

1964

## Government Regulation of Bank Mergers: The Revolving Door of *Philadelphia Bank*

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### Recommended Citation

Alexander E. Bennett, *Government Regulation of Bank Mergers: The Revolving Door of Philadelphia Bank*, 62 MICH. L. REV. 990 (1964).

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## COMMENTS

### GOVERNMENT REGULATION OF BANK MERGERS: THE REVOLVING DOOR OF *PHILADELPHIA BANK*

#### I. SQUARE PEG IN A ROUND HOLE: THE LAW AND THE FACTS

WILLIAM H. ORRICK, JR.: *Certainly there is no disputing the fact that the Philadelphia National Bank case*<sup>1</sup> *was the most important antitrust decision of the year and, perhaps of the decade.*<sup>2</sup>

On November 15, 1960, the second and third largest Philadelphia banks, the Philadelphia National Bank—its assets 1.09 billion dollars, its deposits 603 million dollars—and the Girard Trust Corn Exchange Bank—its assets 757 million dollars, its deposits 560 million dollars—applied to the Comptroller of the Currency for approval to merge.<sup>3</sup> The application stated the intention of the Philadelphia National (PNB) to acquire the Girard, including all its assets, deposits, capital, and retained earnings, thereupon to disgorge stock in a resulting bank to Girard shareholders at a ratio of 1.2875 to 1.<sup>4</sup> Both Girard and PNB had a history of merger and acquisition. Since 1950, PNB had acquired nine formerly independent banks and Girard six, and these acquisitions had aggrandized the banks' asset growth to the extent of 59 and 85 percent, respectively, their deposit growth 63 and 91 percent, their loan growth 12 and 37 percent.<sup>5</sup> The new bank to operate under PNB's national charter would control 36 percent of the area bank total assets, 36 percent of deposits and 34 percent of net loans.<sup>6</sup> The Comptroller of the Currency, passing upon the merger pursuant to his authority under the Bank Merger Act of 1960,<sup>7</sup> took into account, *inter alia*, the effect of the proposed merger upon competition, including any tendency toward monopoly. Disregarding unfavorable advisory opinions from the Department of Justice, the Federal Deposit Insurance Corporation, and the Federal Reserve Board, he approved the union on February 24, 1961, as in the public interest.<sup>8</sup> On the

<sup>1</sup> 374 U.S. 321 (1963) [hereinafter cited as principal case].

<sup>2</sup> Speech before Antitrust Section, American Bar Association, by William H. Orrick, Jr., Assistant Attorney General, Antitrust Division, Department of Justice, August 12, 1963. Reported in 5 TRADE REG. REP. (1963 Trade Cas.) ¶ 50,197, at 55220.

<sup>3</sup> Figures are derived from the Government's exhibits 2 and 8 admitted in evidence at trial, *United States v. Philadelphia Nat'l Bank*, 201 F. Supp. 348 (E.D. Pa. 1962). The deposits are those of individuals, partnerships, and corporations, as distinguished from those of states and municipalities.

<sup>4</sup> See principal case at 332.

<sup>5</sup> *Id.* at 331.

<sup>6</sup> *Ibid.*

<sup>7</sup> 74 Stat. 129 (1960), 12 U.S.C. § 1828 (Supp. IV, 1963).

<sup>8</sup> No opinion was rendered at that time. In his annual report to Congress, however, the Comptroller justified his approval on the ground that there still would be ample banking alternatives in Philadelphia and that the beneficial effect upon national and international competition would outweigh any locally anti-competitive effects. See Government's Exhibit 164, *United States v. Philadelphia Nat'l Bank*, 201 F. Supp. 348 (E.D. Pa. 1962).

day following, the Antitrust Division of the Department of Justice, alleging violation not only of section 7 but also of Sherman Act section 1,<sup>9</sup> filed suit to enjoin the merger.

The language of Clayton section 7 would seem to exclude bank mergers from its ambit:

"No corporation engaged in commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital and *no corporation subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of another corporation* engaged also in commerce, where in any line of commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or tend to create a monopoly."<sup>10</sup>

The Supreme Court settled long ago that the PNB-Girard type of merger is for section 7 purposes an assets acquisition.<sup>11</sup> Further, a bank is not a corporation subject to the jurisdiction of the Federal Trade Commission.<sup>12</sup> Nevertheless, three years after the filing of the complaint, the Supreme Court in a five-to-two<sup>13</sup> decision reversed the trial judge sitting in the Eastern District of Pennsylvania and held that the anti-merger section of the Clayton Act is applicable to banks and that the Philadelphia merger violated that statute since, in reasonable probability, it would produce a substantial lessening of bank competition in the local four-county Philadelphia market.

At first blush the decision would appear astounding. Prior to 1961, the statutory language had been interpreted to be so definite in its thrust that Justice had never challenged a bank merger. Indeed, the Department stood by in 1955 as the 831 million dollar Pennsylvania Company for Banking and Trusts merged with the 228 million dollar First National Bank of Philadelphia to form the city's largest bank. In the nation's financial center, New York City, Justice took no action either in 1954, as the 3.4 million dollar Chemical Corn Exchange Bank absorbed the 859

<sup>9</sup> 26 Stat. 209 (1890), as amended, 15 U.S.C. § 1 (1958). The Government throughout the case vigorously argued the applicability of the Sherman Act and relegated the Clayton Act to a secondary position. The Court found it unnecessary to decide the Sherman Act question once it found the Clayton Act violation.

<sup>10</sup> 64 Stat. 1125 (1950), 15 U.S.C. § 18 (1958). (Emphasis added.)

<sup>11</sup> See *Arrow-Hart & Hegeman Elec. Co. v. FTC*, 291 U.S. 587 (1934); *Swift & Co. v. FTC*, decided together with *FTC v. Western Meat Co.*, 272 U.S. 554 (1926). The PNB-Girard merger was technically a consolidation wherein the merging entities, their assets, liabilities, rights, and franchises would disappear into the resulting bank.

<sup>12</sup> The FTC under § 5 of the Federal Trade Commission Act, 72 Stat. 1750, 15 U.S.C. § 45(a)(6) (1958), has no jurisdiction over banks.

<sup>13</sup> Mr. Chief Justice Warren and Justices Black, Clark, and Douglas joined Mr. Justice Brennan, who delivered the opinion of the Court. Justices Harlan and Stewart dissented. Mr. Justice Goldberg wrote a memorandum in which he argued that the Clayton Act was inapplicable but that the merger violated the Sherman Act. Mr. Justice White took no part in the consideration or decision of the case.

million dollar New York Trust Company, or in 1959, when the 3 billion dollar Guaranty Trust Company fused with the 969 million dollar J. P. Morgan and Company. Again silent was Justice in 1957 when the Chase National and the Bank of the Manhattan Company joined to become the mighty Chase Manhattan. In effect, Justice by 1959 had thrown up its hands. As then Attorney General Brownell testified before the Senate Committee on Banking and Currency, "On the basis of these provisions [Sections 7 and 11 of the Clayton Act], the Department of Justice has concluded, and all apparently agree, that asset acquisitions by banks are not covered by Section 7 as amended in 1950."<sup>14</sup> Attorney General Brownell, along with virtually everyone else, proved misled by the fact that the anti-merger statute speaks not in terms of merger, but of stock and asset acquisition.

The Supreme Court in *Philadelphia Bank* avoided entirely the dilemma created by a literal construction of section 7. The Government, Mr. Justice Brennan reasoned for the majority, argued that the transaction was a stock acquisition. The banks argued it was an assets acquisition. Actually, both were right. The arrangement fitted neither category neatly. The transaction was a merger and could be analyzed only by reference to the congressional design. Construing the intent of putatively inapplicable section 7, the Court reasoned as follows:

"Congress contemplated that the 1950 amendment would give § 7 a reach which would bring the entire range of corporate amalgamations, from pure stock acquisitions to pure assets acquisitions, within the scope of § 7. Thus, the stock acquisition and assets acquisition provisions, *read together*, reach mergers, which fit neither category perfectly but lie somewhere between the two ends of the spectrum."<sup>15</sup>

The Court then held:

"So construed, the specific exception for acquiring corporations not subject to the FTC's jurisdiction excludes from the coverage of § 7 only assets acquisitions by such corporations when not accomplished by merger."<sup>16</sup>

Mr. Justice Brennan's interpretation of the statutory language, while highly sophisticated, was suggested neither by the arguments of the Anti-trust Division, nor by the legislative history, nor by the precedents. The Government in its brief and argument had so subordinated the applicability of section 7 to that of Sherman Act section 1 that Mr. Justice Harlan in dissent was impelled to begin: "I suspect that no one will be more

<sup>14</sup> *Hearings on the Financial Institutions Act of 1957 before a Subcommittee of the Senate Committee on Banking and Currency*, 85th Cong., 1st Sess., pt. 2, at 1030 (1957).

<sup>15</sup> Principal case at 342.

<sup>16</sup> *Ibid.*

surprised than the Government to find that the Clayton Act has carried the day for its case in this Court."<sup>17</sup>

Mr. Justice Harlan's comment was directed not only at the majority's interpretation of the statutory language. The defendants had argued that even if Clayton Act section 7 ever controlled bank mergers, its applicability had been repealed by implication in 1960 when Congress enacted the Bank Merger Act, which delegates to the federal banking agencies responsibility for the approval of almost all bank acquisitions.<sup>18</sup> The act prohibits all forms of bank merger without the consent of the Comptroller of the Currency if the acquiring or resulting bank is to be a national bank, of the Board of Governors of the Federal Reserve System if the acquiring or resulting bank is to be a state member bank, or of the Federal Deposit Insurance Corporation if the acquiring or resulting bank is to be a non-member insured bank. The Comptroller, the Board, or the FDIC, as the case may be, is to base consent upon six factors: the financial history and condition of the merging banks, the adequacy of their capital structure, future earnings prospects, the character of management, the convenience and needs of the community to be served, and the effect of the transaction on competition (including any tendency toward monopoly). The statute charges the appropriate agency not to approve the application unless, after a consideration of all these factors, together with advisory opinions from the other two banking agencies and the Department of Justice, it determines that the merger is in the public interest. It was upon application of this six-strand public interest standard that the Comptroller approved the Philadelphia-Girard union.<sup>19</sup>

The banks' argument rested upon two assumptions: first, that the legislative history of the Bank Merger Act clearly discloses a congressional apprehension that the Clayton Act is inapplicable to banks;<sup>20</sup> second, that Congress, with the supposed inapplicability of section 7 in mind, delegated regulatory responsibility to the Comptroller and the other banking agencies. Therefore, the banks concluded, the Bank Merger Act is the exclusive mechanism created by Congress to solve the problem of adverse competitive consequences ensuing from bank mergers. The merit of this argument must be gleaned from an examination of the interrelationship between antitrust and direct government regulation as tools of national economic policy.

<sup>17</sup> Principal case at 373.

<sup>18</sup> 64 Stat. 892 (1950), as amended, 74 Stat. 129 (1960), 12 U.S.C. § 1828 (Supp. IV, 1963).

<sup>19</sup> The Department of Justice and the Federal Reserve Board had strongly disapproved of the Philadelphia merger in advisory opinions. The FDIC, while conceding an adverse effect upon local competition, pointed out the pro-competitive effects upon the national and international markets.

<sup>20</sup> Compare H.R. REP. No. 1416, 86th Cong., 2d Sess. 5 (1960) ("The federal antitrust laws are . . . inadequate to the task of regulating bank mergers; while the Attorney General may move against bank mergers to a limited extent under the Sherman Act, the Clayton Act offers little help."), with S. REP. No. 196, 86th Cong., 1st Sess. 1 (1959) ("Since bank mergers are customarily, if not invariably, carried out by asset acquisitions, they are exempt from section 7 of the Clayton Act.").

The American economy is readily perceived as divided into two sectors—free market and government regulated. In the predominant sector—the free market—individual entrepreneurial action spurred by the demands of the competitive process is depended upon to maximize economic growth and output. The antitrust laws are thought to be the guardian of this free market sector to assure that entry remains unrestricted, that decisions are independent and not collusive, and that action is competitive and not predatory. In this area, concentration of market power in a few entrepreneurs or even monopoly itself has not been considered a *per se* antitrust offense. Only monopolization—the abuse of market power by practices clearly tending to stifle competition—has been proscribed.<sup>21</sup> Because many American markets are oligopolistic rather than monopolistic in structure, the anti-merger statute is the most formidable weapon in the Government's arsenal against undue concentration of market power. And even section 7, it must be noted, is a weapon against future, not present market domination.

