The Airline Merger Cases: CAB Application of *Clayton § 7* After Deregulation

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I. INTRODUCTION

This article discusses the development of Civil Aeronautics Board merger doctrine as applied in passenger airline merger cases since October 24, 1978, when President Jimmy Carter signed into law the Airline Deregulation Act of 1978 (ADA, or Act).[1] The ADA amended the Federal Aviation Act of 1958,[2] including section 408[3] which governs airline mergers. Since implementation of the ADA, the Civil Aeronautics Board (CAB, or Board) has approved five passenger airline mergers,[4] and rejected two proposed

1. Airline Deregulation Act of 1978, Pub. L. No. 95-504, 92 Stat. 1705 (1978).
2. Federal Aviation Act of 1958, Pub. L. No. 85-726, 72 Stat. 731 (1958).
3. 49 U.S.C. § 1378 (1970) (Federal Aviation Act of 1958, Pub. L. No. 85-726, § 408, 72 Stat. 731 (1958), *as amended by* the Airline Deregulation Act of 1978, Pub. L. No. 95-504, § 26, 92 Stat. 1705 (1978)).
4. Pan Am. World Airways-National Acquisition Case, CAB Order 79-9-163 (1979); Texas Int'l-National Acquisition Case, CAB Order 79-9-163 (1979); North Cent.-Southern Merger Case, CAB Order 79-6-7 (1979); Republic-Hughes Airwest Acquisition, CAB Order 80-9-65 (1980); Continental/Western Merger Case, CAB Order 81-3-__ (1981) [hereinafter cited as Continental/Western II].

Further, the CAB has approved the merger of Tiger International and Seaboard. CAB Order 80-7-20 (1980). The Tiger-Seaboard merger involved freight carriers only, and will not be considered here.

mergers.[5] The Board is currently considering applications for mergers between Texas International and Continental,[6] and between Air Florida and Air California.[7] In light of the Board's most recent merger ruling in *Continental/Western II*, it now appears highly unlikely that the CAB will block either the currently pending mergers, or any mergers proposed in the future.

II. Statutory Framework

The legislative history[8] of the ADA, including the airline merger provisions of section 408, clearly states the intent of Congress to increase competition in the airline industry:

> Section 408 standards must now be interpreted in light of the intent of Congress to move the airline industry rapidly toward deregulation. The foundation of the new airline legislation is that it is in the public interest to allow the airline industry to be governed by the forces in the marketplace.[9]

The specific statutory language amending section 408[10] is found in

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5. Continental/Western Merger Case, CAB Order 79-9-185 (1979) [hereinafter cited as Continental/Western I]; application of Eastern Air Lines, Inc., for approval of Acquisition of Control of National Airlines, Inc., CAB Order 79-12-74 (1979).

6. Texas Int'l-Continental Acquisition Case, CAB Docket 39285 (1981). This case arose when Texas Int'l proposed a tender offer for 48.5% of Continental's outstanding stock just prior to CAB approval of a pending merger between Continental and Western. *See, e.g.*, *CAB Clears Continental-Western Merger and Texas Air's Trust Plan to Block It*, Wall St. J., Mar. 3, 1981, at 4, col. 3.

7. Air Florida-Air California Acquisition Case, CAB Docket 38863 (1981). The Board has ruled that a full hearing will not be necessary in *Air Florida-Air California*, and that the case will be conducted as a Show Cause Proceeding. CAB Order 81-1-58 (1981).

8. H.R. Rep. No. 95-1779, 95th Cong., 2d Sess., *reprinted in* [1978] U.S. Code Cong. & Ad. News 3737 [hereinafter cited as H.R. Rep. No. 95-1779]. For an in-depth discussion of the statutory and regulatory system affecting the airline industry before deregulation, *see* Dempsey, *Rise and Fall of the Civil Aeronautics Board—Opening Wide the Floodgates of Entry*, 11 Transp. L.J. 91 (1979); *see also* Recommended Decision of Administrative Law Judge Joseph J. Saunders at 20-22, North Cent.-Southern Merger Case, CAB Order 79-6-7 (1979).

9. H.R. Rep. No. 95-1779, *supra* note 8, at 3789.

10. 49 U.S.C. § 1378(b) (1978) (as amended by the Airline Deregulation Act of 1978, Pub. L. No. 95-504, 92 Stat. 1726). Relevant portions of section 408(b)(1) of the Federal Aviation Act as amended are:

> Unless, after a hearing the Board finds that the transaction will not be consistent with the public interest or that the conditions of this section will not be fulfilled, it shall, by order, approve such transaction, upon such terms and conditions as it shall find to be just and reasonable and with such modifications as it may prescribe, except that the Board shall not approve such transaction—
> (A) if it would result in a monopoly or would be in furtherance of any combination or conspiracy to monopolize or to attempt to monopolize the business of air transportation in any region of the United States; or
> (B) the effect of which in any regon of the United States may be substantially to lessen competition, or to tend to create a monopoly, or which in any other manner would be in restraint of trade, unless the Board finds that the anticompetitive effects of the transaction are outweighed in the public interest by the probable effect of the transaction in meeting significant transportation conveniences and needs of the public, and unless it finds that

section 26 of the Act. Essentially, Congress in the new section 408 adopted the same merger standard found in section 7 of the Clayton Act,[11] prohibiting any merger the effect of which "may be[12] substantially to lessen competition or to tend to create a monopoly" in any region of the United States.

The legislative history of section 408 indicates that Congress intended more liberal standards to be applied in the airline industry in certain limited situations:

> even if a merger does not meet the antitrust standards of the Sherman and Clayton Acts, it may nonetheless be approved if it meets "significant transportation needs of the community to be served," and if there is no "reasonably available less anticompetitive alternative" to the merger.[13]

Additionally, the ADA amended section 414 of the 1958 Act. These provisions permit the CAB to grant antitrust immunity in merger cases by: 1) clarifying that such immunity is specifically limited to antitrust laws; 2) providing that immunity shall be granted only to complete CAB-approved transactions; and 3) specifying that CAB immunity is discretionary, and should be granted only when CAB finds the grant to be in the public interest.[14]

A final portion of the statute relevant in evaluating airline merger proposals is section 102, the "Declaration of Policy" provisions. Section 102, as amended by section 3 of the ADA, lists various factors deemed by Congress to be in the "public interest." The same "public interest" factors found in section 102 are also used in the "public interest" portion of the airline merger policy set out in section 408.[15]

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the significant transportation conveniences and needs may not be satisfied by a reasonably available alternative having materially less anticompetitive effects.

