and contradictory. The confusion surrounding the instant litigation ultimately stems from the broad and needlessly expansive language of the prior opinion. This is no doubt what prompted the court in the instant case to characterize it as dictum.

However, a competing line of analysis presents itself. It must be borne in mind that the gift and income tax schemes are separate and distinct, and that there is no necessary coincidence between the two. A taxpayer will often be found taxable under both with respect to the same transfer. More to the point, the 1945 Tax Court decision was concerned with income tax only. Petitioner had successfully claimed a specific exemption of over $8,000 in his 1941 gift tax return, the propriety of which was not involved in the 1945 litigation. Thus, although as pointed out above, the present court's re-evaluation of its previous decision leaves much to be desired analytically, it results in no hardship to the petitioner, since he had obtained the benefit of the exemption in 1941. The interests transferred by petitioner in 1941 were not extinguished by the 1945 decision; rather, his wife and three sons continued to enjoy the interests given to them, and the record discloses that during the year 1946, petitioner wound up the partnership and established equivalent pro rata interests in his wife and sons in a new corporation which he formed. No new gift tax was paid at this time. Therefore, to have allowed the exemption in the instant case would have granted an unwarranted

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23 All three dissents argue that there was a completed gift and implicit within them, if not expressed, is the view that the gift was one of income-producing capital. 5 T.C. 60, 78, 84 (1945).

24 327 U.S. 280 (1946).

25 *Id.* at 287.

26 Thorrez v. Commissioner, 155 F.2d 791 (6th Cir. 1946).

windfall to the petitioner, by giving him a specific exemption in excess of the $30,000 granted by statute.

The instant decision represents another example of the theoretical confusion running through the income and gift tax provisions of our federal revenue laws. Legislative adjustment reconciling the divergent thrusts of the two schemes would be welcome at this time, to guarantee a more intelligible pattern of taxation under them.

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