The smaller segment of the economy, in sharp distinction, is subject to direct governmental control. In the so-called regulated industries, Congress has entrusted administrative agencies with basic economic judgments: the conditions of entry into the market, the type of service to be rendered, the expansion or contraction of the area of enterprise, safety and insurance regulations, the issuance of securities, the price structure (rate making), and the market structure (merger, consolidation, and acquisition). Underscoring the distinction is the fact that a number of the so-called regulated industries—with power, radio, and television as notable exceptions—are expressly exempt from the antitrust laws.<sup>22</sup> Indeed, congressional understanding that antitrust regulation applies principally to unregulated markets was indicated by Representative Celler's remarks on the House floor in introducing the 1950 amendments to section 7:

"Four companies now have 64 percent of the steel business, four have 82 percent of the copper business, two have 90 percent of the aluminum business, three have 85 percent of the automobile business, two have 80 percent of the electric lamp business, four have 75 percent of the electric refrigerator business, two have 80 percent of the glass business, four have 90 percent of the cigarette business and so forth.

"The antitrust laws are a complete bust unless we pass this bill."<sup>23</sup>

<sup>21</sup> See, e.g., *United States v. United Shoe Mach. Corp.*, 110 F. Supp. 295, 342 (D. Mass. 1953), *aff'd per curiam*, 347 U.S. 521 (1954); *United States v. Aluminum Co. of America*, 148 F.2d 416, 429 (2d Cir. 1945).

<sup>22</sup> For example, mergers approved by the CAB relieve any person affected by the administrative order from the operation of the antitrust laws "insofar as may be necessary to enable such person to do anything authorized, approved, or required by such order." 52 Stat. 1004 (1938), as amended, 49 U.S.C. § 1384 (1958). Similar exemptions are provided in the Interstate Commerce Act, 54 Stat. 908 (1940), 49 U.S.C. § 5(11) (1958), and the Communications Act of 1934, 48 Stat. 1070, as amended, 57 Stat. 5 (1943), 47 U.S.C. § 222 (1958).

<sup>23</sup> 95 CONG. REC. 11485 (1949) (remarks of Representative Celler).

It seems evident that Representative Celler considered the major target of the 1950 amendment to be further concentration by merger in the free-market sector. It is interesting that conspicuously absent from his remarks was the highly concentrated banking industry.

The Court, however, has come to regard the regulated-non-regulated distinction as more obvious than important. The true issue, as the Court has posed it, is not whether there is regulation, but whether regulation indicates subordination of government planning to competition as the economic policy controlling the particular market. The issue stated in this fashion had emerged from three decisions of the Court prior to *Philadelphia Bank*. While none of the three preceded the breadth of section 7 jurisdiction enunciated by Mr. Justice Brennan, all seemed to provide a basis for rejecting the banks' contention of implied repeal.

In *United States v. Radio Corp. of America*,<sup>24</sup> RCA and its wholly owned subsidiary, the National Broadcasting Company (NBC), agreed to exchange their Cleveland VHF television station for one in Philadelphia. Philadelphia represented the country's fourth largest market area; Cleveland, the tenth. The nature of the exchange—relinquishment then acquisition—was necessitated by FCC regulations limiting NBC to five VHF stations *in toto*.<sup>25</sup> The arrangement received FCC approval, albeit over strong dissent, as in the "public interest, convenience and necessity," and the transaction was consummated. Subsequently, when the Department of Justice challenged the exchange, the Supreme Court held that FCC assent did not conclude the Government upon any antitrust issues involved in the administrative proceeding. FCC approval could not affect a *pro tanto* exemption from the antitrust laws.

Although the relevant agency in *RCA* did not specifically consider the antitrust factor, this was decidedly not the case in *California v. FPC*.<sup>26</sup> There the El Paso Natural Gas Company first acquired the stock of the Pacific Northwest Pipeline Corporation and then sought permission of the FPC to swallow the assets pursuant to section 7 of the Natural Gas Act.<sup>27</sup> Prior to the FPC application, the Antitrust Division had brought suit attacking the acquisition as violative of Clayton Act section 7. Justice repeatedly asked the Commission to stay proceedings pending the outcome of the lawsuit. The FPC refused so to do, and upon continuance of the court proceeding, the Commission, having considered the effect upon competition, went ahead to authorize the merger, which was speedily consummated. The State of California intervened in the administrative proceedings and demanded in vain a stay pendente lite. An appeal ensued and the Supreme Court ultimately granted certiorari. The Court found that the natural gas industry, although publicly regulated, is not exempt from the operation

<sup>24</sup> 358 U.S. 334 (1959).

<sup>25</sup> See 47 C.F.R. § 3.636 (1958).

<sup>26</sup> 369 U.S. 482 (1962).

<sup>27</sup> 61 Stat. 459 (1947), 15 U.S.C. § 717f(h) (1958).

of the antitrust laws. In an opinion by Mr. Justice Douglas the Court held that where a merger is challenged in the courts under the antitrust laws, the Commission must stay subsequently initiated administrative proceedings until a final judicial determination is reached. Once again the presence of regulatory authority failed to preclude the operation of the antitrust laws.

The pattern of decisions indicating that administrative superintendence ordinarily will not pre-empt antitrust enforcement in a regulated industry has not been undeviated. The Supreme Court found the antitrust laws inapplicable in *Pan American World Airways, Inc. v. United States*,<sup>28</sup> where the Government alleged: first, that Pan American and W. R. Grace and Company, each fifty percent owners of Panagra, unlawfully agreed in forming the joint venture that Panagra would enjoy freedom from Pan American competition along the west coast of South America, while Pan American would remain unencumbered by Panagra competition in other areas of Central and South America; second, that Pan American and Grace conspired generally to monopolize air commerce between the United States and Latin America in violation of sections 1, 2, and 3 of the Sherman Act. The Court analyzed the defendants' acts as route-fixing agreements and distinguished such conduct in this context from price-fixing and the monopolization by acquisition alleged in *RCA* and *California*.<sup>29</sup> It was further observed that the CAB, under section 411 of the Civil Aeronautics Act, could investigate and order stopped unfair practices or unfair methods of competition, including allocation of routes or other illegal combinations among carriers.<sup>30</sup> Thus, where regulation is perceived to be this extensive, the antitrust laws are inapplicable.

The impact the *Pan American* decision might have had upon *Philadelphia Bank* would at first appear far-reaching. *Pan American* clearly seemed to resolve the implied repeal issue against the Antitrust Division. But such niceties could not and did not present a multitude of problems to a court that had just found section 7 of the Clayton Act applicable to bank mergers. The facts in *Pan American* were indeed distinguishable.<sup>31</sup> The CAB had continuing authority over Panagra's activities. It could issue a restraining order at any time. Air routes are but a creature of administrative discretion. They are subject to change or cancellation at the stroke of a pen.<sup>32</sup> A merger, however, bears the distinction of finality. When the Comptroller approves, absent antitrust inquiry, the joinder is irrevocable. The Court, in likening the principal case to *California* rather than *Pan American*, took a giant step along the line of decision imposing antitrust policy upon the regulated industries. Mr. Justice Brennan read *California*

<sup>28</sup> 371 U.S. 296 (1963).

<sup>29</sup> *Pan Am. World Airways, Inc. v. United States*, 371 U.S. 296, 306 (1963).

<sup>30</sup> 72 Stat. 731, 769, 49 U.S.C. § 1381 (1958).

<sup>31</sup> Curiously enough, Mr. Justice Brennan, joined by Mr. Chief Justice Warren, dissented in *Pan American*.

<sup>32</sup> See Federal Aviation Act § 401, 72 Stat. 737 (1958), as amended, 49 U.S.C. § 1371(e) (Supp. IV, 1963).



to mean that administrative approval of a merger, even where the agency, in passing on the merger, has taken into account the competitive factor, confers no immunity from Clayton Act section 7. In the context of bank mergers, he reasoned, the Bank Merger Act does not require the Comptroller to accord the competitive factor any particular weight. He merely considers it in passing, along with the other normative standards defined in the statute. It is clear, the Court concluded, that such a scheme of regulation could not have effected an implied repeal of section 7.<sup>33</sup> Both jurisdictional hurdles had now been cleared.

## II. THE MERGER URGE: BANKS AND BANKERS

MR. UNTERMYER: *You are opposed to competition, are you not?*

MR. MORGAN: *No, I do not mind competition.*

MR. UNTERMYER: *You would rather have combination, would you not?*

MR. MORGAN: *I would rather have combination . . . .*

MR. UNTERMYER: *Combination as against competition?*

MR. MORGAN: *I do not object to competition, either. I like a little competition.*<sup>34</sup>

The structure of commercial banking in the United States is unique. While commercial banking is conducted by a small number of centralized institutions in France or England, in the United States the industry consists of thousands of separately incorporated units. Whereas in Belgium or Sweden there are but a few banks with many branches, here branch banking is rarely permitted state-wide and, in any event, it almost never exceeds the borders of a single state. In Germany or the Netherlands, banks are chartered exclusively by the central government; here there is a dual banking system permitting the chartering of commercial banks by both federal and state authorities.

In spite of this structural decentralization, however, commercial banks individually, and the system as a whole, represent vast repositories of economic power. Dealing in credit, the banking system has the power to generate demand deposit accounts amounting to approximately seventy-five percent of the public money supply.<sup>35</sup> In addition to being the most important lenders to individuals, partnerships, corporations, states and municipalities, banks play other roles. They receive and administer time and savings deposits, engage in foreign exchange activities, execute trust functions, provide a source of currency to individuals and businessmen, render safe deposit services, and perform a variety of counseling, agency, and service functions.<sup>36</sup>

Bank competition is vigorous and exists at all levels. There is competition for deposits, competition for loans, competition for trusteeships, and

<sup>33</sup> Principal case at 351-52.

<sup>34</sup> Testimony of J. P. Morgan in response to questions of Special Counsel Samuel Untermyer, before the Pujo Money Trust Investigation, 62d Cong., 2d Sess. 1050 (1912).

<sup>35</sup> Principal case at 374.

<sup>36</sup> See Court Reporter's Typed Transcript at 2286, *United States v. Philadelphia Nat'l Bank*, 201 F. Supp. 348 (E.D. Pa. 1962) [hereinafter cited as Transcript].

competition for counseling and foreign exchange business. The banker competes principally in the rendering of services, since bank prices, *i.e.*, interest rates, indirectly respond to federal regulation. Minimum bank interest rates are virtually set by the Federal Reserve Board and, while the maximum is limited only by state usury laws, rate levels tend to reflect monetary policies of the Board.<sup>37</sup> With respect to loans, of course, interest rates represent only base price.<sup>38</sup> Banks typically extend credit by opening demand deposit accounts in the borrower's name. A percentage of the total loan, it is stipulated, will be kept on deposit at all times. The precise loan percentage a bank will require to be kept on deposit, while independent of federal regulation, is unquestionably a price factor and influences a borrower's selection among competing banks.

Notwithstanding the vigorous nature of banking competition, the Government has taken the attitude that bank power, if left unsupervised, invites revival of the naked restraints, abuses, and exclusionary practices exposed in the Pujo Money Trust Investigation of 1912, which led to the establishment of the Federal Reserve System.<sup>39</sup> Just a half century ago, when Congressman Pujo's committee had occasion to investigate the concentration of control over money and credit, its findings disclosed that the processes of competition were throttled in favor of collusion, combination, and concentration. The committee saw widespread merger and consolidation of competing banks, achieved through acquisition of competitors' stock by powerful interests. The committee noted the formation of confederations of competing banks in a system of interlocking directorates and recognized the influence of the more powerful banking houses in the management of industrial corporations. It exposed ventures undertaken by a few select banking houses to purchase controlling interests in mammoth industrial concerns.<sup>40</sup>

Today, even in spite of federal regulation, it appears that some bank conduct raises serious questions under traditional antitrust analysis. Through the expedient of the clearing house, competing bankers tend to "arrange" the hours of operation, the service charges to be exacted on special accounts, and the interest to be paid on time deposits.<sup>41</sup> Competition from non-commercial bank sources—savings and loan associations, mutual

<sup>37</sup> See principal case at 328. The Federal Reserve Board exclusively fixes the rediscount rate at which member banks discount commercial paper. An increase in the rate means an increase in the costs of borrowing at the Federal Reserve by a member bank. Conversely, a decrease in the rate means a decrease in the cost to member banks of federal credit. Such changes obviously control the "prime" interest rate—the price member banks charge their best customers.

<sup>38</sup> See Transcript 1778.

<sup>39</sup> See note 34 *supra*.