11. 15 U.S.C. § 18 (1970).

12. "May be" has been interpreted to express Congress' concern "with probabilities, not certainties [or] ephemeral possibilities." United States v. Brown Shoe, 370 U.S. 294, 323 (1962).

13. H.R. Rep. No. 95-1779, *supra* note 8, at 3789.

14. *Id.* at 3792.

15. 49 U.S.C. § 1302(a) (1978). Relevant portions of section 102 are:

> In the exercise and performance of its powers and duties under this Act with respect to interstate and overseas air transportation, the Board shall consider the following, among other things, as being in the public interest, and in accordance with the public convenience and necessity:
>
> . . . .
>
> (3) The availability of a variety of adequate, economic, efficient, and low-price services by air carriers without unjust discriminations, undue preferences or advantages, or unfair or deceptive practices, the need to improve relations among, and coordinate transportation by, air carriers, and the need to encourage fair wages and equitable working conditions.
> (4) The placement of maximum reliance on competitive market forces and on actual and potential competition (A) to provide the needed air transportation system, and (B) to encourage efficient and well-managed carriers to earn adequate profits and to attract capital.
>
> . . . .

III. North Central-Southern Merger

The first CAB action taken on a merger application after the ADA became law was the approval of the merger of Southern Airways into North Central Airlines to form Republic Airlines.[16]

In *North Central-Southern* the CAB considered, but declined to rule upon, whether the section 408 merger standard includes a separate public interest test, or whether a public interest test is included within the section 408 antitrust test.[17] This issue was important not only in the *North Central-Southern* case, but in subsequent merger cases as well, because adoption of the view that Congress intended both a public interest test and an antitrust test would pose a more difficult standard for merger applicants to meet.

On one side, the merger applicants, the Department of Justice, and the CAB's Bureau of Pricing and Domestic Aviation[18] argued that a merger found not to violate the section 408 antitrust standard should be approved without further consideration. On the other side, merger opponents, including the Bureau of Consumer Protection and Frontier Airlines,[19] argued that the CAB should enforce the plain meaning of the Act that a merger may not be approved if it is inconsistent with either the public interest *or* the section 408 antitrust standards.[20]

The CAB found, however, that because "no party. . .offered any convincing evidence or argument that the combination of North Central and Southern would fail under. . .the alternative interpretations,"[21] resolution of this statutory issue of first impression was reserved for subsequent decisions.[22] The CAB also declined to rule on the "convenience and needs"

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(7) The prevention of unfair, deceptive, predatory, or anticompetitive practices in air transportation, and the avoidance of—

(A) unreasonable industry concentration, excessive market domination, and monopoly power; and

(B) other conditions;

that would tend to allow one or more air carriers unreasonably to increase prices, reduce services or exclude competition in air transportation.

16. North Cent.-Southern Merger Case, CAB Order 79-6-7 (1979). For an economic evaluation of the competitive effect of this merger, *see* Carlton, Landes, & Posner, *Benefits and Costs of Airline Mergers: A Case Study*, 11 Bell J. of Econ. & Management Sci. 65 (1979).

17. Note that in the section 408 excerpt note 10 *supra*, the statutory language provides that the Board shall approve a merger unless the transaction is not consistent with the public interest *or* that the antitrust provisions will not be fulfilled.

18. *See*, *e.g.*, Brief of Pricing and Domestic Aviation at 12, North Cent.-Southern Merger Case, CAB Order 79-6-7 (1979).

19. *See*, *e.g.*, Opening Brief of Frontier Airlines at 13, North Cent.-Southern Merger Case, CAB Order 79-6-7 (1979).

20. *Id*. at 6. Frontier Airlines was the only participant arguing that the merger would result in a substantial reduction in competition.

21. North Cent.-Southern Merger Case, CAB Order 79-6-7 at 4 (1979).

22. The issue was resolved in a later case in favor of both a distinct "public interest" and

defense.[23] The Board's basic rationale was that because the record did not show that the merger would be anticompetitive, it was "unnecessary to reach the 'convenience and needs' issue."[24]

Despite side-stepping these key issues involved in interpreting the new section 408 merger standards, the Board provided some guidance in determining what is not "anticompetitive" under section 408 by adopting as authority United States Supreme Court interpretations of Section 7 of the Clayton Act. This section of the Clayton Act, like section 408 of the ADA, prohibits mergers the probable effect of which may "substantially lessen competition" or "tend to create a monopoly".[25]

To evaluate competitive effects of the merger, the Board in *North Central-Southern* adopted the "functional" approach used by the United States Supreme Court in *United States v. Brown Shoe*.[26] There, the Court outlined a method for evaluating whether a merger will "substantially lessen" competition. The *Brown Shoe* test involves defining geographical product markets, and then examining each market so defined for such factors as market share,[27] cross elasticity of demand between the product and substitutes,[28] and barriers to entry.[29]

Employing a similar rationale, the CAB noted that the carrier "resulting from the present merger would not have more than a minimal effect on concentration."[30] The CAB also specifically rejected a Frontier Airlines argument[31] that the merger would violate merger guidelines promulgated by the Justice Department for Section 7 of the Clayton Act[32] by increasing concentration in certain regional markets. The Board reasoned that the "regional market identified [by Frontier] ignores commercial realities by ex-

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section 408 "antitrust" test. Pan Am. World Airways-National Acquisition Case, CAB Order 79-9-163 at 60 (1979).

23. *See* the section 408(b)(1)(B) excerpt note 10 *supra*. The "convenience and needs" defense suggests Congress intended, at least in limited circumstances, a more liberal antitrust standard than traditional Clayton Act tests.

24. North Cent.-Southern Merger Case, CAB Order 79-6-7 at 8 (1979).

25. *Id.*; *see also* the section 408(b)(1)(B) excerpt note 10 *supra*.

26. Overall, the Supreme Court indicated "that a merger has to be functionally viewed, in the context of its particular industry." United States v. Brown Shoe, 370 U.S. 294, 328.

27. *Id*. at 343.

28. *Id*. at 325.

