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BEFORE THE

U.S. HOUSE OF REPRESENTATIVES  
COMMITTEE ON PUBLIC WORKS AND TRANSPORTATION  
SUBCOMMITTEE ON AVIATION

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REGARDING

GOVERNMENT POLICIES ON THE TRANSFER OF OPERATING RIGHTS  
GRANTED BY THE FEDERAL GOVERNMENT,  
PARTICULARLY CERTIFICATES OF PUBLIC CONVENIENCE AND NECESSITY  
AND AIRPORT SLOTS

Thank you for the opportunity to appear before your subcommittee today to provide the Department of Transportation's views on the subject of the transfer of airline operating rights granted by the Federal Government, specifically, international route rights and airport landing rights.

I must begin on a strong note of caution. The Department is now in the midst of a major case involving the transfer of international route rights and in rulemaking on the subject of transfer of airport landing rights at high-density airports. In order to protect the procedural rights of the parties affected by both these ongoing actions, my comments must be confined to describing issues of general policy and precedent and to summarizing the statutory authority that is relevant to route transfers and slot constraints.

Route Transfer Agreements

The sections of the Federal Aviation Act which govern route transfers are section 401(h), which specifically addresses the transfer of certificate

authority, and section 408, which concerns mergers and acquisitions of assets. Section 408 is applicable to virtually all proposed transfers because routes have historically been considered a substantial portion of the properties of an air carrier, and route transfer applications almost invariably also include other capital assets such as equipment or airport gates as part of the transaction.

Under section 401(h), no certificate may be transferred, directly or indirectly, unless the transfer is held to be consistent with the public interest.

Under section 408, a transaction to transfer assets — including an agreement to transfer routes — must be approved if it is consistent with the public interest and will not result in a monopoly or substantially lessen competition. Even where it is found that the effect of a transaction would be to substantially lessen competition, the transaction may still be approved if (1) the anticompetitive effects are outweighed by the benefits which the transaction would provide in meeting significant transportation conveniences and needs of the public, and (2) such benefits cannot be achieved by less anticompetitive alternatives.

In addition to our ability to approve or disapprove asset transfer transactions, the Department has the authority to condition the transaction in order to meet public interest concerns or to ameliorate potential anti-competitive consequences. This includes the ability to limit the scope of our approval to only a part of the route package covered by the agreement.

In addition to antitrust considerations, the Department also weighs various public interest factors as part of its review. For example, we would generally consider the implications that approval of a particular route transfer might have on our aviation relations with foreign governments.

The consideration of route transfers under the standards of sections 408 and 401(h), and not as part of a comparative carrier selection case, is consistent with the manner in which the CAB historically treated these cases. Of the dozens of route transfer applications considered by the Board, only five have been subject to comparative hearing with competing applications.

Consolidation of those applications was only ordered where the Board had first determined that it would be necessary to reevaluate the basic service needs of the markets at issue. Since 1978, this has only occurred where the incumbent had ceased operating. In all other cases, the Board's long-standing policy was to decline to consider competing proposals. It believed that consolidation of the transfer application into a comparative selection case would change the fundamental purpose of the proceeding as contemplated by the parties. It would also apply statutory standards which were never intended by Congress to be considered in route transfer cases.

Congress, by explicitly providing for route transfers under section 401(h), distinguished them from awards of route authority under section 401(d). In a carrier selection proceeding, the applicants' fare and service proposals are compared along with consideration of such factors as market structure,

the relative strengths of the applicants' behind-gateway route systems, the accuracy of traffic projections, and past performance. Thus, a route transfer agreement that would satisfy the tests of sections 408 and 401(h) would be required to satisfy a different and additional set of criteria if it were consolidated into a comparative selection case. If the much broader issues relating to public convenience and necessity considerations specified in 401(d) were held to apply to route transfer applications, there would be no need for either section 401(h) or 408 in route transfer cases because the more limited criteria of those sections are subsumed by the broader public convenience and necessity criteria of section 401(d). This would alter the nature of the case from a matter of approval or disapproval of a contractual arrangement to a comparative selection proceeding where the standards of sections 408 and 401(h) would be a secondary consideration. Such a result was consistently avoided by the CAB in over 45 years of precedent, and is one that we believe was never intended by Congress.

