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## Price Discrimination and the Regulation of Air Transportation

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# PRICE DISCRIMINATION AND THE REGULATION OF AIR TRANSPORTATION

BY ALAN H. SILBERMAN†

## CONTENTS

- I. INTRODUCTION—SOME THEORETICAL PRELIMINARIES
  - A. *The Emerging Focal Role Of Price Regulation*
  - B. *The Full Dimension Of Price Regulation*
    - 1. *The Uses of a Single-Entity or Homogeneous Approach*
    - 2. *The Elements of a "Multi-Dimensional" Approach*
- II. HISTORICAL AND ECONOMIC FACTORS IN AIRLINE PRICE REGULATION
  - A. *Transportation Price Discrimination: Its Historical Context*
    - 1. *The Statutory Roots of the Rule Against Price Discrimination*
    - 2. *The Historical Meaning of "Non-Discriminatory" Rates*
    - 3. *The Shift from Consumer Protection to "Competitive" Balance*
    - 4. *The Distinctive Position of the Airline Industry*
  - B. *The Relation Of Economics To Rate Regulation*
    - 1. *The Role of Social and Political Considerations*
    - 2. *The Significant Economic Factors in Air Transport*
  - C. *The Responsibility For The Application Of Economic Theory*
- III. THE Ad Hoc APPROACH TO PRICE DISCRIMINATION
  - A. *Introduction—The Basis For The CAB's Managerial Philosophy*
  - B. *Early Pricing Practices In Air Transportation*
    - 1. *Premium and Discount Pricing*
    - 2. *The Air Travel Plan*
    - 3. *The Treatment of Rate Relationships*
  - C. *Administrative Regulation And The Egalitarian Ethic*
    - 1. *The Avoidance of Product or Market Definitions*
    - 2. *The Use of Different Standards in Competitive and Non-Competitive Cases*
      - a. *The Treatment of Surface Carrier Competition*
      - b. *Balancing "Competition" Between CAB-Regulated Carriers*
      - c. *Meeting the Competition of Unregulated Air Carriers*
    - 3. *The Tendency Toward Cost-Increasing Forms of Competition*
    - 4. *The Absence of a De Minimis Approach to Discrimination*
  - D. *Specific Problems of Pricing Technique*
    - 1. *The Problem of Identity Fares*

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2. *The Use of "Tour Basing" Fares and Similar Excursion Requirements*
3. *The Assumptions of Family-Plan Fares*

#### IV. CONCLUSION—AIR CARRIER OPERATIONS UNDER A MODIFIED REGULATORY SCHEME

- A. *The Findings Suggested By This Study*
- B. *Some Perceptible Changes In CAB Attitudes: The Approval Of Non-Emulative Responses To Inter-Carrier Competition*
- C. *Increasing Managerial Alternatives In Operating Authority: An Area For Future Investigation*

#### I. INTRODUCTION—SOME THEORETICAL PRELIMINARIES

##### A. *The Emerging Focal Role Of Price Regulation*

AS THE domestic air transport industry continues to mature, questions of inter-carrier competition and allowable latitudes in pricing experimentation have begun to emerge as matters of singular importance. In this respect, commercial aviation is no different than any other new industry with high developmental costs. During a period of rapid technological change and major expansion of production facilities, pricing, and price competition in particular, have but limited significance. However, as the pace of technological innovation slows and the producers' market areas stabilize, the industry enters a new phase in which pricing practices may be expected to become the major competitive tool. Recent developments suggest that the domestic trunkline carriers have entered such a phase.

With the application of turbine power to medium and short-range aircraft, the rapid pace of technological development which characterized the first two postwar decades has slowed measurably. Aircraft now being phased into service or just entering the production stage, such as the BAC-111, DC-9, Boeing 737 and the like, are no longer surrounded by the mystique of new aerodynamic frontiers, nor do they partake of the earlier "romance of air transportation" in which any acquisition was viewed as a sign of progress and growth. The decisions to purchase such aircraft and the operational use to which they are put are today essentially market-oriented decisions in which the carrier's ability to stimulate demand and achieve the most efficient use of its resources and maximize revenue, become determining factors. Any estimate of this ability must necessarily rest on the carrier's evaluation of the latitude it has in pricing and packaging its product.<sup>1</sup> While this transformation is not fully com-

<sup>1</sup> Regulatory policy may be an incentive for increased investment in one of two ways, by preserving artificial fare levels or by assisting in the generation of new consumer demand. The recent announcement of substantial new jet aircraft purchases by the major trunkline carriers, points up the conflict which may arise. On the one hand, the aircraft ordered must be paid for, encouraging a "gentlemen's agreement" tacitly supported by the CAB, designed to protect or increase present rate-of-return levels. On the other hand, the added seat-miles produced by the new aircraft must be sold to consumers. While demand for air transportation continues to rise, the potential new consumers are both more cost conscious and also less frequent travelers. The possibility that these factors may run at cross-purposes is obvious.

plete, as anyone following the reactions to the construction of a supersonic transport (SST) may testify, the supersonic age is sufficiently remote and dependent on a number of serious questions of economic practicality yet unresolved, that its current effect on the industry is hardly more than negligible.

Other indices support the hypothesis that domestic air transportation has entered a new phase. With the exception of the route awards which may possibly be made in the *Pacific Northwest-Southwest Case* recently instituted,<sup>2</sup> the era of major trunkline route expansion is over. Moreover, the possibility of new entrants in the trunkline field is highly remote. The control of entry may remain as an interesting academic question, but it cannot be considered as a practical regulatory problem.<sup>3</sup>

These factors combine to make pricing practices the primary focus of carrier competition (and of possible anti-competitive activity as well). While the industry has experienced similar conditions before on a short-term basis, principally in the late forties and again at the beginning of the jet age, the current phase may be expected to be of substantially longer duration. Accordingly, it must be looked upon not merely as a "transitional" period, but as a continuing condition calling for a thorough examination, by the industry and the Civil Aeronautics Board, of the regulatory philosophy which has emerged from the numerous *ad hoc* considerations of carrier pricing proposals.

### B. *The Full Dimension Of Price Regulation*

The probability of increased emphasis on pricing as a potential competitive response poses substantial problems in any industry. For a regulated industry, the problems are heightened. The range of possible responses to competition is narrowed by the fact of agency control. For an agency charged with charting a course in the grey area between complete regulation and full-blown competition, the attendant shift in focus from general competitive rates-of-return and appropriate fare levels to specific competitive rates is a severe test of its institutional capabilities. So long as the primary concern is limited to finding an average rate-of-return which would approximate a competitive model,<sup>4</sup> the industry may be properly

<sup>2</sup> CAB Docket No. 15459, CAB Order No. E-21186 (13 Aug. 1964) (instituting proceeding).

<sup>3</sup> See Caves, *Air Transport and Its Regulators* 86-91 (Harvard Economic Studies, Vol. CXX, 1962) [hereinafter cited as Caves]. Caves' study is a highly successful integration of factual material and economic analysis covering all aspects of the industry and the CAB. Its assistance in the preparation of this essay is gratefully acknowledged. While entry into the trunkline field is restricted by the sheer height of the economic barriers, entry does remain an open question with regard to so-called "third-level air carriers," see, e.g., C. E. Walts, d/b/a Hi-Plains Airways, CAB Docket No. 12258, CAB Order No. E-19343 (1 March 1963). Similar questions are also infrequently posed by applications for exemption from air taxi takeoff weight restrictions, e.g., Aspen Airways, Inc., CAB Docket No. 13159, CAB Order No. E-21761 (4 Feb. 1965), and special services in particular markets for limited periods of time, e.g., Vance Roberts, d/b/a Vance International Airways, CAB Docket No. 15802, CAB Order No. E-21766 (5 Feb. 1965) granting exemption to operate individually-ticketed service with one 99-seat DC-7 aircraft between San Francisco and Los Angeles on the one hand, and Twin Falls, Idaho, on the other, on weekends between 6 Feb. 1965 and 7 March 1965.

<sup>4</sup> The rate-of-return which would "approximate a competitive model" should not be confused with a competitive rate-of-return. The "model" is simply an analytical tool which allows profit to be evaluated against a standard of average efficiency so that a higher-than-specified rate-of-return will be treated as the efficient carrier's just reward. Determining the specified rate-of-return is a separate question.

viewed as a single entity or, as the subject under consideration requires, as a small number of homogeneous groupings. However, such an approach is of little value when the agency is called upon to deal with inter-carrier competition and must focus on different carriers' attempts to use their resources in alternative methods and often in less than all of the markets they serve. Moreover, as we shall note below, the dimensions of price regulation must be extended to comprehend alternative responses to competition which do not involve modifications of the tariff structure but rest on attempts to achieve lower costs or capture new sources of revenue by making operating changes. In such instances, the competitive potential of the industry can only be maximized through the use of a "multi-dimensional" approach in which significant differences in efficiency, equipment and route structure between carriers can be recognized and incorporated in the decision-making process.

### 1. *The Uses of a Single-Entity or Homogeneous Approach*

Within a regulated pricing structure, price regulation decisions take two forms. First, what is the appropriate rate of return for the carrier, carrier-group or industry? Second, how will this return be obtained? Under a system which guarantees each enterprise a standard rate of return without regard to its efficiency, the problem is none too difficult, so long as the units do not purport to be competitive. To be sure, there will be minor problems of allocating charges and perhaps interminable arguments as to the propriety of various cost accounting methods. Still, a decision need only consider what is "fair" to the consumer.<sup>5</sup>

If, however, the industry is competitive, in whole or in part, a standard rate of return for all units is inappropriate. Since it provides no incentive for efficiency, a standard rate would tend to increase costs. So long as the units are the proponents of rate proposals,<sup>6</sup> there is little compulsion toward rational pricing.<sup>7</sup> Where units of varying efficiency are competing with different enterprises in different markets and have noncompetitive rights in others, any determination of appropriate price levels in each market presents insurmountable problems. Under such a system, an attempt to gauge costs on a market-by-market basis or carrier-by-carrier basis would yield no guides. Indeed, it would seem to complicate matters even more. The Civil Aeronautics Board has wisely eschewed suggestions that they involve themselves directly in this morass,<sup>8</sup> although, as will appear later, their rationale is open to questioning. When direct subsidy is also present, decisions as to price level may appear somewhat easier, assuming a bias toward obtaining the highest possible profit and a view

<sup>5</sup> Obviously, the interests of the enterprise demand that long and detailed arguments be made concerning what should be included in the rate base. These problems, however significant, are common to all rate-of-return inquiries and, on the whole, appear to rest on long-standing administrative practice and general, if grudging, industry acceptance.

<sup>6</sup> The CAB, like the ICC, is empowered to make rates. See Federal Aviation Act of 1958 § 1002(d), 72 Stat. 788 (1958), 49 U.S.C. § 1482(d) (1964), set out in note 24 *infra*. However, chief rate-making responsibility rests with the carriers and direct CAB rate-making is a rare occurrence.

<sup>7</sup> See Local-Service Class Subsidy Rate Investigation, 34 C.A.B. 416 (1961).

<sup>8</sup> See Gellman, *The Regulation of Competition in United States Domestic Air Transportation: A Judicial Survey and Analysis—II*, 25 J. Air L. & Com. 148, 161 (1958).

that competition is no more than a device for ensuring adequate service in the market. Here too, the regulatory body must consider what portion of increased (or decreased) profits is to be borne by subsidy, by the enterprise or by consumers in various markets.<sup>9</sup>

The Civil Aeronautics Board, charged by statute to promote "competition to the extent necessary to assure the sound development of an air transportation system . . . ,"<sup>10</sup> has grappled with the problem in dealing, albeit infrequently, with problems of return on investment and the overall fare level:<sup>11</sup>

[T]o use the most poorly situated carrier as the unit of ratemaking would result in the vast majority of the public paying rates greatly in excess of the cost . . . and would unjustly enrich the great majority of the air carriers. By the same token, we obviously cannot fix fare levels on the basis of the need of the most favorably situated carrier.<sup>12</sup>

The Board's solution has been to describe a desirable range for return on investment based on hypothetical costs for homogeneous carrier-groups.<sup>13</sup>

<sup>9</sup> See text accompanying note 129 *infra* for an example of this problem.

<sup>10</sup> Federal Aviation Act of 1958 § 102(d), 72 Stat. 740 (1958), 49 U.S.C. § 1302(d) (1964), set out in note 24 *infra*.

<sup>11</sup> Despite a recent trend toward such proceedings, see, e.g., Rate of Return, Local-Service Carriers Investigation, 31 C.A.B. 685 (1960); General Passenger-Fare Investigation, 32 C.A.B. 291 (1960); and Local Service Class Subsidy Rate Investigation, note 7 *supra*, such investigations may nevertheless be termed "infrequent" when considered in relation to the numerous proceedings investigating specific fares. Moreover, between 1938 and the first case cited herein, there was only one proceeding dealing with rate-of-return and general fare level questions. See text accompanying notes 123-31 *infra*.

As this article is being prepared for publication, the CAB has embarked on a new set of proceedings involving questions of fare level and the level of payments for the carriage of mail. On 21 July 1965, the Board announced a proposed \$4.95 million reduction in domestic service mail rates, Domestic Service Mail Rate Case, CAB Docket No. 15726, CAB Order No. E-22461 (21 July 1965) (statement of provisional findings and conclusions and order to show cause), and, at the same time, instituted a new investigation, Domestic Service Mail Rates, CAB Docket No. 16349, CAB Order No. E-22462 (21 July 1965), to establish mail rates for the period following the expiration of the newly-proposed rates. Previously, carriers had received mail pay on the basis of rates established in 1955. American Airlines, Inc., Domestic Trunklines Service Mail Rates, 21 C.A.B. 8 (1955).

In addition, a new round of passenger tariff revisions proposed in connection with the modification of free baggage allowances has stimulated concern with the general passenger fare level and, more importantly, with the effect the carrier's healthy earnings position has on the development of air transportation. See note 1 *supra*. Thus, the Board severed the proposed tariff revisions from the baggage revision, allowing the latter to go into effect and suspending the fifty-cent increase in first-class fares which had been proposed along with it. Domestic Trunkline Carriers, CAB Docket No. 16363, CAB Order No. E-22483 (27 July 1965).

Perhaps even more significant is the fact that the Board, in the course of its order in *Domestic Trunkline Carriers*, stressed the opportunities for carrier initiative in matters of specific pricing techniques and operating authority which could be exercised within the agency-determined rate-of-return framework:

There are a number of areas which the airlines could examine in order to bring additional service improvements to the public without compromising a healthy earnings position. The following examples illustrate some of the improvements which the carriers may consider. As the short-range jets replace piston aircraft in many additional markets, bringing the benefits of better service at lower unit costs, and as the volume of traffic increases, the industry efforts should be directed toward developing low-cost transportation services on these segments. The carriers could also improve the adequacy of existing coach service by extending such service to more communities, and by increasing, in certain instances, the number of coach seats in dual configuration aircraft to reflect the relative demand for coach and first class service, provide better service to small cities, and experiment with additional economy services to high traffic density markets on a sound economic basis. *Id.* at 7-8.

<sup>12</sup> General Passenger-Fare Investigation, *supra* note 11, at 330.

<sup>13</sup> E.g., the "Big Four," the "Medium Eight" (seven since the United-Capital merger), local service carriers and all-cargo carriers.

The hypothetical cost curve (or "class rate") becomes a standard against which all carriers, despite individual variations in output, density or route structure, can "compete" and be measured.<sup>14</sup> The analysis thus gives the Board a standard upon which to gauge the overall fare level and a means of ascribing profits falling outside the desirable range to highly efficient or inefficient operations.

Such an approach is well suited to this aspect of the pricing problem. However, since it encompasses only one-half of the price regulation function, its reliance on efficiency and cost factors only serves to keep a check on carriers' returns on investment.<sup>15</sup>

Competition against such an external standard is not actual competition. The external standard is built on the hypothesis that all carriers are producers of comparable units—seat-miles, passenger-miles, or ton-miles—when in fact the carriers are multiple-product producers, using aircraft to manufacture point-to-point transportation, which is then sold by seat or ton-mile and may be packaged in various "containers." *E.g.*, the product may be sold non-stop or multi-stop; one-way, round-trip or one of several variations in between; and the manufacturing tool (the aircraft) may be operated so that different products may be produced simultaneously. Accordingly, the "homogeneous" approach cannot be applied when competition within the industry is in issue. It provides no incentive for efficient allocation of resources and offers no guidelines for evaluating specific fare proposals.

However, as this study hopes to demonstrate, the CAB has failed to recognize this distinction and generally has dealt with specific fare proposals on an industry-wide basis, *i.e.*, as if all carriers were identically situated. In the earlier phases of the industry's development, such errors may have had little recognizable effect. However, as specific pricing problems of particular carriers become the central issue in air carrier competition and regulation, the Board's failure to approach these questions with criteria which will promote efficient operations through reliance on competitive norms becomes more significant. The incentive for efficiency provided by an approach based on the assumption of a homogeneous industry

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<sup>14</sup> A class rate structure, however, is prone to abuse by the CAB to the extent that it is used to foster homogeneity within the industry by making decisions to encourage all carriers to conform to the hypothetical cost curve, or to the extent that decisions are based on the result obtained when the formula is used to determine subsidy levels rather than on the actual facts (*e.g.*, a local service carrier may be serving a point at a profit of \$12,000, but deletion of the point will cause the subsidy level determined by class rate formula to drop; reliance on the formula can thus result in the deletion of profitable service in the name of subsidy reduction).

<sup>15</sup> That is not to say that the return on investment which the CAB allows is as low as it might possibly be. On the one hand, allowable return is a function of the risk involved—the extent to which regulatory policy results in a high guaranteed minimum return, route competition notwithstanding. On the other hand, demands for sufficient return to cover the cost of new investment, *supra* note 1, push the allowable return up over what it would be if there was no notion of a guaranteed minimum. The essential question is whether allowing a high rate-of-return is really a function of necessary new investment or vice-versa, *viz.*, that the extent of new investment is in part controlled by the fact that it can be used to prevent a lowering of the allowable return. In any case, controlling the return on investment factor does not involve any inquiry as to how the desired return will be obtained, a problem which becomes even more significant if regulatory policy tends to encourage overinvestment.

is sufficient for rate-of-return and similar questions.<sup>16</sup> Its application to specific pricing proposals is an illogical limitation on the industry's potential efficient development. It is in this second aspect of the pricing problem—the range of possible techniques which may be utilized to gain an allowable return on investment—that the focus of this essay is found.

## 2. *The Elements of a "Multi-Dimensional" Approach*

The ultimate question for future air transport regulation is the allocation of the components of profit between the industry as a whole, the individual carriers and consumers, the latter group being capable of division along market lines (*e.g.*, short-haul vs. long-haul, dense market vs. thin market) or by type of travel (*e.g.*, business; vacation; numerical group; identity group; volume user, etc.) as well as being viewed as a single entity. The term "components of profit" must include a wide range of actual and *potential* factors. Among these are the entire range of cost savings stemming from increased efficiency, more exact cost allocation, technological and market innovations and changes in service to conform to demand patterns. Also included is the simple fact of increasing demand and the more complex problems of matching route structure and density and stimulating demand in a manner which will promote efficient use of resources.<sup>17</sup>

The clearest example of such allocation possibilities and problems is that of specific fares. The techniques may include system-wide reductions (or increases), density-distance variations, excess-capacity traffic evaluated in terms of marginal cost, straight promotional fares designed to take account of different elasticities of demand, or attempts at product differentiation through introduction of "new classes" of service.

Other aspects of regulatory action, however, are no less a function of

<sup>16</sup> *E.g.*, questions of subsidy and mail pay, see cases cited *supra* note 11; allowable rates for services which are operationally distinct from scheduled service such as military contract routes; and for charter carriers engaged in selling non-route transportation differing from flight to flight, describing an allowable per seat-mile rate. In the latter case, a single-entity approach to specific rates is warranted since there is no regularized pattern of production which would justify one carrier to differentiate between flights or consumers on a non-cost basis.

<sup>17</sup> A particular problem arises as new aircraft with greater capacities and lower unit costs are introduced. Realistically, the decision to purchase larger aircraft should be based on the carrier's ability to use the increased capacity efficiently over its entire system. Of course, the lower unit costs make it possible to obtain the same return as before, even if load factors are reduced and the carrier flies with empty seats, or if the aircraft is used in dense markets part of the day and the increased return there compensates for increased costs arising from the plane's use in markets where its capacity and operating characteristics are inefficient. Nevertheless, one would expect some pressure for aircraft which could be used efficiently in the thin markets and could be used advantageously in the dense markets despite lower capacity (*e.g.*, operating two non-stop flights in smaller aircraft, in place of operating a large aircraft from A to B to C, with the possibility of nonstop traffic stimulation and lower operating costs compensating for duplicate fixed costs). There is a substantial question of the technological possibility of developing such an aircraft, but the significant fact is that the aircraft industry has not devoted any substantial research to this area, preferring to concentrate on larger aircraft. Even the short-haul DC-9 or Boeing 737 can hardly be called "small" aircraft, but even in this case the impetus for domestic development came from the British BAC-111. Similarly, in the area of a DC-3/Convair replacement, foreign manufacturers have developed craft such as the Fokker F-27, Nord 262 and Potez 840, while domestic companies have not been heard from. Possibly, the restraint on domestic technological development flows from regulatory policies in which excess capacity can be used as a barrier to prevent route and price competition. Hence carriers are willing to purchase aircraft which may have increased costs in certain markets and fail to demand aircraft development which might yield greater overall efficiency. See also Caves 420.



the pricing problem. Alteration of operating authority by elimination of mandatory stops, "closed-door" restrictions and the like have similar effects on revenue and profit. Carrier expansion may similarly increase efficiency, reduce break-even load factors and increase marginal revenue per unit of resource. In the same way, concern with adequacy of service may provide a "brake" on excessive experimentation or expansion or may be used to enforce competition and competitive service and scheduling practices, altering the "real fare"<sup>18</sup> charged the consumer and increasing the quality of service provided.

A proper view of the pricing problem must include all of these possibilities. They are all possible reactions to problems of reducing costs, increasing efficiency and competition (intercarrier competition and intermodal competition as well). The existence of a varied number of possible responses to every situation is of enormous import when considering increasing the latitude for managerial decision making in the air transport field.

Of course, as we have already noted,<sup>19</sup> the CAB's institutional ability to develop an approach incorporating all of these types of factors is open to question. It would seem, however, particularly in light of the economic characteristics of the industry,<sup>20</sup> that the Board should recognize the existence of these factors and the fact that they differ from carrier to carrier. Such recognition could serve as a basis for allowing carriers greater latitude in experimentation based on the *carrier's* evaluation of its situation. The Board would not have to involve itself in the details, but merely establish a framework definition of reasonable competitive conduct.

At present, however, each attempted competitive response calls for an *ad hoc* decision by the Civil Aeronautics Board. Unless proposed fares or operating changes are not suspended prior to investigation, decisions are reached without actual consumer or market testing. Thus, the battle is one of competing managerial philosophies between carrier and agency, colored heavily by the agency's conception of the best interests of the industry. Accordingly, the agency will generally consider the competitive reaction. The Board, by limiting the range of allowable responses to competition, has generally driven competing carriers to emulation as the standard response. In other words, the focal point for allocation of the "components of profit" has been the same as that used to determine the appropriate profit (or rate of return) level. The Board considers the industry as a whole; unless the proposed allocation can successfully be emulated by all competing carriers, the proposal must fail.

It is difficult to justify such an approach. In fact, the economics of air transportation and the fact that carriers are sufficiently different in terms of present equipment, route structure and efficiency suggest the opposite.

<sup>18</sup> The term "real fare" refers to the price actually paid by the consumer in relation to the service obtained. Hence, if adequacy of service considerations force introduction of daylight coach service where night-coach service was previously provided but little used, the fare paid by the average consumer has dropped even though rate structure modifications have not been made. See Toledo Adequacy-of-Service Investigation, 30 C.A.B. 169 (1959).

<sup>19</sup> See Gellman, *supra* note 8.

<sup>20</sup> This subject will be considered in Section II B 2 *infra*.

Given a multi-dimensional approach which will increase each carrier's freedom to act, an efficiency gaining action on the part of one carrier will not engender an emulative response from his competitors unless it produces a comparable efficiency for them.<sup>21</sup> Factual situations supporting this contention will be noted in Section III of this study. Section IV is, in part, devoted to suggesting a regulatory policy which corresponds to the theory.

In dealing with operating authority, the Board has submerged the basic issue with references to "need for service," "cut-throat competition," "balanced competition" and, when all else fails, "the public convenience and necessity." With respect to fares and related proposals, however, the disguise has been "discriminatory pricing." The few clear-cut cases aside, the Board has been testing for industry-wide profitability under the rubric of "discrimination." The result is an entirely new definition of discriminatory pricing, bearing little resemblance to economic notions of discrimination nor to the historical content of the term in common carriage.

Thus, it is somewhat inappropriate to characterize what follows as a study of airline "price discrimination." Consideration of the instances in which the Civil Aeronautics Board has called forth the label "discrimination" to support its decisions is, in fact, an examination of the Board's philosophy of price regulation and its role as the primary determining factor in the development of airline competition. Consequently, it is a desirable vehicle to employ in focusing on the distinctions between the historic industry-wide, or "homogeneous," approach followed by the Board and the multi-dimensional approach to price regulation suggested herein.