29. *Id*. at 328. For additional Supreme Court doctrine defining relevant antitrust analysis markets, *see also*, United States v. Phillipsburg Nat'l Bank & Trust Co., 399 U.S. 350 (1970); Tampa Elec. Co. v. Nashville Coal Co., 365 U.S. 320 (1961); United States v. E.I. du Pont de Nemours & Co., 353 U.S. 586 (1957).

30. North Cent.-Southern Merger Case, CAB Order 79-6-7 at 10 (1979).

31. Opening Brief of Frontier Airlines at 7, North Cent.-Southern Merger Case, CAB Order 79-6-7 (1979).

32. Justice Department Merger Guidelines, [1977] Vol. 1, TRADE REG. REG. (CCH) 4510. In "highly concentrated" markets (four firms controlling 75% of the business), mergers resulting in the following percentages are considered likely violations:

cluding key points where routes of the two carriers touch each other, thus exaggerating their market shares. None of the market shares in more reasonably defined markets offend the guidelines."[33]

Accordingly, the Board ruled that the merger opponents had not demonstrated that reasonably defined markets were highly concentrated.[34] Largely because they failed this key test, the merger opponents were not able to meet the statutory burden[35] of proving anticompetitive effects of the merger.

In addition to the section 408 antitrust rulings, the CAB also established a clear precedent in a merger-related question by refusing to grant antitrust immunity[36] to the merging airlines. Section 414 permits the CAB to grant antitrust immunity only to the extent necessary for the merger to go forward, unless the CAB finds that "such exemption is *required* by the public interest." (emphasis added)[37] The CAB found "insufficient evidence of either of these requirements to form the basis of a grant of immunity."[38]

The applicants and other proponents of immunity relied principally on the argument that a strong public interest exists in finality of proceeding. They argued that while doctrines of *res judicata* and collateral estoppel might not preclude a Clayton Section 7[39] collateral attack, a grant of immunity would guarantee finality and fulfill the public interest.

However, the CAB was persuaded by the arguments of the opponents of immunity that the plain meaning of section 414 allows the CAB to grant immunity only if the public interest *requires* such grant. The CAB reasoned that finality was not specifically listed among the public interest goals of

Acquiring Firm	Acquired Firm
4%	4% or more
10%	2% or more
15%	1% or more

In "less highly concentrated" markets, the standards are:

Acquiring Firm	Acquired Firm
5%	5%
10%	4%
15%	3%
20%	2%
25%	1%

33. North Cent.-Southern Merger Case, CAB Order 79-6-7 at 11 (1979).

34. *Id.* at 12.

35. "The party challenging the transaction shall bear the burden of proving the anticompetitive effects of such transaction. . . ." 49 U.S.C. § 1378(b)(1) (1978).

36. 49 U.S.C. § 1384 (1978) (as amended by the Airline Deregulation Act of 1978, Pub. L. No. 95-504, § 30, 92 Stat. 1731).

37. *Id.*

38. North Cent.-Southern Merger Case, CAB Order 79-6-7 at 6 (1979).

39. 15 U.S.C. § 18 (1970).

section 102,[40] and further that well-settled doctrine requires deference to administrative holdings absent clear error.[41] Consequently, the CAB held that "in this case, where there are no anticompetitive effects, little or no chance of subsequent litigation, and most importantly, no basis in the record for concluding that immunity is necessary, we believe Congress intended that no immunity be granted."[42]

A third matter the CAB considered in approving *North Central-Southern* was the inclusion of a labor protective provision.[43] By imposing labor protective provisions, the CAB rejected Bureau of Pricing and Domestic Aviation arguments[44] that ADA deregulation goals also terminate the need for such protective provisions.[45] Still, as with other statutory issues of first impression, the CAB in *North Central-Southern* reserved judgment "on the question of labor protection as a policy matter."[46]

The CAB rested its decision on the facts that: 1) the record indicated both parties litigated the case as if a labor protective provision would be imposed; 2) elimination of labor protective provisions is inconsistent with the statutory language and legislative history; and 3) the Bureau of Pricing and Domestic Aviation argument was not raised until after the hearing, and therefore the issue was not fully and fairly litigated.[47]

IV. The Struggle to Control National

A. *CAB Approval of Texas International-National Merger*

Although the CAB approved both the applications of Pan Am and TXI to control National, only the *Pan Am-National* merger actually took effect. Just before the Board granted official approval of both applications, Pan Am and National agreed between themselves that Pan Am would purchase control of National for $300 million.[48] Nonetheless, the Board's decision approving TXI's application[49] provides some guidance for Board merger

40. *See*, note 15 *supra*.

41. *See*, e.g., Udall v. Tallman, 380 U.S. 1 (1965) (great deference was paid to agency interpretation of statute).

42. North Cent.-Southern Merger Case, CAB Order 79-6-7 at 8 (1979).

43. *Id.* at 5.

44. Brief of Bureau of Pricing & Domestic Aviation at 96, North Cent.-Southern Merger Case, CAB Order 79-6-7 (1979).

45. The Bureau of Pricing & Domestic Aviation did not argue that CAB authority to issue labor protective provisions was eliminated by the ADA. In fact, labor protective provisions in the Federal Aviation Act of 1958 were left unchanged by the ADA.

46. North Cent.-Southern Merger Case, CAB Order 79-6-7 at 5 (1979).

47. *Id.*

48. Although Pan Am ultimately outbid TXI to purchase National, TXI still netted a $47 million pretax profit by selling to Pan AM TXI's previously acquired 9.2% interest in National's outstanding stock. *See A New Air War: Pancho Lorenzo Flies High*, Time, Sept. 22, 1980, at 72, col. 1.

49. Texas Int'l-National Acquisition Case, CAB Order 79-9-163 (1979).

policy under the ADA.