The passage of the Airline Deregulation Act and the International Air Transportation Competition Act added another important consideration to the historic rationale for the CAB's refusal to consolidate route transfer cases into carrier selection proceedings. Both pieces of legislation mandated that regulatory interference with the marketplace allocation of route authority be kept to an absolute minimum. A requirement that route transfer agreements be consolidated with carrier selection cases would have the effect of discouraging carriers from attempting to transfer route authority no matter how advantageous such a transfer might be. A carrier proposal to transfer routes would be involved in a complicated and costly

carrier selection case with an uncertain outcome. On the other hand, carriers seeking to avoid a consolidated proceeding and to ensure that a transaction is reviewed under section 408, might be encouraged to consider undertaking a full merger so that the route transfer would be considered in conjunction with the disposition of a company's other assets. Such a policy would undercut managerial discretion in the operation of airlines and discourage the efficient allocation of route authority, all to the ultimate detriment of the traveling public.

The Department's treatment of route transfers is consistent with the general principle of allowing the marketplace to function with as little interference as possible, consistent with the provisions of the Federal Aviation Act. We would much prefer to allow the marketplace to select carriers and the routes which they fly, and we do this wherever we can. Of course, total freedom to enter international markets without government review is precluded, in some instances, by entry limitations contained in our bilateral agreements. As a result, we must engage in the carrier selection process in a limited number of instances. However, I can see no reason to extend this kind of regulation to an area where it is not required by circumstances outside of our control and where we have been presented with agreements which, in many respects, represent the market allocation of limited entry route authority.

Although we would generally not consolidate a route transfer proceeding into a comparative selection case for the reasons which I have just mentioned, the ability of other carriers to provide better service does play a role in the decision as to the disposition of a

particular transfer application. Opposing carriers may offer their own service proposals into evidence in an effort to demonstrate that public interest objectives could be better achieved by rejecting or conditioning the route transfer and, where appropriate, instituting a comparative selection case. A carrier opposing a transfer application can also argue that the agreement would substantially lessen competition and that its proposal demonstrates the availability of a less anticompetitive alternative.

Finally, where the proposed transfer involves temporary authority, potential applicants will be able to contest the renewal of the routes at the time of their scheduled expiration. I would note that the Department has issued a Notice of Proposed Rulemaking which proposes to continue the CAB's practice of awarding new and renewal certificate authority in limited-designation international markets on an experimental basis and for a term of five years. Where carriers propose to transfer permanent authority, the Department has the ability to condition its approval, should it be deemed necessary, on the conversion of the certificates at issue to five-year experimental authority.

The imposition of labor protective provisions are another type of condition which is often litigated in merger and transfer cases. The CAB, in its post-deregulation review of section 408 cases, held that it would only apply LPP's if they are shown to be necessary to mitigate possible labor strife that would adversely affect the air transportation system as a whole. The Department adopted this standard in both the Midway-Air Florida Show Cause Proceeding and in the Southwest-Muse Acquisition Case. In

instituting the Pacific Division Transfer Case it was our tentative view that the same standard should be applied in that proceeding; however, as we said in the instituting order, parties may argue that this standard has been met, and we will also consider arguments that a different standard should be applied.

Because both the public interest and competitive implications of any proposed route transfer are extensively considered, we do not believe that such a transaction should be automatically disapproved merely because the agreement provides for the payment of cash or other consideration. The important issue in considering a route transfer agreement is not whether cash payment is involved or the amount of any such payment. Rather, we must look at whether approval of the overall route transfer is in the public interest and what its effect is on competition in the air transportation industry. I can assure you that before any action is taken on a proposed transfer agreement the Department will have thoroughly analyzed these issues and considered the arguments raised by all parties in the proceeding.