## II. HISTORICAL AND ECONOMIC FACTORS IN AIRLINE PRICE REGULATION

After three-quarters of a century of regulation, the efficacy of federal supervision of the transportation industries as businesses "affected with a public interest" is hardly, if ever, questioned. As CAB Vice Chairman Robert T. Murphy recently reminded one carrier's executives, the notion of public responsibility for transportation has existed,

since the days of King James I . . . who, upon receiving so numerous complaints from his outraged subjects regarding the ferry service and tolls then obtaining in Merry Old England, referred the matter for resolution to his Chancellor, Lord Hale. That learned and famous old judge thereupon laid it down that:

Every ferry ought to be under a public regulation, to wit: that it give attendance at due time, keep a boat in due order, and take but reasonable toll.

So, the essence of this rule has been part of our Anglo-Saxon tradition and jurisprudence for almost four centuries.<sup>22</sup>

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<sup>21</sup> "Efficiency" is used here to describe not only the most desirable utilization of resources, but also to include the action dictated by the carrier's self-interest after his competitor has taken some action. Accordingly, what may have been efficient before the competitor acted may not be so afterward.

<sup>22</sup> Address by Robert T. Murphy Before the Eastern Air Lines Management Council, Charlotte, N.C., 4 Feb. 1965.

Questions of current significance, however, are not related to the existence of agency regulation, but rather to the forms and method of regulation. In such matters, Vice Chairman Murphy's reliance on the wisdom of Lord Hale's formulation of the public interest will hardly suffice. The "how" of public regulation reflected in the present managerial philosophy of the CAB can neither be explained nor examined without reference to the historical and economic facts which have produced a weighty if not always luminous gloss on the simple principle Lord Hale set down. A brief consideration of some of these factors must necessarily precede any consideration of specific CAB decisions.

### A. *Transportation Price Discrimination: Its Historical Context*

#### 1. *The Statutory Roots of the Rule Against Price Discrimination*

The approach to carrier pricing practices found in the original Civil Aeronautics Act of 1938,<sup>23</sup> and carried forward in the present Federal Aviation Act of 1958,<sup>24</sup> rests on the guides formulated in the Act to

<sup>23</sup> 52 Stat. 973 (1938).

<sup>24</sup> Federal Aviation Act of 1958, 72 Stat. 737-806 (1958), 49 U.S.C. §§ 1301-1542 (1964). The following sections are of particular importance with respect to this study:

Section 102, 72 Stat. 740, 49 U.S.C. § 1302:

In the exercise and performance of its powers and duties . . . the Board shall consider the following, among other things, as being in the public interest, and in accordance with the public convenience and necessity:

- (c) the promotion of adequate, economical, and efficient service by air carriers at reasonable charges, without unjust discriminations, undue preferences or advantages, or unfair or destructive competitive practices;
- (d) competition to the extent necessary to assure the sound development of an air-transportation system. . . .

Section 403, 72 Stat. 758, 49 U.S.C. § 1373:

(a) Every air carrier . . . shall file with the Board, and print, and keep open to public inspection, tariffs showing all rates, fares and charges for air transportation between points served by it and points served by any other carrier . . . when through service and through rates shall have been established, and showing to the extent required by regulations of the Board, all classifications, rules, regulations, practices and services in connection with such air transportation. . . .

Section 404, 72 Stat. 760, 49 U.S.C. § 1374:

- (a) It shall be the duty of every air carrier . . . to provide safe and adequate service . . . to establish, observe, and enforce just and reasonable individual and joint rates, fares, and charges, and just and reasonable classifications, rules, regulations, and practices relating to such air transportation. . . .
- (b) No air carrier . . . shall make, give, or cause any undue or unreasonable preference or advantage to any particular person, port, locality, or description of traffic in air transportation in any respect whatsoever or subject any . . . [person, etc.] to any unjust discrimination or any undue or unreasonable prejudice or disadvantage in any respect whatsoever.

Section 411, 72 Stat. 769, 49 U.S.C. § 1381:

The Board may, upon its own initiative or upon complaint by any air carrier, foreign air carrier, or ticket agent, if it considers that such action by it would be in the interest of the public, investigate whether any air carrier, foreign air carrier, or ticket agent has been or is engaged in unfair or deceptive practices or unfair methods of competition. . . .

Section 1002, 72 Stat. 788, 49 U.S.C. § 1482:

(d) Whenever, after notice and hearing, upon complaint, or upon its own initiative, the Board shall be of the opinion that any individual or joint rate, fare, or charge . . . or any classification, rule, regulation, or practice affecting such rate, fare, or charge, or the value of service thereunder, is or will be unjust or unreasonable, or unjustly discriminatory, or unduly preferential, or unduly prejudicial, the Board shall determine and prescribe the lawful rate, fare or charge (or the maximum or minimum, or the minimum and maximum thereof). . . .

Regulate Commerce of 1887<sup>25</sup> which established federal regulation over rail transportation. Thus, for example, the CAB continually refers to "like and contemporaneous service" or "similar circumstances and conditions," language found in Section 2 of the Interstate Commerce Act, but wholly absent from aviation legislation.

The institution of regulatory supervision was called into being out of concern for something labeled "discrimination,"<sup>26</sup> stated politically in terms of an egalitarian ethic and economically in terms of specific "undesirable practices." For theoretical support, advocates of regulation "dust[ed] off the musty precedents of a 'public calling' . . .,"<sup>27</sup> an approach which had already received judicial support.<sup>28</sup>

As a political rallying cry, "public calling" is an attractive sounding term. Unfortunately, it offers no guide for regulation. It is convenient to speak of a duty to refrain from unjust discrimination as an inherent part of common-carrier status. An examination of legal history, however, yields no such conclusion.<sup>29</sup> All payments exacted for carriage had to be "reasonable," but "unjust discrimination," *i.e.*, variations between persons, commodities or destinations, was not prohibited.<sup>30</sup>

Obviously, there is some close alliance between "reasonable pricing" and "discriminatory pricing," viewed here without the gloss of seventy-five years of ICC practice. The former would seem to be directed at the rate *level*, while the latter would be concerned with specific relationships within a given rate structure—the two components of the pricing problem described above.<sup>31</sup> In this early period, however, problems of rate levels

<sup>25</sup> Interstate Commerce Act, Part I, 24 Stat. 379 (1887), as amended, 49 U.S.C. §§ 1-300 (1964). The following sections are relevant to the discussion here:

Section 2, 24 Stat. 379 (1887), 49 U.S.C. § 2:

If any common carrier subject to the provisions of this chapter shall, directly or indirectly, by any special rate, rebate, drawback, or other device, charge, demand, collect, or receive from any person or persons a greater or less compensation for any service . . . that it charges, demands, collects, or receives from any other person . . . for doing for him . . . a like and contemporaneous service in the transportation of a like kind of traffic under substantially similar circumstances and conditions, such common carrier shall be deemed guilty of unjust discrimination, which is prohibited and declared to be unlawful.

Section 3, 24 Stat. 380, 49 U.S.C. § 3:

(1) It shall be unlawful . . . to make, give, or cause any undue or unreasonable preference or advantage to any particular person, company, firm, corporation, association, locality, port, port district, gateway, transit point, region, district, territory, or any particular description of traffic, in any respect whatsoever; or to subject any . . . [particular person, company, etc.] to any undue or unreasonable prejudice or disadvantage in any respect whatsoever. . . .

Section 4, 24 Stat. 380, 49 U.S.C. § 4:

(1) It shall be unlawful . . . to charge or receive any greater compensation in the aggregate for the transportation of passengers, or like kind of property, for a shorter than for a longer distance over the same line or route in the same direction, the shorter being included within the longer distance. . . .

<sup>26</sup> See Dam, *The Economics and Law of Price Discrimination: Herein of Three Regulatory Schemes*, 31 U. Chi. L. Rev. 1 (1963); and Keyes, *Price Discrimination in Law and Economics*, 27 So. Econ. J. 320 (1961).

<sup>27</sup> Meyer, Peck, Stenason & Zwick, *Competition in the Transportation Industries* 9 (1959) [hereinafter cited as Meyer, et al.].

<sup>28</sup> See *Munn v. Illinois*, 94 U.S. 113 (1876).

<sup>29</sup> See Kline, *Origin of the Rule Against Unjust Discrimination*, 66 U. Pa. L. Rev. 123 (1918).

<sup>30</sup> *Id.* at 137.

<sup>31</sup> See text accompanying note 5 *supra*.

and carrier practices were restricted to Sherman Act prosecutions.<sup>32</sup>

Of course, no great exercise in verbal logistics is required to arrive at the position that the existence of certain types of discriminations suggests that a rate level is per se unreasonable. However, without the maximum rate authority conferred on the ICC by the Hepburn Act in 1906<sup>33</sup> (and even, perhaps, without the later grant of minimum-rate authority),<sup>34</sup> the connection is tenuous at best, relying on hindsight to support an otherwise empty argument. In short, the sounder view is that the "rule against unjust discrimination" was wholly sui generis, that it came upon the scene simply as a "term of art" subject to future and continuing definition by the regulatory agency itself. The broad terms of the statute would seem to support this contention.<sup>35</sup>

The foregoing argument has substantial implications for evaluating CAB practice and fashioning an appropriate framework for the regulation of air transport pricing. Arguments which do no more than inveigh against the undesirability of "discrimination" are unsatisfactory. The essential concern should be toward an understanding of what sorts of discrimination have come under attack and the situations which, at particular times, have called certain practices into question. As one author points out: "Just, reasonable and non-discriminatory rates will result from the application of correct principles, not from the tautology that such rates are desirable."<sup>36</sup> The enactment of anti-discrimination provisions in the Civil Aeronautics Act of 1938 was no more than a congressional expression of some amorphous public policy. Rather than being a reference to some transcendental notion of "discrimination" to be extracted from "natural law," it calls for definition in the light of the particular responsibilities of the CAB and the conditions in the industry it regulates.<sup>37</sup>

## 2. *The Historical Meaning of "Non-Discriminatory" Rates*

The basic meaning of the "rule against discrimination" stems from the development of specific undesirable practices in the railroad industry. Aided by speculative fervor, land grants, and personal ambition, railroad expansion before the start of this century was both rapid and disorganized.<sup>38</sup>

<sup>32</sup> E.g., *United States v. Joint Traffic Ass'n*, 171 U.S. 505 (1898); *United States v. Trans-Missouri Freight Ass'n*, 166 U.S. 290 (1897).

<sup>33</sup> Hepburn Act § 4, 34 Stat. 589 (1906), 49 U.S.C. § 15(1) (1964).

<sup>34</sup> Transportation Act of 1920 § 418, 41 Stat. 484 (1920), 49 U.S.C. § 15(1) (1964).

<sup>35</sup> See Interstate Commerce Act § 2, *supra* note 25.

<sup>36</sup> Grossman, *Principles of Carrier Rate Regulation*, 26 N.Y.U.L. Rev. 475, 480 (1951).

<sup>37</sup> The variations regarding certificate authority and route security between the Civil Aeronautics Act of 1938 and other transportation legislation suggests that Congress (or at least Representative Lea who authored the Act) recognized the need for new regulatory approaches owing to the peculiar characteristics of the aviation industry. Compare Federal Aviation Act of 1958 § 401(g), 72 Stat. 754 (1958), 49 U.S.C. § 1371(g) (1964) with Interstate Commerce Act, Part II (Motor Carrier Act), § 212(a), 49 Stat. 555 (1935), 49 U.S.C. § 312(a) (1964). See also 83 Cong. Rec. 6407 (1938) (remarks of Representative Lea). Apparently, Congress expected that the needs of the aviation industry would require considerable reshuffling of operating authority. Is it not valid to extend this same expectation of novel conditions to other provisions of the Act?

<sup>38</sup> Sorell, *General Principles That Should Govern the Expansion of the Domestic Airline System* (a study by the Air Transport Association of America), in *Monopoly Problems in Regulated Industries—Part I*, Vol. 3, *Airlines, Hearings Before Subcommittee No. 5 of the House Committee on the Judiciary*, 84th Cong., 2d Sess., 1706 (1957) [hereinafter cited as *Monopoly Problems in Regulated Industries, Hearings*]. See also, Meyer et al. 4-7; Dearing and Owens, *National Transportation Policy* 229 (1949); Dewey, *The Long and Short Haul Principle of Rate Regulation* 1 (1935); and Koontz, *Government Control of Business* 81 (1941).

High fixed costs associated with railway construction and operation meant that within specific geographic areas, "natural monopolies" were obtained. Parallel route structures in marginal traffic areas were limited by conspiratorial agreement; in the long-haul point-to-point markets, however, they yielded intensive competition. In these latter markets, rail carriers faced not only intramodal competition, but substantial intermodal competition as well.<sup>39</sup> The economic structure induced a compulsion to cultivate volume traffic, driving rates to the floor set by short-run marginal costs. Thus, neither monopoly power nor competitive chaos is acceptable as a uniform characterization of the early railroad industry.

Clearly, both conditions were present. The need for regulation, however, stems less from the public interest inherent in either characterization (*i.e.*, some notion that "balanced competition" is automatically necessary in transportation industries) and more from the fact that the benefits and detriments of both power and competition had clear-cut geographic applications. Traffic volume can only be cultivated where large shippers are found. Rate reductions will have less significant effect unless those shippers are highly competitive. Once rates are set below the total average cost, each below cost price produces an amount which must be recouped if total average costs are to be covered. The easiest source of such additional revenue is within the natural monopoly area. Such recoupment, however, is possible only where shippers are small and where their competition, if any, will be similarly affected, else the higher rate will operate to restrict the much needed volume.<sup>40</sup> These conditions were met by the distribution of manufacturing and agriculture between east and west. The eastern region of the United States had both the large, competitive, shippers and the intense transport competition. The agricultural regions, on the other hand, were the natural monopoly areas for the railroads, and the consumers of transportation were small agricultural producers or new entrants in manufacturing.

It is hardly surprising, then, that rail regulatory legislation became one of the keystones of the Populist movement in the middle western states. It is essential, however, that the embodiment of their protests in statutory language be understood in *terms of their specific grievances*. Despite the broad language of Section 2, 3, and 4 of the Act to Regulate Commerce<sup>41</sup>—covering persons, commodities and localities—the vice complained of was not differential pricing in itself. The focus is not on "like and contemporaneous service." Rather, the emphasis is on the "exaction by the carrier of varying rates from different persons"<sup>42</sup> who, because of their economic status, should be treated equally.

Arguably, the intent of Sections 2 and 3 of the Act, viewed in this historical setting, is directed toward a single type of discriminatory prac-

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<sup>39</sup> Meyer, et al. 5. See also Koontz, *op. cit. supra* note 38, at 92, 112.

<sup>40</sup> Two other conditions are helpful. First, the product being shipped should have a low value with respect to the total price of the finished product to the consumer. Second, the shipper should be under an economic compulsion to ship at whatever price he gets for his product.

<sup>41</sup> Set out *supra* note 25.

<sup>42</sup> Dearing & Owens, *op. cit. supra* note 38, at 230.

tice: the use of rebates and preferences for individual shippers which, as noted above, necessarily was confined to particular localities and particular types of traffic. This attitude is clearly reflected in the opinion of a middle western district judge:

Secret rates will inevitably become discriminating rates. Whenever discriminating rates or practices are made public, a thousand forces of self-interest and of public policy will be set at work to reduce them to fairness and equality.<sup>43</sup>

The sole grievance not amenable to categorization as a form of secret rebate or preference was the so-called "long-and-short haul discrimination," dealt with specifically in Section 4 of the Act. This, too, goes no farther than is necessary to combat the specific practice complained of. Certainly, if the intent was to establish a principle of uniform pricing, the application of the section would not have been limited to receipt of "greater compensation in the *aggregate*" (emphasis added) nor to only those situations where the short haul is included wholly within the longer distance.

It is easy to capsule the history of the movement toward rail regulation with a statement such as "the public discovered by experience that whether the railway industry was competitive or monopolized, it was incapable under a regime of *laissez faire* of securing just and reasonable rates to all persons."<sup>44</sup> If "just and reasonable rates" is taken to mean a rate structure wholly devoid of differential pricing, the summary goes too far. It suggests that this is to be the goal of regulation. The most that can be said is that past the two specific discriminations already discussed, proponents of regulation evidenced a desire to withdraw pricing practices from the domain of private government and place them in an open, public forum. This does not mean, however, that all pricing practices, in all transportation industries, should be withdrawn from the market and determined by an agency. The requirement of publicly filed tariffs simply makes such consideration possible. Substantive agency intervention is only necessary when conditions in the specific industry make reliance on competition impossible.

The range of discriminations beyond secret preferences, rebates, and long-and-short haul policy are, therefore, products of the regulatory process tied to specific conditions relevant to the industry under regulation. The present elaborate system of "value of service" pricing, wholly unrelated to costs, is a consequence of rate regulation.<sup>45</sup> Putting aside any question of its efficacy as a method of allocation, the issue of "discrimination" in a value of service scheme revolves less around the appropriate way for a rail carrier to price his product and more around the effect the proposal will have on the shipper's industry. While the structural scheme was far less elaborate than today, many such differentials were inherited by the ICC. Given the pervasive influence of rail rates on the location and

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<sup>43</sup> *United States v. Ill. Terminal R.R.*, 168 Fed. 546 (S.D. Ill. 1909).

<sup>44</sup> Dewey, *op. cit. supra* note 38, at 1.

<sup>45</sup> Meyer, et al. 7-8, 178-79.

development of industries, there is some force in the argument that "the Commission can hardly upset these fine balances."<sup>46</sup>

For the purposes of this study, however, the significant fact is that the Civil Aeronautics Board has not inherited such a scheme, nor even with the growth of air cargo does the air transport industry reach the level of a "universal input" in all production processes. The effects of rate structure alterations in air transportation are therefore unlikely to effect wholesale changes in the economy. Hence, one major reason for withdrawing rail pricing from the market place at the turn of the century is absent in air transportation. For the CAB, the question is solely one of the techniques available to the air carrier for pricing his product.<sup>47</sup>

### 3. *The Shift from Consumer Protection to "Competitive" Balance*

Following the passage of the Motor Carrier Act,<sup>48</sup> the term "discrimination" acquired a new hue. By placing rail and motor carrier regulation under the control of a single agency, problems of carrier pricing became inextricably bound with planned "modal balance," a protectionist philosophy euphemistically disguised as "national transportation policy."

Rather than focusing on the "historical" concern with "exploitation" of consumers, emphasis was significantly re-directed toward limiting price competition.<sup>49</sup> To be sure, the policy yielded some beneficial trends in pricing policy. These arose, however, from particular competitive biases rather than from a general belief in the soundness of an allocative technique (e.g., cost-related pricing) standing alone. Thus, the ICC "required the truckers to base their rates upon the fully allocated cost (constant and variable costs) theory of rate-making while the railroads were permitted to establish rates upon an added cost basis."<sup>50</sup> Even if one wishes to accept the efficacy of the protectionist scheme, it is unnecessary to characterize proposed rate structure changes by motor-carriers as "discriminatory" and justify identical rail practices as "meeting competition." Indeed, it might be more appropriate to refer to the present motor-carrier rate structure as a system of discrimination and then justify it by indicating that it was required by the public interest involved in protecting the railroads. This, at least, would satisfy any academic concern with theories of transport

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<sup>46</sup> Koontz, *op. cit. supra* note 38, at 109. See also, Fifteen Percent Case, 226 I.C.C. 41 (1938) (blanket increase of certain percentage applied to all rates impracticable).

<sup>47</sup> This is not to say that air carrier pricing based on factors outside the conditions of carriage (or, more properly, based on factors not relevant to the carrier's self-interest) is to be treated as a desirable technique. The question of "societal" justifications for rate differentials will be treated *infra* in a discussion of "identity" fares.

<sup>48</sup> Interstate Commerce Act, Part II, 49 Stat. 543-67 (1935), 49 U.S.C. §§ 301-27 (1964).

<sup>49</sup> See generally Williams, *The Regulation Of Rail-Motor Rate Competition* (1958), and particularly at 92-115 (ICC § 4 cases). The justification for limiting price competition looks back toward pre-1887 conditions, but arguably, as suggested earlier, price competition was more a symptom of particular conditions than the cause of the grievance; the provisions of the Act to Regulate Commerce (now Interstate Commerce Act, Part I, *supra* note 25) were sufficient to control those conditions. Intermodal competition was not complained of except as it, too, was localized geographically, a situation which was not present in 1935. The trend toward limiting price competition seems to have been built on post-depression psychoses, although it did not receive explicit consideration as such.

<sup>50</sup> Huntington, *The Marasmus of the ICC: The Commission, The Railroads and the Public Interest*, 61 Yale L.J. 467, 496 (1952). See also, Roberts, *The Regulation of Transport Price Competition*, 24 Law & Contemp. Prob. 557 (1959).



pricing.<sup>51</sup> Obviously, such a blunt statement would be politically undesirable.<sup>52</sup> However, it would have eliminated any possibility of fostering the "transcendental" approach to discrimination in which the ICC's approach to discrimination and pricing is thought to apply with equal force to all transportation modes.

#### 4. *The Distinctive Position of the Airline Industry*

The significance of the foregoing for air carrier regulation is clear. Except, perhaps, for specific problems with the all-cargo carriers,<sup>53</sup> commercial air transport has not faced intermodal conflict within the regulatory process. Thus, if the Civil Aeronautics Board adopts the position that certain price practices are discriminatory per se or required a "meeting competition" justification, it errs in converting a "term of art" designed with reference to peculiar rail characteristics and problems of rail-motor competition into a general principle.

Reference to history yields but two such general principles, the "classic" discriminations of rebating and secret preferences. Such discrimination is avoided by requiring adherence to publicly filed tariffs and demanding that differentiated services be functionally<sup>54</sup> available to a significant group.<sup>55</sup>

Given the economic and technological characteristics of air transportation, "unjust discrimination" should be defined simply as:

(1) the remission of rebates to consumers, in secret or by indirect methods;<sup>56</sup>

<sup>51</sup> Not that the result in practice would have been correct. At least, however, there would have been some recognition of the fact that alterations in historic rate-making practices were not "discrimination." The battle would then properly have focused on the agency's conception of the public interest and notions of "discrimination" would not have floated over to regulatory agencies where the intermodal competition problem was absent.

<sup>52</sup> Consider, for example, the range of political pressures affecting the amendment of § 15 of the Interstate Commerce Act in 1958 (Transportation Act of 1958, 72 Stat. 572 (1958)), 49 U.S.C. § 15(a)(3) (1964)) detailed in Friendly, *The Federal Administrative Agencies: The Need for Better Definition of Standards—III*, 75 Harv. L. Rev. 1263, 1288 (1962).

<sup>53</sup> The problems posed by the all-cargo carriers do resemble the intermodal conflict in the ICC. However, the CAB's approach to these carriers is not shrouded in irrelevant legalism. The attempt to provide "water wings" for this sinking segment of the airline industry is being made openly and without recourse to "discrimination." See Extemporaneous Remarks by Alan S. Boyd, [then] Chairman, CAB, Before the Fourth Annual Air Cargo Seminar, Commodore Hotel, New York City, 14 Feb. 1962; CAB Regulation No. PS-24 (7 Aug. 1964) (policy statement on all-cargo carriers blocked-space tariffs); and Trans World Airlines, CAB Docket Nos. 15829 & 15831, CAB Order No. E-21820 (19 Feb. 1965) (rejecting combination-carrier blocked-space rates). The Board's policy may not be economically sound, but the visibility of its decision making focuses attention on the public policy features of the CAB's position.

<sup>54</sup> Regarding "functional" availability, see *FTC v. Morton Salt*, 334 U.S. 37, 42 (1948).

<sup>55</sup> A similar view has been infrequently espoused in CAB cases, twice in hearing examiners' initial decisions: *National Airlines, Inc., DC-6 Daylight Coach Case*, 14 C.A.B. 331 (1951), considered in text following note 175 *infra*; *Trans World Airlines Siesta Sleeper-Seat Service*, 27 C.A.B. 788 (1958), considered in text following note 278 *infra*, and in one early CAB opinion: *Air Passenger Tariff Discount Investigation*, 3 C.A.B. 242 (1942), see text accompanying note 117 *infra*.

<sup>56</sup> See, e.g., *Las Vegas Hacienda, Inc., and Henry F. Price, Enforcement Proceeding*, 31 C.A.B. 415 (1960), *aff'd sub nom. Las Vegas Hacienda v. CAB*, 298 F.2d 430 (9th Cir. 1962), *cert. denied*, 369 U.S. 885 (1962); *Pan American Ferry Flight Case*, 18 C.A.B. 214 (1953). The possible reach of the indirect rebate prohibition is reflected in *Private Airline Club Waiting Rooms*, CAB Docket No. 13448, CAB Order No. E-18102 (14 March 1962) (instituting investigation), 27 Fed. Reg. 2612 (1962).

(2) the granting of secret preferences;<sup>57</sup> and

(3) the filing of tariffs which fall short of the first two categories because they are public, but are not functionally available to a significant group of consumers, functional availability being a quantitative inquiry to be made by the Board and "significance" being a qualitative criterion (*e.g.*, elasticity of demand) which an air carrier must support with reference to its own theories of costing, subject only to a "good faith" test by the agency.