In *TXI-National*, the CAB reversed an Administrative Law Judge (ALJ) finding that the proposed merger would substantially lessen competition in violation of section 408.[50] While the ALJ relied principally on market share statistics in individual city pairs, the Board adopted the broader *Brown Shoe* analysis used in the previous *North Central-Southern* decision.[51] For example, the ALJ found that the existing competition would be substantially lessened in the Houston-New Orleans market. At the time of the Board's decision, TXI controlled 24% of the market, National held 27% of the market, and Delta maintained 23% of the market. The ALJ reasoned that because a TXI-National merger would produce a 51% market share for the new firm, and a 74% market share for the two top firms (the merged firm and Delta), a TXI-National merger would violate guidelines proscribed by the United States Supreme Court in *United States v. Philadelphia National Bank*.[52] There, the Court found a violation of section 7 of the Clayton Act where the two merged firms would have had a 30% market share and the merged firm plus its second-ranking competitor would have controlled 59% of the market.[53]

The Board noted, however, that *Philadephia Bank* merely raised a presumption that a 30% merged firm market share and 59% two-firm concentration ratio violated Clayton section 7.[54] Moreover, the CAB cited with approval a more recent section 7 case, *United States v. General Dynamics*.[55] There, as in *Brown Shoe*, the Supreme Court examined all competitive factors in the industry involved, and found no violation of section 7 even though the market shares involved were presumptively illegal under *Philadelphia Bank*.[56]

Summarizing its views, the Board stated: "We believe that we should apply antitrust law functionally, and in light of the recent and ongoing deregulation of the airline industry. The case law just reviewed reveals a reemphasis of the Supreme Court's belief that a thorough review of competitive circumstances is advisable."[57]

The CAB opinion also favorably noted TXI statistics that 84% of the

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50. Initial and Recommended Decision of Administrative Law Judge William H. Dapper at 62, Texas Int'l-National Acquisition Case, CAB Order 79-9-163 (1979).

51. Texas Int'l-National Acquisition Case, CAB Order 79-9-163 at 9 (1979).

52. 374 U.S. 321 (1963); *see also*, United States v. Aluminum Co. of America, 377 U.S. 271 (1964). In *Alcoa*, a section 7 violation was found even though the acquiring firm would have increased its market share by only 1.3%.

53. United States v. Philadelphia Nat'l Bank, 374 U.S. 321, 362 (1963).

54. *Id.* at 367; *see also* Texas Int'l-National Acquisition Case, CAB Order 79-9-163 at 16 (1979).

55. 415 U.S. 486 (1974).

56. Texas Int'l-National Acquisition Case, CAB Order 79-9-163 at 16 (1979).

57. *Id.*

top 200 city pairs have two-firm concentrations in excess of 74%. Such markets are therefore as concentrated as Houston-New Orleans would have been after a TXI-National merger. As TXI ao aptly stated in its brief to the Board: "If a two-firm city pair concentration ratio of 74% is held to imply the likelihood of anticompetitive performance, then it would be necessary to conclude that the entire deregulated industry is likely to be rampant with monopoly power."[58]

Thus, the Board concluded that market share data should by *only one* of several factors in resolving whether an airline merger substantially lessens competition in violation of section 408.[59] The decision lists other factors such as ease of entry and exit under deregulation as examples of competitive factors tending to overcome a presumption of lessened competition under a *Philadelphia Bank* market share analysis. The board pointed out that by the fourth quarter of 1978, TXI, a relative newcomer, had captured the largest share of the Houston-New Orleans market.[60] More significantly, the decision noted the success of Southwest Airlines, which entered the Houston-New Orleans market in February, 1979, and by August, 1979, accounted for 24% of the nonstop capacity.[61]

Further, the CAB opinion asserts that Southwest's experience demonstrates that TXI's "hub strength," i.e., its established gates and network center at Houston, does not create a significant entry barrier for new firms lacking such "hub strength." Merger opponents had argued unsuccessfully that lack of "hub strength" creates entry barriers by substantially increasing entry costs. However, prior to entering the Houston-New Orleans market, Southwest had no such gate facilities, and also lacked the feed traffic afforded other carriers with established flight networks. The Board concluded that Southwest's success reflects a strong competitive environment in the Houston-New Orleans market, despite market share statistics suggesting otherwise.[62]

Besides ruling that the loss of National would not substantially reduce actual competition in the Houston-New Orleans market, the Board also reversed an ALJ decision that a National-TXI merger would substantially reduce *potential* competition in sixteen other city pairs.[63] Specifically, the

58. *Id.* at 74-75.

59. *Id.* at 6.

60. *Id.* at 18.

61. *Id.*

62. *Id.* at 19.

63. The 16 additional markets examined by Administrative Law Judge Dapper were: 1) Houston-Los Angeles; 2) Houston-Las Vegas; 3) Houston-Ft. Lauderdale; 4) Houston-Miami; 5) Houston-Tampa; 6) Houston-Orlando; 7) Houston-San Diego; 8) Houston-Orlando; 9) Houston-Phoenix; 10) Houston-Tucson; 11) New Orleans-Tampa; 12) New Orleans-Orlando; 13) New Orleans-Ft. Lauderdale; 14) New Orleans-Miami; 15) New Orleans-Jacksonville; 16) Houston-Albuquerque. *Id.* at 70-79.

Board stated:

> a TXI acquisition of National would not substantially reduce the future competitive performance in any of these Southern Tier markets. The doctrine of potential competition, as explained in various federal court cases, has been developed to protect the diminished competitive pressures that are often found in concentrated industries where entry is expensive and not altogether likely.[64]

Supporting its conclusion that the *TXI-National* merger would not substantially lessen potential competition, the Board cited *United States v. Marine Bancorporation*:

> The potential competition doctrine has meaning only as applied to concentrated markets. That is, the doctrine comes into play only where there are dominant participants in the target market engaging in interdependent or parallel behavior and with the capacity effectively to determine price and total output of goods or services. . .there would be no need for concern about the prospects of long-term deconcentration of a market which is in fact genuinely competitive.[65]

The CAB noted that the *Marine Bancorporation* decision reiterated the view that concentration statistics may be rebutted by evidence of other competitive factors. Further, the Board cited *Federal Trade Commission v. Procter & Gamble*[66] for the notion that the elimination of one of several potential entrants is insignificant.[67] The Board's decision goes on to note that "the most significant barrier to competitive entry in the domestic system was a regime of restrictive licensing, . . .eliminated by passage of the Deregulation Act."[68]

In addition to legal and regulatory constraints, the Board held that commercial factors such as start-up costs do not pose significant entry barriers for the domestic airline industry. "Since November of 1978, multiple permissive entry awards have generated new entry into more than 130 markets throughout the country. . . .Entry on this scale is persuasive of low entry barriers."[69] Finally, the CAB concluded in *TXI-National* that, besides regulatory or commercial barriers, no other special conditions exist which might result in a loss of potential competition.[70]

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64. *Id*. at 23.