<sup>40</sup> See *Report of the House Committee To Investigate the Concentration of Control of Money and Credit*, 62d Cong., 3d Sess. 56 (1913).

<sup>41</sup> See ALHADEFF, *MONOPOLY AND CONCENTRATION IN BANKING* 25 (1954); *cf.* *United States v. Duluth Clearing House Ass'n*, 5 TRADE REG. REP. (1964 Trade Cas.) ¶¶ 71020-22 (D. Minn. Feb. 11, 1964).

savings banks, and finance companies—is severely limited. State statutes place severe limitations upon savings institutions. Competition afforded by finance companies is virtually nonexistent, not only because of rate differentials and service disparities, but also because finance companies derive their capital from commercial bank loans. It is said that the atmosphere created is a naturally coercive one wherein finance companies are compelled to make full disclosure of customers and operations to their potential competitors.<sup>42</sup> Antitrust inquiry into the banking industry has never been extensive. For example, the antitrust agencies have never inquired into bank correspondent relationships wherein a number of banks participate jointly in the extension of credit to a single customer and agree upon the rate charged and the terms exacted. If two shoe companies agreed to supply a purchaser with his total requirements—the first to supply seventy-five percent and the second to supply twenty-five percent, with the price fixed by mutual agreement of the two companies—serious antitrust problems would unquestionably be raised. Bank correspondent relationships, however, although seemingly analogous, have never been so analyzed.

The Government has nevertheless created a regulatory antidote to curb the unfettered exercise of monetary power by individual banks or groups of banks. The regulatory structure—both federal and state in origin—in part dates to 1819, when the Court, in *McCulloch v. Maryland*,<sup>43</sup> held that Congress has the power to charter a bank. Regulation of banks in part responds to the disclosures of the 1912 Money Trust Investigation, and in part is the product of the bank failures of the Great Depression and the Rooseveltian federalism that followed. National banks, for example, are chartered and supervised by the Comptroller of the Currency. Varying state laws and regulations, the most important of which govern de novo branching intrastate, regulate both state and national banks at the local level. Most state banks, as well as all national banks, are members of the Federal Reserve System, the Board of Governors of which possesses broad monetary and fiscal powers. Federal Reserve member banks are subject to numerous provisions designed specifically to insure sound banking management. Illustrative are the rules prohibiting member banks from paying interest on demand deposits,<sup>44</sup> paying interest on time or savings deposits in excess of the rates fixed in Washington,<sup>45</sup> or holding for their own account investment securities of any one obligor in an amount greater than ten percent of the bank's unimpaired capital and surplus.<sup>46</sup> With respect to national banks the ten percent limitation applies to loans as well,<sup>47</sup> and many state legislatures have extended the ten percent lending limit to state-chartered banks. More than ninety-five percent of all banks are insured by the Federal

<sup>42</sup> *Id.* at 16.

<sup>43</sup> 17 U.S. (4 Wheat.) 316 (1819).

<sup>44</sup> 49 Stat. 714 (1935), 12 U.S.C. § 371a (1958).

<sup>45</sup> 49 Stat. 715 (1935), as amended, 12 U.S.C. § 371b (Supp. IV, 1963).

<sup>46</sup> 48 Stat. 165 (1933), 12 U.S.C. § 335 (1958).

<sup>47</sup> 34 Stat. 451 (1906), as amended, 12 U.S.C. § 84 (1958).

Deposit Insurance Corporation. The principal function of the FDIC is to see that the public is protected by deposit insurance in the event of failure. From the banks' point of view, however, there runs with the benefit of confidence that the Government stands surety the burden of frequent and intensive bank inspections by federal examiners.<sup>48</sup>

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The Court in *Philadelphia Bank* carefully analyzed the unique nature of American commercial banking and the nature and extent of regulation by all agencies of federal and state government. Taking into account these factors, it concluded that as to the banking industry, Congress, by imposing regulatory supervision, did not intend to displace competition and consequently did not repeal applicable antitrust laws:

"Section 7 . . . does require . . . that the forces of competition be allowed to operate within the broad framework of governmental regulation of the industry. The fact that banking is a highly regulated industry critical to the Nation's welfare makes the play of competition not less important but more so. . . . [U]nless competition is allowed to fulfill its role as an economic regulator in the banking industry, the result may well be even more governmental regulation."<sup>49</sup>

Congress itself had made the judgment that maintenance of competition was to be retained as the national policy regarding the banking industry when it enacted the Bank Merger Act of 1960:<sup>50</sup>

"Vigorous competition between strong, aggressive, and sound banks is highly desirable. Competition in banking takes many forms—competition for deposits by individuals and corporations and by personal and business depositors; competition for individual, business, and governmental loans; competition for services of various sorts. Competition for deposits increases the amounts available for loans for the development and growth of the Nation's industry and commerce. Competition for loans gives the borrowers better terms and better service and furthers the development of industry and commerce. Vigorous competition in banking stimulates competition in the entire economy, industry, commerce and trade."<sup>51</sup>

The ultimate dilemma facing the Court in *Philadelphia Bank* was how to walk successfully the tightrope between judicial legislation—reaching a congressionally unintended result—on the one hand, and judicial impotence—forbearance from doing justice when justice can be done—on the other. The desirability of applying Clayton Act proscriptions to bank mergers seems evident. Banking is not sacrosanct. Absent the Court's decision, legislative extension to banks of Clayton Act jurisdiction would have been

<sup>48</sup> See 64 Stat. 882 (1950), as amended, 12 U.S.C. § 1820(b) (Supp. IV, 1963).

<sup>49</sup> Principal case at 371-72.

<sup>50</sup> 64 Stat. 892 (1950), as amended, 74 Stat. 129 (1960), 12 U.S.C. § 1828 (Supp. IV, 1963).

<sup>51</sup> H.R. REP. No. 1416, 86th Cong., 2d Sess. 3 (1960); S. REP. No. 196, 86th Cong., 1st Sess. 16 (1959).

unlikely.<sup>52</sup> Suppose, however, that Congress intended in 1950 to exclude assets acquisitions by commercial banks from the ambit of section 7, perhaps not because it deemed such an exclusion desirable, but because bank influence was such that this was the only way to rally the votes necessary for passage. Even upon this hypothesis, the tightrope remains. A Court's function is to adjudicate, not legislate. A judicial tour de force, however, is always most inviting.<sup>53</sup> Remaining only is the admonition of Mr. Justice Brandeis:

"When a court decides a case upon grounds of public policy, the judges become, in effect, legislators. The question then involved is no longer one for lawyers only. It seems fitting, therefore, to inquire whether this judicial legislation is sound."<sup>54</sup>

So let it be inquired in *Philadelphia Bank*.

### III. DEBITS AND CREDITS: THE ECONOMIC RECKONING

PHILIP PRICE: *What the Department of Justice is trying to do here is not to enhance competition but to stifle it. It is trying to make it impossible for two banks here who have the energy and will to try to go out and meet competition that now comes from New York to try and serve the members of the business community (in the larger business community). . .*<sup>55</sup>

As if to underscore its holding that the Clayton Act is applicable to bank mergers, the Court in *Philadelphia Bank* enunciated two legal doctrines which transcended the specialized factual setting of bank merger and dispelled some hopes that the Court's decision in *Brown Shoe Co. v. United States*<sup>56</sup> seemed to hold for the merger defendant. The first of these doctrines is a prima facie presumption of unlawfulness where a merger produces a firm controlling thirty percent or more of the relevant market. The Court tacitly conceded the evidentiary advantage this illegality slide rule affords the Government: "Such a test lightens the burden of proving illegality only with respect to mergers whose size makes them inherently suspect in light of Congress' design in § 7 to prevent undue concentration."<sup>57</sup> While the Court's language indicates that the presumption is rebuttable and not conclusive, the dictum appears to contradict *Brown Shoe's* rule of

<sup>52</sup> Representative Celler in 1956 introduced another amendment to § 7 which would have rendered banks expressly subject to Clayton Act jurisdiction. 102 CONG. REC. 2109 (1956). The bill passed the House but failed in the Senate. See principal case at 396 (dissenting opinion).

<sup>53</sup> Mr. Justice Harlan characterized the Court's holding as a tour de force. Principal case at 396 (dissenting opinion).

<sup>54</sup> Brandeis, *Cutthroat Prices, the Competition that Kills*, Harper's Weekly, Nov. 15, 1913, p. 10.

<sup>55</sup> Argument sur Pleadings and Proof by Philip Price, Counsel for Girard Trust Corn Exchange Bank, at 179, *United States v. Philadelphia Nat'l Bank*, 201 F. Supp. 348 (E.D. Pa. 1962).

<sup>56</sup> 370 U.S. 294 (1962).

<sup>57</sup> Principal case at 363.

reason test for section 7 unlawfulness: "Congress indicated plainly that a merger had to be functionally viewed, in the context of its particular industry."<sup>58</sup>

The principal impact of the doctrine will be felt at two distinct levels of inquiry. In a motion for a preliminary injunction, the Government assumes the burden of proving, among other things, the prima facie illegality of the challenged merger.<sup>59</sup> Previously, prima facie illegality had been only nebulously defined. The Court's dictum renders these criteria somewhat more certain. The dictum, moreover, also alters the burden of proof at the trial level. In the future, where the merging firms control thirty percent or more of the relevant market, they will assume the burden at trial of rebutting the presumption of illegality. The deterrent effect of this principle upon future mergers is obvious.

The presumption of illegality was not the only new doctrine the Court was to expound in *Philadelphia Bank*. An intriguing argument that had arisen sporadically in section 7 cases was the "better able to compete" defense. Defendant merging entities would try to justify any perceived anti-competitive effect in the relevant market by advancing the appealing contention that economies and advantages of size and combination would better enable the merged complex to compete with industry leaders both within and beyond the relevant market. The doctrine was first advanced—and flatly rejected—in *United States v. Bethlehem Steel*.<sup>60</sup> There the defendants, Bethlehem Steel and Youngstown Sheet and Tube, urged the court, in considering the competitive impact of the proposed merger, to take into account what they termed "certain beneficial aspects," that is, the enhancement of power in the merged complex to compete effectively and vigorously with U.S. Steel and other industry leaders. Finding this argument untenable, the court said:

"[T]he argument does not hold up as a matter of law. If the merger offends the statute in any relevant market, then good motives and even demonstrable benefits are irrelevant and afford no defense. . . . The consideration to be accorded to benefits of one kind or another in one section or another of the country which may flow from a merger involving a substantial lessening of competition is a matter properly to be urged upon Congress. It is outside the province of the Court."<sup>61</sup>

The "better able to compete" defense, which seemed to have been sent to its demise in *Bethlehem-Youngstown*, obtained both partial resurrection and some respectability in *Brown Shoe*. There the Supreme Court observed:

"When concern as to the Act's breadth was expressed, supporters of the amendments indicated that it would not impede, for example,

<sup>58</sup> 370 U.S. 294, 321-22 (1962).

<sup>59</sup> See *United States v. Schine Chain Theatres*, 31 F. Supp. 270 (W.D.N.Y. 1940).

<sup>60</sup> 168 F. Supp. 576 (S.D.N.Y. 1958).

<sup>61</sup> *Id.* at 617-18.

a merger between two small companies to enable the combination to compete more effectively with larger corporations dominating the relevant market, nor a merger between a corporation which is financially healthy and a failing one which no longer can be a vital competitive factor in the market."<sup>62</sup>

Consequently,

"Congress foresaw that the merger of two large companies or a large and a small company might violate the Clayton Act while the merger of two small companies might not, although the share of the market foreclosed be identical, if the purpose of the small companies is to enable them in combination to compete with larger corporations dominating the market."<sup>63</sup>

Although the Court confined its comments to a situation involving "two small companies," it concluded that the Brown-Kinney merger would in all reasonable probability foreclose competition in a substantial share of the relevant market, and noted not only the presence of the unlawful effect but the absence of "any countervailing competitive, economic, or social advantages."<sup>64</sup> This last dictum, coupled with the rationale of the "two small companies" doctrine, could be said to invite the very argument rejected in *Bethlehem-Youngstown*. There are countervailing economic and social advantages, the defendants in *Philadelphia Bank* could argue, and while there may not be "two small companies" in terms of the relevant market, any local lessening of competition will be more than counterbalanced by the fact that competition will be substantially increased in the national and international setting. Indeed, in *Philadelphia Bank* the banks, relying on *Brown Shoe*, contended that, even assuming the relevant geographic market was the Philadelphia four-county area, the increased lending limit effected by the merger, together with other economies of scale, would better enable the merged institution to compete with larger banks in the New York and international markets. The Court was not impressed:

"[I]t is suggested that the increased lending limit of the resulting bank will enable it to compete with the large out-of-state banks, particularly the New York banks, for very large loans. We reject this application of the concept of 'countervailing power.' . . . If anti-competitive effects in one market could be justified by pro-competitive consequences in another, the logical upshot would be that every firm in an industry could, without violating § 7, embark on a series of mergers that would make it in the end as large as the industry leader."<sup>65</sup>

The Court, attempting to harmonize its position with *Brown Shoe*, went on to qualify its pronouncement: "This is not a case, plainly, where two small firms in a market propose to merge in order to be able to compete

<sup>62</sup> 370 U.S. 294, 319 (1962).