Beyond this, price regulation policy must rest wholly on factors indigenuous to air transport, and, as already noted, this study submits that these factors indicate that CAB concern should be directed primarily to questions of general price level, leaving carriers wide latitude to employ experimental techniques in order to obtain that over-all rate of return.<sup>58</sup>

### B. *The Relation Of Economics To Rate Regulation*

#### 1. *The Role of Social and Political Considerations*

Economists are quick to remind us that "price discrimination," as used by regulatory agencies in the course of their decisions, bears little relation, if any, to discrimination in an economic sense. As Caves, for one, points out:

Any economist . . . with a theoretical definition of price discrimination in mind is immediately struck by the spottiness and selectivity with which the regulators act . . . . Some forms of discrimination are banned entirely while others are tolerated or even encouraged and required. Some pricing phenomena are branded discriminatory and banned even though they do not or at least may not meet the economist's definition of price discrimination.<sup>59</sup>

However, even if we recognize that the regulatory definition of price discrimination stems from social and political theories rather than any economic base, economic analysis cannot be ignored in determining the regulatory policy which is best suited for attaining the social and political goals.

Let us assume, *arguendo*, that the historical analysis of the rule against discrimination set forth above is inaccurate and that in fact the CAB inherited, at the outset, a well-developed series of per se rules thought to govern all forms of transportation. Application of such rules to the airline industry is justifiable as a matter of public policy only if, in fact, the airline industry has the same technological and economic characteristics as the earlier forms of transportation. Of course, the air carrier industry is easily distinguishable from rail and motor carriers on the basis of tech-

<sup>57</sup> See, *e.g.*, Investigation of Seaboard & Western Airlines, Inc., 11 C.A.B. 372 (1950); Viking Airliners, Aero-Van Express Corp., & Viking Air Transport Co.—Non-Certificated Operations, 11 C.A.B. 401 (1950); United Air Lines, Inc.—Enforcement Proceeding, CAB Docket No. 15714, CAB Order No. E-21903 (15 March 1965) (cease and desist order); and Trans-Caribbean Airways, Inc.—Enforcement Proceeding, CAB Docket No. 15682, CAB Order No. E-22391 (30 June 1965) (cease and desist order).

<sup>58</sup> Of course, in considering level and rate-of-return, the CAB must not allow a carrier to benefit from its own mistakes. Hence, if a carrier (or the industry) falls below a desired return, the CAB should be obliged to consider the possibility that the deficiency arises from unsound management. For example, it might increase the "revenue" figure used by the amount of revenue lost through "self-diversion" to an unjustifiable special fare and judge the return on that basis.

<sup>59</sup> Caves 155-56. See also, Dam, *supra* note 26, and Keyes, *supra* note 26.

nology and economics. Thus, the automatic application of theories developed on account of the peculiar characteristics of rail and motor transport is not simply an instance of bad economics. It is irrational public policy.

## 2. *The Significant Economic Factors in Air Transport*

From an economic standpoint, the differences between the air transport industry and other modes of transportation make the "dangers" of air carrier competition both qualitatively and quantitatively less than any which were ever supposed to exist in surface transportation.<sup>60</sup>

Unlike the railroad industry, air transportation reflects few economies of scale built on size alone. Even within a single market, it is claimed that "operating costs tend to become constant or to flatten out at around five to seven frequencies per day."<sup>61</sup>

Thus, in commercial aviation, not only is size a less crucial factor, but also, an air carrier runs little risk in re-allocating his productive resources: reducing frequencies in one market and increasing them in another; changing service patterns; re-assigning different aircraft to different markets, etc. Particularly with a good market for used aircraft, the carrier sacrifices little, in terms of economies of scale, by contracting his investment, so long as he does not fall below the minimums essential for efficient operation and satisfactory earnings potential.<sup>62</sup>

There are further distinctions between surface and air carriers in terms of operating economies of scale as to distance and volume. While the ICC has consistently represented that motor carrier *line-haul* costs decline with distance,<sup>63</sup> line-haul costs for all surface carriers are actually constant for all mileage blocks.<sup>64</sup> Direct operating costs for air carriers, on the other hand, have a clear distance taper, varying with the technological characteristics of the aircraft used.<sup>65</sup> Moreover, an air carrier is able to increase efficiency by attempting to maximize *stage* length. The cost of travel between A and B is increased more than one-third if made in seven hundred-mile stages than if it were non-stop.

<sup>60</sup> The fear of cut-throat competition and unsound practices may stem, in part, from the ridiculously low competitive bidding for air mail routes before passage of the 1938 Act. See Caves 124. (Braniff Airlines bid \$0.00001907378 per plane-mile for a Houston-San Antonio mail route, but was high bidder over Eastern's \$0.00 bid.) See also, Pan American Airways Co.—Mail Rates, 1 C.A.A. 220, 249 (1939). This situation, however, stemmed solely from regulatory provisions allowing the contractor to renegotiate a fair rate after one year of operation. It did not arise from actual industry conditions.

<sup>61</sup> Northwest Airlines, Inc.—Certificate of Public Convenience and Necessity, 2 C.A.B. 627, 639 (1941). With larger aircraft, capable of carrying greater revenue per flight, it is probable that unit costs flatten out at even less frequencies, assuming that the spacing of frequencies does not distort any variable. See also, Exhibits of Bureau Counsel BC-708, *Contractibility of Airline Expenses*, General Passenger Fare Investigation, *supra* note 11 and Caves 59, 81-82.

<sup>62</sup> The minimum efficient point represents only 2-4% of the industry's actual production. Caves 86. The level necessary for potentially satisfactory returns on investment would seem to be somewhat higher, *supra* note 3, but not significantly higher as would effect the conclusions herein.

<sup>63</sup> ICC, Cost Study of Class I Carriers (1953).

<sup>64</sup> See Meyer, et al. 93, 156, 190. The ICC data rests on a spurious correlation reflecting the fact that long-distance shipments have greater volume.

<sup>65</sup> Caves 76. Aircraft operating costs tend to be U-shaped since at some point payload must be sacrificed to accommodate the fuel needed for a long stage. In 1958, Caves found that the direct costs for a 2250 mile trip exceeded those for a 1750 mile trip (on a per revenue passenger mile basis). Today, the point at which the curve begins to rise is much higher, well beyond the standard transcontinental stages of domestic operations.

Similar differences exist with regard to economies from volume carried. All transport modes reflect economies in terms of volume, viewed alone or in conjunction with the distance of the haul.<sup>66</sup> The significant difference is in *how* this volume is carried. The rail carrier is more concerned with the total volume he can realize in any time-block (week, month, etc.) rather than the distribution of timing preferences within that block. His volume capability and related flexibility lead him to focus on the long-run market share he can obtain.

The air carrier's concerns regarding volume are significantly different. The volume capability of each productive unit is comparatively small and power is technologically fused with available space; aircraft cannot be "ganged" with a single power unit as railway cars can. The air carrier thus quickly reaches the point where additional volume requires major added investment. But, where in the long-run rail carriers may have more flexibility in dealing with volume, in the short-run, the positions are reversed; the air carrier's additional volume comes in small uniform units, posing no problem whatsoever for the management of traffic.

Thus, the air carrier should be less concerned with his long-run market share, except as it bears on the load factors for particular flights. Because of speed, timing has increased significance and consumers may have different degrees of flexibility in timing preference. While other motives may lead the air carrier to seek increased volume, efficient operation only dictates that a limited quantity of additional volume be sought. Furthermore, the air carrier is encouraged to concentrate on the development of particular types of additional volume, in particular markets and among particular types of consumers.

In short, differences in economics of scale between air transport and surface modes provide substantial economic justification for differential pricing schemes based on trip length or type of consumer which are not found in other transport modes.

The market factors in air transportation lead to similar conclusions. Unlike the true "value of service" discrimination, differentiation of the air travel market by type of travel has a correlative cost dimension with regard to routes flown, distance, and type of service. The businessman may fly more often and more consistently, but he flies to a wider range of destinations, uses short-haul services more often, has keener time preferences, and is more often a first-class passenger. In a peak/off-peak scheme of utility pricing, he would be considered the peak user.<sup>67</sup> Such a scheme

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<sup>66</sup> See Caves 153-57.

<sup>67</sup> Consider the problem of American Airlines before reducing long-haul first-class fares in January 1964. A first-class seat costs more to produce and in theory should yield higher revenues. However, because of low first-class load factors and the low family-fare level, a coach seat was producing more revenue per available seat-mile than a first-class seat. The low load factors were in part a result of United's one-class service. Accordingly, American reduced first-class fares, basically to the benefit of the peak-user businessman. This suggests that in a competitive system where the competition is able to alter its pricing structure, the peak-user cannot be charged a price which is higher than that resulting from his actual demand on the carrier's productive capacity. Thus, in a sense, United's one-class service worked to eliminate some "discrimination" against the first-class passenger. However, as we shall note *infra*, under the regulatory philosophy normally used by the CAB, it would have been United's service that would have been labeled "discriminatory."

must raise at least two questions. First, to what extent should grandmothers flying to San Francisco subsidize businessmen flying to Schenectady? Second, should not grandmothers<sup>68</sup> who might consider flying to Schenectady be treated differently than businessmen?<sup>69</sup>

Moreover, the "market structure of air transportation is not one that would yield abnormally high profits under unregulated operation."<sup>70</sup> Given the economics and technology, the problem of discrimination is in one sense greater than in other modes as the number of alternatives are almost unlimited. On the other hand, in view of the possibility of reallocation of resources and the technological flexibility of current aircraft,<sup>71</sup> detriment to the industry or consumer is unlikely, particularly where carriers are able to use their potential for efficiency by being able to choose from among the wide range of alternatives. In other words, one may argue that "discrimination," as popularly perceived, is possible. One cannot, however, in light of the economic characteristics of air transportation, argue that such freedom would produce discriminations which are "unjust," as rail and rail-motor competition is thought to have produced. The public policy of regulation must be shaped with this in mind.

### C. *The Responsibility For The Application Of Economic Theory*

If economic factors are to have any effect on the price regulation decisions of the CAB, they must be evidenced in concrete terms. Advocacy of a regulatory philosophy which gives carriers increased latitude in pricing decisions in light of their individual needs should not be equated with a policy of giving carriers *carte blanche* to experiment without assessing the cost and revenue consequences of their proposals before they are implemented. Rather, the necessity of setting forth an analysis of the probable economic result is a matter of increased importance. If a carrier is free to adopt a pricing structure which cannot be supported by an analytical presentation of market conditions or operating data, its com-

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<sup>68</sup> "Grandmothers" is simply an illustrative example of a passenger who does not fit the business travel norm. It would also include businessmen to the extent that they deviate from the norm by using "no-reservation" services, etc.

<sup>69</sup> The problem is much more complex than the simple formulation in the text. In the short-haul market, the businessman is more likely to fly because of the time advantage, but the "grandmother" is more cost-conscious. The maintenance of fare levels in the long-haul markets which do not fully reflect economies of scale in traffic volume and distance is thought to be demanded by the CAB's concept of "internal subsidization." However, characterizing the practice as subsidization is inaccurate since it suggests that the carrier is using profits in one market to offset unavoidable losses in another. In the short-haul market, even if the basic fare was maintained, the carrier could increase profit by selling excess capacity to "grandmothers" at marginal profit factors. And, to the extent that the business market is truly stable, a fare increase is always another alternative. Hence "subsidization" only occurs in the sense that the CAB prevents carriers from adopting pricing techniques which vary from market-to-market attempting to find a balance between the forces which cut down the demand elasticity of regular users of air transportation and the rising interest in air transportation which is appearing among cost-conscious infrequent travelers. See also, Caves 35-36.

<sup>70</sup> Caves 136.

<sup>71</sup> An examination of operating statistics by carriers and aircraft type shows the wide range of cost results which depend on the way in which aircraft are used. The flexibility in reallocating productive resources is further increased by the fact that the range of stage lengths and profitable load factors for short, medium, and long-range aircraft overlap considerably. It is thus possible to match density, frequency, and available capacity more closely. Moreover, reallocation should not yield adverse economic results. See note 61 *supra* and accompanying text. A balance between density, frequency, and available capacity may be struck at various size levels.

petitors will be encouraged to meet competition by similarly irrational proposals. Increasing the range of alternatives open to air carrier management is justified only to the extent that it will encourage efficient allocation of resources. Absent any compulsion to estimate (and later evaluate) the efficacy of a pricing theory in terms of its cost and revenue effects, this goal cannot be achieved.

As already suggested, the relevant costs which yield a basis for regulatory policy will vary depending on whether the inquiry is in terms of price or subsidy level (to develop a rate-of-return or class-rate model)<sup>72</sup> or is in terms of particular fares, types of fares and operations within a particular market.<sup>73</sup> In other words, the central issue in the air transport industry is not cost-finding per se,<sup>74</sup> but rather the selection and application of appropriate costing techniques in varying circumstances and recognition of the fact that use of one or another technique may be desirable depending on the issue under consideration and the carrier involved.

An examination of CAB decisions in the pricing field reveals but few instances in which the question of appropriate costing techniques is given serious attention and forms the basis for the Board's decision.<sup>75</sup> More often, Board decisions, and carrier proposals as well, are characterized by the absence of relevant economic data. Any attempt to explain the failure of

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<sup>72</sup> See text accompanying notes 10-14 *supra*.

<sup>73</sup> While questions of operating authority and adequacy-of-service should be incorporated into this second category, one qualification is necessary. Where the inquiry is designed to determine the point at which fare policies have an adverse effect on the adequacy-of-service in a market (*e.g.*, action by carrier A, albeit in "good faith," which makes it impossible for carrier B to continue serving or carrier C to enter and where competition is necessary to provide adequate frequency or type of service and avoid distortion in other markets served by A) the costs which are relevant are much more like those in the "level, subsidy, rate-of-return" category. Under present regulatory restrictions, the point at which an adverse effect might occur is relatively low so that most proposals by A precipitate concern for the health of the industry. Part of this is a matter of regulatory attitudes, but with greater freedom, the "point" would be much higher and would rarely be reached.

<sup>74</sup> Great emphasis has been placed on cost-finding programs in transportation. See Kennedy, 1962 *Transportation Message to Congress*, H.R. Doc. No. 384, 87th Cong., 2d Sess. 3 (1962). Meyer et al. is an outstanding example of scholarly work in this field. The air transportation industry has less barriers to cost-finding than surface modes in which joint-costs predominate and the number of historic commodity classifications and varying commodity characteristics (volume-density relations, special equipment, etc.) make the costs to be found qualitatively as well as quantitatively difficult. The question for air carriers is how costs will be reflected in rates; cost-finding per se is relatively easy.

<sup>75</sup> The only example of any real significance is the Board's recent adoption of Examiner Herbert K. Bryan's Initial Decision in *Business and Economy Fares*, CAB Docket No. 13939 et al., CAB Order Nos. E-22103, E-22104 (29 April 1965). Examiner Bryan spends the major part of his decision considering questions such as the use of available seat-miles or revenue passenger-miles as the basis for unit costs; the use of a percentage-of-aircraft allocation for costs on multiple configuration flights; and the relation between stimulation factors and gross revenue as a factor in the reasonableness of a fare ratio between two classes of service. The opinion fails to deal with all of these problems satisfactorily in that it approaches each dimension singly instead of fashioning a framework which integrates density, demand and alternatives open to carriers and consumers. *E.g.*, a \$92.50 economy fare will yield the same revenue result as a \$105.45 coach fare if traffic is stimulated 14%. This, however, assumes that all former coach passengers will use economy services and that there will be only 14% new traffic. The revenue results (and the fare derived by the calculation) will vary if 10% of present coach traffic continues to use coach services and there is still a 14% overall increase in coach and economy traffic. (Assuming that present coach traffic = 100, and coach traffic uses economy services, the increase amounts to 14 new passengers, all passengers paying \$92.50; in the alternative example, 10 passengers pay \$105.45 and 104 pay \$92.50. If revenue parity is sought, the fare then must be somewhat lower than \$92.50). The fare calculation would also have to be adjusted to the extent demand and capacity were not evenly matched. One cannot find serious fault with the Examiner, however, inasmuch as the reasonableness of the fare being investigated was patent at the outset.

the carriers to submit such data would require detailed consideration of each proposal involved. However, one can hardly ignore the possibility that the carriers, recognizing the Board's apparent reluctance to consider more sophisticated forms of economic analysis, have deemed it more advisable to rest many of their proposals on generalizations, hoping that the use of the proper "catch-words" or of undiscussed citations to prior cases (in which the basis for decision may also be unsupported) will strike a responsive chord in the agency.<sup>76</sup>

No one can seriously contend that the Board's staff (if not the members themselves) are unaware of the range of possible costing techniques which might be applied to carrier price proposals. Indeed, in those instances where recognition of significant differences in a carrier's operation has a negligible effect on its competitive position, costing techniques have been allowed to reflect such differences.

For example, Pan American Airways' original transatlantic certificate contemplated two different routes with different mileages between the same final termini. In *Pan American Airways Company (Del.)—Mail Rates*,<sup>77</sup> the agency's subsidy determination allocated fixed costs in terms of their actual use:

Whether a particular route be used on a major or minor portion of the total number of trips, much the same facilities must be maintained. The *fixed portion* of the total cost of the operation, therefore, may best be regarded as divided among the *total number of trips* to be flown in a given year, with the amount of total cost so allocated per trip to be *the same* whatever route may be used in a particular instance.<sup>78</sup>

Carried forward to pricing policy, this approach suggests two possibilities. First, a uniform per-mile rate might be inapplicable (or, conversely, a differential per-mile rate might be justifiable), since on a per-mile basis, the cost for one route is lower than for another. Second, a differential in the density of each route might be used to determine the total charge per trip, since the carrier's out-of-pocket cost is allocated equally between flights on either route.<sup>79</sup>

A corresponding theory, regarding operating costs, is raised in *Pennsylvania-Central Airlines Corporation—Service to Atlantic City, N.J.*,<sup>80</sup> considering applications by three carriers to serve that community. Eastern Air Lines, one of the applicants, already flew between New York and Baltimore and New York and Washington. It proposed to divert some of these flights, adding the stop at Atlantic City. The question, then, was whether Eastern's cost should be the added twenty miles of flying needed to include the stop, or whether the full mileage between the three cities should have been used.<sup>81</sup> The Board found it unnecessary to decide the

<sup>76</sup> E.g., references to "generating new traffic," asserting "cost savings" (or their absence), or claiming that a proposal is "economically unsound."

<sup>77</sup> 1 C.A.A. 220 (1939).

<sup>78</sup> *Id.* at 255 (emphasis added).

<sup>79</sup> "Might" is the important word, since other factors might tend to influence the carrier's decision. This approach, however, would be justifiable.

<sup>80</sup> 3 C.A.B. 144 (1941).

<sup>81</sup> *Id.* at 152-53.

issue; however, the theory, known as "double circuitry costing," is often used to determine the profitability of services to a community.<sup>82</sup>

Obviously, direct application of such a principle to the field of fares would yield anomalous results, since, no matter what distance is involved, a city located on a direct line between two other points has a circuitry cost of zero. The importance of the circuitry approach lies in its orientation to marginal cost. Indeed, the Board's opinion in *Service to Atlantic City* seems to suggest that Eastern would have to make some allowance in "cost" for the traffic it would lose to competitors by downgrading a non-stop flight to serve Atlantic City. Stated differently, costing techniques should consider the actual alternatives of employing productive resources. This alternative is expressed as circuitry cost when the point-in-issue is service to a particular community. Regarding fare policies, the alternatives depend on the structure and efficiency of the carrier and the freedom to act which regulatory policy accords him.

Owing to a regulatory bias against considering distinctive characteristics of individual carriers and the resulting limitations on the carriers' freedom of action, the approach suggested above has received little attention by carriers or the Board. Indeed, the first mention of a promotional fare practice in the agency's opinions lacks any comment on the subject of cost.<sup>83</sup>

A curious ambivalence regarding cost is also exhibited in *Capital Group Student Fares*.<sup>84</sup> Here, the Board chastized Capital for failing to provide cost-savings data in connection with its proposal to offer twenty-five person student groups a reduced fare. While disapproving the reduced rate, the Board indicated that it would remand the proposal to the hearing examiner, if Capital agreed to remove the student restriction. Several months later, this new proposal was approved, the continued absence of cost data notwithstanding.<sup>85</sup>

Generally, if the Board looks to cost in connection with fare structure or promotional inquiries, the cost factors examined are not those associated with the carrier's over-all operations, but rather the cost of the service features deleted or added. It is disconcerting, and of questionable value, to see a CAB hearing examiner attempt to evaluate the costs of cloth napkins, choicer cuts of meat and an additional toilet in the aircraft and apply these to passenger fares.<sup>86</sup>

The area of promotional fares is generally one in which the discussion of cost-of-service differences tends to cloud the more significant issue of maximizing the efficient use of resources:

In theory, the profitable use of price discrimination consists of setting dif-

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<sup>82</sup> This approach does not always yield an accurate portrayal of cost since the "circuitry cost" of a terminal point will be based on the actual mileage between the last intermediate and the terminal, there being no third point against which circuitry may be calculated. Accordingly, service to all of the intermediates can be treated as "profitable" when the route taken as a whole is not.

<sup>83</sup> *Western Air Express Corp.—Mail Rates*, 1 C.A.A. 341, 349-50 (1939).

<sup>84</sup> 25 C.A.B. 280 (1957).

<sup>85</sup> *Capital Group Student Fares*, 26 C.A.B. 451 (1958).

<sup>86</sup> *United Custom Coach*, 26 C.A.B. 23, 27-37 (1957) (excerpts from the Initial Decision of Examiner Ferdinand D. Moran).



ferent profit margins for sales to different groups of customers. Intrinsicly, it depends on demand (elasticity) differences, and the presence or absence of cost (level) differences is unimportant.<sup>87</sup>

Hence, to require this type of cost difference for promotional pricing devices is to suggest a per se rule against discrimination. While the CAB decisions (to be considered *infra*) clearly belie the existence of any such rule, it would appear that the Board has often "waived" application of the rule in certain circumstances rather than recognize that the factors being considered are not always relevant.<sup>88</sup>

The area which the Board has ignored—costing techniques reflecting marginal costs and other factors varying from carrier to carrier—is a particularly complex one. As Caves notes:

[T]he levels of most activities carried on by an airline are not rigidly related to one another. Total passenger-miles can vary significantly without causing proportional changes in plane-miles flown, aircraft operated, reservations and sales personnel employed or many other factors. . . . In airlines and the other service industries it is hopeless to try to make a distinction between production cost and promotion expenditures. Faced with a seasonal or cyclical fall of demand, an airline may well maintain its output level as an investment in protecting its future market share.<sup>89</sup>

However complex, these are the costs which yield justifications for carrier pricing approaches. What is significant is that Congress has generally left control over the factors producing these costs in the hands of the carriers themselves.<sup>90</sup> Accordingly, it does not seem too outrageous to suggest that this congressional policy can best be effectuated by giving carriers similar latitude to develop costing techniques built on their respective operations and apply these to their fares, subject only to a requirement that data be introduced to evidence the "good-faith" nature of the particular fare modification.

### III. THE *Ad Hoc* APPROACH TO PRICE DISCRIMINATION

#### A. Introduction—The Basis For The CAB's Managerial Philosophy

The historical and economic factors heretofore presented suggest that

<sup>87</sup> Caves 162.

<sup>88</sup> See discussion of Business and Economy Fares, *supra* note 75. Had the CAB truly accepted the examiner's economic analysis as the justification for approving three-level fares in the Chicago-Los Angeles market, it would have had to make a similar analysis to approve Continental's Houston-Los Angeles three-level structure. The fact that the Board relied on the Chicago-Los Angeles findings as the rationale for dismissing the latter proceeding, Continental Air Lines, Inc. (economy fares in the Houston-Los Angeles market), CAB Docket No. 15245, CAB Order No. E-22195 (21 May 1965), suggests that the question of "discrimination" was simply "waived." In fact, the Houston-Los Angeles rate structure is justified principally by the fact that Continental would be unable to utilize its equipment efficiently if it could not operate the same aircraft in both markets. The CAB's assertion that the markets are similar is highly inaccurate, since there is no equivalent to United's one-class service in the Houston-Los Angeles market and therefore no justification for authorizing five-abreast seating (with first-class seats) at coach fares. Of course, under the view espoused herein, such a practice is not at all discriminatory.

<sup>89</sup> Caves 82.

<sup>90</sup> Federal Aviation Act of 1958 § 401(e), 72 Stat. 754 (1958), 49 U.S.C. § 1371(e) (1964):

No term, condition, or limitation of a certificate shall restrict the right of an air carrier to add to or change schedules, equipment, accommodations, and facilities for performing the authorized transportation and service as the development of the business and the demands of the public shall require. . . .

the Civil Aeronautics Board had *carte blanche* to evolve a new regulatory framework for commercial air transport and, indeed, had an obligation to do so with particular reliance on the unique congressional declaration in favor of competition.<sup>91</sup> However, the history of CAB action in pricing and related fields indicates that the Board has chosen to ignore the opportunity. Despite the frequent decisional references to ICC case law and recourse to "familiar" categories of "discrimination" (like and contemporaneous service; the rule of equality; undue prejudice to a locality, etc.),<sup>92</sup> it is inconceivable to suggest that the Board's members have felt themselves bound by the regulatory counterpart of *stare decisis*. Rather, such tests have been used because they are in accord with a philosophy of regulation: a managerial philosophy in which the legislative mandate of competition "*to the extent necessary*" serves as the rationale for cartelization by regulation.