65. 418 U.S. 602, 630-31 (1974). For additional United States Supreme Court potential competition doctrine, *see also* United States v. Falstaff Brewing Corp., 410 U.S. 526 (1973). For an economic analysis of the importance of potential competition in disciplining monopolistic and duopolistic airline routes, *see* Bailey & Panzar, *The Contestability of Airline Markets During the Transition to Deregulation*, 44 L. & CONTEMP. PROB. __ (1981).

66. 386 U.S. 568 (1967).

67. Texas Int'l-National Acquisition Case, CAB Order 79-9-163 at 24 (1979).

68. *Id*. at 27.

69. *Id*. at 29.

70. *Id*.

B. CAB Approval of Pan Am-National Merger

The CAB also overturned an ALJ decision in *Pan Am-National* that such a merger would substantially lessen competition in violation of section 408.[71] As in *TXI-National*, the Board held that a presumed violation of section 408 based on a *Philadephia Bank* market share analysis was overcome in this case by other procompetitive factors: "the most crucial factors [in determining the anticompetitive effects of a merger] are those which determine the nature of competition—for example ease of entry, traffic density, the number of actual competitors, and the likelihood of new entry."[72]

1. The United States-Western European Market

Applying the above standards to the effect of the *Pan Am-National* merger on the United States-Western European market,[73] the CAB was unconvinced that the reduction of one scheduled carrier would substantially lessen competition. In particular, the CAB called attention to the large number of scheduled and charter carriers, as well as foreign and domestic carriers now serving and willing to enter, the northern transatlantic market. The Board cited a number of bilateral agreements[74] between the United States and various nations across the Atlantic, including Germany, Israel and the Benelux countries, as further evidence of strong competitive conditions in the United States-Western European market.[75]

Additionally, the Board cited ADA provisions: 1) permitting expedited procedures without oral hearing in route application cases;[76] 2) allowing incumbents more flexibility to exit markets;[77] and 3) easing the exemption requirement.[78] Clearly, evaluation of all such competitive factors is consistent with *Brown Shoe*, and follows the Board precedent set in the original section 408 case, *North Central-Southern*.

Finally, the CAB noted that discount fares in such markets as New York-Frankfurt the New York-Amsterdam actually declined in the twelve

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71. Pan. Am. World Airways-National Acquisition Case, CAB Order 79-9-163 at 32 (1979).

72. *Id.* at 37.

73. *Id.* at 32-34. The Board adopted the ALJ's recommended decision that the United States-Western Europe and United States-London be adopted as relevant markets for considering the competitive effects of the merger.

74. *See, e.g.*, Air Transport Services Agreement between the United States and Switzerland, Amending the Interim Agreement of August 3, 1945, as amended, and the Agreed Minute of February 6, 1957, signed at Bern, December 9, 1970. *See also*, Air Transport Services Agreement between the United States and France, March 27, 1946, as amended.

75. Pan. Am. World Airways-National Acquisition Case, CAB Order 79-9-163 at 37-40 (1979).

76. 49 U.S.C. § 1371(p) (1978).

77. *Id.* § 1371(g).

78. *Id.* § 1371(b).

months ending June, 1979.[79] The CAB questioned whether National was ever a "vigorous price competitor." In the first five years of National's Miami-London service, National merely followed International Air Travel Association (IATA) fares. After National began serving Paris and Frankfurt, it either followed IATA or matched off-peak fares charged by Air France and Lufthansa. On such evidence, the CAB concluded that the record did not support a finding that National was a vigorous price competitor.[80] "We do not feel that by losing National as an independent competitor, we are losing a price innovator in the transatlantic."[81]

2. The Miami-London Market

Contrary to its finding in the United States-Western Europe market, the CAB did find that competition in the London-Miami submarket would be "substantially lessened"[82] after the merger because Pan Am would be the only scheduled carrier remaining. Further, granting Pan Am the Miami-London market would leave Pan Am with approximately 35% of the United States-London market. Section 408(b) permits the CAB "to impose such terms and conditions as it shall find to be just and reasonable when approving a merger." As a result, the CAB was able to approve the National-Pan Am merger on the condition that Pan Am agree to divest itself of National's Miami-London route authority. However, Pan Am was also required to maintain National's current gate facilities at London's Heathrow Airport—facilities which were in short supply and difficult to obtain—until suitable competitive service was approved by the CAB.

Finally, the CAB resolved in *Pan Am-National* the issue left unresolved in *North Central-Southern*: it held section 408 *does* require both a "public interest" test and an "antitrust" test,[83] thus rejecting arguments by the Departments of Transportation and Justice that the section 408 "public interest" and "antitrust" tests were one and the same.

The Board conceded that many of the antitrust factors are included in "public interest" considerations, but emphasized that the section 408 "public interest" tests include other factors as well.[84] The Board's decision thus leaves open the possibility that a proposed merger could meet the antitrust test, yet be rejected for failure to meet somewhat nebulous "public policy" considerations. A literal reading of section 408—"Unless. . .the Board finds that the transaction will not be consistent with the public interest

79. Pan. Am. World Airways-National Acquisition Case, CAB Order 79-9-163 at 41 (1979).

80. *Id*. at 43.

81. *Id*. at 44.

82. *Id*. at 46.

83. *Id*. at 59.

84. *Id*. at 60.

or that the section 408 antitrust tests will not be fulfilled. . ."[85]—suggests that the CAB decision is correct.

C. CAB Rejection of Eastern-National Merger

In what now appears to be little more than a historical anomaly, a Board majority rejected the Eastern-National merger.[86] The CAB believed a substantial reduction of competition in violation of section 408 was likely, particularly due to capacity restraints at certain airports along the eastern seaboard.

In disapproving *Eastern-National*, the Board endorsed an ALJ finding that the proposed Eastern-National merger would have caused a substantial lessening of actual competition in the New York-Florida, Washington-Florida, New York-Washington, and intra-Florida markets.[87] The ALJ had earlier held that unavailability of slots (airside space) at Washington's National Airport and New York's LaGuardia and JFK Airports may well have posed insurmountable barriers to entry in New York-Washington, New York-Florida, and Washington-Florida markets.[88] Interestingly, with the Board's recent approval of *Continental-Western II*,[89] *Eastern-National* became the only merger proposal since deregulation to be disapproved.