<sup>63</sup> *Id.* at 331.

<sup>64</sup> *Id.* at 334.

<sup>65</sup> Principal case at 370.

more successfully with the leading firms in that market."<sup>66</sup> This dictum would appear to indicate that the "better able to compete" defense is not yet defunct and that it will retain some relevancy in a section 7 case where the merging companies are "two small firms." The *Brown Shoe* doctrine of countervailing power, however, has been narrowed in scope of application. Naturally, one is impelled to inquire how small the firms must be. As to this the Court has been silent. One thing, however, seems clear. Any general usefulness the "better able to compete" doctrine may have afforded the typical merger has now been impaired. Unquestionably, however, the Court has preserved the "two small companies" doctrine as a narrow corridor within which certain consolidations can be justified. *Philadelphia Bank* evidently did not concern "two small companies."

#### IV. NEW VOGUE IN MISCELLANEOUS AUTHORITY: THE REVOLUTION IN JUDICIAL NOTICE

WILLIAM J. BRENNAN, JR.: *The writing of an opinion always takes weeks and sometimes months. The most painstaking research and care are involved. Research, of course, concentrates on relevant legal materials—precedents particularly. But Supreme Court cases often require some familiarity with history, economics, the social and other sciences, and authorities in these areas, too, are consulted when necessary.*<sup>67</sup>

In the course of a two-month trial creating a record of some 3,900 pages, the Government in *Philadelphia Bank* offered four economists who testified to a variety of economic analyses indicating that the merger would, if consummated, not only eliminate competition between the merging institutions in the Philadelphia four-county area and thereby diminish the number of alternative banking sources available to the small businessman,<sup>68</sup> but would also effect an increase in service charges and interest rates,<sup>69</sup> trigger a renewed rash of horizontal mergers in the relevant market,<sup>70</sup> and culminate in an exportation of capital redounding to the detriment of the Philadelphia community, whose stream of deposits provided the banks' life blood.<sup>71</sup> These witnesses presumably were subjected to pre-trial examination by counsel for the bank. The record discloses that all were intensively cross-examined as to their qualifications, their familiarity with the Philadelphia situation, and the underlying facts and assumptions which had led them to their conclusions. The district court, sometimes adverting to the government economists by name, sifted this testimony at length and rejected most of it.<sup>72</sup>

The Supreme Court, however, did not mention the economic evidence

<sup>66</sup> *Id.* at 370-71.

<sup>67</sup> N.Y. Times, Oct. 6, 1963, § 6 (Magazine), p. 102.

<sup>68</sup> Transcript 1609-10, 1729, 1791, 1795.

<sup>69</sup> *Id.* at 1982-2049.

<sup>70</sup> *Id.* at 1796-97.

<sup>71</sup> *Id.* at 616-17.

<sup>72</sup> See *United States v. Philadelphia Nat'l Bank*, 201 F. Supp. 348, 367 (E.D. Pa. 1962).



introduced by either side; instead, it took judicial notice of economic sources extrinsic to the record. In the section of its opinion entitled "The Lawfulness of the Proposed Merger under Section 7," the Court cited the following economic works, among others: Bock, *Mergers and Markets* (1960); Kaysen and Turner, *Antitrust Policy* (1959); Hale and Hale, *Market Power: Size and Shape Under the Sherman Act* (1958); and Machlup, *The Economics of Sellers' Competition* (1956).<sup>73</sup>

Kaysen and Turner's work received particular attention. For instance, the Court followed Kaysen and Turner's view of the relationship between quantitative market power and section 7 illegality:

"Specifically, we think that a merger which produces a firm controlling an undue percentage share of the relevant market, and results in a significant increase in the concentration of firms in that market, is so inherently likely to lessen competition substantially that it must be enjoined. . . .

"Furthermore, the test is fully consonant with economic theory [citing, *inter alia*, Kaysen and Turner]."<sup>74</sup>

At another point, the Court assessed the significance of quantitative market power in a merger of two banks producing a single bank controlling over thirty percent of the commercial banking resources in the Philadelphia community:

"Without attempting to specify the smallest market share which would still be considered to threaten undue concentration, we are clear that 30% presents that threat [citing, *inter alia*, Kaysen and Turner, who suggest that twenty percent should be the line of prima facie unlawfulness]."<sup>75</sup>

In going on to discuss the cogency of the Kaysen and Turner analysis, the Court noted: "We intimate no view on the validity of such tests for we have no need to consider percentages smaller than those in the case at bar, but we note that such tests are more rigorous than is required to dispose of the instant case."<sup>76</sup>

Kaysen and Turner's work advanced a "substantial legislative amendment" to traditional antitrust policy.<sup>77</sup> At the outset the authors distinguished specific acts of misconduct from undue market power. In their view, the former is a mere manifestation of the latter—the latter being the substantive evil to be proscribed and the more fundamental enemy of the competitive

<sup>73</sup> Principal case at 355 *passim*. The Court also cited, among others, Bok, *Section 7 of the Clayton Act and the Merging of Law and Economics*, 74 HARV. L. REV. 226, 308-16 (1960); Markham, *Merger Policy Under the New Section 7: A Six-Year Appraisal*, 43 VA. L. REV. 489, 521-22 (1957); Stigler, *Mergers and Preventive Antitrust Policy*, 104 U. PA. L. REV. 176, 182 (1955).

<sup>74</sup> Principal case at 363.

<sup>75</sup> *Id.* at 364.

<sup>76</sup> *Id.* at 364 n.41.

<sup>77</sup> See KAYSEN & TURNER, *ANTITRUST POLICY* xl (1959).

process.<sup>78</sup> They went on to summarize their position by proposing a shift in legislative antitrust policy and in legislative design: "We propose . . . the reduction of undue market power, whether individually or jointly possessed; this to be done normally by dissolution, divorcement, or divestiture."<sup>79</sup> The thesis is basically this. Present antitrust policy primarily focuses on unreasonable restraints or practices exclusionary in economic effect. This policy, Kaysen and Turner contended, is wholly ineffectual in breaking down undue market power—the breeding ground of "conscious parallel action," which is the unassailable handmaiden of conspiracy. An examination of the American economy, the authors argued, discloses oligopolistic markets in which monopoly power is often effectively exercised with impunity. Oligopolistic markets consist of two structural subclasses: first, those in which the top eight firms have at least fifty percent of total markets sales and the top twenty firms have at least seventy-five percent of the total market sales; second, those where the eight largest sellers command a market share of thirty-three percent with the rest of the market relatively unconcentrated. Applying the goals of antitrust policy to the current American economy, the authors suggested proscription not only of conduct, but of excessive concentration of market power. They proposed amendments to the antitrust laws: first, provisions enabling a direct attack on undue market power regardless of the absence of conspiracy; and second, severe limitations upon forms of conduct contributing to or tending to contribute to undue market power.

The Court's attention to extra-record economic analyses like those of Kaysen and Turner raises a number of interesting questions. Long before *Philadelphia Bank*, economic analysis of market behavior was considered relevant in merger cases as an aid in applying broad statutory language to a specific questioned practice. Mr. Justice Brennan, however, went a step further. By using economic analyses of market structure, he seemed to accept the thesis of some economists that certain market behavior is inextricably interwoven with a certain market structure, and that once the latter is confirmed, the former is presumed without a further factual showing. The implications of this were not long in coming to light. Commissioner Elman of the Federal Trade Commission, in finding the recent Procter & Gamble-Clorox merger violative of section 7, cited a string of economic writings at one point and then noted: "The Supreme Court in the *Philadelphia National Bank* case by its repeated citation of economic analyses . . . has clearly indicated the propriety of a reviewing tribunal's consideration of such analyses in reaching its decision in a Section 7 case."<sup>80</sup> In spite of Mr. Justice Brennan's repeated use of economic sources, one may still take issue with Commissioner Elman's interpretation as to their propriety. The

<sup>78</sup> *Id.* at 44-45.

<sup>79</sup> *Id.* at 46.

<sup>80</sup> Procter & Gamble Co., 3 TRADE REG. REP. (1963 Trade Cas.) ¶ 16673, at 21568 n.19. (FTC Dec. 15, 1963).

Court in *Philadelphia Bank* neither used, nor needed to use, the theories of Kaysen and Turner or any other economists to reach its findings of section 7 jurisdiction or section 7 violation. Mr. Justice Brennan may have intended the economic analyses of market structure as a backdrop against which to view the merger functionally in the light of its particular industry. Surely *Philadelphia Bank* embodied the definite factual showing of illegality required by *Brown Shoe*. Nowhere did the Court intimate that the rule of law is now that oligopoly structure is conclusive evidence of a substantial lessening of competition without a further showing. With the conflicting inference available, one must accept with caution Commissioner Elman's conclusion as to the propriety of judicial economics in antitrust cases. Moreover, if judicial economics is now the law, surely the Court should restrict itself to the record or more liberally to the record and briefs of counsel. It does not seem unlikely that counsel for the banks, had they had ample warning, could have unearthed accredited economic theorists to take issue with the analyses of Kaysen and Turner and the others cited by the Court. Not forewarned, however, is to be most out of vogue. The banks' brief cited cases, statutes, and congressional materials but not one economist. Finally, judicial notice of an economic theory so inconsistent with the present policy of the antitrust laws that its proponents recommend a legislative amendment to effectuate its implementation seems suspect as a judicial tool. If new conditions indeed require that the Government add to its arsenal such remedial measures as direct attack on oligopoly or proscription per se of all mergers where there will be produced an entity controlling an unreasonable market share, the legislature vested with the power and the facilities to gather all the relevant facts must make such a judgment. Congress, of course, moves slowly, and it may be appropriate for the Court to act in compelling circumstances. If the Court makes such a judgment, however, it should do so openly and unequivocally. It seems strange to delegate the task by indirection to economists through the dubious expedient of judicial notice.

#### V. JUSTICE AND THE COMPTROLLER: TWO REGIMES IN THE REVOLVING DOOR

JAMES J. SAXON: *We believe it to be incumbent upon the bank supervisory agencies to institute studies aimed at developing proper standards to insure adequate competition in banking. It is the banking agencies alone that have the facilities, the background knowledge, the constant concern with the adequacy of banking to serve the financial needs of government and industry, as well as the understanding of the monetary and fiscal policies and problems of the nation necessary to adequate consideration of this matter.*<sup>81</sup>

The enactment of the Bank Merger Act of 1960, coupled with the *Philadelphia Bank* decision, has created an anomalous situation in public regulation of bank mergers. The vesting of concurrent jurisdiction over

<sup>81</sup> Opinion by James J. Saxon, Comptroller of the Currency, denying application to merge, The First National City Bank of New York and The National Bank of Westchester, White Plains, New York at p. 14 (Dec. 19, 1961).

bank mergers in a vigorous enforcement agency—the Department of Justice—on the one hand, and a permissive administrative agency—the Comptroller of the Currency—on the other, only invites the clash of two regimes. Manifestly, this imbroglio came to pass because Congress in 1960 took it for granted that by nothing under the sun short of a tour de force could the Clayton Act be made applicable to banks.<sup>82</sup> The result is a thicket of legislative intendment. The situation is further snarled by the Comptroller's conclusion in the recent Crocker-Anglo National Bank merger approval that *Philadelphia Bank* requires him to apply Clayton Act tests to merger applications under the effect-on-competition provision in the Bank Merger Act of 1960.<sup>83</sup> The Court in *Philadelphia Bank*, however, construed one statute and one statute only in the process of finding illegality—section 7 of the Clayton Act. Part of the reasoning, of course, is that the Bank Merger Act of 1960 did not repeal by implication Clayton Act section 7 in directing the Comptroller to consider the competitive factor “in passing”—as one of six strands comprising “the public interest.” Nowhere did the Court intimate that the Comptroller was to apply section 7 tests under the Bank Merger Act. Nowhere did the Court intimate that, if the Comptroller applied such tests, banking would be thereby relieved of the operation of Clayton Act section 7.<sup>84</sup> Nevertheless, the Comptroller has undertaken a private reading of *Philadelphia Bank*. Accentuating the problem is the fact that when the Comptroller clashes with Justice today, the dispute is delineated by the same standard, Clayton Act section 7. This was not the case prior to the Comptroller's decision in *Crocker-Anglo*. It would seem then that, from the point of view of effective government, the Comptroller's view of *Philadelphia Bank* can only be an apple of discord.