Of course, not every decision and order of the Board can be relied on to support such an indictment. On various occasions, the Board has departed from its "cartel-in-the-public-interest" philosophy. Until recently, however, it has been most closely adhered to in the most significant area: carrier pricing practices.

The notion of cartelization by regulation is curious indeed. A rational cartel would presumably allocate territories to take account of any existing economies of scale. Absent economies of scale, it would presumably act to keep the price level high, but where over-all economies of scale were slight and each producer had the technological and financial ability to utilize his resources in varying degrees in any one of a number of markets, a cartel would be an unlikely result. It would seem even more unlikely where, as in air transport, a large consumer market remains to be tapped. The Board, however, has traditionally certified more carriers in the long-haul markets where operating economies are present,<sup>93</sup> while at the same time ignoring the fact that fares in these markets are higher-than-average<sup>94</sup> and initially attempting to forestall attempts to have the fare structure reflect the economies in long-haul operations.<sup>95</sup>

Thus striving for a theoretical "best of both worlds," the Board ends up with neither. It allocates routes in precisely the opposite way of a rational cartel, but restricts the competitive tendencies flowing from that allocation. At the same time, it speaks of the need for efficient operations

<sup>91</sup> Federal Aviation Act of 1958 § 102(d), 72 Stat. 740 (1958), 49 U.S.C. § 1302(d) (1964) set out *supra* note 24.

<sup>92</sup> For a discussion of CAB decisions analyzed on the basis of these "tests," see Caves 160-64.

<sup>93</sup> *Id.* at 19. A rational cartel would most probably do the opposite.

<sup>94</sup> The fares for hauls west of Chicago (generally longer hauls) average 7.7¢ per plane-mile while the level is 7.5¢ per plane-mile in the markets east of Chicago. American Aviation, July 1963, p. 27. But *cf.* CAB Press Release No. 63-62, 17 Oct. 1963: "The fare increases proposed by Western . . . would make the disparity in yields between western markets and other domestic markets even greater than they are at present." This is a departure from prior claimed ignorance of the differential, but since Western's routes are confined to the western half of the United States (reaching no farther east than Minneapolis) and it has less competition than most carriers, the question of the differential really was not in issue.

<sup>95</sup> Thus, for example, Continental Air Lines' initial attempts to introduce economy service met with an unfavorable response. See Continental Air Lines, Inc., CAB Docket Nos. 13163, 13177, 13182, 13184, 13187, 13188, 13191 and 13195, CAB Order No. E-17756 (22 Nov. 1961) (investigating and suspending economy fare proposal and related defensive filings).

and adopts policies under which efficiency cannot be fully reflected and may well be discouraged by the maintenance of high price levels. Such an approach looks to "the simultaneous maximization of things that probably cannot be simultaneously maximized."<sup>96</sup> The public interest factor is expressed as little more than the certification of some number of carriers—herein of "balanced competition"—with little concern for the potential results of such action.<sup>97</sup>

Where the issue is one of fares, Board decisions reflect this same attitude. The public interest is defined as the maximization of industry-wide profits without placing any carrier in jeopardy. Politically, this definition would seem to be required, for industry-wide profit is the most obvious, although hardly the most reliable, index for determining whether the agency is doing a good job. This is particularly true when the agency is called upon to defend its annual request for subsidy appropriations and is faced with pressures for subsidy reduction.

If, however, such an approach was justifiable in a period long since past, it is nonetheless indictable for its masquerade as the promotion of competition or the avoidance of discriminatory pricing. If one accepts the industry-wide view as valid, then the Board's treatment of carrier pricing proposals, aside from the misuse of the term "discrimination," has been satisfactory. However, any such conception of the Board's role as manager of an industry fails to consider the economics of air transportation and the changes which have occurred in the course of the industry's development.

So long as the industry-wide view remains, the criteria for determining whether a particular pricing technique is desirable are limited to those which test the ability of each carrier to emulate the proposal profitably. The thesis of this study, however, is that the airline industry has reached a stage of development where emulation is no longer the only avenue for meeting competition successfully. If this assertion is correct, the industry-wide view fostered by the Board's managerial philosophy is no longer an adequate or desirable basis for price regulation.

### B. *Early Pricing Practices In Air Transportation*

During the early phases of an industry, high developmental costs usually result in pricing which bears little relation to production costs. The widespread reluctance of the general public to fly,<sup>98</sup> coupled with the guarantee of government subsidy, encouraged pricing practices designed to attract traffic and simply "go as far as possible in covering costs."<sup>99</sup> A few attempts at creative rate-making may be found, but, in general, they had limited competition effect and were ignored by the CAB.

<sup>96</sup> Caves 126-27.

<sup>97</sup> The CAB pays great attention to the competitive effect of additional certification vis-a-vis increased frequencies, traffic stimulation and ensuring adequate service. But beyond two carriers, little is gained in these regards. See generally Gill & Bates, *Airline Competition—A Study of the Effects of Competition on the Quality and Price of Airline Service and the Self-Sufficiency of the United States Domestic Airlines* (1949).

<sup>98</sup> See Jones & Davis, *The "Air Coach" Experiment and National Transportation Policy*, 17 *J. Air L. & Com.* 1, 3 (1950).

<sup>99</sup> Gill & Bates, *op. cit. supra* note 97, at 418.

[D]irect regulatory attainment of reasonable and non-discriminatory commercial rates was not conceived to be one of the primary tasks of the Board, nor did this issue assume any great significance in the period immediately following the enactment of the [Civil Aeronautics Act].<sup>100</sup>

Nevertheless, the few cases dealt with by the Board are particularly interesting. They represent the first reactions to pricing schemes which attempted to have fares reflect differences in market factors, carrier operating characteristics and cost differences. However, the Board's treatment of these questions can be explained wholly on the basis of their revenue and subsidy effects, rather than as an attempt to define allowable pricing techniques.

### 1. *Premium and Discount Pricing*

Beginning in 1933, American Airlines' predecessor had sold script coupons with a face value of 250 dollars at a discount price of 212.50 dollars.<sup>101</sup> Sleeper service was priced at a minor premium, varying from carrier to carrier depending on the aircraft it used. Modification of the standard DC-3 to the sleeper-type DST reduced capacity by one-third. The premium, however, was set at only eight per cent.<sup>102</sup> It is conceivable that this "discrimination" could have been justified by examining the actual traffic density to determine if the seat reduction actually displaced DC-3 revenue passengers. Apparently, no such data was considered, but it is interesting to note that following World War II, when demand had risen considerably, American priced this same service at fifty-seven per cent premium.<sup>103</sup>

United Air Lines experimented with a low-fare "Sky-Coach" service, designed to increase the attractiveness of its inferior Boeing 247-D equipment which it was forced to operate in some markets because of ill-equipped airports and poor traffic.<sup>104</sup> It operated DC-3 equipment non-stop between Los Angeles and San Francisco, in competition with Trans World Airlines (TWA). Intermediate airports could not handle DC-3 equipment, nor could they support any service without a base of Los Angeles-San Francisco through traffic. The justification for a fare differential for terminal-to-terminal passengers using the inferior service and for denying this differential to passengers originating or terminating at one of the intermediate points is obvious. TWA requested suspension of the tariff, but evidently the Board ignored the complaint and United's plan went into effect without comment.<sup>105</sup>

Thus, in at least three instances, the CAB had an opportunity to deal with rate structure issues, if only to voice approval of an approach which based fares on a sound conception of the alternatives available to the

<sup>100</sup> Keyes, *Passenger Fare Policies of the Civil Aeronautics Board*, 18 J. Air L. & Com. 46 (1951).

<sup>101</sup> Air Passenger Tariff Discount Investigation, 3 C.A.B. 242, 248 (1942). American later switched to credit cards with the same discount, the forerunner of the Air Travel Plan.

<sup>102</sup> Gill & Bates, *op. cit. supra* note 97, at 142 n. 10.

<sup>103</sup> *Ibid.* This may also have been a device to "re-train" the public and orient them to daylight transcontinental flights.

<sup>104</sup> Mayer, Meyer, Austrian & Platt (now Mayer, Friedlich, Spiess, Tierney, Brown & Platt), *Corporate and Legal History of United Air Lines 573-74* (1953) [hereinafter cited as *History of United Air Lines*].

<sup>105</sup> There is no recorded CAB order on the tariff. TWA's complaint is noted in *History of United Air Lines 574*.

carrier.<sup>106</sup> Just as in *Western Air Express Corporation-Mail Rates*,<sup>107</sup> its concern seemed to be limited to whether or not schemes would increase, rather than re-allocate, revenue.

## 2. *The Air Travel Plan*

The Air Travel Plan (ATP) was the focus of the first full-dress investigation of air carrier rate structures undertaken by the CAB.<sup>108</sup> Under the plan, eight of the then eighteen trunkline carriers entered into contracts with consumers of air transportation, offering them a 15 per cent discount on air travel, provided a minimum of 300 dollars worth of transportation was purchased annually and a deposit of 425 dollars was maintained.<sup>109</sup> All eighteen carriers honored the card on these terms, the ten non-contracting lines being "non-issuing participants."

One feature of the plan, put in issue by TWA,<sup>110</sup> was clearly anti-competitive in design. It prevented participating carriers from contracting with subscribers already under contract with another carrier. Hence, since all billing, both on-line and interline, was done by the first contracting party, it could "check" on its subscribers' use of competing services and focus sales pressure on them. This provision was struck down by the Board.<sup>111</sup>

Apparently, the pressure for the investigation stemmed from pressures by travel agents who lost their sales commissions when ticketing ATP subscribers.<sup>112</sup> The Board, however, argued that the plan stimulated the use of air transportation<sup>113</sup> and increased revenue. Indeed, with the savings from agency commissions and the fact that the 15 per cent discount was applied to one-way fares rather than to the already discounted round-trip rate, the Board suggested that ATP rates probably saved the carriers a good deal of money.<sup>114</sup>

Having found these facts, the Board then turns to the question of "discrimination":

Considering the impetus that subscribers have given to the development of air transportation . . . a classification of this character does not appear to result in unjust or unreasonable rates.<sup>115</sup>

Looking for the widest possible support for this bold assertion, the Board quotes the Supreme Court in *Texas & Pac. R.R. v. ICC*:

<sup>106</sup> See discussion in text following note 82 *supra*. Of course, American's scrip plan might not necessarily represent a choice of alternatives by the carrier.

<sup>107</sup> *Supra* note 83.

<sup>108</sup> Air Passenger Discount Investigation, 3 C.A.B. 242 (1942).

<sup>109</sup> Cf. Passenger Credit Plans Investigation, CAB Docket No. 10917, CAB Order No. E-19197 (16 Jan. 1963), *remanded for reopened hearings and modified sub nom.* Reopened Passenger Credit Plans Investigation, CAB Docket No. 10917, CAB Order No. E-20280 (19 Dec. 1963).

<sup>110</sup> 3 C.A.B. at 247. See also, Gill & Bates, *op. cit. supra* note 97, at 470.

<sup>111</sup> 3 C.A.B. at 252.

<sup>112</sup> *Id.* at 247.

<sup>113</sup> *Id.* at 249. To support this, the Board cited the fact that (1) the number of subscribers had risen; (2) the number of ATP cards issued had risen; and (3) the average monthly billing to subscribers was \$216.00. These facts alone prove nothing. No comparison was made with overall traffic growth.

<sup>114</sup> *Id.* at 250.

<sup>115</sup> *Ibid.*

[A]ll circumstances and conditions which reasonable men would regard as affecting the welfare of the carrying companies, and of the producers, shippers and consumers should be considered by a tribunal . . . .<sup>116</sup>

The Board concludes by noting that there is no competitive relationship between ATP subscribers and non-subscribers and that "the reduced rates are reasonably open to all. . . ."<sup>117</sup>

Thus, one is left in the dark as to "discrimination." The plan is possibly non-discriminatory, since it is open to anyone and does not push non-ATP rates up beyond a "zone of reasonableness" (a view consistent with this study's approach); or, the "discrimination" is justified either because it stimulates traffic, because volume air transportation is a "different product" than flight-by-flight transportation (despite the lack of differences in ticketing cost and service); or, because the absence of a "competitive relationship" between consumers makes rates based on differential elasticity of demand permissible. With all eighteen carriers participating, no question of inter-carrier competition was involved. The Board's primary concern seems to have been with maximizing industry-wide revenue. "Discrimination" is subordinate to this concern and, arguably, the inquiry was designed simply to give the policy determination a gloss of legalistic equity.

This analysis is supported by the Board's action shortly thereafter, permitting carriers to eliminate all discounts, including the Air Travel Plan.<sup>118</sup> Given the high demand for airline space during the war,<sup>119</sup> the action increased carrier revenues by some ten per cent. No consideration was given the possibility that this modification of the rate structure might have been an instance of "discrimination."<sup>120</sup>

Following the war, carriers again filed a Universal Air Travel Plan (UATP) tariff, this time with a five per cent discount. Air travel had become an accepted mode of transport and some were already expressing fears that carriers' planning for the post-war period was overly optimistic. The Board suspended the discount feature and docketed the matter for investigation,<sup>121</sup> but the discount was cancelled before investigation.<sup>122</sup>

### 3. *The Treatment of Rate Relationships*

Following the original ATP decision, rate relationships underwent their first major alteration. Again, the changes were the incidental result of the Board's concern with industry revenue. While wartime demand yielded profitable operations, the Board was undoubtedly embarrassed by the fact that the highly competitive carriers, whose unit revenues were from ten to twenty per cent higher than carriers with little route competition, were charging a higher level of fares than other lines.<sup>123</sup> In a show-cause

<sup>116</sup> 162 U.S. 197, 219 (1896).

<sup>117</sup> 3 C.A.B. at 251.

<sup>118</sup> See Gill & Bates, *op. cit. supra* note 97, at 409.

<sup>119</sup> See History of United Air Lines 570.

<sup>120</sup> This is not to suggest that the change or resulting rate structure should be classed as a discrimination. Given thorough examination, probably it is not. However, it is clear that the CAB was not concerned with pricing techniques in a revenue-increasing setting.

<sup>121</sup> Universal Air Travel Plan Case, CAB Docket No. 1939, CAB Order No. 3763 (23 June 1945) (order instituting investigation).

<sup>122</sup> History of United Air Lines 571.

<sup>123</sup> Gill & Bates, *op. cit. supra* note 97, at 447.

order directed to eleven of the carriers,<sup>124</sup> the Board proposed a blanket ten per cent reduction in fares.

The "Big Four" carriers (American, Eastern, TWA, and United) opposed this order, proposing instead specific reductions with a view to obtaining uniform per-mile rates over their systems.<sup>125</sup> Their support of a uniform base-rate, however, came not from any conception of "discriminatory" or differential pricing (in which systemwide uniformity could be looked upon as non-discriminatory or as a *justified discrimination*). Rather, their highest fares being in competitive markets,<sup>126</sup> they sought to avoid application of any reduction to their lower non-competitive market fares.<sup>127</sup>

CAB-carrier compromises, predicated on the adoption of uniform base rates, obviated the need for investigation and produced a four per cent drop in the general fare level.<sup>128</sup> Thus, the fare decreases occurred principally in competitive, dense markets, other carriers meeting the Big Four rate when necessary.

One cannot take issue with the result insofar as we would expect competitive rates to be below non-competitive rates (or at least not above them) and, given the high level of demand and profitability in almost all sectors, uniformity appears to be within a "zone of reasonableness." The willingness of the Board to accept the compromise and drop its plans for investigation seems to have stemmed more from a concern with subsidy than with pricing techniques.

A little over a year later, the Board issued a new set of show-cause orders, directed at the relation between subsidy and fare levels.<sup>129</sup> The presence of a uniform base-rate among the Big Four made it appear equitable to calculate mail-pay on the same basis. Thus, passenger fares and mail rates were reduced to a common level at forty-five cents per ton-mile<sup>130</sup> and the Board was able to claim that it had effectively eliminated the subsidy component from the Big Four's mail-pay.<sup>131</sup>

CAB attitudes have thus directed air carrier management toward pricing techniques which will increase net revenue and away from rate structure

<sup>124</sup> American Airlines, Inc. et al., CAB Docket No. 850, CAB Order No. 2164 (27 Feb. 1943) (order to show cause in the matter of rates, fares and other charges for transportation of passengers).

<sup>125</sup> See, e.g., History of United Air Lines 540.

<sup>126</sup> Gill & Bates, *op. cit. supra* note 97, at 450.

<sup>127</sup> The uniform base rate approach might have been justified at the time in question since almost all carriers were operating DC-3 aircraft in all markets (80.7% of commercial trunkline aircraft were DC-3s) and direct operating costs were much less varied than they are today with long non-stop stage lengths and different aircraft types.

<sup>128</sup> Gill & Bates, *op. cit. supra* note 97, at 409-10.

<sup>129</sup> American Airlines, Inc., CAB Docket No. 1698, CAB Order No. 3351 (22 Dec. 1944) (order to show cause—systemwide mail rates); Eastern Air Lines, Inc., CAB Docket No. 1697, CAB Order No. 3350 (22 Dec. 1944); Transcontinental & Western Air, Inc., CAB Docket No. 1700, CAB Order No. 3353 (22 Dec. 1944); and United Air Lines, Inc., CAB Docket No. 1699, CAB Order No. 3352 (22 Dec. 1944). Unlike the 1943 show cause order, note 124 *supra*, these orders led to actual adjudications. See American Airlines, Inc., Mail Rates, 6 C.A.B. 567 (1945); Eastern Air Lines, Inc., Mail Rates, 6 C.A.B. 551 (1945); Transcontinental & Western Air, Inc., Mail Rates, 6 C.A.B. 595 (1945); and United Air Lines, Inc., Mail Rates, 6 C.A.B. 581 (1945).

<sup>130</sup> Gill & Bates, *op. cit. supra* note 97, at 411.

<sup>131</sup> The claim is far less valid than it sounds for it assumes that the cost of transporting passengers and mail is equal.

proposals which would increase a single carrier's profit, efficiency or competitive position at the same net revenue level or at a lower unit revenue level.<sup>132</sup> The efficacy of promotional fares or discounts, while argued in terms of discrimination, is keyed wholly to questions of maintaining the general fare level.<sup>133</sup>

Although some significant steps away from this position have been taken (and will be noted *infra*), the elimination of direct subsidy for trunkline carriers and other developments have not altered this general attitude. Thus, in the course of approving a general fare increase in 1960, the Board noted that "the higher level of fares should afford sufficient financial latitude to enable *the industry* to experiment with promotional fares. . . ."<sup>134</sup> However, later in the same year, the CAB's concern with the industry profit rate led to approval, without a formal investigation, of an increase in jet coach fares.<sup>135</sup> No consideration was given to the possibility of narrowing the first-class/coach differential by other means nor to the cost differential between classes.<sup>136</sup> The recent reduction in first-class fares was similarly predicated on the requirement that carriers reduce the family fare discount and minimize first-class lounge space<sup>137</sup> attempting thereby to safeguard industry revenue levels.

### C. Administrative Regulation And The Egalitarian Ethic

As many theorists have observed, governmental action in economic regulation through legislation is shaped, as a political phenomenon, by egalitarian pressures. In administrative action, the egalitarian ethic is no less effective as an institutional phenomenon. The regulation of equals is inherently easier. Hence, a regulated industry is faced with continued pressure for homogeneity. The sections which follow explore the ways in which references to price discrimination are used to avoid regulatory problems which would arise if the assumption of homogeneity were discarded and a multi-dimensional approach recognizing the non-equality of all carriers were substituted.

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<sup>132</sup> Keyes, *Passenger Fare Policies of the Civil Aeronautics Board*, 18 J. Air L. & Com. 46, 60 (1951).

<sup>133</sup> Thus, as the demand created by the war slackened and costs increased, the rate structure underwent a series of revenue-seeking gyrations without much concern for rate relationships. Uniform base rates disappeared; new aircraft bore premium-fare tariffs (and older aircraft were held to no-discount fares, see, e.g., States-Alaska Fare Case, 21 C.A.B. 354 (1955)); general fare increases coupled with elimination of premium fares, reintroduction of discounts and changes in discount features were generally approved without much comment. See generally, Gill & Bates, *op. cit. supra* note 97, at 458-76.

<sup>134</sup> Domestic Trunkline Passenger Fare Increases, 31 C.A.B. 984 (1960). (Emphasis added.)

<sup>135</sup> See CAB Order No. E-15894 (7 Oct. 1960).

<sup>136</sup> See Caves 166. However, the next time around, the CAB refused to permit another coach increase. Its apparent lack of interest in the overall question of rate relationships, however, was still present. It ignored other features of the proposed tariff which involved varying applications of dollar amount increases and dollar plus percentage increases by both aircraft (piston or jet) and class, thus introducing a distance taper and, to the extent that piston craft were being operated in certain markets because traffic was insufficient to support jet service, a density-operating cost integration as well. Instead, the CAB announced that it would view a flat 3% general increase favorably. See United Air Lines (proposed passenger fares), CAB Docket No. 13313, CAB Order No. E-17885 (28 Dec. 1961); 1A Av. L. Rep. ¶ 21,236 at 14684.

<sup>137</sup> See CAB Press Release No. 63-92, 20 Dec. 1963.



### 1. *The Avoidance of Product or Market Definitions*

One aspect of the pressure for homogeneity is reflected in decisions on pricing technique and "discrimination" which ignore the necessity of defining the market or the products involved in clear terms.

For example the Board's two decisions in *Capital Group Student Fares*<sup>138</sup> failed to consider Capital's proposal in the light of its route structure or the traffic it was seeking to develop. The majority of Capital's routes and flight patterns were keyed to Washington, D.C. While its proposal was theoretically applicable throughout the system, it is clear that Capital assumed that the tariff would have its greatest application (indeed, its only significant application) in the Washington market among school groups visiting the city. The tariff was applicable only on Saturdays and Tuesdays, its historic "weak traffic" days in the Washington market.

While Capital competed for Washington traffic in a number of dense city-pairs (*e.g.*, Chicago-Washington, Detroit-Washington), many of its Washington pairs were non-competitive and, in any case, the route structures of its competitors were not wholly dependent on Washington traffic. Had the market and product been defined this way, it would have been apparent that Capital was attempting to sell a marginal-cost product in a geographically limited market.

The carrier is to blame for its failure to support the filing with cost data.<sup>139</sup> The Board, however, was willing to reverse its examiner's finding that the excursion fare itself was discriminatory. It singled out the "student" restriction as an unjust discrimination.<sup>140</sup> Once the relevant market is considered, the approval sans restriction is meaningless—the fare will be effectively utilized only by student groups.<sup>141</sup>

On the other hand, there are instances where ignorance of the relevant market characteristics and the consequent application of a "rule against discrimination" *in vacuo* makes the fare proposal seem absurd. Thus the Board recently suspended and ordered investigation of a proposal by Mohawk Airlines<sup>142</sup> focusing on the possible discriminatory nature of a 40 per cent discount to certain university students traveling between Buffalo, Ithaca, Rochester or Syracuse and New York/Newark on specified dates. While Mohawk submitted an excellent statement justifying its proposal on market and operating characteristics, the Board bluntly stated that "such allegations do not justify the discrimination inherent [in the

<sup>138</sup> *Capital Group Student Fares*, 25 C.A.B. 280 (1957) (disapproving student feature but proposing remand to examiner if carrier agrees to delete student requirement) and *Capital Group Student Fares*, 26 C.A.B. 451 (1958) (approving tariff with deletion; ignoring factors relating to price differential). See text accompanying notes 84-85 *supra*.

<sup>139</sup> Given the fact that the Board ended up ignoring cost data of a more elementary sort, see text accompanying note 85 *supra*, some part of the blame must be laid to the CAB itself. See discussion in text accompanying notes 75-76 *supra*.

<sup>140</sup> *Capital Group Student Fares*, 25 C.A.B. 280, 281 (1957). Cf. the Board's treatment of "youth" fares in text accompanying note 240 *infra*, in which "student" becomes "ages 12-22."

<sup>141</sup> If Capital was, as suggested here, basically seeking to tap the "school trip to Washington" market, there would be additional savings to the extent that student groups would be likely to "repeat" each year and past the initial sales development, little selling cost would be involved. If so, approval of the tariff without the student restriction at the same proposed rate is open to question.

<sup>142</sup> *Reduced Fares for Students Proposed by Mohawk Airlines*, CAB Docket No. 15949, CAB Order No. E-21912 (16 March 1965).

student restriction of the proposal].<sup>143</sup> Given this response, Mohawk cancelled the tariff revision and the investigation was dismissed.<sup>144</sup>

Briefly, Mohawk was seeking a solution to the student practice of making multiple reservations during peak holiday travel periods. The damage inflicted on Mohawk is undoubtedly heightened by the fact that the university communities it serves are located at its major traffic points. Accordingly, Mohawk conceived of a plan whereby students at such institutions would be given a discount if tickets were issued at least ten days prior to the date of departure. If presented for refund during the week before departure, no refund would be made.<sup>145</sup> The fare, of course, would be applicable only during the peak travel periods.