V. The First Show Cause Proceeding: The *Republic-Hughes* Merger

After processing six merger applications, the CAB promulgated a new Part 315 of the Board's Procedural Regulations,[90] providing that merger applications will be processed by hearing unless the Board states otherwise. Based on its experiences in processing previous mergers under amended section 408, and on approximately 4,000 pages of information filed by Republic to comply with the new part 315 Board merger application procedure,[91] the Board concluded that a Show Cause Order would be the

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85. *See* note 15 *supra*; *see also* section 408 excerpt note 10 *supra*. Besides arguing that the legislative history indicates Congress intended the section 408 and public interest standards to be one and the same, the Justice Department cited Train v. Colorado Pub. Interest Research Group, 426 U.S. 1 (1976), for the notion that legislative history should be considered no matter how unambiguous the statutory language might seem. Posthearing Brief of the Department of Justice to Administrative Law Judge Stephen J. Gross at 10-13, Continental/Western I, CAB Order 79-9-185 (1979).

86. Application of Eastern Airlines for Approval of Acquisition of National, CAB Order 79-12-74 (1979).

87. Initial Decision of Administrative Law Judge Richard J. Murphy at 63, Eastern-National Acquisition Case, CAB Order 79-12-74 (1979).

88. *Id.*, at 43.

89. Continental/Western II, CAB Order 81-3-__ (1981).

90. 14 C.F.R. 315 (1980). *See also* CAB Regulation PR-221 (1980), which provides additional background for the Board's Procedural Regulations.

91. Application submitted by Republic Airlines, Inc., for Approval of the Acquisition of Hughes

best method for handling the Republic-Hughes merger.[92]

On May 16, 1980, pursuant to new Part 315, the CAB issued to the public an Order to Show Cause within sixty days why the CAB should not make final its tentative conclusion to allow Republic to acquire control of Hughes.[93] Republic's application and supporting material were sufficient to support a Board conclusion[94] that: 1) the merger would not be inconsistent with the public interest; 2) the merger would not violate section 408 antitrust standards; and 3) the application presented no issues of material fact. On September 12, 1980, the Board formally adopted the tentative conclusions listed in the Show Cause Order, and approved Republic's purchase of Hughes.[95]

The Show Cause Order reflected the Board's view that "a coherent theoretical framework for analyzing mergers has evolved. . .as a synthesis of our experiences with mergers under the amended Section 408."[96]

In its Show Cause Order, the Board outlined the standards which have evolved to date for interpreting the new section 408.[97] First, it emphasized that the product market has consistently been defined as scheduled air transportation, and the relevant geographic markets have been city pairs, cities, regions, and the nation.[98] Second, the CAB affirmed applicability of the *Brown Shoe* "functional" test for each merger's individually defined markets. The CAB reaffirmed the notion that *Brown Shoe* requires an examination of a relevant market's structural characteristics, including entry barriers, potential entrants,[99] ability of merging firms to increase entry barriers, and the degree of concentration in particular markets.[100]

Applying the above standards to *Republic-Hughes*, the CAB found that "Republic and Hughes do not engage in any single-plane competition in any city pair at the present time."[101] The Board also found that the two carriers did engage in "a *de minimus* amount of single carrier competition through connecting service in three markets."[102] However, because each carrier's share was "infinitesimal," the Board believed it highly unlikely that

Air Corp., Republic-Hughes Airwest Acquisition, CAB Order 80-9-65 (1980) [hereinafter cited as Republic Application].

92. CAB Order 80-5-108 (1980) [hereinafter cited as Show Cause Order]

93. *Id*.

94. *Id*. at 2.

95. Republic-Hughes Airwest Acquisition, CAB Order 80-9-65 at 1 (1980).

96. *Id*. at 6.

97. *Id*. at 7.

98. *Id*.

99. *Id*. For United States Supreme Court potential competition doctrine, *see* cases cited note 65 *supra*.

100. *Id*.

101. *Id*. at 8.

102. *Id*.

the merger would reduce actual competition to any harmful extent.[103]

On a regional basis, the Board found that in the six cities where the two systems met, the merger was not likely to lessen substantially *actual* competition because of a large number of other carriers and potential entrants.[104]

On a national level, the Board ruled that Republic's application satisfactorily demonstrated that the merger would not violate the Justice Department Merger Guidelines:[105] the proposed merger of Republic (twelfth largest carrier) and Hughes (fourteenth largest carrier) would only result in the nation's eleventh largest carrier. Therefore, the Board found that a Republic-Hughes merger was unlikely to lessen substantially *actual* competition in any city pair, city, region, or the nation.

The Board also declared that *potential* competition was not likely to be substantially lessened in any of the relevant markets (city pairs, cities, regions, the nation). To reach this tentative finding, the Board relied on the assertion in Republic's application that neither "Republic nor Hughes Airwest has any plans to enter any of the other carrier's markets absent an acquisition."[106]

As for the separate section 408 "public interest" test required since *Pan Am-National*,[107] the Board concluded without discussion that the merger was not inconsistent with the public interest.[108]

Finally, as in every merger case since the ADA became law, the Board declined to grant antitrust immunity under section 414. "Republic has not requested immunity for the acquisition, and we have decided not to confer it because we do not believe that immunity is required by the public interest."[109]

VI. Reversal of a CAB Rejection: The *Continental/Western* Merger Cases

In *Continental/Western I*, a Board majority found that the "merger may have resulted in a substantial lessening of competition for several reasons."[110] Those reasons included findings that "Continental and Western are both aggressive competitors,"[111] that certain pricing inflexibilities still

103. *Id.*
104. *Id.*
105. Justice Department Merger Guidelines, note 32 *supra*.
106. Republic Application, *supra* note 91, at 10.
107. *See* text containing notes 83-85 *supra*, concerning the Board's holding that section 408 requires both a public interest test and an antitrust test.
108. Show Cause Order, *supra* note 88, at 9.
109. *Id.* at 10.
110. Continental/Western I, CAB Order 79-9-185 (1979), at 1.
111. *Id.*

remained from the prederegulation environment,[112] and that airport entry limitations at Denver, San Francisco, and San Diego might substantially delay competitive entry by new and different carriers.[113] The Board was particularly concerned that such airport access problems might prevent other carriers from entering affected routes quickly enough to avoid a duopoly between the merged carrier and United in the region west of Denver.[114] However, when Continental and Western re-submitted their merger application approximately one year later in *Continental/Western II*,[115] the Board found that post-deregulation circumstances had changed enough that the anticompetitive effects of the merger no longer rose to the level of substantially lessening competition in violation of section 408 of the ADA.