The Comptroller of the Currency traditionally has taken a permissive attitude toward bank mergers. At trial in *Philadelphia Bank* a former acting Comptroller testified that between 1950 and 1959 his office received approximately 840 merger applications and denied “only a few” because of their adverse effect upon competition.<sup>85</sup> In recent years the number of mergers approved by the Comptroller has burgeoned. The Comptroller in 1961 approved seventy-two mergers. In 1962, with the incumbent Comptroller, James J. Saxon, firmly at the helm in the Treasury Building, the figure soared to 110 approvals out of 118 applications. As of June 28, 1963, Mr. Saxon had approved 35 applications and disapproved one, with 27 pending.<sup>86</sup> He

<sup>82</sup> See note 53 *supra*.

<sup>83</sup> See Decision of the Comptroller on the Application to Merge Crocker-Anglo National Bank, San Francisco, California with Citizens National Bank, Los Angeles, California. Sept. 30, 1963.

<sup>84</sup> Indeed, in *California v. FPC*, 369 U.S. 482 (1962), the Court clearly indicated otherwise.

<sup>85</sup> Testimony of Lewellyn A. Jennings. Transcript, 3405-07.

<sup>86</sup> These data have been culled from official reports of the Comptroller of the Currency. For further statistics see Appendix.

consistently has refused to deny a merger application solely on the basis of the competitive factor even in cases where concentration approaches Sherman Act dimensions.<sup>87</sup> The Comptroller's permissive merger policy can be viewed only as part of a general scheme of bank regulation. Mr. Saxon, for example, has evoked considerable criticism from state bankers for his liberal propensity to grant national bank charters, as well as his advocacy of special legislation enabling national banks to branch state-wide regardless of local law.<sup>88</sup> This trifurcated policy of permissiveness can admit of but one underlying meaning. The Comptroller wants to spur the entry of an increasing number of banks chartered under the federal roof. Once the banks are in, he wants them to be institutions of great strength, the only check on their power being his own regulatory authority. This he proposes to effect by allowing easy entry, ease of expansion by de novo branching, and ease of growth by merger or acquisition. This stand is buttressed by the jurisdictional language of the Bank Merger Act. The consent to merge is within the jurisdiction of the Comptroller *if and only if the resulting bank is a national bank*.

The Comptroller can justify his attempt to expand his regulatory power by an appealing economic and administrative argument. Banking, as noted earlier, is a heavily regulated industry. This provides the basis for a salient economic distinction. One of the Comptroller's chief economists has contended:

"The antitrust laws are an integral part of a public policy which places essential reliance upon private decision making. . . . In the regulated industry of banking the reverse is true. Public intercession in the decision making process takes place at each stage of bank formation and expansion through branching or merger. Private entrepreneurs are not permitted to enter the banking industry without the consent of the public authorities. Where they are allowed to enter, they may branch or merge only with the approval of the public authorities."<sup>89</sup>

The thesis is thus developed. The market structure itself is under the exclusive aegis of the regulator and is not determined by decisions of individual entrepreneurs. Therefore, it is misleading and erroneous to speak of competition in an antitrust sense within the context of the regulated banking industry. The degree of competition, indeed the very market structure, is a creature of state planning and, as such, should not be cognizable under Clayton Act tests.

<sup>87</sup> See, e.g., Denial of Application To Merge The First National City Bank of New York and The National Bank of Westchester, White Plains 14-24 (Dec. 19, 1961).

<sup>88</sup> See N.Y. Times, Oct. 3, 1963, p. 47, col. 5, where Norris E. Hartwell, President of the National Association of Supervisors of State Banks, criticizes the Comptroller's policies and charges that the Comptroller does the bidding of the banks he regulates.

<sup>89</sup> Abramson, *Private Competition and Public Regulation*, National Banking Rev. Sept. 1963, pp. 101-02. Mr. Abramson is the Director, Department of Banking and Economic Research, Comptroller of the Currency.

The Supreme Court, however, has spoken in *Philadelphia Bank*. As the Comptroller understands the decision, his duty is to apply Clayton Act tests under the Bank Merger Act. This, however, will not change basic merger policy, for the Comptroller is not the Department of Justice. Justice's duty is to bring all the lawsuits its facilities will allow, to test the "outer limits" of the antitrust laws, and to press for their applicability to any and all new industries and situations where the courts might decide that competition is endangered unlawfully. Of course, the Comptroller will not read *Philadelphia Bank* as divesting him of jurisdiction over the competitive consequences of a given merger, but instead will continue to fulfill his statutory duty to pass upon merger applications.

Justice would take a diametrically opposite view. The Comptroller, it is argued, is not really the exclusive regulator of entry into the industry. To begin with, for the nonce at least, entry is regulated by state authority as well. Besides, regulation does not fully displace individual initiative. The Comptroller indeed holds veto power, and while it is conceded that he may block entry, no policy of permissiveness, however promulgated, will spur individual entrepreneurs to enter a market in which merger has created undue concentration. The Comptroller has conceded his own impotence with respect to stimulation of market entry. Testifying before the House Committee on Banking and Currency hearings on the conflict of federal and state banking laws, he said:

"There is one broad area, however, in which the initiative has had to rest primarily with the banks themselves. This area concerns the competitive conditions which will prevail in the banking industry. We have the authority to pass upon applications for new national charters, for the establishment of new branches by national banks, and for the merger of existing institutions. But we do not have, nor do we seek, the authority to initiate such applications."<sup>90</sup>

Entry, the Comptroller has correctly stated, is not a creature of regulatory authority, as his economists claim; it is entirely dependent upon the existence of a market amenable to further competition. Whether there is to be entry rests upon private decision. If there is to be any opportunity for entry, competition in an antitrust sense must be preserved. The Comptroller may apply Clayton Act tests under the Bank Merger Act. Surely there is nothing in *RCA* or *California* which suggests he may not so do. But in *California* the Court clearly stated that the ultimate administration of the antitrust laws is exclusively vested in the courts: "Our function is to see that the policy entrusted to the courts is not frustrated by an administrative agency."<sup>91</sup> If the Comptroller continues an attitude of permissive-

<sup>90</sup> Statement of James J. Saxon, Comptroller of the Currency, to *Hearings Before the House Committee on Banking and Currency*, 88th Cong., 1st Sess. 275 (1963).

<sup>91</sup> *California v. FPC*, 369 U.S. 482, 490 (1962).

ness, notwithstanding his application of Clayton Act tests, complaints will issue from the Antitrust Division.<sup>92</sup>

While the clash between Justice and the Comptroller has yet to produce a victor, it has conceived two minor skirmishes, neither of which appears to have affected the existing stalemate. On August 9, 1963, the Comptroller approved the merger of the 48.3 million dollar Calumet National Bank of Hammond, Indiana, and the 42.9 million dollar Mercantile National Bank, also of Hammond.<sup>93</sup> Calumet was the largest bank in Hammond, with 43 percent of the deposits and 37 percent of the loans; Mercantile, the second largest, with 37 percent of the deposits and 44 percent of the loans. The merged bank would have over 80 percent of Hammond's commercial banking business. In analyzing the competitive factor under section 7, the Comptroller produced an interesting piece of legal legerdemain. *Philadelphia Bank*, he reasoned, determined that section 7 applies to bank mergers. *Philadelphia Bank* relied upon *Brown Shoe*. Quoting *Brown Shoe*, the Comptroller stated:

"[T]hat 'Congress recognized the stimulation to competition that might flow from particular mergers' and . . . 'Congress foresaw that the merger of two large companies or a large and a small company might violate the Clayton Act while the merger of two small companies might not . . . if the purpose of the small companies is to enable them in combination to compete with larger corporations dominating the market.' The instant merger is just such a case."<sup>94</sup>

The Comptroller seems to have forgotten that the Court in *Philadelphia Bank* narrowly interpreted this *Brown Shoe* doctrine.<sup>95</sup> Justice, however, had a better memory. On October 10, 1963, the Attorney-General filed a complaint in the Northern District of Indiana alleging that the merger violated not only section 7, but also Sherman Act section 1.<sup>96</sup> Shortly thereafter the banks abandoned their plan to merge.<sup>97</sup>

Justice, however, has not always triumphed. On May 13, 1963, Crocker-Anglo National Bank of San Francisco, fifth largest in California, with 2.3 billion dollars in assets, and Citizens National Bank, Los Angeles, sixth largest with 775 million dollars, sought the Comptroller's consent to merge. California is a unique banking state. State-wide branch banking is permitted and practiced. Concentration since the mid-1930's has been unusually high, with the largest bank holding 39.5 percent of the deposits in the state, the three largest, 63.5 percent, and the five largest, 78.6 percent. Crocker-

<sup>92</sup> The representations herein of the views of the Comptroller and the Department of Justice are based on a series of interviews the author had with officials in both departments, Nov. 5-7, 1963.

<sup>93</sup> See Decision of the Comptroller, Aug. 9, 1963.

<sup>94</sup> *Id.* at 5.

<sup>95</sup> See discussion of countervailing power in Part III *supra*.

<sup>96</sup> See 5 TRADE REG. REP. (1963 Trade Cas.) ¶ 45063 (N.D. Ind. Oct. 10, 1963).

<sup>97</sup> See N.Y. Times, Oct. 23, 1963, p. 65, col. 3.

Anglo controlled 7.2 percent of the deposits; Citizens National, 2.5 percent. The merged complex would be fourth in the state; it would control 9.7 percent of the banking resources in California. The case presented an interesting question under the Clayton Act, since the two banks, although both within California, did not have offices or branches in the same counties. Citizens National had 78 banking offices in five southern California counties. Crocker-Anglo had 124 banking offices in 29 counties sweeping from northernmost Siskiyou County to southern Santa Barbara County, over four hundred miles away. Three Citizens National counties—Ventura, Los Angeles, and San Bernadino—are contiguous to three Crocker-Anglo counties—Santa Barbara, San Luis Obispo, and Kern—with the nearest offices of the merging banks less than 50 miles apart. At the hearing before the Comptroller it was adduced that the banks had 140 common depositors.

In passing on the merger, the Comptroller was quick to distinguish the *Crocker-Anglo* case from the competitive situation in *Philadelphia Bank*. In *Philadelphia Bank*, competition between the merging institutions was real and direct; in *Crocker-Anglo*, competition was inchoate and potential only. Philadelphia and Girard were respectively second and third in the relevant market; Crocker-Anglo and Citizens were fifth and sixth. Philadelphia and Girard were situated in close proximity and operated their branches in a contiguous four-county area; Crocker-Anglo and Citizens maintained their principal offices in different cities over 400 miles apart. The merger, the Comptroller concluded, would not foreclose banking alternatives to the small borrower or depositor. Its consummation would be in the public interest. The application was approved September 30, 1963.<sup>98</sup>

On October 8, 1963, the Department of Justice sought to enjoin the merger.<sup>99</sup> Justice proceeded upon three theories: first, the merged complex would amass vastly increased resources, thereby redounding to the detriment of the banks' smaller competitors; second, actual and potential competition between Crocker-Anglo and Citizens would be eliminated in that, but for the merger, Crocker-Anglo would branch southward and compete with Citizens National for the rich deposit preserves of the populous San Joaquin Valley; third, competition in California commercial banking would be substantially lessened. On November 1, 1963, a three-judge district court, in a per curiam opinion, denied the Government's motion for a preliminary injunction during pendency.<sup>100</sup> The court, like the Comptroller, distinguished the market situation from that of *Philadelphia Bank*. The court reasoned that the actual competition involving each bank is with other banks and not *inter se*, as was the case in *Philadelphia Bank*. The Government's "foreclosure of potential competition" theory, it was determined, is not tenable in that local conditions suggested no reasonable probability that, but for the merger, Crocker-Anglo would branch south of the

<sup>98</sup> See note 83 *supra*.

<sup>99</sup> See 5 TRADE REG. REP. (1963 Trade Cas.) ¶ 45063 (N.D. Cal. Oct. 8, 1963).

<sup>100</sup> See 5 TRADE REG. REP. (1963 Trade Cas.) ¶ 70934 (N.D. Cal. Nov. 1, 1963).