Since the tariff revision is based on these specific factors, the Board's assertion that the student restriction is a discrimination of such magnitude as to outweigh any other consideration is plain folly. The specifics raised by Mohawk are precisely what make the students the relevant group. Consideration of the proposal without reference to students would not only suggest an even greater potential for discrimination but would look like irrational pricing, which, as noted *supra*,<sup>146</sup> might force other carriers to follow suit. As it was, no trunkline carrier competing in the markets involved objected to Mohawk's plan. Since each trunkline had sources of revenue beyond Buffalo, Rochester and Syracuse, elimination of multiple reservations would be highly beneficial to them, opening seats for long-haul passengers and thereby compensating for any revenue loss from student diversion to Mohawk. By avoiding any market definition, this effect is ignored. The proposal is evaluated in terms of *all* markets and *all* carriers and, accordingly, the matter of "discrimination" assumes different proportions.

This same attitude is revealed in the *Capital Family-Plan Case*.<sup>147</sup> Here, Capital supported its proposal to extend its family-fare plan to Saturdays by producing data indicating that, owing to its route structure, it carried 26.8 per cent less traffic on Saturdays than on other days.<sup>148</sup>

The CAB examiner concluded that Capital's proposal was unjustly discriminatory, since, if each carrier could extend the family fare to its lowest fare day, competition would make the family fare applicable on all days of the week, the supposed "leveling" effect on traffic would be eliminated.<sup>149</sup> No consideration was given to the fact that, owing to the routes of other carriers, their lowest fare days were already covered by the middle-of-the-week family plan. The Board reversed, stating that it was not prepared to pass on the discrimination issue until after a broader

<sup>143</sup> *Ibid.*

<sup>144</sup> Reduced Fares for Students Proposed by Mohawk Airlines, CAB Docket No. 15949, CAB Order No. E-22094 (28 April 1965).

<sup>145</sup> This would seem to be the only feature of the proposed tariff legitimately open to question, insofar as it establishes a 100% penalty. However, the Board had standards for such penalties from the abortive "no-show" plan. Hence, had it wanted to allow the tariff to go into effect, it could have stipulated a lower penalty pending investigation.

<sup>146</sup> See text preceding note 72 *supra*.

<sup>147</sup> 26 C.A.B. 8 (1957).

<sup>148</sup> *Id.* at 9.

<sup>149</sup> *Id.* at 13.

family fare investigation.<sup>150</sup> It noted, however, that "If it should develop that Capital's Saturday family fare plan has a significant weakening effect on other carriers, we can re-examine the reasonableness of the plan. . . ."<sup>151</sup> CAB member Harmar Denny, dissenting, was more explicit, stating that he considered "that both Capital and the industry would suffer a severe loss."<sup>152</sup> However, Capital's competitors found no reason to emulate the Saturday plan<sup>153</sup> and the proposed investigation was dropped. Experiences of this sort apparently have had no effect on the Board's attitudes. The assumption of automatic emulation continues to serve as the justification for an industry-wide approach.

The lack of market or product definition does more than ignore pertinent data. It leaves "discrimination" without a well-defined object. In the recent *Delta Off-Peak Coach Case*,<sup>154</sup> Delta sought the right to apply its normal coach fare to seating in both coach and first-class compartments of Convair 880 aircraft departing San Francisco for Dallas between the hours of 10:00 p.m. and 4:00 a.m. Its competitor in the market, American, objected. In finding the Delta proposal to be discriminatory, the Board advanced a multitude of supposed discriminations. Thus, the fare involved would discriminate between passengers on the flight in question; between coach passengers on daytime flights and passengers on the flight in question;<sup>155</sup> between coach passengers on Delta's flights *in other markets* and passengers on this flight;<sup>156</sup> and would be a discrimination against American's passengers as well.<sup>157</sup>

An examination of the facts which prompted Delta to make this proposal indicates the absurdity of these conclusions. As the dissent notes, Delta's Convair 880 aircraft were purchased primarily for other services prior to its extension from Atlanta to the West Coast via Dallas.<sup>158</sup> The aircraft is smaller than American's Boeing 707 equipment<sup>159</sup> and bears a heavy proportion of first-class to coach seats. Delta was thus forced to turn away potential coach passengers while flying with its first-class compartment partially empty. American had no such problem, owing to its larger craft and greater proportion of coach seating. Delta was not proposing to maintain first-class services while up-grading selected passengers to the first-class compartment. It sought to eliminate first-class amenities, save the seating, and offer the entire capacity at coach fare on a first-come, first-served basis. Given its particular situation, the coach revenue to be

<sup>150</sup> *Id.* at 9.

<sup>151</sup> *Id.* at 13.

<sup>152</sup> *Id.* at 15 (dissenting opinion).

<sup>153</sup> See Gellman, *The Regulation of Competition in United States Domestic Air Transportation: A Judicial Survey and Analysis—II*, 25 J. Air L. & Com. 148, 154 (1958).

<sup>154</sup> CAB Docket No. 13040, CAB Order No. E-20268 (16 Dec. 1963).

<sup>155</sup> *Id.* at 2, 10.

<sup>156</sup> *Id.* at 2-4.

<sup>157</sup> *Id.* at 8-10.

<sup>158</sup> *Id.*, p. 8 (separately numbered dissenting opinion). See Southern Transcontinental Service Case, 33 C.A.B. 701 (1961).

<sup>159</sup> The Convair 880s operated by Delta had an average seating capacity of 89.1 passengers, while American's Boeing 720s averaged 106.1 and its 707s 123.5. American Aviation, July 1963, p. 43. More importantly, the Convair's narrow cabin accommodates only five coach seats, as opposed to six in other aircraft.

gained more than offset any loss from eliminating first-class service. American's situation was hardly similar and it is therefore doubtful that it would have found any competitive necessity to adjust its policies in kind.

The Board's finding of discrimination between American and Delta passengers rests on the assumption that these services are comparable. To support this, it notes that the Delta departure time is not "off-peak," since it attracts a substantial amount of the intercity traffic. This ignores the fact that American, when it was the sole carrier in the market, provided its only quality service late in the evening, shaping consumer habits.<sup>160</sup> Moreover, San Francisco is the terminus for a number of American's flight patterns. Thus it has several alternatives in utilizing aircraft late at night. Delta, on the other hand, enters San Francisco on but one route and must choose between operating as at present or moving the departure time to 9:00 a.m. with an attendant loss of utilization.<sup>161</sup> Since Delta's primary routes are in the eastern half of the nation, its equipment is more useful in Atlanta than in San Francisco during daylight hours. Thus, Delta's nighttime flights from San Francisco are qualitatively different from its daytime flights. The same cannot be said for American. Moreover, the product produced by Delta's night flight is "off-peak" in an operational sense, even if the departure *time* may not be off-peak for passengers.

The Board also ignores the fact that, unlike American's service, Delta's flight continues to Atlanta, which, in terms of departure-time preference, is certainly off-peak. The result is that a passenger in the first-class compartment pays the first-class fare to Dallas, but is charged a reduced fare for the same accommodations between Dallas and Atlanta, a non-competitive market.<sup>162</sup>

Such anomalies occur when the Board ignores the role of variations in carrier resources and operations and attempts to make pricing decisions under an assumption of uniformity. Once these variations are recognized, the argument that proposals must be tested under the assumption that each carrier will emulate the policies of the other becomes untenable.<sup>163</sup> Under the definition of unjust discrimination heretofore advanced, neither of Capital's proposals, nor Mohawk's and Delta's schemes should be labeled "discriminatory." They are functionally available to all (or to a significant group) and the particular characteristics of the carrier support the creation of the distinction.

## 2. *The Use of Different Standards in Competitive and Non-Competitive Cases*

Operating under the industry-wide approach, the Board's conception of price discrimination is radically different where intermodal rather than

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<sup>160</sup> Delta Off-Peak Coach Case, *supra* note 154, at 3-4. (separately numbered dissenting opinion).

<sup>161</sup> *Id.* at 9.

<sup>162</sup> See Official Airline Guide, February 1964. Delta has since changed its operating pattern, overflying Dallas and flying nonstop to Atlanta, Dallas being served on a multi-stop San Francisco-New Orleans service. The introduction of the nonstop flight changes the conditions sufficiently to warrant maintenance of the regular first/coach rate structure.

<sup>163</sup> A pattern of non-emulative responses is discussed in text accompanying notes 277-88 *infra* (1957-58 strategies in the transcontinental market).

intramodal relationships are involved, or where factors outside of the agency's control come into play.

a. *The Treatment of Surface Carrier Competition*—Thus, the practice of common-faring all West Coast cities (San Diego, Los Angeles, Portland, Seattle, etc.) for traffic from the east and middle west is justified, in part, by the railroad practice.<sup>164</sup> No consideration is given to the possibility that the comparative levels of rail and air rates (as well as other factors) may make the competitive advantage secured by the practice *de minimis*. Similarly, the Board reversed an examiner's finding that common-faring Portland and Seattle with respect to Alaska traffic was discriminatory,<sup>165</sup> but accepted his conclusion that common-faring Alaska cities was to be proscribed.<sup>166</sup> The Board noted that water carriers followed the first practice;<sup>167</sup> common-faring Alaska points, on the other hand, was related to *intramodal* competition.

In *Investigation of Braniff Airways Excursion Fares*,<sup>168</sup> the Board heeded protestations by Eastern, and Braniff's original proposal was modified.<sup>169</sup> The theory of an excursion fare, however, was maintained, arguably in response to the argument that

air fares in southern Texas are too high for effective competition with surface transportation, and therefore the solution to [the] problem of lean traffic is to be found in lower fares.<sup>170</sup>

When Examiner Edward T. Stodola indicated that surface competition was not relevant in justifying a ten per cent discount for military traffic,<sup>171</sup> the Board was quick to dispel the doubt<sup>172</sup> and reverse. Similarly, in the *Free and Reduced-Rate Transportation Case*,<sup>173</sup> discounts for travel agents were held discriminatory in domestic travel but justifiable in international transportation where the practice was common among shipping lines.<sup>174</sup>

b. *Balancing "Competition" Between CAB-Regulated Carriers*—As the Board's actions in *Braniff Excursion Fares* and *Pacific Northwest-Alaska* (the common-fare case) suggest, "discrimination" is no more than a distinction between competition the CAB wishes to allow and that which it finds undesirable. In *National Airlines, Inc., DC-6 Daylight Coach Case*,<sup>175</sup> Eastern attempted to prevent introduction of daylight coach service in the New York-Miami market. The Board, while refusing to accept Examiner R. Vernon Radcliffe's conclusion that discrimination was im-

<sup>164</sup> West Coast Common Fares Case, 15 C.A.B. 90, 92 (1952).

<sup>165</sup> Pacific Northwest-Alaska Tariff Investigation, 17 C.A.B. 903 (1953).

<sup>166</sup> *Id.* at 907, 930 (examiner's initial decision).

<sup>167</sup> *Id.* at 905.

<sup>168</sup> 12 C.A.B. 227 (1950).

<sup>169</sup> *Id.* at 231.

<sup>170</sup> *Id.* at 228.

<sup>171</sup> Certificated Air Carrier Military-Tender Investigation, 28 C.A.B. 902 (1959).

<sup>172</sup> *Id.* at 905, 907.

<sup>173</sup> 14 C.A.B. 481 (1951).

<sup>174</sup> As one would expect, representatives of competing modes of transportation gain little by complaints to the CAB. See, e.g., American Airlines, Inc., CAB Docket Nos. 15925, 15983, 16025 and 16026, CAB Order Nos. E-22068 (22 April 1965) and E-22186 (20 May 1965) (concerning complaint by National Trailways Bus System); Eastern Airlines, Extension of Air-Bus Fares (Complaint of the National Association of Motor Bus Owners), 33 C.A.B. 1033 (1961); ATC Fare Discounts, 29 C.A.B. 1344 (1959).

<sup>175</sup> 14 C.A.B. 331 (1951).

possible since space on the flight was "offered to all at the same fare,"<sup>176</sup> approved the tariff on the finding that the daycoach service was sufficiently different from first-class to pass muster under the "like and contemporaneous" rule.

What passed unnoticed in *Daylight Coach* was the fact that National apparently based its fare reduction on factors in addition to the increased density of aircoach seating. At a 75 per cent load factor, its 58 dollar fare represents a reduction of over 6.50 dollars beyond the reduction occasioned by increased capacity.<sup>177</sup> Apparently, part of this reduction stemmed from National's substitution of the true New York-Miami mileage on a "Great Circle" route for the circuitous "all-stop" mileage previously used in rate construction.<sup>178</sup> Thus, National's tariff threatened to undermine Eastern's entire all-stop structure and break its Miami fares constructed with gateways other than New York. The examiner's references to this problem are oblique,<sup>179</sup> and he carefully includes a general "policy" statement indicating the efficacy of allowing more freedom to price as the industry's financial position improves.<sup>180</sup> Had he pointed up the anti-discrimination aspects of National's approach, the Board's *per curiam* type approval of the tariff

<sup>176</sup> *Id.* at 332.

<sup>177</sup> The capacities and fares are set out in the examiner's initial decision, *id.* at 334. The \$6.50 figure is arrived at by calculating revenue for each service at a 75% load factor and applying the difference from the first-class revenue yield per seat to the number of coach passengers at a 75% load. National's reduction would seem to be opposite to the general trend which has been to price coach accommodations at a level where they yield higher plane-load revenue.

<sup>178</sup> See *Monopoly Problems in Regulated Industries, Hearings, supra* note 38, at 2206 (testimony of Alexander G. Hardy, Senior Vice-President, National Airlines). The entire question of all-stop mileage as the figure for rate calculation has been generally ignored by the Board, although it is noted in CAB, Bureau of Air Operations, Rates Division, Commercial Rates Section, Preliminary Report on Domestic Passenger Fare Structure, June 7, 1954, in *Monopoly Problems in Regulated Industries, Hearings, supra* Vol. 1, p. 221 at 232-33. See generally, Gill & Bates, Airline Competition—A Study of the Effects of Competition on the Quality and Price of Airline Service and the Self-Sufficiency of the United States Domestic Airlines 400-08 (1949). By applying circuitous all-stop mileage, the fare per nonstop mile charged varies because of the vagaries of the carrier's certificate without regard to cost, density, or other rational factors. Hence Gill & Bates found that Eastern Air Lines' per nonstop mile fare between Louisville and Chattanooga was almost 20% higher than the fare for a similar haul between Louisville and Chicago. In the latter instance, the intermediate certificated point was Indianapolis, with almost no circuitry; in the former instance, Nashville, with 49 miles circuitry, was the intermediate. Of course, all-stop mileage may be partially justified as a device for obtaining a premium for the faster nonstop flight. On the other hand, one might argue that if Chattanooga-Louisville is a thin market and operations via Nashville are thus required, use of all-stop mileage is simply a means of allocating cost to the consumer in line with density. If, however, this justification is to be used, some factor must be introduced which will account for revenue produced by the stop at Nashville. One possible method is suggested by reversing the approach suggested by the CAB in *Service to Atlantic City, supra* note 80. If the cost of downgrading a nonstop flight to a one-stop service may be expressed as circuitry cost plus revenue lost by downgrading the flight (plus station expense, etc.), is it not also possible to cost Nashville-Louisville and Nashville-Chattanooga service which operates via the three cities by (1) including lost revenue to the extent that a Nashville passenger cancels a possible through sale (see text accompanying notes 193-96 *infra*) or (2) if the through market is thin and space is available for the Nashville passenger on a marginal cost basis? This should not change the fare charged the Nashville passenger, however, in determining the cost of the Louisville-Nashville-Chattanooga service as a basis for the Louisville-Chattanooga fare. The difference between marginal cost and fully-allocated cost for each leg of the Nashville dogleg would be subtracted from the circuitry cost, so that the cost occasioned by the Nashville stop is not borne wholly by the Louisville-Chattanooga passenger but is allocated in terms of the additional revenue thus made available to the carrier.

<sup>179</sup> National Airlines, Inc., DC-6 Daylight Coach Case, *supra* note 175, at 341.

<sup>180</sup> *Id.* at 349. See also, Gellman, *supra* note 153, at 152. Gellman suggests that the examiner's "policy" statement is in fact the Board's policy. That may be true; however, it is not a conclusion which can be drawn from this case. If the CAB were allowing carriers more "freedom" to price, it would be looking to pricing techniques. A temporary policy of approving experimentation is not a policy of freedom.

would have been unlikely. As CAB Member Gurney's dissent indicates,<sup>181</sup> the Board was, as usual, more concerned with revenue than with pricing techniques.

The relation of "discrimination" to inter-carrier competition is further pointed-up by two other sets of decisions. In both *Pittsburgh-Philadelphia No-Reservation Fare Investigation*<sup>182</sup> and *Frontier Rate Matter*,<sup>183</sup> local service carriers sought to institute reduced-rate "go-show" tariffs to reduce excess capacity. The former proposal went into effect, yet the latter was held to be "discriminatory," the examiner noting that it could even be considered "unfair competition."<sup>184</sup> The result is even more curious when one considers that the Pittsburgh-Philadelphia operation was to be nonstop while Frontier's proposal involved multistop flights in a market served non-stop by a trunkline carrier.

The explanation may be found in the fact that the Pittsburgh-Philadelphia market, while served by trunklines, had trunkline frequencies keyed to long-haul markets. Thus, Allegheny's proposal was essentially non-competitive. Indeed, the Board explicitly pointed out that it was not accepting any marginal cost justification for the lower rate.<sup>185</sup> The assumption was that the new fare would not divert passengers from TWA or United, but rather would promote new travel.<sup>186</sup> Frontier's proposal, on the other hand, was liable to have a direct effect on Western Air Lines.

Similarly, the Board recently acceded to the request of National Air Lines and suspended Delta's proposed routing of West Coast-Atlanta flights via Orlando, Florida.<sup>187</sup> Delta is certificated to serve both markets from the West Coast and clearly could have obtained better utilization of its equipment and provided better service by combining the two services and including additional traffic at Orlando destined for Atlanta or beyond. The Board, however, observed that the practice would be a long-and-short-haul discrimination, since a "jet passenger destined for Atlanta (which is nearer to the West Coast) would pay from twelve to sixteen dollars less, but travel 399 miles more than a passenger on the same aircraft who deplaned at Orlando."<sup>188</sup> In addition, Orlando passengers could purchase the cheaper ticket to Atlanta and still deplane at Orlando.

<sup>181</sup> 14 C.A.B. at 333.

<sup>182</sup> 34 C.A.B. 508 (1961).

<sup>183</sup> CAB Docket No. 14150, CAB Order Nos. E-20309 (initial decision of examiner) and E-20310 (adopting initial decision as CAB opinion) (26 Dec. 1963). 1A Av. L. Rep. ¶ 21,429 at 15167.

<sup>184</sup> In declining review of the examiner's decision and adopting it as the CAB opinion, the Board noted that the unfair competition finding presented a novel question which was not necessary to the decision. Regarding the multi-stop v. nonstop issue, cf. United's early "Sky Coach" service, text accompanying notes 104-05 *supra*.

<sup>185</sup> Pittsburgh-Philadelphia No-Reservation Fare Investigation, 34 C.A.B. 508, 510-11, 514 (1961).

<sup>186</sup> *Id.* at 515.

<sup>187</sup> CAB Press Release No. 63-59, 11 Oct. 1963. National also serves Orlando from the West Coast.

<sup>188</sup> *Ibid.* The "long and short haul" clause is found only in § 4 of the Interstate Commerce Act, *supra* note 25, not in legislation relating to air transport. Cf. Federal Aviation Act of 1958, *supra* note 24. Had the CAB looked to regulatory history, it would have found that the long and short discrimination arose as a result of competition and particular situations, rather than having been a technique designed to create competition, and in no case could have been justified by efficiency, given the characteristics of surface transport.

This same "discrimination," however, was approved by the Board in the *Allegheny Fare Case*<sup>189</sup> where the competitive impact was minimal. Allegheny was thus able to route Washington-Hartford service via Providence, charging 26.90 dollars for the Providence trip and 23.50 dollars for the service through Providence to Hartford. The Board noted that "it would be impracticable for a Providence-bound passenger to check his baggage to Hartford/Springfield and somehow thereafter reclaim it [at Providence] . . ." in order to obtain the lower fare.<sup>190</sup>

c. *Meeting the Competition of Unregulated Air Carriers*—In rare instances, the Board is called upon to deal with pricing practices brought about by competition from air carriers which are beyond the Board's regulatory reach. In such cases, consideration of "discrimination" takes a back seat to the agency's benevolent, albeit parochial, attitude toward protecting its subjects.

An early example of this approach is found in *IATA Agreement Providing for North Atlantic Passenger Fares*.<sup>191</sup> In *IATA Agreement*, transatlantic carriers increased Gander-Europe fares by twice the increase in the New York-Europe market. The discriminatory appearance of this differential was held to be justified because Trans-Canada Air Line's (now Air Canada) U.S.-Gander services had heretofore made the U.S.-Gander-Europe interline fare lower than the transatlantic carriers' on-line fare.<sup>192</sup> Curiously, the discrimination, if any, was probably reversed, since the IATA cartel applied a high "over-water" per-mile rate to the total haul, notwithstanding the fact that the Gander-U.S. sector had cost characteristics akin to normal domestic routes.<sup>193</sup>

This aspect of the problem is ignored by the Board, but even more important is its failure to deal with the carriers' defense based on the characteristics of its route. Under this approach, the higher charge for Gander traffic is justified by the fact that Gander-U.S. was a thin market and therefore, any Gander-Europe passenger effectively blocked a seat from New York, displacing a potential New York-Europe sale and leaving no revenue alternative. The Board does evaluate the loss on a passenger-mile basis,<sup>194</sup> but ultimately, this factor plays no part in its approval<sup>195</sup> even though a pricing technique of this type is derived from an approach the

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<sup>189</sup> *Allegheny Fare Case*—Proposed Routing between Hartford/Springfield and Washington, 34 C.A.B. 327 (1961).

<sup>190</sup> *Id.* at 334 (initial decision of examiner adopted by the Board). This impracticability is wholly ignored in the discussion of Delta's Orlando proposal. Board policy is entirely different with respect to cargo carriage, see *Delta Air Lines, All-Cargo Flight Amendments*, 14 C.A.B. 1149 (1951). Delta was allowed to carry Dallas-bound cargo via New Orleans from Atlanta, the Board noting that the consumer could not care how the cargo went unless it involved "a higher rate or prevent[ed] a timely delivery." *Delta Air Lines, supra* at 1163. Why passengers should differ in this respect is beyond comprehension. See also, Notice of Proposed Rule-Making, EDR-15B, ODR-2, CAB Docket Nos. 11618 and 11785, 27 March 1964, at pp. 5-7, discussing desirability of amending § 221.41 (a) of the Board's Economic Regulations (14 C.F.R. § 221.41 (a)) to allow carriers to file open routing air cargo tariffs.

<sup>191</sup> 10 C.A.B. 330 (1949).

<sup>192</sup> *Id.* at 335-36.

<sup>193</sup> The Board pleads that cost data is inexact, *id.* at 338, however, it did note that TCA was able to base its charges on its average domestic cost, *id.* at 335.

<sup>194</sup> *Id.* at 334.

<sup>195</sup> Approval was conditioned on the continued existence of TCA's present fare. *Id.* at 339.



Board itself suggested in the early *Service to Atlantic City* case.<sup>196</sup>

A more recent, and certainly more outrageous, example of CAB inconsistency in applying its rules against "discrimination" is found in a comparison of the Board's treatment of competitive strategies in the Los Angeles-Las Vegas market (where all carriers are subject to CAB regulation) and the Los Angeles-San Francisco market (in which Pacific Southwest Airlines, an intrastate air carrier, is a potent force).

In order to meet PSA's competition, United and Western, the major regulated competitors in the market, set "jet commuter" fares of 13.50 dollars. TWA, the other trunkline in the market, proposed a similar reduction in its Los Angeles-San Francisco fare, applicable, however, to dual-configured aircraft.<sup>197</sup> In opposition, Western filed a complaint with the Board, charging that TWA's reduction was unjustified because it was not restricted to high-density aircraft and would be part of a through service rather than the turnaround service which Western and United are able to provide. In this instance, the Board felt it unnecessary to involve itself in questions such as the allowable seat-pitch and the use of the identical seat as a coach seat in one market and a reduced-fare in another.<sup>198</sup> It dismissed Western's complaint on the basis that TWA was "meeting competition."<sup>199</sup>

Of course, if the Board had wanted to delve deeper into the problem, it would have found that Western's argument was unsound. Competition aside, TWA's proposed fare and its use of dual-configured aircraft are justifiable for the reasons which Western asserts demonstrate its unreasonableness. Since Los Angeles-San Francisco is TWA's only West Coast route, and it cannot operate turnaround service, the marginal cost of its excess capacity between those cities is extremely low. Competitively, the effect on Western or United will be minimal, since TWA will only fly between Los Angeles and San Francisco when doing so is justified by its beyond Los Angeles traffic or by its pattern of equipment utilization. If TWA is required to operate in that market with high density aircraft which it cannot use in its through services, all possible benefit to it is lost. Had the CAB in fact engaged in such an analysis, they would have been hard-pressed to justify their concern over seating density and economic practicality with respect to United's contemporaneous proposal for the Los Angeles-Las Vegas market.<sup>200</sup>

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<sup>196</sup> *Supra* note 80.