#### Allocation of Slots at Airports

I would like to turn now to the complex issue of slot allocation at the high-density airports. As you know the Department published two notices of proposed rulemaking on June 7, 1984 dealing with this subject. One proposed to permit air carriers to transfer slots for any compensation (buy and sell) and the other proposed a lottery mechanism for the allocation of newly available slots once a scheduling committee reached a deadlock. Many comments were received raising significant issues and suggesting alter-

native approaches. We have been carefully examining the issues and alternatives but have not reached a decision on how to proceed. However, I will try to respond to the issues you have raised to the extent that it is appropriate for me to do so while the rulemaking process is still going on.

Three major alternatives for allocating slots at high-density airports have been identified as a result of the Department's rulemaking proposals noted earlier and our review and analysis of the comments they elicited.

The first alternative is the buying and selling of slots at the high-density airports, as proposed in the NPRM or with various modifications. This alternative would allow slots to be transferred for any consideration acceptable to the parties to the transaction. The market could apply only to air carriers as proposed in the NPRM or be extended to commuters as some respondents suggested.

The second alternative, a periodic auction by the federal government, was suggested by some respondents. It would allow all or a portion of the slots to be periodically withdrawn and then reallocated by an auction conducted by the Federal government. Newly available slots would also be auctioned. Proceeds could be channeled back to airlines and/or to airports for capacity enhancing measures.

Finally, some respondents suggested that the scheduling committees could effectively allocate slots if a deadlock breaking mechanism were adopted. The NPRM proposed that in the event of a deadlock, newly available slots be

allocated by lottery with preferential treatment to new entrants. As a modification it has also been suggested that the deadlock breaking mechanism be applied, not only to the allocation of newly available slots, but also where agreement cannot be reached on seasonal or other schedule adjustments. This might entail the periodic withdrawal and reallocation of some portion of the slots held by incumbents, through a lottery, in order to provide a greater incentive for the scheduling committees to reach agreements.

The Department has received a substantial number of comments on the buy/sell and auction alternatives. The major arguments for and against the alternatives that were presented in the comments may help to illustrate some of the issues that must be addressed.

#### Buying and Selling of Slots

Those commenters supporting the buying and selling of slots offered the following arguments.

- It would provide a continuous pro-competitive market mechanism both for new entrants and for adjustments required by incumbent carriers, and it would result in an economically efficient use of congested airport capacity.
- The carriers would make the allocation decisions while government actions would be limited to those slots needed for public purposes.
- It is unlikely to be disruptive, particularly since transactions could be expected to involve only a small portion of the total slots.

- The buy/sell approach would reduce or eliminate the role of the scheduling committees and thus would eliminate the need for a grant of antitrust immunity. (The Department's authority to grant that immunity expires in 1988.)

On the other side of this issue, those who opposed the buying and selling of slots voiced the following concerns.

- If not structured properly, this approach could lead to a reduction in competition and public benefits, e.g. dominant carriers refusing to sell to competitors and using their deep pockets to acquire the slots of small carriers.
- New entrants would have more difficulty financing the purchase of slots.
- Incumbent carriers would likely reap a "grandfathering" windfall by initially holding the slots.
- Some small communities might lose direct service to high-density airports.
- There is uncertainty over whether fares will increase because of the purchase price of slots.
- Buy/sell would establish a precedent of charging for airport access which some fear may spread to non-high-density airports.
- The government's firm position that no private property right obtains in a slot could be discounted in bankruptcy court if the FAA allows a party to transfer a slot for value. This could tie up slots in bankruptcies or limit the government's access to an airport's slots in situations where their withdrawal is required for legitimate public purposes (such as EAS or international air service).

Periodic Auction by Federal Government

Commenters favoring an auction approach to the allocation of slots had two principal arguments.