Tehachapi Mountains to compete with Citizens National.<sup>101</sup> Upon the denial of the preliminary injunction the banks consummated the merger.<sup>102</sup> The Government has announced it will go to trial on the merits, perhaps with the additional burden of asking the court to design a remedy which will unscramble the omelet and at the same time restore the competitive situation as it existed prior to consummation.

At trial the government will face the problem of producing a specific theory to support its broad allegations. It appears possible, for example, to argue that the merger will result in a substantial potential "vertical foreclosure" of other banks in the relevant market. National banks, as previously pointed out, are limited in the amount they can lend any one obligor to a sum equal to 10 percent of unimpaired capital and surplus.<sup>103</sup> When a borrower seeks funds in excess of the lending limit, and sometimes even where this is not the case, the originating bank arranges a lending participation with correspondent banks—sometimes as many as 14 or 15—who assume the risk *pro tanto* and extend the loan. As of February 28, 1963, Citizens National, the smaller bank, had unimpaired capital and surplus of 46.5 million dollars. This means that the bank's lending limit was approximately 4.6 million dollars. The Government may be able to marshal facts disclosing that Citizens National typically entered into a substantial number of correspondent relationships with other California banks competing directly with Crocker-Anglo for such participations. The merger, it might be demonstrated, would foreclose these banks because, by virtue of the increased lending limit and enlarged sphere of geographical influence effected by the merger, the merged entity would no longer enter into such participations. In other words, by swallowing Citizens National, Crocker-Anglo potentially will cease to compete with other California banks for correspondent relationships. The same argument is equally applicable to competitors of Citizens National who, but for the merger, would be correspondents of Crocker-Anglo. In view of Crocker-Anglo's already high lending limit of 14.8 million dollars, however, such foreclosure may not be substantial. Whether there is evidence of a substantial number of such "vertical" participations so as to sustain the argument, is a question that can be resolved only at trial.<sup>104</sup> The problem for the merged bank is that the denial of the preliminary injunction hardly ends the uncertainty of doing business during pendency of trial on the merits.

\* \* \*

It seems that of all the controversial effects flowing from the *Philadelphia Bank* decision, the conflict between Justice and the Comptroller is the least

<sup>101</sup> *Id.* at 78723.

<sup>102</sup> See *Fortune*, Dec. 1963, p. 217.

<sup>103</sup> See note 46 *supra*.

<sup>104</sup> In approving the merger the Comptroller considered the probable anti-competitive effects on correspondent relationships of the merging banks, but he dismissed such effects as insubstantial. Decision of the Comptroller on the Application To Merge Crocker-Anglo National Bank, San Francisco, California with Citizens National Bank, Los Angeles, California, Sept. 30, 1963.

salutary. The applicability of section 7, while it may not be good law, seems to be sound policy. The birth of the thirty percent presumption of illegality and the neutralization of the "better able to compete" defense of countervailing power seem rules of convenience designed to reduce unnecessary protraction of a trial without impairing consideration of all relevant factors. The supervention of the antitrust laws upon administrative approval based upon a vague public interest standard has support in Supreme Court precedent. To rule otherwise is to invite a lack of harmonization in the accommodation of two sets of laws. The Court's decision, however, should certainly not be taken to mean that, if the Comptroller applies Clayton Act tests and approves the merger, the transaction deserves less scrupulous scrutiny from the judge.

*Philadelphia Bank*, even its opponents will concede, was a decision that addressed itself to the future. The Department of Justice may easily accept the decision as a mandate for more vigorous enforcement of section 7. Justice and the FTC may read the Court's opinion as an invitation to test new situations under the expanded jurisdiction of section 7.<sup>105</sup> *Philadelphia Bank* in conjunction with *Brown Shoe* may well invite antitrust scrutiny of correspondent relationships and loan participations where banks separated geographically like Crocker-Anglo and Citizens National seek to merge. However, the decision, because decided under Clayton Act section 7, should not preclude a test of bank mergers under Sherman Act section 1.<sup>106</sup> Finally, the decision should stimulate the legislator and the administrator to coordinate regulatory policy with the prosecution of the antitrust laws. For, as *Philadelphia Bank* and subsequent cases so clearly demonstrate, the statutory thicket regulating the banking industry has become so dense that the situation merits re-examination and reappraisal by the Congress.

James D. Zirin

#### APPENDIX

##### THE MERGER PICTURE, 1962-63

I. Summary of Comptroller's decisions on bank merger applications. Data is taken from 1963, 1964 COMPTROLLER OF THE CURRENCY ANN. REP.

##### A. Mergers: January 1, 1962-December 31, 1962

Approved by Comptroller .....	110
Denied by Comptroller .....	7
Withdrawn .....	1

##### B. Mergers: January 1, 1963-June 28, 1963

##### Applications

Applications pending as of January 1 .....	16
Applications received .....	48
Total .....	64

<sup>105</sup> See *Procter & Gamble Co.*, 3 TRADE REG. REP. (1963 Trade Cas.) ¶ 16673 (FTC Dec. 15, 1963).

<sup>106</sup> See, e.g., *United States v. First Nat'l Bank & Trust Co.*, *probable jurisdiction noted*, 374 U.S. 824 (1963).

## Disposition

Approved .....	35
Disapproved .....	1
Withdrawn .....	1
Pending .....	27
Total .....	64

II. The following are tabular representations of the comments of the Department of Justice, the Federal Reserve Board, and the Federal Deposit Insurance Corporation on bank absorption applications passed on by the Comptroller of the Currency in 1962. The terminology is that of the individual agencies. Data is taken from 1963 COMPTROLLER OF THE CURRENCY ANN. REP.

## A. Department of Justice

1. Favorable .....	0
2. No adverse effect .....	12
3. Not substantially adverse .....	37
4. Slightly adverse .....	3
5. Adverse effect .....	26
6. Significantly adverse .....	3
7. Substantially adverse .....	34
8. Substantially adverse and serious anti-competitive effect .....	7
9. Threat of litigation .....	1
Total .....	115 [sic]

## B. Federal Reserve Board

1. Will increase competition .....	4
2. May increase competition .....	6
(with caveat of trend toward concentration) .....	1
	7
3. No adverse effect on competition .....	30
(with caveat of trend toward concentration) .....	3
	33
4. No serious adverse effect on competition .....	2
(with caveat of trend toward concentration) .....	1
	3
5. Will have little adverse effect on competition .....	12
(with caveat of trend toward concentration) .....	9
	21
6. Probably no adverse effect on competition .....	2
7. Might have adverse effect on two parties involved .....	2
8. Might have adverse effect on competition .....	4
(with caveat of trend toward concentration) .....	2
	6
9. Will eliminate competition between two banks, exposing remaining banks to greater competition .....	8
(with caveat of trend toward concentration) .....	3
	11
10. Will eliminate some competition .....	6
(with caveat of trend toward concentration) .....	6
	12
11. Will eliminate substantial competition .....	4
(with caveat of trend toward concentration) .....	2
	6
12. Will have adverse effect on competition .....	2
13. Will eliminate present and potential competition .....	3
(with caveat of trend toward concentration) .....	2
	5
14. Will result in concentration .....	1
Total .....	115

## C. Federal Deposit Insurance Corporation

1. Enhancement of competition .....	1
2. Overall effect on competition would not be unfavorable .....	102
3. No effect on competition .....	2
4. No adverse effect on competition .....	1
5. Appears unfavorable .....	1
6. Effect would be unfavorable .....	8
Total .....	115

## TRANSFER OF OPERATING RIGHTS

Traditional public utilities have certain economic characteristics which engender the creation of monopoly franchises and the imposition of stringent economic regulation. Such enterprises have a "natural monopoly."<sup>1</sup> That is, the technology of the industry is such that unregulated competition will lead to the establishment of a single enterprise in a given market. These industries are characterized by huge capital investment, the allocated cost of which is large in proportion to the total costs of production. Plant and equipment are highly specialized as to function and use. Because of economies of scale, service may be provided at a decreasing unit cost for greater volume of output up to the total demand in the market. In competition, the firm with the lowest unit costs will lower rates to a point at which competitors will be forced to cease operations in order to minimize losses. Thus, competition is inevitably destructive in such cases. Entry of new firms is discouraged by the high cost of entry and the danger of loss of the specialized equipment and plant. In such industries the grant of a monopoly franchise by the government leads to orderly construction of facilities; ideally, government regulation of the monopoly firm also protects consumers.

Not all industries under regulation by government bodies fit this description, nor are all treated as monopolies. Neither air carriers under the jurisdiction of the Civil Aeronautics Board,<sup>2</sup> nor motor carriers of property under the jurisdiction of the Interstate Commerce Commission,<sup>3</sup> nor radio and television broadcasting stations under the jurisdiction of the Federal Communications Commission<sup>4</sup> conform to the monopoly model. Generally

<sup>1</sup> See generally BONBRIGHT, PUBLIC UTILITY RATES 10-13 (1961).

<sup>2</sup> There are some economies of scale in air transport, but they fall far short of the economies of scale in a traditional utility. See CAVES, AIR TRANSPORT AND ITS REGULATORS 55-83 (1962); FULDA, COMPETITION IN THE REGULATED INDUSTRIES: TRANSPORTATION 17-19 (1961); MEYER, PECK, STENASON & ZWICK, COMPETITION IN THE TRANSPORTATION INDUSTRIES 228 (1960).

<sup>3</sup> Motor trucking is generally thought to have no significant economies of scale. See FULDA, *op. cit. supra* note 2, at 9-11; MEYER, PECK, STENASON & ZWICK, *op. cit. supra* note 2, at 94-97; Pegrum, *The Economic Basis of Public Policy for Motor Transport*, 28 LAND ECON. 244 (1952). Because of considerations peculiar to the carriage of passengers, regulation of passenger carriers will not be considered in this comment.

<sup>4</sup> Classification of the broadcasting industry has been difficult. See BONBRIGHT, *op. cit. supra* note 1, at 3. But, assuming the existence of networks, there are no operating cost advantages to be derived from ownership of more than one station.

the business units in these industries face significant competition both from other members of the same industry in the same market and from members of other industries which provide substitutable services. Yet entry of new competitors is limited, to a greater or lesser degree, by the government agency which regulates the industry.<sup>5</sup>

The economic regulation of the CAB extends to all air carriers engaged in interstate air transportation. No enterprise can operate as a common carrier of passengers or property for hire across state lines without Board authorization.<sup>6</sup> The requirement of authorization is enforced by both civil and criminal sanctions.<sup>7</sup> Thus entry into the business of interstate air carriage—and geographical expansion of such an existing business—is limited by government control as well as by economic forces. Similarly, motor carriers, to engage in interstate operations, must have a valid authorization issued by the ICC,<sup>8</sup> and commercial radio and television stations can broadcast only with permission of the FCC.<sup>9</sup> Necessary licenses, permits, or certificates can be obtained through original grant or by transfer from the holder of an existing certificate. This comment will consider the policies of the FCC, the ICC, and CAB regarding the transfer of rights to operate within their respective jurisdictions.

# I. TRANSFER OF BROADCASTING STATION LICENSES

There is an active market in transfers of rights to operate broadcasting stations. The absolute number of transfers which come before the FCC for approval each year and the number of transfers as a percentage of all stations are high and have been so for a number of years.<sup>10</sup> Many of these transfers involve substantial consideration, often considerably in excess of the value of the physical properties transferred.<sup>11</sup> More than thirty brokers

<sup>5</sup> See generally FULDA, *op. cit. supra* note 2; Hale & Hale, *Competition or Control III: Motor Carriers*, 108 U. PA. L. REV. 775 (1960); Hale & Hale, *Competition or Control II: Radio and Television Broadcasting*, 107 U. PA. L. REV. 585 (1959).

<sup>6</sup> Federal Aviation Act of 1958, § 401(a), 72 Stat. 758, 49 U.S.C. § 1371(a) (1958). Under § 416 the Board has the power to classify and exempt air carriers. 72 Stat. 771, 49 U.S.C. § 1386 (1958).

<sup>7</sup> See Federal Aviation Act of 1958, §§ 902, 1007, 72 Stat. 784, 796, 49 U.S.C. §§ 1472, 1487 (1958).

<sup>8</sup> Motor Carrier Act § 203(c), 49 Stat. 544 (1935), as amended, 49 U.S.C. § 303(c) (1958).

<sup>9</sup> Communications Act of 1934, § 301, 48 Stat. 1081, 47 U.S.C. § 301 (1958).