<sup>197</sup> Trans World Airlines, Inc. (jet commuter fare decrease), CAB Docket No. 15939, CAB Order No. E-21957 (29 March 1965). Sixty days before, when TWA first established jet commuter fares, it additionally filed a tariff for a ten-trip ninety-day commuter ticket at a 5% discount. See Trans World Airlines, Inc. (jet commuter fares), CAB Docket No. 15805, CAB Order No. E-21767 (8 Feb. 1965). See also, Trans World Airlines, Inc. (reduced jet coach fares), CAB Docket No. 16021, CAB Order No. E-22053 (19 April 1965) (reducing jet coach fares in the Los Angeles-San Francisco market by 34.6%, from \$23.70 to \$15.50).

<sup>198</sup> In general, the Board's concern with seat-pitch must result in more discrimination to the carriers than any possible injury to the consumers. One doubts that the average consumer is really sensitive to the differences between 34 inches, 35-1/2 inches, or 37 inches.

<sup>199</sup> This, of course, must be the competition of PSA, rather than United or Western, since United and Western reduced their fares in response to PSA.

<sup>200</sup> United Air Lines, Inc. (propeller commuter fare between Los Angeles and Las Vegas), CAB Docket No. 15996, CAB Order No. E-21958 (29 March 1965).

Aside from the absence of an unregulated carrier, the situation in the Los Angeles-Las Vegas market appears to be comparable to Los Angeles-San Francisco. Western operates multiple-frequency DC-6B commuter services at 11.43 dollars each way. Bonanza, a local service carrier, operates a "budget-aire" service at 13 dollars in modern, jet-prop F-27 equipment. United sought approval to meet Western's 11.43 dollars fare with DC-6 aircraft.<sup>201</sup> The United DC-6 however, would seat 69 persons four-abreast, whereas Western's DC-6Bs were configured five-abreast, seating 87-92 passengers. Upon complaints by Western and Bonanza, the United proposal was suspended and set for investigation,<sup>202</sup> the order pointing out that four-abreast service meant upgrading the service at the same rate, thereby undermining the basis upon which Western's low-fare proposal was approved. Seeking reconsideration, United stated that it would refrain from any advertising of the four-abreast feature, making any competitive advantage minimal. The Board, denying United's petition, specified a 13 dollar fare (*i.e.*, the same fare as applicable to jet and jet-prop commuter service) as the minimum it would consider.<sup>203</sup> In the face of this pre-investigation determination, United cancelled its proposed tariff revision.<sup>204</sup>

The CAB's references to "undermining the economic basis" of low-fare proposals and uneconomic use of a first-class aircraft in a low-fare service which lead it to conclude that United's proposal is unjust and discriminatory are hardly appropriate. They suggest that the Board is donning full battle garb to fight United's attempt to engage in a rate-making war which it expects will be carried out on an atomic scale. United, however, pointed out that its proposal was intended to apply to *one* flight per day in each direction and that it contemplated no additional frequencies. This one flight—the only United DC-6 service to Las Vegas—is demanded by

<sup>201</sup> Not to confine its operating alternatives too much, United also provided that the tariff would apply to DC-6B aircraft. DC-6B seating would be mainly four-abreast but would have some five-abreast rows and would have 74 seats compared to the DC-6's 69 (and Western's 87 or 92).

<sup>202</sup> United Air Lines, Inc. (propeller fare between Los Angeles and Las Vegas), *supra* note 200.

<sup>203</sup> United Air Lines, Inc. (propeller fare between Los Angeles and Las Vegas), CAB Docket No. 15996, CAB Order No. E-22130 (4 May 1965) (denying petitions for reconsideration). More recent developments point up the analysis advanced in the text. Since the Board indicated that it would approve the same \$13 jet commuter fare for a propeller service, Western filed a \$13 jet commuter tariff applicable to L-188 (Electra) aircraft with five-abreast seating at a 38-inch pitch. The complaint of Bonanza was dismissed and the tariff went into effect. Western Air Lines, Inc. (propeller commuter fares and seating configuration revision), CAB Docket No. 16198, CAB Order No. E-22307 (14 June 1965). TWA then filed a revision applicable to its jet commuter service in the Las Vegas and San Francisco markets, proposing to use Convair 880 aircraft whose coach configuration is five-abreast. TWA argued that this service was "essentially similar" to Western's Electra service. The CAB disagreed and ordered the tariff revision suspended. Trans World Airlines, Inc. (jet commuter service seating configuration revisions), CAB Docket No. 16301, CAB Order No. E-22364 (28 June 1965). Thus, the Board has held that five-abreast jet-prop service is essentially similar to six-abreast jet coach, *Western Air Lines, supra*; that five-abreast jet coach is essentially similar to six-abreast jet coach (the distinction never even being suggested); but that five-abreast jet coach is not essentially similar to five-abreast Electra service, despite the fact that between Las Vegas and Los Angeles, the flight times on the two craft are almost identical. Of course, CAB Order No. E-22364 *supra* suspended only the Convair 880 tariff in the Las Vegas market. As would be expected, the revision in the Los Angeles-San Francisco market was approved.

<sup>204</sup> United Air Lines, Inc. (propeller fare between Los Angeles and Las Vegas), CAB Docket No. 15996, CAB Order No. E-22304 (14 June 1965) (noting cancellation of proposed tariff and dismissing proceeding).

the carrier's certification to serve Grand Junction, Colorado. As in any rational rate scheme considering traffic density, the flight serving Grand Junction operates on a first-class basis. United, therefore, was simply seeking the small amount of additional revenue which efficient use of its resources demanded.<sup>205</sup> Its position was hardly different from TWA's San Francisco service. The marginal cost of a four-abreast seat on a United DC-6 was undoubtedly less than the marginal cost (let alone the direct cost) of one additional passenger for Western. Aside from the matter of PSA's unregulated participation in the San Francisco market, the inconsistency between the two decisions considered here is without any rational explanation. In such circumstances, the Board's references to "competition" and "discrimination" are little more than a verbal smokescreen.

One can only conclude that the Board's predominant concern remains today unchanged from that which it emphasized during the industry's developmental and subsidized phase: proposals which maximize revenue will be given favorable consideration. Those which may reduce the overall revenue level will generally receive summary—and usually negative—treatment with little concern for the fact that they may have a sound economic basis and, indeed, might even yield increased profits.<sup>206</sup>

### 3. *The Tendency Toward Cost-Increasing Forms of Competition*

The consequence of limiting the efficiency-based responses which a carrier can make to competition is to emphasize competitive conduct which increases costs.<sup>207</sup> For the most part, regulation has ignored this factor, as in *Capital Airlines, Inc. v. Northwest Airlines, Inc.*,<sup>208</sup> where the Board refused to consider the charge that selling liquor aboard aircraft might be a form of unfair competition. The Board has acted, however, where a carrier's practice would reflect on the "uniform" indices necessary for regulation. Thus, in considering an early United proposal similar in result (although not in motivation) to the Las Vegas proposal treated immediately above, it noted that:

by regularly selling less seats than the number specified in this tariff on

<sup>205</sup> As noted earlier, the air carrier is encouraged to seek particular types of volume in particular amounts by the economic characteristics of the industry. If United (or Western) operated twelve Los Angeles-Las Vegas frequencies in four-abreast DC-6 aircraft and charged \$11.43, it might not be economically sound. Neither would it be sound if United offered coach service to Grand Junction so that it could have a properly-configured aircraft for an \$11.43 Las Vegas service which it would operate once a day. The Board's action gave United the chance only to choose between two inefficient operations; for Western, efficiency would require that it maintain its present posture and not respond to United's maneuver. United now operates the service through Las Vegas to Grand Junction and beyond in coach aircraft. This may be more efficient given the CAB's position, but the fact that the carrier is able to operate the entire flight as a coach flight should not be taken as a sign that the Board's decision was correct or that absent regulatory intervention, this operating pattern would be an efficient use of resources.

<sup>206</sup> The relation between *ad hoc* adjudication and the Board's philosophy cannot be overlooked. The "increased profits" prospect, while occasionally visible in the context of one case (as in United's Las Vegas proposal), more often will depend on the carrier's ability to make other adjustments in his operations in other markets. *E.g.*, had Delta been allowed to pool Orlando and Atlanta traffic (note 187 *supra*), one aircraft would have been freed for production in another market. When the CAB approaches a problem on a subject-matter basis, it generally does much better. *Cf.* Seating Configurations, Domestic Trunklines, 30 C.A.B. 1571 (1960) (seating configurations may vary by aircraft and carrier so long as space is adequately utilized).

<sup>207</sup> See generally Gellman, *supra* note 153. See also Caves 168.

<sup>208</sup> 18 C.A.B. 145 (1953). See also, Gellman, *supra* note 153, at 160.

coach flights, United is able to offer Coach service superior to that offered by other carriers. The competitive impact . . . would probably force other carriers to follow suit. . . . This, in turn, would make coach service un-economic and impossible on many routes.<sup>209</sup>

What United proposed was to offer the coach passenger the same amount of room he previously had, simply removing the center seat to provide wider aisles.<sup>210</sup> The passenger received no more or less for his fare than before. Any "discrimination," therefore, was a function of inter-carrier relationships. United determined that it could make a profit with this configuration.<sup>211</sup> The Board feared that other, less efficient carriers could not. Thus, as a "penalty" for its efficiency, United would be required to invest in extensive cabin modifications in order to have the prescribed five-abreast configurations, or sacrifice efficiency and revenue potential by retaining first-class service. In short, emphasis on service competition is not only a matter of increasing costs, but also forces the carrier to incur increased out-of-pocket expense.<sup>212</sup>

In part, this serves to explain the phenomenon of high fare levels in competitive markets which—since they are generally long-hauls with lower operating costs—would otherwise be expected to produce the opposite result. This tendency is justified by the Board by referring to the need for "internal subsidization": the support of operations in "thin" markets by profits obtained in more profitable "dense" markets. Therefore, the argument proceeds, competitive fares must be kept sufficiently high to absorb a part of this burden. Moreover, if this practice is to achieve the desired end, carriers must be dissuaded from seeking increased profitability by reducing costs or increasing the revenue-cost ratio in competitive markets if the efficiency is derived wholly from the carrier's operating characteristics or route structure, since the benefits of such a maneuver will flow only to the single carrier and the competitive advantage over its competitors will make it more difficult for them to practice internal subsidization.

The argument ignores the fact that "the Board no longer gets much internal subsidy for its trouble."<sup>213</sup> Trunklines have been relieved of their obligation to serve numerous small communities and, indeed, have been suspended in favor of local-service carriers at profitable points.<sup>214</sup> Thus,

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<sup>209</sup> United Air Lines, Inc.—Petition for a Change in Coach Policy and for Exemption, CAB Docket No. 5884, CAB Order No. E-7062 (6 Jan. 1953). See also, United Air Lines, Inc.—Reduction in DC-4 Seating Configurations for Air Coach Service, CAB Docket No. 5914, CAB Order No. E-7126 (2 Feb. 1953).

<sup>210</sup> See Berge, *Regulation of Air Coach Service Standards*, 20 J. Air L. & Com. 25, 27 (1953).

<sup>211</sup> *Ibid.*

<sup>212</sup> Both practices reduce net income, but unlike United's single expenditure for seat removal, Northwest had to add a continuing expenditure for liquor. This is not to say that Northwest was engaging in unfair competition; or that a decision to sell (or provide) liquor on flights was irrational; or that the CAB should deal with liquor, cloth napkins and similar matters on an adjudicatory basis. However, the cost-increasing effects of the CAB's approach to competition will be felt more and more in the current phase, as technologically-based fare reductions cease to occur and demand for air transportation increases among cost-conscious consumers.

<sup>213</sup> *Caves* 446.

<sup>214</sup> Consider, e.g., the points deleted from American Airlines' routes during 1962-63: Springfield and Peoria, Illinois, Ozark Air Lines and American Airlines, Service at Peoria & Springfield, CAB Docket Nos. 11482 and 11486, CAB Order No. E-18446 (13 June 1962); Akron-Canton, Ohio,

the question is no longer one of "loss" routes vs. profitable ones, but simply the recognition that not all routes are equally profitable. If competition in the profitable markets will lower fares and result in fare increases in less profitable markets, the resulting fare-structure need not automatically be one in which some consumers receive a discriminatory preference and others bear a discriminatory burden. Such practices would only be "discriminatory" if air transportation between Chicago and Los Angeles is considered to be the same "product" as air transportation between, say, Evansville, Indiana, and Huntsville, Alabama.<sup>215</sup>

If, however, one accepts the premise that the air carrier industry is a multi-product producer, rate-making principles such as that suggested by Grossman are applicable: "The rate for a service shall in no case be higher *because of another service of the same carrier*, than it would be if the other service were non-existent."<sup>216</sup> This implies a recognition of factors such as marginal cost and elasticity of demand reflected in the carrier's operations. Such a standard would, of course, have to be incorporated into the definition of discrimination heretofore advanced. In part, it is accomplished by requiring that the carrier establish, through its own method of costing, the qualitative significance of the proposed rate. Further, it means simply that losses from experimentation in rate structure should not serve as grounds for pushing other rates beyond the "zone of reasonableness."

Once the theory of "internal subsidization" is recognized as little more than another variation on the theme of industry homogeneity, the treatment of attempts to reduce costs must be altered to correspond to the rate-making principle quoted above. The following standard would appear appropriate:

Costs incurred by a carrier in producing a given product should not be higher, because of any competitor's service, than they would be if the other competitor's service was non-existent, *unless such costs will result in a profitable increase in revenue which would not be obtained if the increased costs were not incurred.*<sup>217</sup>

Applied, for example, to Delta's proposed West Coast-Orlando-Atlanta routing,<sup>218</sup> National's competitive services should not be relied upon as a ground for denying Delta the cost-savings inherent in being able to pool

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American Airlines Service to Akron Case, CAB Docket No. 12438, CAB Order No. E-19259 (31 Jan. 1963); and Joplin, Mo., Reopened Kansas-Oklahoma Local Service Case, CAB Docket No. 5482 et. al., CAB Order No. E-19560 (3 May 1963).

<sup>215</sup> Even if the "product" is expanded to some wider definition, the "burden" theory would only be applicable to the extent that costs were identical. See Caves 163. Moreover, even if costs were identical, differentiating between consumers might still be justified. "In its meaning as simple English, a discrimination is more than a mere difference. Underlying the meaning of the word is the idea that *some relationship exists between the parties . . .* which entitles them to equal treatment. . . ." 80 Cong. Rec. 9416 (1936) (remarks of Representative Utterback).

<sup>216</sup> Grossman, *Principles of Carrier Rate Regulation*, 26 N.Y.U.L. Rev. 475, 477 (1951).

<sup>217</sup> Of course, costs may be higher for a number of other reasons aside from competition. As the italicized portion emphasizes, costs which yield increased profit should not be viewed adversely, even if they are incurred as a result of competition. However, the profit judgment should be made by comparing the outcome if the costs are not incurred with that which will obtain if they are. Thus, if incurring costs because of competition will simply yield lower net income at the same market share, the carrier should evaluate the possibility of sacrificing market share in favor of maintaining the present return.

<sup>218</sup> See text accompanying notes 187-88 *supra*.

Orlando and Atlanta traffic. If market factors change and Delta can operate separate flights at a higher level of profitability, the increased costs are justified. However, in such an instance, no regulatory agency will have to order Delta to cease pooling traffic on one flight. The change will be dictated by the carrier's own self-interest.

#### 4. *The Absence of a De Minimis Approach to Discrimination*

One final manifestation of the Board's attempt to impose uniformity on the industry is demonstrated by its failure to develop a substantial category of pricing conduct in which any possible negative effect is considered as *de minimis*. The decision in *Allegheny Fare Case*<sup>219</sup> seems to be the closest the Board has come to recognizing the possibility of such an approach, although it was unwilling to apply the reasoning of that case to a competitive situation (Delta's Orlando proposal) and apparently never even treated the *de minimis* aspect in United's Las Vegas fare.<sup>220</sup> Arguably, this failure also arises from the interaction of the Board's concern for maximizing industry revenues and its desire to avoid differences between carriers.

Thus, on the one hand, the Board has stated that a carrier's claim that a proposed tariff will not affect a substantial amount of revenue "proves too much, for it derogates from any asserted promotional value."<sup>221</sup> On this ground, the Board rejected American Airline's fifty per cent discount to former employees traveling once a year to their annual convention. While the practice would appear to be a reasonable goodwill gesture of little impact, it is subject to criticism inasmuch as it is not functionally available to the public. The Board's analysis, however, does not rest on functional availability. It applies the same principle in instances where the carrier is attempting to increase traffic, even when a non-competitive point is involved.<sup>222</sup> One would expect that the same approach would be used to defeat a carrier's special fare for "grandmothers to Schenectady."<sup>223</sup>

On the other hand, if the tariff is functionally available to more people than its promotional value can produce, the Board argues that the proposal is "self-diverting." Thus, while personal discrimination is apparently *de minimis*, the tariff is "discriminatory" because it debases revenue. For example, in the *Summer Excursion Fares Case*<sup>224</sup> the Board noted that proposed Florida summer excursion fares would be available to practically

<sup>219</sup> *Allegheny Fare Case*, *supra* note 189.

<sup>220</sup> *But cf.* National Airlines, Inc., Enforcement Proceedings, 31 C.A.B. 390, 393 (1960) (sale of lounge seats as first-class accommodations not discriminatory in view of the fact that only 5 such sales were made out of 4,600 opportunities). This is so *de minimis* as to make any use of the case as establishing a *de minimis* precedent highly questionable.

<sup>221</sup> American Airlines Reduced Fares For Former Employees, CAB Docket No. 14325, CAB Order No. E-19906 (15 Aug. 1963). See also, Keyes, *Passenger Fare Policies of the Civil Aeronautics Board*, 18 J. Air L. & Com. 46, 62 (1951).

<sup>222</sup> See Northern Consolidated Airlines, Inc., Proposed Fares, 33 C.A.B. 440 (1961). Here, factors of subsidy and truly below-cost rates may be the real basis for the decision. However, the extent to which the "how much revenue is affected" test is merely a tool employed in the CAB's revenue-seeking management is demonstrated by the fact that when National Trailways Bus System applied the test to a military standby tariff, the Board quickly pointed out that no per se rules existed. See *Allegheny Airlines, Inc. (military standby fare)*, CAB Docket No. 15845, CAB Order No. E-21845 (26 Feb. 1965).

<sup>223</sup> See notes 68-69 *supra* and accompanying text.

<sup>224</sup> 11 C.A.B. 218 (1950).

all passengers already using Florida air service in the summer. On this basis, it found that a reduced summer fare would discriminate against users of the service *in the winter!*<sup>225</sup> The carriers justified the fare as a promotional device, encouraging off-season use of Florida services. However, even if we accept the Board's conclusion that the excursion fare does not stimulate traffic<sup>226</sup> (probably an erroneous conclusion since the effect of economic recession on travel volume was ignored),<sup>227</sup> we are still left with the fact that summer service is off-peak and a rational system of cost-allocation would take that into account.

The CAB, however, refused to accept Eastern's estimate of marginal cost which made the fare proposal more than "compensatory."<sup>228</sup> In fact, the Board did not even argue that the fare fell below fully-allocated costs. Its sole concern was with "improving or maintaining the net financial position of the carriers."<sup>229</sup> Thus, both sides of the *de minimis* argument are foreclosed.

The crux of the self-diversion argument is nothing more than a barrier to cost-based rate-making with the competitive activity which that would entail. It must proceed from the assumption that the carrier will act irrationally so that the paternal judgment of the CAB is required. As in *Summer Excursion Fares*, the Board's judgment is likely to be colored by its concern with revenue. This may be appropriate where the carrier is heavily subsidized,<sup>230</sup> but it would appear to be unjustifiable where operations cover costs and the carrier can choose between maintaining Florida summer service to foster his "identity" in the market and employing some portion of his resources in other markets where the marginal profit is greater. If a fare is truly self-diverting, consumers will switch to the lower-fare service in such volume as will eliminate the off-peak condition and precipitate a return to a higher fare. Given the fact that all carriers have the option of re-allocating resources to other markets and even the option of contracted operations with minimal adverse effects<sup>231</sup> it would seem doubtful that any fare would be driven so low as would make it injurious to any carrier in a meaningful sense.

The Board's failure to carve out a *de minimis* area is but another example of its inability to promote meaningful competition. More unfortunate, however, is its institutional inability to define an area in which rates, or relations between rates are *prima facie* reasonable, requiring only a good-faith demonstration by the carrier, perhaps by filing an analysis based on *its* managerial philosophy which sets out the cost data and/or promotional factors which lead it to propose the rate.<sup>232</sup> At the same time, the

<sup>225</sup> *Id.* at 220-21.

<sup>226</sup> *Id.* at 221.

<sup>227</sup> See Gellman, *The Regulation of Competition in United States Domestic Air Transportation: A Judicial Survey and Analysis—II*, 25 J. Air L. & Com. 148, 150-51 (1958).

<sup>228</sup> *Summer Excursion Fares Case*, *supra* note 224, at 221.

<sup>229</sup> *Id.* at 223.

<sup>230</sup> See, e.g., Seattle-Fairbanks Fare Investigation, CAB Docket No. 13055, CAB Order No. E-18212 (12 Apr. 1962).

<sup>231</sup> See text accompanying notes 61-62 *supra*.

<sup>232</sup> While the CAB is still somewhat unwilling to let each carrier's philosophy be determinative, it has recognized the value of requiring carriers to compare their predictions of stimulation with actual revenue and expense results. See CAB Press Release No. 63-63, 4 Nov. 1963.

Board could continue to use its maximum rate power to assure that managerial miscalculations in one market would not force rates above the "reasonable" level in other markets and would continue to use its "single-entity" approach to describe an appropriate range of returns on investment.

This "area of freedom" might well be based on Caves' suggestion of setting a minimum and maximum at ten per cent above and below prevailing fares<sup>233</sup> or by removing minimum restrictions entirely (or by a two-step process incorporating both ideas).<sup>234</sup> No doubt most carriers, whose attitudes have been formed by the fact of regulation, will approach the open door with considerable trepidation and forecasts of impending doom. Indeed, one can expect that the general fare level will initially rise somewhat.<sup>235</sup> The regulation which has been developed on an *ad hoc* basis is in almost total opposition to the economic characteristics and condition of the industry. Continuation of the present approach does not foster sound conditions, no matter what the short-run effect. In the long run, it tends to increase reliance on regulatory rather than market forces, increase costs and further rate-making and operations which are unrelated to cost.

#### D. Specific Problems Of Pricing Technique

In considering the theoretical shortcomings of the *ad hoc* approach to regulation and the institutional pressures for uniformity reflected therein, the preceding sections have dealt with a number of varied pricing techniques. It would seem desirable, in addition, to briefly consider a few of these techniques directly, to discuss the specific problems they pose and their possible treatment under the philosophy of increasing managerial freedom in carrier pricing which has been suggested herein.

##### 1. The Problem of Identity Fares

The definition of discrimination heretofore suggested<sup>236</sup> does not fully consider the question of differentials for specific groups. Assuming that the Board finds a differential to be functionally available to a category of persons, it would then have to face the question of what sort of groups are appropriate for differential treatment. This is a particularly thorny question. It is none too difficult if the group can be described in terms of travel characteristics, as may be possible for excursion fares or the "Visit U.S.A." fares available to overseas tourists.<sup>237</sup> It is even easier if prior experience demonstrates that the group has specific cost characteristics, as numerical group fares and a proper view of both the *Pittsburgh-*

<sup>233</sup> Caves 448.

<sup>234</sup> Since the success of any such plan would depend on the alternatives carrier management has in responding to competition, the removal of minimum restrictions would in no case succeed without some corresponding increase in management alternatives in the field of operating authority. The possibility of moving to this point in stages is discussed *infra* note 315.

<sup>235</sup> Caves 432.

<sup>236</sup> See text accompanying notes 56-57 *supra*.

<sup>237</sup> The \$150 fare and 21-day duration, coupled with the local service carrier-only applicability, require substantial traveling in a short period of time in order to result in a savings. However, in setting the fare level, the CAB informally urged carriers to consider the tariff as "a means to help solve our balance of payments problems." See CAB Press Release 65-51, 18 May 1965.



*Philadelphia No-Reservation Fare* case<sup>238</sup> and the Mohawk student proposal<sup>239</sup> would demonstrate. What, however, if "hard" evidence of these factors is absent?

The problem is most clearly pointed-up by the recent "youth fare" experiment.<sup>240</sup> The carriers could only guess at the demand elasticity of persons aged twelve to twenty-two and at the extent to which regular passengers would be diverted. On the one hand, even if demand was not increased greatly, the tariff might have a salutary effect in peak traffic periods by moving the student passengers to stand-by status and freeing reservations on prime flights. On the other hand, the problem of no-shows was likely to be increased by duplicate (and even multiple) reservations. The Board's decision to allow actual experience to be determinative was soundly based. As it was, most carriers cancelled the tariff before its expiration date.