- Auctioning slots to establish the initial allocation would provide an economically efficient allocation and would avoid a windfall for the incumbent carriers, as could occur under buy/sell with initial grandfathering of rights.
- The use of an auction would largely avoid the potential for collusion among the dominant carriers to restrict competition which could occur under an improperly structured buy/sell proposal.

The comments opposing the auction approach included the following points.

- A widespread disruption of service patterns could occur if the majority of slots are periodically re-auctioned.
- The cost to the airlines might be high.
- Except for the initial allocation feature, periodic auctions are less efficient than buy/sell because a transaction is required even to maintain the use of all slots, even those being used efficiently.
- Legislation would be necessary for the federal government to auction slots and channel proceeds back to airports or airlines.
- Even this limited use of an auction mechanism could act as a precedent for local authorities to use auctions to allocate airport groundside capacity which could result in an undesirable burdening of interstate commerce.

The other alternative mentioned earlier, i.e., scheduling committees with a deadlock breaking mechanism, was raised by several commenters on the June 7 proposals; however, the arguments for and against that alternative were not nearly as well developed, even though we are certain the issues relating to the implementation of that alternative are just as significant as those relating to the others. Because of this and the complexity of the issues raised by the commenters, I think you can begin to understand why it is taking us some time to reach a decision.

Within the constraints of our pending rulemaking let me now briefly address some of the specific buy/sell issues you identified in your invitation to this testimony.

#### Grandfathering/Windfall Profits

Several respondents commented on the windfall profits they felt would accrue to incumbent carriers if their slots are grandfathered. Actually the carriers who now have valuable slots are already realizing significant profits that flow from their scarcity. Allowing carriers to buy and sell slots simply reveals the magnitude of the windfall accruing. In view of the fixed investments incumbent carriers have made to provide existing service and the high cost implied in "purchasing" the slots to maintain service, it could be unrealistic to auction all slots initially. Carriers and other commenters have indicated this would be very disruptive and costly.

### Ability to Afford Slots

While the major carriers (especially those with strong balance sheets) may generally be in the most advantageous financial position to acquire slots, other carriers who can reasonably anticipate significant revenues from slot purchases ought also to be able to compete successfully. For example, during the six week period in 1982 when airlines were allowed to buy and sell slots, People Express acquired a significant number of slots, and a number of small carriers, including Provincetown-Boston, Arrow, Pilgrim and American International increased the number of slots they operated. Further, under some buy/sell options, carriers could lease slots and thereby reduce their initial slot costs significantly.

### Protection of Small Community and Short Haul Service

It is unclear whether buy/sell would have a significant adverse impact on small communities. Nonetheless, if there is serious concern about the loss of service to small communities, various protections are feasible. For example, the NPRM applied only to air carrier slots and would have prohibited air carriers from purchasing commuter and general aviation slots. The NPRM also provided for EAS slots.

### Anti-competitive Practices

Although various anti-competitive safeguards could be incorporated into any buy/sell rule which would cause the sale to take on many of the characteristics of a public auction, these measures would likely expand the government's regulatory role substantially. A less intrusive alternative would be to rely on the threat of antitrust prosecution to discourage any anti-competitive behavior.

Effect on Fares

The effect of buy/sell on fares is unclear. Some feel that buy/sell will increase fares; others believe that, while some fares may increase and some decline, the overall effect of resulting gains in economic efficiency would be an aggregate fare drop.

Creation of Property Rights or Assets for Purposes of Bankruptcy and Tax Law

If a buy/sell rule for slots is adopted, it would first have to be established that no property right in a carrier results for any reason.

We have been working quite hard to sort out and evaluate the complicated questions connected with the various slot allocation alternatives. Let me assure you that we are completing our assessment of the alternatives and hope to reach a decision soon.

This concludes my statement, and I would be happy to answer questions from the committee on either of these matters at this time.