<sup>10</sup> The number of applications for transfers of AM, FM, TV, and auxiliary stations has not been less than one thousand in any year since 1955. See 19-28 FCC ANN. REPS. (1953-1962). Those involving substantial consideration are probably few more than half of the total. See EMERY, *BROADCASTING AND GOVERNMENT* 467 (1961). The number of station transfers each year is about 20% of the total number of licenses outstanding. See 23 P & F RADIO REGS. 1503, 1516 (1962) (report and order of the FCC adding "trafficking" regulations).

<sup>11</sup> In 1962, a New York City AM station was sold for \$10.9 million, and a half-interest in a Pittsburgh television station for \$10.6 million. 28 FCC ANN. REP. 56 (1962). Average prices are somewhat less. See EMERY, *op. cit. supra* note 10, at 467; Broadcasting, Feb. 15, 1960, p. 80. However, television station facilities cost only from 250 thousand to one million dollars to construct. FCC Network Study Staff, *Network Broadcasting*, H.R. REP. No. 1297, 85th Cong., 2d Sess. 46 (1958) [hereinafter cited as *Network Broadcasting Report*].

are actively engaged in soliciting purchases and sales of such operating licenses.<sup>12</sup>

#### A. *Statutory Standards for License Transfers*

Section 310(b) of the Communications Act of 1934<sup>13</sup> forbids transfers of station licenses except upon a finding by the FCC that the "public interest, convenience, and necessity" will be served thereby. A 1952 amendment to the section forecloses consideration by the Commission of whether the public interest would be better served by a transfer to a person other than the proposed transferee.<sup>14</sup> The purpose of the amendment was to eliminate the so-called AVCO rule, which provided for a comparative hearing before the FCC involving all qualified applicants prepared to meet the proposed transferor's terms of contract.<sup>15</sup> Repeal of this amendment has been urged by the FCC, although apparently not with the intention of reviving the AVCO rule.<sup>16</sup> Legislative proposals to repeal this amendment to 310(b) have not been successful.<sup>17</sup>

#### B. *FCC Policy Regarding License Transfers*

The FCC has long been wrestling with the problem of evolving standards to govern the transfer of certificates. Foreclosed by the statute from requiring a comparative hearing on transfer applications, the Commission rarely has formal hearings of any type on transfers.<sup>18</sup> Assuming that the prospective transferee meets minimum citizenship, character, financial, and technical qualifications, a proposed transfer is generally approved without serious objection.<sup>19</sup> The sale price is not important in determining the

<sup>12</sup> Broadcasting, Feb. 15, 1960, p. 80.

<sup>13</sup> 48 Stat. 1086 (1934), as amended, 47 U.S.C. § 310(b) (1958).

<sup>14</sup> 66 Stat. 716 (1952).

<sup>15</sup> S. REP. NO. 44, 82d Cong., 1st Sess. 8-9 (1951). The FCC had already repealed the AVCO rule in 1949. 14 Fed. Reg. 3235 (1949). The AVCO rule got its name from Powel Crosley, Jr., 11 F.C.C. 3 (1945), which involved The Aviation Corporation as transferee of the rights in question.

<sup>16</sup> Letter and Enclosed Statement from Chairman E. William Henry to Speaker John W. McCormack, June 27, 1963, in 1 P & F RADIO REGS. 10-71. Without wishing to reinstate the AVCO rule, the FCC wants more flexibility to deal with transfer problems.

<sup>17</sup> Neither H.R. 11340, 86th Cong., 2d Sess. (1960), nor H.R. 1165, 87th Cong., 1st Sess. (1961), was reported out of committee.

<sup>18</sup> Seven proposed transfers (five involving FM stations) reached hearing in fiscal 1962. 28 FCC ANN. REP. 20 (1962). None reached hearing in fiscal 1961. 27 FCC ANN. REP. 18 (1961). The latter is probably a more typical year. See *Hearings Before the Antitrust Subcommittee of the House Committee on the Judiciary*, 84th Cong., 2d Sess., ser. 22, pt. 2, vol. 1, at 3228-30 (1957) (Chairman McConaughy testifying that hearings on transfers and sales are almost nonexistent).

<sup>19</sup> Section 310(b), governing transfers, states that the Commission shall dispose of the application as if the proposed transferee were making application under § 308 for an original license. Communications Act of 1934, § 310(b), 48 Stat. 1086, as amended, 47 U.S.C. § 310(b) (1958). Section 308(b) instructs the Commission to consider the citizenship, character, financial, and technical qualifications of the applicant. 48 Stat. 1086 (1934), as amended, 47 U.S.C. § 308(b) (1958); see § 319(a), 48 Stat. 1087 (1934), as amended, 47 U.S.C. § 319(a) (1958).

legality of the transfer, regardless of its relationship to the value of the physical property involved.<sup>20</sup> All the energies of the Commission have been directed at the problem of so-called "trafficking" in licenses—basically, the practice of procuring licenses for the purpose of sale at a profit.<sup>21</sup> The efforts devoted to this problem have diverted attention from more important issues raised by FCC policy.

### C. *Competition in the Broadcasting Industry*

There is available only a limited number of television stations of commercial importance. From 1948 to 1952, the FCC "froze" television authorizations in order to devise a master plan for the allocation of television broadcasting frequencies.<sup>22</sup> By the time the freeze was lifted, the FCC had set aside for commercial television purposes far more channels on the UHF portion of the band than on the VHF portion.<sup>23</sup> However, by 1952 VHF had achieved great competitive advantages. No UHF station had been commercially broadcasting, and the viewing public had in its hands more than seventeen million television sets incapable of receiving UHF signals.<sup>24</sup> In addition, UHF has a slightly shorter range of transmission than VHF, although the picture received is equally good.<sup>25</sup> Advertisers, of course, prefer to patronize stations which reach wider audiences, and thus the commercial significance of UHF stations has been stunted. Although much lamented, the situation is unlikely to be improved markedly in the near future.<sup>26</sup>

<sup>20</sup> See, e.g., *Wrather-Alvarez, Inc.*, 10 P & F RADIO REGS. 539 (1953); Edward J. Noble, 11 F.C.C. 569 (1946).

<sup>21</sup> In addition to concern long expressed by the FCC, criticism of trafficking has come from congressional sources as well as others. H.R. REP. NO. 1258, 86th Cong., 2d Sess. 39-40 (1960); H.R. REP. NO. 2711, 85th Cong., 2d Sess. 39 (1959); *Hearings on the Investigation of Regulatory Commissions and Agencies Before a Subcommittee of the House Committee on Interstate and Foreign Commerce*, 85th Cong., 2d Sess., pt. 8, at 2908-90 (1958); Note, 30 IND. L.J. 351 (1955). These sentiments led to promulgation in 1962 by the FCC of special rules aimed at curbing transfers of certificates that have been procured for the purpose of sale. With certain exceptions, a formal hearing is required in every case with respect to application for consent to the transfer of the license of a station which has been operated by the proposed transferor for less than three years. 47 C.F.R. § 1.365 (Cum. Supp. 1963). The principal exceptions are for death, disability, unavailability of capital, or other changed circumstances. 47 C.F.R. § 1.365(a)(3) (Cum. Supp. 1963). Presumably the purpose of the hearing will be determination of the motive of the transferor in acquiring the license, and, if the motive is sale or resale, the application for transfer will be denied.

<sup>22</sup> 13 Fed. Reg. 5860 (1948) (the "freeze" order); 17 Fed. Reg. 3905 (1952) (lifting the "freeze"). See generally Note, 75 HARV. L. REV. 1578 (1962).

<sup>23</sup> Seventy of the eighty-two channels set aside for commercial television are on the UHF (ultra-high frequency) portion of the band, leaving twelve VHF (very-high frequency) channels. STAFF OF THE SENATE COMM. ON INTERSTATE AND FOREIGN COMMERCE, 84TH CONG., 1ST SESS., MEMORANDUM ON TELEVISION NETWORK REGULATION AND THE UHF PROBLEM 5 (Comm. Print 1955).

<sup>24</sup> *Id.* at 3.

<sup>25</sup> STAFF OF THE SENATE COMM. ON INTERSTATE AND FOREIGN COMMERCE, 84TH CONG., 1ST SESS., PROGRESS REPORT ON INVESTIGATION OF TELEVISION NETWORKS AND THE UHF-VHF PROBLEM 6 (Comm. Print 1955). UHF stations face other technical and economic problems. *Id.* at 6-8.

<sup>26</sup> In 1962 the Communications Act was amended to provide the FCC with authority

VHF stations still dominate the commercial market, and, since most of these stations have already been allocated, means of entry of new broadcasters are limited as a practical matter to transfers by purchase from existing licensees. Therefore, hope for the improvement of television broadcasting must to a great extent rest on competitive forces.<sup>27</sup> Motion pictures, newspapers, magazines, radio, and other media of mass entertainment and information offer competition. Still, competition between television broadcasters is important, and the entry of new individuals with new capital and fresh ideas into television broadcasting is critical to intramedium competition.

There exists a similar scarcity of commercial radio broadcasting frequencies. There has never been a master plan for the allocation of radio frequencies. The FCC has promulgated a comprehensive set of general rules which limit the location, power, and times of transmission on radio frequencies throughout the country. Any person who is able to discover a frequency and place to transmit may apply for a license to do so.<sup>28</sup> Nevertheless, on AM frequencies—those of greatest commercial importance—the desirable markets are already well covered by station licenses. Thus, transfer from an existing licensee is the most convenient method of new entry.

#### *D. Significance of the Qualifications and Status of the Transferee*

Ordinarily, in the original grant of a station license the FCC has an opportunity to choose among several applicants who compete in a comparative hearing. The FCC disqualifies at the outset any candidate who fails to meet minimum character, citizenship, financial, and technical standards,<sup>29</sup> and has stated that any applicant who appears in a comparative hearing would be awarded the license if he were the sole applicant.<sup>30</sup> In the comparative hearing itself, the applicants are compared with respect to such additional factors as local ownership,<sup>31</sup> integration of management

to require that television receivers shipped in interstate commerce be equipped to receive all allocated television broadcasting frequencies. Apparatus may not be shipped in interstate commerce for sale or resale to the public unless it complies with FCC rules. Pub. L. No. 87-529, 76 Stat. 150 (1962). At about the time of this legislation, only 103 UHF stations were in actual operation, although the FCC has allocated space for 1,544 UHF stations. On the other hand, 500 VHF stations were in operation, although space for only 681 VHF stations has been allocated. S. REP. NO. 1526, 87th Cong., 2d Sess. 2 (1962). Obviously this legislation is aimed at fostering the development of UHF television, but it will be some years before the impact is fully felt.

<sup>27</sup> Station licenses are not granted in perpetuity, but must be renewed every three years by the FCC. Communications Act of 1934, § 307(d), 48 Stat. 1083, as amended, 47 U.S.C. § 307(d) (1958). This provision makes broadcasters sensitive to current FCC policies, and probably exerts some influence on programming.

<sup>28</sup> An applicant for a license must show, among other things, that objectionable interference will not be caused to existing stations or that the need for the new service outweighs the need for the service lost by the interference. 47 C.F.R. § 3.24(b) (Cum. Supp. 1963).

<sup>29</sup> See Comment, 66 YALE L.J. 365, 373 (1957).

<sup>30</sup> E.g., Radio Wisconsin, Inc., 10 P & F RADIO REGS. 1224 (1955).

<sup>31</sup> See, e.g., WBUD, Inc., 32 F.C.C. 915 (1962).



with ownership,<sup>32</sup> diversification of control,<sup>33</sup> and broadcasting experience.<sup>34</sup> As noted above, the FCC does not conduct comparative hearings on proposed transfers, and characteristics of the proposed transferee that would weigh heavily against him in the context of a comparative hearing do not disqualify him as a transferee. Thus, whatever objectives are served by selection of licensees on the basis of comparative factors are frustrated through the transfer process.<sup>35</sup>

Transfer has been an instrument by which multiple owners, networks, and owners of competing media have acquired station licenses.<sup>36</sup> Multiple ownership has certainly not barred the acquisition of operating rights by purchase, although in a comparative hearing a multiple owner must typically overcome issues of local ownership and diversification by countering with broadcast experience. Multiple ownership enhances bargaining strength. Generally a multiple owner is in a better position than a single owner to procure network affiliation and syndication contracts.<sup>37</sup> Affiliation with a particular network is generally limited to one per service area;<sup>38</sup> thus, single owners may be left to choose from less desirable affiliations. However, as far as the public is concerned, it seems to make little difference whether the station carrying the programs of a particular network is owned by a multiple owner or by a single owner. The FCC has proceeded directly by rule-making to limit multiple ownership,<sup>39</sup> and to prevent elimination of competition in any individual market area.<sup>40</sup> Further limitations on

<sup>32</sup> See, e.g., *Radio Associates, Inc.*, 32 F.C.C. 166 (1962).