The latest Continental/Western application asserted that deregulation has brought about dramatic changes in entry and pricing behavior.[116] Specifically, the applicants noted that deregulation has already resulted in fourteen new carriers using jet aircraft, in new carrier exits and entries in 67% of the nonstop routes west of Denver, and in extended western route operations by Delta, Eastern, USAir, Republic, Air California, Southwest, and PSA.[117]

Commenting on whether the merger will lead to a duopoly between United and the merged carrier in the routes west of Denver, the application noted that "Denver has been entered by five new carriers since 1977; San Diego, San Francisco, and Los Angeles have been entered by three each."[118] Further, Continental/Western asserted that there "is no longer any reason for concern"[119] about airport access limitations which might hinder a competitive response to possible duopolistic behavior between United and the merged carrier west of Denver. The application noted:

> All of the Continental and Western route overlap cities have had new entrants since deregulation. Most have been entered by three or more new carriers and all have experienced a net increase in carriers. The two airports which had evidenced reservations about new entry when this case was last heard, San Diego and San Francisco, have formally adopted policies to accommodate new entrants. Every carrier wanting to serve these cities has been granted entry. Indeed, the four airports of concern to the Board, namely Denver, San Diego, Los Angeles, and San Franisco, today have as many or more carriers serving them than do other cities which generate the same or even more pas-

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112. *Id.* at 2.

113. *Id.*

114. *Id.*

115. Continental/Western II, CAB Order 81-3-__ (1981).

116. Joint Application of Continental Air Lines, Inc., and Western Air Lines, Inc., for Approval of Merger at 9, Continental/Western II, CAB Order 81-3-__ (1981).

117. *Id.*

118. *Id.*

119. *Id.* at 17.

sengers.[120]

The application added that Denver has accommodated 37% more departures since deregulation.[121] Furthermore, Continental/Western pointed out in its second application that the potential duopoly between the merged carrier and United is no worse than most markets around the country: "Continental and Western derive only 25.6% of their mainland revenues from routes also served by United. Every other carrier, except Ozark, derives a larger portion of its revenues from routes also served by its primary competitor."[122]

In approving *Continental/Western II*, the Board sustained an ALJ finding that the competitive climate has changed sufficiently so that the merger of Continental and Western can now be approved.[123] Still, while agreeing with the ALJ's conclusions, the Board in *Continental/Western II* clarified its views on the importance of market definitions, hub strength, and airport access problems in analyzing mergers.

In defining relevant antitrust analysis markets, the CAB found that aggregating airline traffic into "broad geographic regions ignores the differing service characteristics of the city pairs or clusters of city pairs in a region and the varying capabilities of airlines to serve particular types of routes."[124] Consequently, the Board concluded that analyzing mergers through regional markets is no longer consistent with the "functional" analysis, which determines whether a merger will result in excessive economic power in any relevant market.[125] Curiously, rejection of "regions" as relevant antitrust analysis markets appears to reverse, at least in *Continental/Western II*, Board policy in all previous merger cases decided since deregulation, including *Republic-Hughes*[126] which was decided only six months before *Continental-Western II*.

As in *TXI-National*,[127] the Board discounted the importance of hub strength, standing alone, as an insurmountable barrier to entry. The Board opinion agreed with the ALJ that "feed is a relative efficiency factor and that carriers with other types of economies can successfully compete against feed-rich carriers."[128] In so ruling, the Board downplayed possible distinctions between Houston, where Southwest Airlines successfully initiated service without previous hub strength, and Denver, the major hub of a

120. *Id.*
121. *Id.* at 19.
122. *Id.* at 21.
123. Recommended Decision of Administrative Law Judge John M. Vittone, Continental/Western II, CAB Order 81-3-__ (1981).
124. Continental/Western II, CAB Order 81-3-__ (1981), at 3.
125. *Id.*
126. Republic-Hughes Airwest Acquisition, CAB Order 80-9-65 (1980).
127. See text containing notes 60-62 *supra*.
128. Continental/Western II, CAB Order 81-3-__ (1981), at 6.

merged Continental-Western. In Denver, United, the merged carrier, and Frontier would control sixty-five of eighty-four available gates. Such hub strength is not altogether unlike the situation in Atlanta, where the "super hubs" of Delta and Eastern were reportedly significant factors in United's decision to abandon Atlanta.[129]

By downplaying the importance of feed and hub strength, the Board was also able to discount the relative significance of airport access problems at Denver. "Feed at Denver is not that essential to sustain a potential competitor and so the ability to bank a substantial number of flights is not required."[130] The Board thereby effectively circumvented arguments raised by merger opponents that the Director of Aviation at Denver's Stapleton International Airport has stated publicly that eight or ten airlines that would like to operate at Stapleton cannot, due to lack of space.[131]

Still, the immediate dearth of gates at Stapleton is quite severe. Because most existing gates at Denver are leased to incumbent carriers until 1993, two established Denver carriers, Frontier and Continental, are investing approximately $10 million apiece to build remote gate facilities at Denver, and approximately $1 million per year to maintain such facilities (as against $150,000 per year to maintain an ordinary airport gate).[132] It seems highly unlikely that new entrants would risk such outlay for remote gates, and no new gates are expected to be added for at least two or three years.[133] Consequently, potential entrants at Denver would appear to be, at least in the short term, precluded from entering and disciplining Denver markets.

However, because of mitigating factors such as a commitment by the City of Denver to foster new entry and expand existing services,[134] plus the merger opponents' failure to convince the Board that a fourth carrier capable of substantial hubbing at Denver is needed to preserve competition,[135] the CAB concluded that physical constraints at Denver will not cause the merger to result in a substantial lessening of competition.[136]

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129. *See, e.g., The Airlines Are Flying in a Fog*, Fortune, Oct. 20, 1980, at 50, col. 1.