However, before reaching the conclusion that the experiment is desirable, there should be some probability that, after experience, some sort of cost or travel characteristic will be found. In other words, the dimensions of an identity group would have to be sufficiently wide to provide a basis for correlating the data obtained with an index of significance.<sup>241</sup>

While many identity fares undoubtedly will have wide application,<sup>242</sup> there will be instances where one carrier's route or market structure makes a particular group appropriate for differential treatment by it alone. Indeed, this has occurred with youth fares, which remain in effect on two local service lines<sup>243</sup> and in partial effect in the Caribbean area.<sup>244</sup>

It would also seem desirable to establish a per se rule against singling out groups for differential treatment on the grounds of "social policy" alone. Two carriers, Frontier and Ozark, have attempted such action to date. Both maintain a 50 per cent clergy tariff, subject to an annual 5 dollar identification card charge. In *Frontier Teachers' Tariff*,<sup>245</sup> however, Frontier's attempt to offer educational personnel a 40 per cent discount

<sup>238</sup> Pittsburgh-Philadelphia No-Reservation Fare Case, *supra* note 185.

<sup>239</sup> Reduced Fares For Students Proposed by Mohawk Airlines, *supra* note 142.

<sup>240</sup> In the matter of "youth" fares proposed by the Domestic Carriers, CAB Docket No. 12985, CAB Order No. E-17367 (25 Aug. 1961).

<sup>241</sup> As to "significance," see text following note 57 *supra*. An identity fare for, say, editors of legal periodicals, would not be appropriate for "experimental" treatment. While it might be possible to categorize the travel habits and cost aspects of such a group, the dimensions of the group are not wide enough to suggest that the data which would be compiled would reveal any distinctions between the group and the general travel market.

<sup>242</sup> To the extent that it would appear in advance that an experimental identity fare would probably be emulated by all carriers (as the "youth" fare), the Board is justified in applying the "industry revenue" tests it has used in fare level and rate-of-return investigations. There is a point at which the possibility of detriment to the industry outweighs the value of testing for identity groups, particularly where the carriers have alternatives in the area of market-density correlations, and other techniques which will have a greater effect on the overall public. Note, however, that we are concerned here only with identity fare proposals that cannot be cost-justified in advance.

<sup>243</sup> Trans-Texas and Frontier airlines. Frontier's tariff is particularly interesting in that it requires purchase of an annual identification card at a \$5 fee. See Carter, *Shifting Fixed Costs in a Scheme of Promotional Fares*, 22 J. Air L. & Com. 283 (1955). This same card fee is used by Frontier for its clergy tariff and was incorporated in Ozark's "Senior Citizen" tariff, *infra* note 246.

<sup>244</sup> See Caribbean-Atlantic Airlines, Inc. (Student Standby Fares), CAB Docket No. 15786, CAB Order No. E-21667 (12 Jan. 1965) (suspending the carrier's proposal except for those routes involving foreign air transportation, where no suspension power exists).

<sup>245</sup> CAB Docket No. 14526, CAB Order Nos. E-20436 (examiner's initial decision) and E-20437 (adopting examiner's decision as CAB opinion) (4 Feb. 1964).

was rejected. More recently, Ozark's proposal to extend the 5 dollar annual fee to "Senior Citizens," offering a round-trip at 150 per cent of the one-way fare to persons 62 and older, was suspended by the Board<sup>246</sup> and subsequently cancelled by the carrier.<sup>247</sup>

The clergy fare may be justified by the railroad practice, although it is odd that only two carriers have felt the competitive impact in this area.<sup>248</sup> The teachers' tariff, however, is admittedly based on the median incomes of educators in the states served by Frontier.<sup>249</sup> Ozark's senior citizen proposal may well have been developed with some assumption regarding the number of elderly persons in small middle western communities and the migration of younger family members to larger communities. If so, it could have been supported by a market analysis and possibly drawn to describe the group by travel characteristics (length of stay, frequency of trips, possibly even destination) rather than by the passenger's age. As presented, however, it rested wholly on offering elderly persons a preference.

To introduce the concept that the airlines are the guardians of our social conscience and base fares on this notion is of questionable value. Of course, the Board's treatment of military stand-by fares<sup>250</sup> is not in line with this approach. Assuming that stand-by transportation is in fact a different product, as the Board asserts,<sup>251</sup> the justification for restricting the sale of this product to military personnel is based solely on considerations of soldier's morale and the similar practices of surface-carriers.<sup>252</sup>

However, whatever the theoretical deficiencies of the Board's treatment of the problem, as a practical matter the military stand-by fares are probably legitimately excluded from the general rule.<sup>253</sup> Were the Board to act otherwise, it would be safe to assume that Congress would carve out a legislative exception to the same effect.

## 2. *The Use of "Tour Basing" Fares and Similar Excursion Requirements*

As we have noted, one method of taking advantage of variations in demand elasticity in the consumer market is by focusing on the travel characteristics of groups susceptible to stimulation, using these character-

<sup>246</sup> Ozark Air Lines, Inc. (Senior Citizen Excursion Tariff), CAB Docket No. 16004, CAB Order No. E-21973 (31 March 1965).

<sup>247</sup> Ozark Air Lines, Inc. (Senior Citizen Excursion Tariff), CAB Docket No. 16004, CAB Order No. E-22129 (4 May 1965).

<sup>248</sup> In any case, the Civil Aeronautics Act of 1938 was specifically amended to allow this practice, 70 Stat. 784 (1956), carried forward in Federal Aviation Act of 1958, § 403(b), 72 Stat. 758, 49 U.S.C. § 1373(b) (1958).

<sup>249</sup> Frontier Teachers' Tariff, CAB Docket No. 14526, CAB Order No. E-20436 (4 Feb. 1964) at 5-6.

<sup>250</sup> These tariffs, originally put into effect in the spring of 1963, have now generally been made effective indefinitely. See Allegheny Airlines, Inc., CAB Docket Nos. 15845, 15925, 15973, 15983, 16000, 16025 & 16026, CAB Order No. E-22186 (20 May 1965); American Airlines, Inc., CAB Docket Nos. 15925, 15983, 16025 & 16026, CAB Order No. E-22068 (22 April 1965); Braniff Airways, Inc., CAB Docket Nos. 15973 & 16000, CAB Order No. E-22000 (6 April 1965); and Allegheny Airlines, Inc., *supra* note 222. Civilian employees of the federal government lost any privileges long ago. See Governmental Travel Discount Tariff Investigation, 6 C.A.B. 825 (1946).

<sup>251</sup> Allegheny Airlines, Inc., CAB Order No. E-22186 (20 May 1965) at 3.

<sup>252</sup> Cf. the finding of Examiner Edward T. Stodola in Certificated Air Carrier Military-Tender Investigation, 28 C.A.B. 902 (1959) *supra* note 171.

<sup>253</sup> Another isolated example might be the CAB's treatment of United Nations delegates. Although the Board denied a blanket exemption for special UN trips at a 20% discount, American Airlines United Nations Delegates Group Fares, CAB Docket No. 14959, CAB Order No. E-20385

istics to describe the applicability of a lower fare. The result is often an excursion fare tariff, conditioned on a stated interval between going and returning trips or a "tour basing fare," *i.e.*, a tariff whose applicability depends on additional factors outside of the conditions of carriage.

Initially the Board dealt with tour basing tariffs under a *per se* approach which stemmed from erroneously labeling the technique a "tie-in" sale. Thus, in *Tour Basing Fares*,<sup>254</sup> a Pan Am proposal for a fare differential on excursions to South America which required passengers to travel on an all-expense tour was found to represent,

"an objectionable form of discrimination, in that [it] embod[ies] the essentials of a tie-in sale. . . . Nothing in the promotional and competitive considerations advanced by the carriers is sufficient to justify such a discrimination."<sup>255</sup>

Inasmuch as there seems to have been no evidence that passengers were limited in their choice of land accommodations nor any discussion of Pan Am's subsidiary, Intercontinental Hotels Corporation,<sup>256</sup> the conclusion that the tariff represented a tie-in is somewhat inaccurate.

In any case, beginning in 1960, various tour basing fares were permitted on an "experimental" basis.<sup>257</sup> A formal investigation of such fares, docketed in 1963,<sup>258</sup> proceeded through the hearing stage, but upon cancellation of the particular tariff involved, the proceeding was dismissed.<sup>259</sup> Immediately afterward, the Board announced that it would not investigate proposed East Coast-Florida group tour basing/excursion fares which required purchase of an "advertised air tour" whose non-air components sold for at least 28 dollars.<sup>260</sup> While not giving unqualified approval to the practice, the Board noted that the summer-only fare would expire before investigation was practical.

Shortly thereafter, East Coast-Florida carriers filed individual tour basing fares at prices identical to the group tariffs. All were suspended for investigation.<sup>261</sup> A proposal to eliminate minimum-stay provisions from

(22 Jan. 1964), it has, on two occasions, allowed such flights to take place. American Airlines, CAB Docket No. 14257, CAB Order No. E-19839 (22 July 1963); United Air Lines, CAB Docket No. 14663, CAB Order No. E-19842 (22 July 1963). *But cf.* Trans World Airlines, Inc., CAB Docket No. 16272, CAB Order No. E-22375 (29 June 1965) (denying exemption to provide discount round-trip to five members of winning team in Marine Corps-sponsored physical fitness contest).

<sup>254</sup> 14 C.A.B. 257 (1951).

<sup>255</sup> *Id.* at 259.

<sup>256</sup> A sketch of International Hotel's operations may be found in *Monopoly Problems in Regulated Industries, Hearings, supra* note 38, at 2596-97. One wonders why more carriers did not turn to vertical integration to promote vacation travel during the period when they could not offer significant fare differentials because of CAB policy.

<sup>257</sup> See Eastern Air Lines, Inc. (Group Fares), CAB Docket No. 16129, CAB Order No. E-22128 (4 May 1965).

<sup>258</sup> Tour Basing Fares Case, CAB Docket No. 14901, CAB Order No. E-20276 (18 Dec. 1963) (investigating an economy tour-basing fare proposed by Trans Caribbean for New York-San Juan service in particular).

<sup>259</sup> Tour Basing Fares Case, CAB Docket No. 14901, CAB Order No. E-21880 (8 March 1965).

<sup>260</sup> Eastern Air Lines, Inc., CAB Docket No. 15991, CAB Order No. E-21952 (26 March 1965) (while National and Northeast Airlines joined Eastern in group excursion fare proposals, only Eastern filed a group tour basing fare. National filed an individual excursion fare which was suspended).

<sup>261</sup> Eastern Air Lines, Inc., CAB Docket No. 16228, CAB Order No. E-22289 (10 June 1965) (filed 14 May 1965).

individual excursion fares was treated similarly.<sup>262</sup> Finally, when Midwest-Florida carriers filed group tour basing tariffs, the Board (while allowing the fares to become effective) set the matter for a forthcoming investigation.<sup>263</sup>

While the tariffs involved may expire before the procedural process is completed, the recurrent nature of Florida summer strategies suggest that this time the Board will consider the matter to its conclusion. Assuming that the antitrust based tie-in argument is discarded, the objections to tour basing tariffs are still valid, insofar as the air carrier should not be concerned whether the tourist stays in a hotel or with friends. In terms of the definition of discrimination advanced herein, the ground facilities used by the passenger do not impart "significance" to the category.

The duration limits of excursion fares are a sufficient device for separating passenger types.<sup>264</sup> Indeed, the tariff originally proposed by Eastern recognizes that no distinction is provided by the tour basing feature. The fare specified for the tour is identical to the excursion (non-tour) fare.<sup>265</sup>

The identity of proposed individual and group *excursion* fares, on the other hand, may stand on a different ground. At this stage, the issue seems to have focused on the assumed cost savings in group travel. However, in light of the pendency of a formal investigation, carriers will undoubtedly also consider possible distinctions in elasticity and travel habits between individuals and group-ticketed passengers. Assuming that cost differences do exist, identical fares may nonetheless be justified by different stimulation factors;<sup>266</sup> variations in the minimum stay required<sup>267</sup> may be a further device for differentiating between individual and group traffic.

### 3. *The Assumptions of Family-Plan Fares*

The Board has never faced the question of family fares in a full-scale proceeding, the first investigation projected in *Capital Family-Plan Case*<sup>268</sup> and the recent *Family Fares* case<sup>269</sup> both having been dismissed. In passing, however, Board members have suggested that family fares represent the

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<sup>262</sup> Eastern Air Lines, Inc., CAB Docket No. 15986, CAB Order No. E-22020 (9 April 1965).

<sup>263</sup> Eastern Air Lines, Inc., *supra* note 257.

<sup>264</sup> The extent to which the duration limits can be used to describe the boundaries of excursion travel is indicated in Continental Air Lines' recent Denver stopover provision in its Middle West-Los Angeles excursion tariff. See Continental Air Lines, Inc., CAB Docket No. 15811, CAB Order No. E-21787 (11 Feb. 1965) (eighteen-day travel limit; stopover must be made at Denver on either going or return trip; Denver stopover can be no less than twelve hours). While the twelve-hour specification does not seem too lengthy, the fare established (\$1 over the nonstop rate) limits the value of the tariff to those who actually want to stop at Denver for something more than a business conference. The tariff might have been more artfully drawn without losing effectiveness, however the introduction of stop-over requirements, along with time limits opens the door to a number of variations on the same theme.

<sup>265</sup> Eastern Air Lines, Inc., *supra* note 260.

<sup>266</sup> Assuming, of course, that individual excursions and group tours are not interchangeable alternatives for many people.

<sup>267</sup> Presently, carriers have confined themselves to stating lengths of time, e.g., 6-22 days. If individual excursioners have different travel habits, it might be found in length of stay requirements which cover only part of the range, e.g., requiring return trips to be made after 6-9 days or after 20-24 days for individuals and 8-16 days for groups. This is another possible variation on duration limits. See also, *supra* note 264.

<sup>268</sup> 26 C.A.B. 8 (1957).

<sup>269</sup> CAB Docket No. 14813, CAB Order No. E-20229 (4 Dec. 1963) (instituting investigation); CAB Order No. E-21617 (28 Dec. 1964) (dismissing investigation).

outer limits of allowable discrimination and have made vague references to "the social interest in the family [which] will justify special fares which would otherwise contravene the rule."<sup>270</sup>

The discussion of identity fares above suggests that justification of family fares on some societal theory is ill-considered.<sup>271</sup> As a first-class only tariff, the practice seeks justification in the argument that all family members occupy otherwise empty first-class seats and thus, the marginal cost of the service provided is more than covered by the discounted fare and coach seats may be sold at the full rate. When extended to coach and other low fare services,<sup>272</sup> the promotional effect of the tariff on wholly new traffic otherwise lost to air transportation is emphasized.

In short, the grouping of family fares is subject to justification on a differential elasticity theory rather than on the notion that the carrier saves costs because it is a two, three, or four-person group. Given the multiple dimensions of market, product (first-class, coach, etc.), and possibly even season, different approaches may be justifiable for different carriers. It may be advantageous for one to apply a single rate systemwide and for another carrier to use different rates in different markets.

The most recent modification in family fares<sup>273</sup> appears to confirm this analysis, with carriers extending the family discount to weekend traffic at a different discount and a different coach/first-class ratio. The full import of these innovations will be considered *infra*.<sup>274</sup>

#### IV. CONCLUSION—AIR CARRIER OPERATIONS UNDER A MODIFIED REGULATORY SCHEME

##### A. *The Findings Suggested By This Study*

The preceding parts of this study have been devoted to an examination of the historical bases for carrier regulation, the interplay between economic characteristics and regulatory attitudes and the evolution, by the Civil Aeronautics Board, of restrictions on the freedom of air carriers to act as individual competitive units in pricing and producing the products they are capable of selling.

The discussion of these problems leads to several conclusions which must be set down before proceeding further:

1. The economics and technology of commercial air transport make competitive pricing possible and desirable.

<sup>270</sup> Group Excursion Fares Investigation, 25 C.A.B. 41, 47 (1957).

<sup>271</sup> Since no verification of marital relationships is made, such a justification may well be inaccurate.

<sup>272</sup> This extension was precipitated by the numerous family fare proposals and counter-proposals filed in the fall of 1963. See text accompanying notes 289-96 *infra*. See also, CAB Press Releases No. 63-62, 16 Oct. 1963 and No. 63-92, 20 Dec. 1963.

<sup>273</sup> Family-Plan Fare Revisions filed by Domestic Trunkline Carriers, CAB Docket Nos. 16122 & 16124, CAB Order No. E-22170 (17 May 1965). See also CAB Press Release No. 65-50, 17 May 1965.

<sup>274</sup> See text accompanying notes 296-99 *infra*. Briefly, the coach family fare discount was increased from 25% to 33½% for the second family member and to 66½% for additional family members under 21, these fares applicable on week-days only. No such change was made in first-class fares. The 25% discount for all passengers in all classes applies on Friday midnight to Sunday noon travel.

2. The variations between carriers and differential pricing within a single carrier's price structure would neither violate the "classic" notions of transportation discrimination nor foster carrier practices which would injure the air transport industry or the consumer, providing they fulfilled the tests of functional availability and could be supported by a "good faith" analysis of promotional value or theory of cost allocation.

3. It is desirable to define a range of "reasonable" fares without reference to conditions in any particular city-pair market, within which carriers would be free to price.

4. The possible extent of this range is related to the number of alternatives carriers have in seeking efficiency and responding to competition eliminating emulation as the automatic response.

5. The regulatory process is institutionally unable to create these conditions or allow diversity to develop so long as it deals with pricing techniques on an *ad hoc* basis or in a procedural context where competitive responses are directed toward verbal maneuvers rather than toward realistic market reactions.

6. The regulatory process will be unable to promote competition to the fullest possible extent if it continues to use industry-wide tests and relies on a managerial conception of its responsibility or if it uses its power to enjoin discrimination as a facade to prevent competition.

7. The philosophy of regulation which the CAB has generally followed finds no support in the economics of the transportation industry, particularly when air transportation is compared to other modes, and tends to encourage cost-increasing forms of competition rather than the use of sound costing techniques.

8. Therefore, the CAB's present approach to price regulation is inappropriate and should be modified, limiting the rule against "unjust discrimination" to the two "classic" examples and the functional availability test and removing most carrier pricing *techniques* (as opposed to rate-of-return questions) from the case-by-case regulatory scrutiny involved in suspensions before investigation, thus allowing actual market experience to act as the primary investigatory focus.<sup>275</sup>

Recent developments suggest that both the Board and the industry are beginning to explore the problems which give rise to these findings, reaching conclusions apparently not wholly dissimilar from those set out above. Accordingly, a brief consideration of the nature and extent of these developments and an even briefer mention of regulatory frontiers meriting attention in the future are necessary capstones to this study.

#### B. *Some Perceptible Changes In CAB Attitudes: The Approval Of Non-Emulative Responses To Inter-Carrier Competition*

The focal role of pricing technique in today's air carrier industry is vividly demonstrated by the significant series of tariff proposals implemented in the past twenty-four months. While the Board has tended to

<sup>275</sup> There would, of course, be no objection to CAB-carrier informal discussions (such as developed in promulgating the no-show plan) which might evaluate current trends in general terms, subject, however, to public disclosure of the records of such conferences.

approve each individual innovation under a general banner of "increased experimentation," the carrier proposals, taken as a whole, reveal a pattern of sound competitive conduct in which each carrier's response is shaped by factors indigenous to its operations: route structure, market structure, operating patterns, and managerial philosophy.

As noted earlier, there have been previous instances in which the assumption of industry-wide emulation has been disproved in practice.<sup>276</sup> None of these, however, involved changes of major proportions. Since only one or two carriers and/or one or two specific markets were involved, approval of the tariffs did not stimulate competitive strategies by other carriers leading to a visible pattern of non-emulative responses.

The earliest sign of the type of competitive conduct which might result from a policy of allowing individualized responses is found in the strategies undertaken in the transcontinental market by United, American, and TWA in 1957-58. The Board's concern with "discrimination" and revenue and its *ad hoc* approach explain the failure to consider the filings as an indication of an emerging form of competition. However, the 1957-58 cases provide a background against which the CAB's current treatment of competitive developments *without recourse to meaningless concepts of discrimination* may be viewed.

The starting point for the 1957-58 strategies was United's attempt to increase its share of the transcontinental coach market by offering a more luxurious service in faster DC-7 aircraft. The service, styled "Custom Coach," featured new seating, hot meals, an additional stewardess and other appointments at an increased fare above the more spartan coach level. United succeeded in convincing the Board that this was a "new class of service" rather than simply "coach with meals," which would have contravened existing Board policy.<sup>277</sup>

With slower Constellation equipment, TWA faced a different problem. It was losing first-class traffic to United and American DC-7 flights, its share decreasing from 36 per cent to 14 per cent.<sup>278</sup> It had, however, equipment being phased out of its transatlantic operation with the introduction of jet aircraft. This equipment had larger, fully-reclining "sleeper-seats" in its first-class configuration. TWA thus transferred the equipment to the domestic transcontinental run, offering 30 per cent more room—albeit in slower aircraft—at no increase over the first-class fare.

Following complaints by United and American, TWA's practice was investigated, although, in the interim, TWA was permitted to operate the service, providing actual rather than hypothetical data by which the technique could be evaluated. Using this data, the examiner found that no discrimination was involved. Here, as in *National Daylight Coach*, the conclusion was that the fare was "available to all."<sup>279</sup> Moreover, TWA's

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<sup>276</sup> E.g., the Capital Family Plan Case, *supra* note 147; the Mohawk Student Proposal, *supra* note 142 (American, Mohawk's competitor in the markets, neither objected nor filed a defensive tariff); and the continued existence of "youth" fares, *supra* notes 243-44.

<sup>277</sup> United Custom Coach, Suspension and Investigation, 26 C.A.B. 23, 24-27 (1957).

<sup>278</sup> Trans World Airlines Siesta Sleeper-Seat Service, 27 C.A.B. 788, 789 (1958).

<sup>279</sup> *Id.* at 804 (dissenting opinion).

load factor in the first-class compartment had previously dropped to 46 per cent.<sup>280</sup> The room that it was sacrificing, therefore, was unnecessary room.<sup>281</sup> As Board Member Hector noted:

"The transcontinental TWA coach passenger does not pay any more for his seat because of the siesta seat in the first-class compartment, and he would not pay any less for his seat if the TWA siesta seat were discontinued."<sup>282</sup>

The majority, however, found TWA's practice discriminatory, noting its fears that TWA's practice would have an "uneconomical effect on the operations of the carriers. . . ."<sup>283</sup>

American's proposal, rejected in *American Airlines Off-Peak Coach Service*,<sup>284</sup> was filed in response to the TWA move.<sup>285</sup> American would have flown an off-peak overnight service using regular first-class equipment at coach fares. The Board, however, concluded that the service was "like and contemporaneous" with day service since there was no evidence that the departure time was inconvenient.<sup>286</sup> The Board did not consider that this additional flight could be produced by equipment already being utilized economically and that in terms of American's efficiency, the flight may have been "off-peak." As in *Delta Off-Peak*, it chose to use the "time" standard which could be applied to all operations in all markets on an equal basis. Thus, again, the only discrimination is in terms of an artificially imposed uniformity.

The CAB's switch from the decision in *Custom Coach* to the restrictiveness of *TWA Siesta Sleeper Seat* and *American Off-Peak Coach* has been ascribed to its desire to "stop a new series of product competition strategies."<sup>287</sup> Of course, the TWA and American proposals only become a "new series" if each carrier's proposal is looked upon separately. In fact, the three tariffs were part of one series which never was allowed to mature.

Had the Board left the carriers free to act, each would have chosen a response to competition that best achieved efficient operation, given route structure, equipment, and operations. United would have continued its daylight Custom Coach, TWA its overnight luxury seats, and American its off-peak coach. The public would have been offered a choice of services which comported with efficient operation rather than identical service running against it.<sup>288</sup>

<sup>280</sup> *Id.* at 790.

<sup>281</sup> *Cf.* text accompanying notes 102-03 *supra* (early DST premium pricing).

<sup>282</sup> *Trans World Airlines Siesta Sleeper-Seat Service*, *supra* note 278, at 806 (dissenting opinion). *Cf. Grossman, Principles of Carrier Rate Regulation*, 26 N.Y.U.L. Rev. 475, 477 (1951), text accompanying note 216 *supra*.

<sup>283</sup> *Trans World Airlines Siesta Sleeper-Seat Service*, *supra* note 278, at 792.

<sup>284</sup> 28 C.A.B. 25 (1958).

<sup>285</sup> See *Trans World Airlines Siesta Sleeper-Seat Service*, *supra* note 278, at 800 (dissenting opinion).

<sup>286</sup> *American Airlines Off-Peak Coach Service*, *supra* note 284, at 26, 27.

<sup>287</sup> *Caves* 235.