130. Continental/Western II, CAB Order 81-3-__ (1981), at 14.

131. *See, Airport Chief Talks About Crowded Skies*, Rocky Mtn. News, Sept. 21, 1980, at 10, col. 1. Obtaining airport gates is not just a Denver problem. For an account of the problem at various locations nationwide, *see, Finding Space for New Airlines*, Bus. Week, Dec. 8, 1980, at 104, col. 1.

132. *See, e.g.*, Frontier Exhibits in Continental/Western II, CAB Order 81-3-__ (1981).

133. *See* Peat, Marwick, Mitchell & Co., Airport Master Plan, Stapleton International Airport (July, 1980).

134. Continental/Western II, CAB Order 81-3-__ (1981), at 16.

135. *Id.*

136. *Id.*

VII. Conclusions

In analyzing merger cases, it is interesting to note the relative profitability of the parties involved. Pan Am, despite its successful acquisition of National, reported record losses of $66.3 million for the second quarter of 1980. These extensive losses compare to a $37.1 million profit for the same period in 1979.[137] Similarly, TXI, outbid for National by Pan Am, reported net income of $645,000 for the second quarter of 1980, as against net income of $1.58 million for the same period in 1979.[138] Ironically, Eastern, whose bid to acquire National was dismissed as anticompetitive, was one of only two profitable passenger airlines (the other was Delta) in the first quarter of 1980.[139] While some analysts believe deregulation has been an overwhelming success,[140] others have argued that the airlines' successes and failures are more a result of general economic conditions than deregulation.[141] Virtually the entire passenger airline industry, whether or not involved in mergers, suffered substantial losses during the 1980 recession.

The seven passenger airline merger cases decided under the amended section 408 clearly indicate the Board has adopted a policy of examining all competitive factors which might affect competition in any relevant markets.

In *North Central-Southern*,[142] the CAB approved a merger involving two relatively small regional carriers whose routes met in a few common points, but did not overlap to any significant extent. The Board also found that without a merger, there was very little chance that either North Central or Southern would enter the other's territory. Arguably, the union of North Central and Southern actually increased passenger airline competition by affording the merged carrier, Republic, the economies of scale necessary to enter markets neither carrier would have entered alone. Similar reasoning applies to Republic's subsequent purchase of Hughes,[143] although there, the argument that Republic was an unlikely entrant into Hughes' route network becomes more tenuous because of Republic's strengthened route system acquired in the merger which created it. Still, no party in *Re-*

137. Wall Street J., July 25, 1980, at 5, col. 2.

138. Wall Street J., July 30, 1980, at 24, col. 7.

139. *Airline Layoffs and Flight Cuts Spread*, Wall Street J., June 19, 1980, at 4, col. 1.

140. *See, e.g.*, Miller, *Is Airline Deregulation Working?*, Wall Street J., Mar. 26, 1980, at 22, col. 4.

141. *See, e.g.*, Willard, *Airlines and the Economy*, Wall Street J., Apr. 7, 1980, at 19, col. 1. Willard argued that 11.2% of increased passenger travel in 1978 was due to income distribution alone, and that only 5% was due to fare cuts. Willard also predicted that after the economy headed into a recession in 1980, most airlines would lose money, regardless of deregulation.

142. North Cent.-Southern Merger Case, CAB Order 79-6-7 (1979).

143. Republic-Hughes Airwest Acquisition, CAB Order 80-9-65 (1980).

public-Hughes challenged Republic's assertion that absent a merger, Republic had no plans to enter Hughes' markets.

By contrast, both *Continental/Western I*[144] and *Eastern-National*[145] would have consolidated airline companies with substantial actual and potential route overlaps. Both applications were rejected as anticompetitive. The potential route overlap problem in *Continental/Western I*, coupled with airport access and price inflexibility problems, caused particular Board concern about the possible creation of a duopoly between United Airlines and the merged carrier in the region west of Denver.

TXI-National[146] and *Pan Am-National*[147] both strengthened and refined the trend begun in *North Central-Southern* toward antitrust law being applied functionally, and toward a thorough review of the industry characteristics in each case. Additionally, both the *TXI* and *Pan Am* cases emphasized that market shares are only one of many factors to be considered in determining whether the effect of a merger "may be substantially to lessen competition or to tend to create a monopoly." Although both TXI and Pan Am engaged in some direct competition with National, analysis of other competitive factors led the Board to conclude that neither merger would have violated Section 408. In the *TXI* case, existing competition and likely new entrants in actual and potential markets outweighed the loss of one independent competitor, National. In the *Pan Am* case, the Board found that bilateral agreements between the United States and Britain impede competitive entry into the Miami-London route. Still, the Board exercised its statutory power to "impose terms and conditions" and approved *Pan Am-National* on the condition that Pan Am divest itself of Miami-London route authority. The Board's questioning whether "National was ever a vigorous price competitor,"[148] further supports the finding that *Pan Am-National* and *TXI-National* did not substantially lessen competition.

Finally, in *Continental/Western II*,[149] the Board reversed its eighteen month-old finding in *Continental/Western I* that a merger of Continental and Western would substantially lessen competition in violation of section 408. The Board held that regional market definitions were not relevant in analyzing *Continental/Western II*, and downplayed the importance of "feed" traffic and airport congestion at Denver in approving Continental's and Western's second merger application. In light of the CAB's strong *laissez-faire* approach in approving the merger of Continental and Western, it seems highly unlikely that the Board will disapprove any future mergers,

144. Continental/Western I, *supra* note 5.

145. Eastern-National Merger, CAB Order 79-12-74 (1979).

146. Texas Int'l-National Acquisition Case, CAB Order 79-9-163 (1979).

147. Pan Am. World Airways-National Acquisition Case, CAB Order 79-9-163 (1979).

148. *Id*. at 43.

149. CAB Order 81-3-__ (1981).

including those now pending between Continental and Texas International, and between Air Florida and Air California. Perhaps merger opponents, including the United States Department of Justice,[150] will now attempt to circumvent Board merger policy by challenging airline mergers in the courts. Such collateral attacks are indeed possible, because the CAB has not once granted antitrust immunity since deregulation.

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150. *See, e.g.*, Brief of the Dept. of Justice at 4, Continental/Western II, CAB Order 81-3-__ (1981).