<sup>288</sup> Efficiency here is a function of the situation in which the carrier finds itself after its competitor has acted. Thus, prior to United's and TWA's proposals, American might have found efficient operations in an additional daytime flight or in not responding at all. Afterward, however, reducing the number of daylight flights and adding a night transcontinental flight may have yielded greater revenue per unit of production and better utilization of resources, if the aircraft could be used in



The responses to United's one-class tariff and Continental's three-level rates are, in many ways, reminiscent of the carrier strategies during 1957-58. This time, however, the Board has not employed the subterfuge of "discrimination," thereby allowing carriers the right to make differentiated responses.

Following United's one-class filing, American countered with its favored competitive tool, introducing family fares at an increased discount.<sup>289</sup> Despite complaints by TWA and Delta,<sup>290</sup> the tariff went into effect. Surprisingly, it worked too well, the increased discount creating the anomalous situation of making two coach fares more expensive than two first-class family fares. Pressure to reduce the discount naturally resulted.

Accordingly, TWA posted a family plan tariff with a 60 per cent discount from first-class fares. During the next four weeks all trunkline carriers engaged in what can best be described as mock warfare, filing no less than thirty-two separate tariff revisions, introducing family rates covering—with varying discounts—jet coach, one-class, propeller coach and economy services, some discounts applying systemwide and others limited to segments in which a systemwide discount was proposed by a competitor.<sup>291</sup>

The filings, defensive filings, counter-proposals and defensive matching of counter-proposals, while indicative of the wide range of possible adjustments, degenerated into a mere numbers game in which the initial object of lowering the discount was submerged and the competitive practicality of the proposals in terms of market effect ignored.<sup>292</sup> Recognizing this, American turned to balancing the family discount with over-all rate structure changes. United was its principal competitor in almost all of its long-haul markets. Thus, American's strategy was to introduce a justifi-

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a new market during the day. Of course, with the introduction of jet equipment by all of the carriers, these services would have been eliminated inasmuch as the competitive need would have disappeared.

<sup>289</sup> See Henzey, *The Fare Muddle*, American Aviation, January 1964, pp. 55-63.

<sup>290</sup> American Airlines, Inc. (proposed reduced family fares), CAB Docket Nos. 14332 & 14333, CAB Order No. E-19535 (7 March 1963) (dismissing complaints of Trans World Airlines and Delta). Curiously, no other carriers filed complaints with the Board, suggesting that there may have been additional reasons for the increased discount aside from United's one-class service. Carriers such as Braniff and Northeast would not adopt the increased discount on a systemwide basis as a response to either United or American since their routes are not aligned against those carriers to any significant degree.

<sup>291</sup> All of these proposals were suspended for investigation, American Airlines, Inc., CAB Docket No. 14813, CAB Order No. E-20099 (16 Oct. 1963). The entire filing pattern is presented in tabular form in CAB Press Release No. 63-62, 16 Oct. 1963.

<sup>292</sup> This is an expected result in any system which relies on playing-out competitive responses verbally without any market testing. By filing defensive tariffs identical to the main proposal, the spectre of unchanged market shares at lower revenue is easily created. By filing counter-proposals in an ever-descending spiral, the spectre of cut-throat competition is raised. In both cases, the necessity for the CAB's industry-wide approach is artificially confirmed. Moreover, carriers can rely on generalizations which are factually unsubstantiated. See United Air Lines, Inc., CAB Docket Nos. 14768 & 14813 (proposing extension of family plan to one-class service), Complaint of Delta Air Lines, pp. 1-2 (alleging that United's proposal is "uneconomic and unsound, unjust and unreasonable [and] would have a profound adverse effect . . .") and Letter from C. E. Woolman, President and General Manager, Delta Air Lines, to Irving Roth, Director, CAB Bureau of Economic Regulation, 25 Sept. 1963, responding to request for economic data on family fares by advising that until recently, no records were kept and the carrier is unable to state the relation between family fare discounts and actual revenue with any accuracy. Hence, Delta had no basis for the allegations made in United Air Lines, Inc., *supra*. See also, note 76 *supra* and accompanying text.

fiable long-haul taper into its first-class rates, narrowing the gap between first-class and one-class service.

American's tariff reduced first-class fares in selected markets from four to fifteen per cent, eliminated jet surcharges in other markets and applied a 25 per cent family fare discount to all domestic services. Its competitors proceeded to request suspension and investigation of the proposal<sup>293</sup> and TWA countered with a plan to offer luxury service at an increase above first-class, a "standard" service a bit below first-class and an economy service a shade below present coach fares. American's plan (and the "meeting competition" tariffs filed by others) went into effect,<sup>294</sup> and TWA's proposal was subsequently withdrawn.<sup>295</sup> Other carriers who had retained the old first-class fare in specific markets and the former 50 per cent family-fare as well, reduced the family fare discount to 25 per cent in all markets shortly thereafter.

The implementation of the long-haul taper and the family fare revisions in such circumstances produced, as one would expect, different effects on each of the carriers. These responses cannot be treated uniformly, but are best viewed in three categories: (1) an additional family fare revision; (2) an individual carrier-based restructuring of fare relationships; and (3) a similarly-based change in seating/class/service relationships. These developments are best considered singly despite their chronological concurrency.

The details of the most recent family fare revision have been noted above<sup>296</sup> and need not be repeated. Their particular significance as part of a pattern of competitive responses stems from the shift from the leveling approach which focused on the marginal cost of a passenger "going along" on someone else's trip to the promotional approach looking toward the generation of new traffic.<sup>297</sup> While the 25 per cent discount was uniformly adopted as an initial response, this reaction was arguably in each carrier's self interest, making it possible to analyze the promotional effect of family fares on coach and first-class travel in general and as a function of the spread between coach and first-class fares in particular.<sup>298</sup>

The experience of several months' testing was evidently beneficial. The features of the present plan, extending family fares to weekend travel, increasing the coach fare discount for weekday travel, instituting an added coach discount for family groups of more than two only for week-

<sup>293</sup> In this case almost all carriers filed complaints. *Cf.* note 290 *supra* (the limited reaction to the first American proposal). This concern was undoubtedly brought about by the appearance of the distance taper which, unlike a variation in family fare discounts, required detailed consideration of route and market structure by each carrier.

<sup>294</sup> See CAB Press Release No. 63-92, 20 Dec. 1963.

<sup>295</sup> Complaints of United Air Lines, Inc. & Continental Air Lines, Inc. against fares proposed by Trans World Airlines, Inc., CAB Docket Nos. 14930 & 14935, CAB Order No. E-20434 (4 Feb. 1964) (noting cancellation of proposal and dismissing complaints).

<sup>296</sup> Note 274 *supra*.

<sup>297</sup> See text accompanying note 272 *supra*.

<sup>298</sup> The CAB, however, did not approach the subject in this manner. Since it was concerned primarily with the first-class family fare/coach regular fare inconsistency, it refused to allow first-class fare reduction where carriers had not lowered the family discount. When the carriers all adopted the lower family discount, it ignored the fact that the first-class fares remained at their previous level and dismissed the entire first-class fare investigation. *Reduced First-Class Fares*, CAB Docket No. 14951, CAB Order No. E-21963 (30 March 1965).

day travel, and making no corresponding distinction in first-class fares would appear to be based on a highly sophisticated approach integrating notions of demand elasticity and excess capacity. In dismissing complaints against the tariff,<sup>299</sup> the Board did not suggest that the various differentials posed problems of discrimination, nor did it dwell on the fact that one carrier's tariff applied only to competitive points and three carriers filed no revision at all. While these four carriers subsequently adopted the basic plan, this reaction may rest more on continuity of tradition than on CAB pressure. United was left free to apply the coach features to its one-class service, the first-class features to the second traveler in the "standard" compartment of triple-configured aircraft and an in-between 50 per cent discount to additional children in standard service, despite the fact that the service features and (in most instances) the basic fare are identical in one-class and standard class service. Apparently, the Board would have been willing to take the same "no reliance on discrimination" approach had other carriers sought to meet competition in competitive markets and vary discounts, discount relationships or other factors in others.

This assumption is bolstered by the Board's treatment of Eastern's restructuring of fare relationships. Although American's introduction of a long-haul first-class taper had narrowed the gap between first-class and coach fares, it had not altered distance relationships in coach fares. Eastern was faced with continued operating losses, a substantial number of short and medium-haul services in comparatively inelastic markets (justifiably given only first-class service) and long-haul routes which presumably had greater potential for stimulation of first-class and coach traffic. By adjusting existing fares to reflect a 5 per cent decrease and a flat 2.50 dollar increase, it sought to obtain increased revenue in all short and medium-haul markets; stimulate long-haul traffic generally; and stimulate coach traffic selectively, increasing the cost of short-haul coach service.<sup>300</sup> These changes were applied systemwide, notwithstanding the fact that Eastern had already altered its rate structures in certain markets on the basis of American's scheme.

The approval of this tariff on a cost-density basis, answering other carrier's complaints relating to *their* fare structures by noting that their route structures were not comparable and relegating the issue of Eastern's losses to a footnote is, in itself, a major step forward. It is the first instance in which approval of a pricing technique of major proportions has been based on recognition of one carrier's distinct operating structure. Possibly even more important, the Board then proceeded to allow other carriers to meet Eastern's reduced fares in competitive markets, maintaining their lower fares in markets in which Eastern had raised its fare.<sup>301</sup>

The final development in individually-based competitive responses emerging in the past twenty-four months and gaining similar CAB approv-

<sup>299</sup> Family-Plan Fare Revisions Filed by Domestic Trunkline Carriers, *supra* note 273.

<sup>300</sup> Eastern Air Lines, Inc., CAB Docket No. 15713, CAB Order No. E-21637 (4 Jan. 1965).

<sup>301</sup> Braniff Airways, Inc., et. al., CAB Docket No. 15823, CAB Order No. E-21806 (17 Feb. 1965); American Airlines, Inc., CAB Docket No. 15798, CAB Order No. E-21756 (3 Feb. 1965). See also, CAB Press Release No. 65-14, 3 Feb. 1965.

al has its genesis in the Chicago-Los Angeles market. In 1962, prior to the appearance of United's one-class service and American's long-haul taper reaction, Continental succeeded in introducing business and economy fares into the market,<sup>302</sup> operating triple-configured aircraft as a result. While the three-level fare structure was docketed for investigation, the innovations proposed by United and American were implemented. These carriers, together with TWA, form the competition facing Continental along its Chicago-Los Angeles route.<sup>303</sup>

In its triple-configured aircraft, Continental's business class felt the squeeze from United's one-class service; its first-class compartment was too small to accommodate increased demand stemming from the first-class fare reduction; its coffee-only economy section was hardly an alternative for recapturing lost traffic and while profitable, yielded somewhat less profit per revenue-passenger mile (particularly on non-stop flights) than other classes. Aside from an investment in new seating configurations, it had one efficient choice: cancel the business-class tariff and sell the five-abreast business seats (and a more modest meal) at coach fares. The service had but minor distinctions from United's one-class service; the coach fare was substantially lower. Forsaking its historic attitudes, the Board approved.<sup>304</sup>

American, TWA, and United had various alternatives to the Continental move. American, operating several turnaround flights in the Chicago-Los Angeles market, could, if it chose, maintain dual-configured flights operated as first/coach or first/economy as it thought best, ignoring seat-pitch differences between coach and economy. All carriers could operate triple-configured aircraft, selling "economy" seats as "coach" in other markets. Other variations on this theme were also possible, any of which might have been susceptible to the charge of "discrimination" as previously employed by the Board. No such charge was levied.

In addition, Continental's competitors' transcontinental route structure made other responses possible, introducing operating changes to avoid diversion to economy services at Chicago. At the same time, United's one-class experiment felt additional pressures from the lower first-class fares. In part, shifting of equipment resources and alteration of the one-class fare in Continental's markets was an effective response.

However, the combination of first-class and three-class developments offered United an additional alternative. If one-class services attracted less volume than expected in certain markets, pooling classes on a single flight

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<sup>302</sup> Business & Economy Fares, CAB Docket No. 13939, CAB Order No. E-18759 (31 Aug. 1962) (allowing fares to become effective pending investigation). After a procedural gap of some thirty-two months, the fares were found to be reasonable, Business & Economy Fares, *supra*, CAB Order No. E-22103 (initial decision of the examiner, discussed *supra* note 75) and No. E-22104 (adopting decision as CAB opinion) (29 April 1965) (discussed *supra* note 78).

<sup>303</sup> United serves all four cities involved (Chicago, Kansas City, Denver and Los Angeles), but has a closed-door restriction (and does not operate) between Chicago and Kansas City. American serves neither Kansas City nor Denver. TWA serves all four points although its participation in Denver traffic is minimal.

<sup>304</sup> Seating Configuration Tariff Proposed by Continental Air Lines, Inc., CAB Docket Nos. 14942, 14943 and 14947, CAB Order No. E-20381 (21 Jan. 1964). Cf. National Airlines Economy Fares, 30 C.A.B. 1572 (1960) (seating capacities of high density aircraft may vary during low-fare experiment to avoid modification costs, but only until it is clear that experiment is sound). No such restrictions were placed on Continental.

was a reasonable alternative: hence, the introduction of "standard" class. So configured, the first-standard-coach aircraft could also be used to provide first-coach-economy service in competing against Continental. Of course, in order to maintain efficient aircraft utilization, the three-class aircraft would have to be used in varying markets. Such use introduced three-class service into new markets, in some instances opposite carriers who did not serve the Chicago-Los Angeles route and therefore had no substantial motivation for adopting similar triple configurations.

The significance of these innovations which the Board has allowed into effect is not confined to the "discrimination" aspects of seating/class/fare relationships. Even though CAB approval is based on experimentation rather than on any notion of competitive freedom,<sup>305</sup> it cannot overlook the fact that the strategies of Continental and United have not resulted in automatic emulative responses. In some instances these strategies apparently have benefited the carrier without occasioning any response at all from its competitors,<sup>306</sup> casting doubt on the belief that action by one carrier in its own self-interest will necessarily have an adverse effect on the industry.

### *C. Increasing Managerial Alternatives In Operating Authority: An Area For Future Investigation.*

One premise of the theoretical "multi-dimensional" approach discussed at the outset of this study<sup>307</sup> is that changes in operating authority should be viewed as possible efficiency-seeking responses to competition in the same way as alterations in rate structure. Many of the cases heretofore discussed, particularly those immediately above, indicate the close relationship between pricing and route structure. If a sound regulatory approach

<sup>305</sup> See discussion note 78 *supra*. There are, of course, limits to "experimentation" as evidenced by the CAB's refusal to allow trunkline carriers to recoup part of the excess baggage income lost under liberalized baggage allowances by increasing first-class fares. Domestic Trunkline Carriers, CAB Docket No. 16363, CAB Order No. E-22483 (27 July 1965). The Board noted that if the costs of liberalizing the baggage allowance were so significant as to require alteration of the fare structure, the revision proposed would shift the burden from the one passenger in ten actually shipping "excess" baggage to all passengers. The identifiability of the passengers using the liberalized baggage privileges would demand that such costs be assessed against them. Cf. the ratemaking principle suggested in text accompanying note 216 *supra*.

The Board's opinion in *Domestic Trunkline Carriers* is further evidence of the trend noted in the recent decisions of the Board. Testing the baggage revision proposal on an industrywide basis would appear to be justifiable in view of the issue under consideration. Since neither baggage carried nor aircraft space will generally vary from carrier to carrier, costs would best be described by using an industrywide model. If, notwithstanding the absence of significant costs, the carriers were in need of additional income, the loss of excess baggage income would in no case provide justification for the particular revision in rate-relationships proposed, *i.e.*, a first-class increase only.

Had United proposed a 50¢ first-class fare increase in connection with its proposal to reduce certain long-haul (over 700 miles) fares (considered and approved in *Domestic Trunklines*) instead of tying it to the baggage revision along with other carriers, the healthy earnings position of the industry would have been of little value as a ground for suspending the increase. Such a proposal might have been analogized to Eastern's tariff revision (see text accompanying notes 300-01 *supra*), *i.e.*, a revision in rate relationships rather than a direct attempt to increase income. An industrywide approach to this type of question would not have been justified. It is doubtful, of course, that the Board actually made such a distinction. Nonetheless, its reliance on general industry conditions as a decisional ground in this case is a step in the right direction.

<sup>306</sup> *E.g.*, American has not found that competition requires it to offer three-level fares in the Houston-Los Angeles market; Northwest continues to operate dual configured aircraft against United's triple-configured aircraft; aside from Continental's five-abreast coach, no carrier has copied United's one-class service.

<sup>307</sup> See text accompanying notes 17-18 *supra*.

to air transportation is found in increasing management's decision-making latitude in the pricing field to the fullest possible extent, a similar evaluation of the extent to which control over operating authority can be given over to management would appear to be warranted as a next step.

The relationship between pricing and operating authority is certainly a two-way street. Just as pricing strategies may precipitate operational changes or be based on existing operational characteristics, so too, operational changes may have a direct effect on fares and lead to cost savings which may have an indirect effect on fares or be an alternative strategy to be used in place of pricing changes.

A new route authorization or operating pattern may produce a lower fare per nonstop mile. As Examiner William J. Madden noted in the *Charleston-Columbus Case*,<sup>308</sup> authorizing new service from Detroit, Toledo, and Columbus direct to Charlotte, N.C., fare reductions might result from eliminating "the Pittsburgh and Cincinnati doglegs over which fare 'equalizations' are not now made."<sup>309</sup> Similarly, in *Philadelphia-Transatlantic Service Case*,<sup>310</sup> the examiner argued that Boston had a greater "claim" to transatlantic service than Philadelphia since, *density aside*, Boston passengers would pay higher aggregate fares than New York passengers although located closer to their ultimate destinations. However, if one does not put density aside, there is clearly some point at which the marginal cost of serving Boston on a transatlantic route becomes more than the profit obtained from serving the thinner market, particularly if loss of revenue resulting from downgrading a nonstop flight is calculated. At this point, efficiency may suggest an operating alternative to a fare increase, the most obvious being to pool traffic at New York, maintaining the same Boston-Europe fare, but applying it to a back-haul routing.

Assuming all service was in jet aircraft, such a modification would increase the Boston passenger's travel time, particularly because of the domestic-international connection at New York. Applied to domestic travel, in which thinner markets have less jet service, if any, and using medium-sized cities as the hubs, a system of back-haul rates would appear to have significant potential. In particular, it might serve as an acceptable substitute allowing for the elimination of trunkline-local carrier route competition at smaller cities where trunkline operations have been maintained to provide on-line long-haul connections.

For example, United is certificated to serve small communities such as

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<sup>308</sup> 19 C.A.B. 731 (1955).

<sup>309</sup> *Id.* at 754 (examiner's initial decision).

<sup>310</sup> 15 C.A.B. 148, 169-70 (1952) (examiner's initial decision). The most recent explicit recognition of the relationship between fares and route structure is found in the matter of Ozark Air Lines, Inc., CAB Docket No. 15697, CAB Order No. E-22465 (22 July 1965), authorizing a change in Ozark's service pattern to enable it to provide single-plane service between Milwaukee, Wis., and St. Louis, Mo., with only one intermediate stop. By eliminating the interline connecting fare, passengers are able to travel between the two cities for \$25.75—\$3.10 less than the lowest connecting fare. Moreover, Ozark's service is some 18 minutes faster than the fastest connecting service, notwithstanding the fact that the latter uses jet coach service from Chicago. Much of the time savings stems from eliminating Chicago as a necessary junction point for Milwaukee-St. Louis travel. These facts suggest the importance of further study regarding the effects of linear route descriptions in carrier certificates, particularly as they relate to trunkline-local service route competition.

Cedar Rapids from Chicago. Ozark provides similar service, but United's presence makes nonstop service impossible. The justification for United's service is to convenience long-haul traffic, but density considerations prohibit jet service. Thus an on-line connection at the first major hub (Chicago-eastbound) is required. Des Moines is the nearest medium-sized community. Its traffic volume supports jet service, but it is insufficient to make meaningful nonstop service (*e.g.*, without a Chicago east-bound stop) profitable. In a system of back-haul rates, United would withdraw from the Chicago-Cedar Rapids market, creating substantial traffic and revenue benefits for Ozark.<sup>311</sup> Given a coordinated schedule and the proper rate, long-haul traffic originating at Cedar Rapids would back-haul on Ozark to Des Moines. By pooling such traffic at Des Moines, United might be able to overfly Chicago on an eastbound flight. The carrier could gain from increased stage length; passenger convenience could be increased; and total elapsed time, even for the back-haul passenger, would be no greater than at present.<sup>312</sup>

Changes along these lines and the efficacy of closed-door and long-haul restrictions are certainly among the subjects which should be considered in evaluating the extent to which increasing the operating alternatives open to carrier management might yield beneficial results. In addition, the effects of linear route descriptions need closer examination.

Of course, the fastest way to increase the operating alternatives open to a carrier is to free the trunklines from the strictures of their certificates and throw all city-pair markets open to unrestricted entry by existing trunklines. As Caves points out:

this change would improve the flexibility of the allocation of transport resources among major markets. . . . Problems of seasonal imbalance would be substantially corrected. The rising recognition of mutual interdependence among the trunks would be set back sharply, unless too many were eliminated from the business in the process; this seems unlikely . . . all could surely survive on rationalized systems. . . . Such a reform would hardly reduce recognized mutual dependence enough to encourage great investment of capital in new equipment by present trunks; and without this it is difficult to envision the proliferation of any undesirable forms of competitive conduct.<sup>313</sup>

Even if the assertion that complete freedom of operating authority

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<sup>311</sup> The elimination of competitive United service would not only give Ozark new sources of revenue and reduce its dependence on subsidy, but additionally would benefit beyond-Cedar Rapids traffic, improving the quality of their service to Chicago. The savings to Ozark would enable it to participate in a joint backhaul fare with United without appreciable difficulty.

<sup>312</sup> The Cedar Rapids passenger formerly traveled to Chicago in propeller aircraft and incurred ground time there. The connecting time at Des Moines can be substantially reduced from that required at the busy Chicago airport. It should also be noted that this principle may be applied in situations which involve no backhaul. Moreover, elimination of United from the Cedar Rapids market is not essential to the extent that scheduling permits it to operate its own backhaul service, the westbound Chicago-Cedar Rapids flight continuing to Des Moines, loading eastbound passengers at Cedar Rapids for connecting eastbound service at Des Moines.

<sup>313</sup> Caves 433. By "mutual dependence," Caves suggests that the tendency to actual competition is limited by the fact that carriers' route structures presently put them in overall competition with only one or two carriers in their major markets. The predictability of the competitor's response to competition is increased and all are quick to recognize that they are in the classic oligopolistic situation in which any competitive strategy will produce unchanged market conditions at lower revenue. By widening the range of possible alternatives, predictability is lessened.

would not precipitate undesirable effects is theoretically accurate, one may justifiably question the practicality of immediate and total implementation of the policy Caves advances. It may be more desirable to adopt policies which would encourage each carrier to begin to rationalize its operations at present levels of investment, analyzing the probable effects and evaluating the actual results on a continuing basis.<sup>314</sup> Unquestionably, sound public policy suggests that the direction and speed of any such major innovation be determined by testing the practical results of theoretical assumptions each step along the way; adjusting the assumptions when practice shows them to be inaccurate; and solving problems which were not originally contemplated.<sup>315</sup> The maximum possible limits of carrier freedom in air transportation may be somewhat less than those which Caves proposes. Nonetheless, we should be committed to probing outward toward new and far horizons.

The approach suggested herein, while significantly different from past regulatory history, can be implemented by the CAB without any additional statutory authority. To some extent, specific decisions evidence a beginning. It remains, however, to be expanded into a consistent policy approach. One may conclude that such an approach would be more closely in line with the CAB's legislative mandate than many previous policies and decisions of the Board. The declaration in favor of "competition to the extent necessary to assure the sound development of an air transportation system"<sup>316</sup> was not intended as an instruction to freeze regulatory attitudes in the shape required by conditions in 1938, 1948, or 1958. It should be read to mean that the quality as well as the quantity of competition must necessarily be adjusted in the light of the industry's growth, its economic characteristics, and technological advances.

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<sup>314</sup> One possibility here would be to experiment with limited unrestricted entry which did not involve a significant increase in the carrier's investment, *e.g.*, allowing carriers to enter city-pair markets in which terminal facilities were already maintained. Capital investment would have to be regulated in the sense that a "good faith" showing would have to be made, demonstrating the relation of proposed new investment to the carrier's "basic" (*i.e.*, certificated) route structure. If the pricing latitude were contemporaneously increased (*e.g.*, Caves' 10% above-and-below existing fares proposal; see text accompanying notes 233-34 *supra*), carriers would only take advantage of the operating authority opportunity if it in fact resulted in more efficient operations.

<sup>315</sup> Some regulatory problems are apparent from the start. Procedural safeguards would have to be established to minimize confusion for consumers. The necessary advance notice requirements for tariff changes already exist, however, some scheme would have to be devised to limit route modifications to particular times. Under such a system, some problem of "unfair competition" might also arise, if a carrier instituted a modification and another carrier matched it solely for the purpose of inducing the first carrier to cancel his proposal (and upon cancellation, the competitor similarly followed suit). Finally, the CAB would be called upon to develop market-by-market adequacy of service standards on a continuing basis, holding the carriers to minimum standards in their certificated markets.

<sup>316</sup> Federal Aviation Act of 1958 § 102(d), 72 Stat. 740, 49 U.S.C. § 1302(d) (1964).