<sup>33</sup> See, e.g., *Radio Wisconsin, Inc.*, 10 P & F RADIO REGS. 1224 (1955).

<sup>34</sup> See, e.g., *Community Telecasting Corp.*, 32 F.C.C. 923 (1962).

<sup>35</sup> Comparative licensing has been cited as an example of a regulatory activity with no economic significance. Address by Professor Roger C. Cramton, American Economic Association Annual Meeting, December 28, 1963, to be printed in 76 AMERICAN ECONOMIC ASSOCIATION, PAPERS AND PROCEEDINGS (1964).

<sup>36</sup> Levin, *Regulatory Efficiency, Reform and the FCC*, 50 GEO. L.J. 1, 11 n.35 (1961). Multiple ownership is one of the problems in the general category of diversification of control. The main danger of multiple ownership is the possibility of misuse of economic power, mainly over advertisers. Ownership by persons controlling competing media, such as newspapers, presents broader questions of the diversification of communications media as a whole. Economic misuse is again a danger, but probably more important is the fear that such ownership leads to control of thought and opinion. Consideration of these questions is beyond the scope of this comment. See generally LEVIN, *BROADCAST REGULATION AND JOINT OWNERSHIP OF MEDIA* (1960); Comment, *Diversification and the Public Interest: Administrative Responsibility and the FCC*, 66 YALE L.J. 365 (1957).

<sup>37</sup> *Network Broadcasting Report* 241-43, 564-68; STAFF OF THE SENATE COMM. ON INTER-STATE AND FOREIGN COMMERCE, 84TH CONG., 1ST SESS., MEMORANDUM ON TELEVISION NETWORK REGULATION AND THE UHF PROBLEM 39 (Comm. Print 1955).

<sup>38</sup> See *Network Broadcasting Report* 263-78. See also 47 C.F.R. § 3.132 (1958). However, there is necessarily some overlap. *Network Broadcasting Report* 216-20.

<sup>39</sup> A licensee may not own or control more than seven AM stations, 47 C.F.R. § 3.35(b) (1958), more than seven FM stations, 47 C.F.R. § 3.240(b) (1958), or more than seven television stations, only five of which may be on the VHF portion of the band. 47 C.F.R. § 3.636(a)(2) (1958). See *United States v. Storer Broadcasting Co.*, 351 U.S. 192 (1956).

<sup>40</sup> The so-called "duopoly" rule provides that no licensee may own or control more than one television station in "substantially" the "same area." 47 C.F.R. § 3.636(a)(1) (1958). There are similar restrictions on ownership or control of AM stations, 47 C.F.R. § 3.35(a) (1958), and FM stations, 47 C.F.R. § 3.240(a) (1958).

ownership, if necessary, can be imposed directly by rule and need not be imposed indirectly through a policy of refusing to approve transfers to multiple owners.<sup>41</sup> Networks, as well as non-network multiple owners, have often developed their systems of owned stations by means of transfer. The pros and cons of network ownership have been heatedly debated without any clear consensus emerging.<sup>42</sup> At any rate, it is doubtful that network owners supply programming of lower quality than non-network owners.<sup>43</sup> Multiple ownership presents problems of diversification of broadcasting media. Other issues are raised by ownership of competing media involving diversification of the media of dissemination as a whole. Owners of competing media have procured station licenses by means of transfer. However, the position of the FCC is not even definitive as to original grants to owners of competing media.<sup>44</sup> Criticism of such ownership does not include any complaint that it results in inferior programming.

#### E. *Significance of the Price Paid for Transfer of the License*

The public does not pay directly for the broadcasting service it receives,<sup>45</sup> and the FCC has no rate powers over broadcasting services. The basic control over the industry is the licensing function. Failure of the Commission to control prices of transfers has been criticized,<sup>46</sup> perhaps because there is an element of windfall in each transfer of a station license for substantial consideration. This is truer perhaps of television than of radio. The right to operate a VHF television station in a large metropolitan area is itself an extremely valuable asset. On the other hand, more individual broadcasting skill is generally required to develop the exchange value of a radio station. An important reason is that radio licenses are not as scarce as VHF licenses. There is also a difference in the nature of radio and television broadcasting. VHF television stations usually operate with

<sup>41</sup> But see *Network Broadcasting Report* 584-90; Levin, *supra* note 36.

<sup>42</sup> The arguments are summarized in *Network Broadcasting Report* 577-82; STAFF OF THE SENATE COMM. ON INTERSTATE AND FOREIGN COMMERCE, 85TH CONG., 1ST SESS., *THE TELEVISION INQUIRY* 89-92 (Comm. Print 1957). There are polar extremes of opinion on network practices generally. Compare STAFF OF THE SENATE COMM. ON INTERSTATE AND FOREIGN COMMERCE, 84TH CONG., 2D SESS., *THE NETWORK MONOPOLY* (Comm. Print 1956) (prepared by Senator Bricker), with COLUMBIA BROADCASTING SYSTEM, *AN ANALYSIS OF "THE NETWORK MONOPOLY"* (1956). A very large share of total network income is derived from network-owned stations. See 27 FCC ANN. REP. 66 (1961).

<sup>43</sup> See COLUMBIA BROADCASTING SYSTEM, *op. cit. supra* note 42, App. xxxiv-lxvi (1956) (relating the record for local service of four CBS-owned stations).

<sup>44</sup> See LEVIN, *op. cit. supra* note 36; *Network Broadcasting Report* 106-24; Comment, 66 YALE L.J. 365 (1957). If the FCC could formulate intelligent standards for comparative hearings regarding diversification, these same standards could be applied by rule to transfers in order to close the "loophole."

<sup>45</sup> Broadcasting revenues, of course, come mainly from the sale of advertising time. On the arrangements for these sales between networks and affiliated stations, see generally *Network Broadcasting Report*.

<sup>46</sup> Note, 30 IND. L.J. 351 (1955). See *Hearings on the Investigation of Regulatory Commissions & Agencies Before a Subcommittee of the House Committee on Interstate & Foreign Commerce*, 85th Cong., 2d Sess., pt. 8, at 2908-15 (1958).

a network affiliation which has built-in "viewability."<sup>47</sup> Most radio stations are not affiliated with a network;<sup>48</sup> instead, programming is often geared to the development of a limited audience, *e.g.*, teen-agers. A radio station often must seek to develop its own personality with its own shows. Thus, the transfer of radio stations at high prices results less in a windfall than does a similar transfer of a television station; radio station transfers have therefore attracted less attention.<sup>49</sup>

High prices are the inevitable consequence of a limited supply when the market price is free to climb, and high prices stimulate "trafficking" in station licenses.<sup>50</sup> However, the new Commission rules,<sup>51</sup> if properly applied, should put an end to at least the most flagrant cases. High prices are likewise said to install as operators licensees bent on recovering investment through poorer service to the public.<sup>52</sup> This is an unlikely consequence. It is a fair assumption that broadcasters are businessmen, and a businessman maximizing his income over time must provide the service which will have that effect.<sup>53</sup> The limit on poor or obnoxious service is service of a quality which will cause the FCC to revoke or fail to renew the license.<sup>54</sup> Most licensees operate well within that limit and provide service which attracts an audience and hence advertisers. The behavior of a licensee in this respect is the same regardless of the price he paid to acquire the station, because profit maximization is *prima facie* the goal of every licensee. The same argument applies to any contention that wealthier broadcasters can afford to, and do, provide better service.

A prospective license transferee calculates the price he is willing to pay by capitalizing expected future income. A free market in licenses attracts the most economically efficient individuals to broadcasting. It is impossible to say that, as a class, such persons provide less satisfactory service to the public. The difficulties of the FCC in applying "comparative" factors testifies to the impossibility of formulating objective standards to judge future broadcasting performance. Probably the soundest means of assuring per-

<sup>47</sup> STAFF OF THE SENATE COMM. ON INTERSTATE AND FOREIGN COMMERCE, 84TH CONG., 1ST SESS., INVESTIGATION OF TELEVISION NETWORKS AND THE UHF-VHF PROBLEM 20-21 (Comm. Print 1955).

<sup>48</sup> In 1946, 80.8% of the AM stations in operation were affiliated with a network. Since 1946 there has been a trend to non-affiliation, and, by 1956, only 42.7% of the AM stations were affiliated. *Network Broadcasting Report* 600-07.

<sup>49</sup> It has been suggested that new licenses be auctioned off, and an annual royalty charge for operations be collected to recapture the franchise value of broadcasting stations. Levin, *Regulatory Efficiency, Reform and the FCC*, 50 GEO. L.J. 1 (1961). See Coase, *The Federal Communications Commission*, 2 J. LAW & ECON. 1 (1959).

<sup>50</sup> Note, 30 IND. L.J. 351, 357 (1955).

<sup>51</sup> See note 21 *supra*.

<sup>52</sup> SIEPMAN, *RADIO'S SECOND CHANCE* 165 (1946).

<sup>53</sup> Persons who operate stations on commercial channels will generally be forced to sell the license or provide income-producing programming. The scarcity value of the license will cause the opportunity cost to rise until non-commercial operations are no longer feasible.

<sup>54</sup> See E. G. Robinson, Jr., 33 F.C.C. 250 (1962), 47 MINN. L. REV. 465 (1963).

formance is a free market in licenses. And free entry is at least consistent with the long-standing FCC policy of encouraging entry and increasing competition.<sup>55</sup>

## II. TRANSFER OF MOTOR CARRIER OPERATING RIGHTS

Like broadcasting station licenses, motor carrier certificates and permits are transferred in an active market.<sup>56</sup> Transfer of property and operating rights to an existing carrier requires authorization by the ICC under section 5(2) of the Interstate Commerce Act<sup>57</sup> if the aggregate number of vehicles involved exceeds twenty.<sup>58</sup> Transfers to non-carriers, or transfers involving twenty vehicles or less, are excluded from section 5,<sup>59</sup> but transfers so excluded must, under section 212(b) of the Motor Carrier Act,<sup>60</sup> conform to rules and regulations prescribed by the Commission.<sup>61</sup>

### A. Section 212(b) Transfer Rules

Regulations promulgated pursuant to section 212(b) apply only to transactions exempted from section 5.<sup>62</sup> The rules state that a transfer will generally be approved upon a showing that the proposed transferee is fit, willing, and able to perform the service and to conform to the act and Commission rules and regulations.<sup>63</sup> The transfer rules, however, contain a number of general bases of disapproval. These include undue division of rights by the transferor;<sup>64</sup> creation of "duplicating rights" which authorize transportation of passengers, or of the same commodities, between the same points;<sup>65</sup> and transfer of "dormant rights," where the transferor has ceased operations for a substantial period of time under circumstances over which he had control.<sup>66</sup> In addition, the rules provide that a proposed transfer will be disapproved upon a finding that the transferee does not intend to engage in bona fide operations, or upon a finding that the transferor procured the rights for the purpose of profiting therefrom without engaging in bona fide operations.<sup>67</sup> The Interstate Commerce Commission has es-

<sup>55</sup> See *Network Broadcasting Report* 64-105.

<sup>56</sup> The number of applications for approval of transfer, lease, or acquisition exceeds, on the average, one thousand per year. See ICC, *INTERSTATE COMMERCE COMMISSION ACTIVITIES 1937-1962*, at 199 nn.1-3 (1962). Applications for transfer or lease under § 212(b) alone totaled 870 for fiscal 1962, and 989 for fiscal 1961. 76 ICC ANN. REP. 81 (1962).

<sup>57</sup> 54 Stat. 905 (1940), as amended, 49 U.S.C. § 5(2) (1958).

<sup>58</sup> Calculation of the number of vehicles involved is discussed in *Hagerstown Motor Express Co.*, 87 M.C.C. 473 (1960); see 49 C.F.R. § 180.3 (1961).

<sup>59</sup> 54 Stat. 905 (1940), as amended, 49 U.S.C. § 5(10) (1958).

<sup>60</sup> 49 Stat. 555 (1935), as amended, 49 U.S.C. § 312(b) (1958).

<sup>61</sup> 49 C.F.R. pt. 179 (1961); see *United States v. Resler*, 313 U.S. 57 (1941).

<sup>62</sup> 49 C.F.R. § 179.1(a) (1961).

<sup>63</sup> 49 C.F.R. § 179.3 (1961).

<sup>64</sup> 49 C.F.R. § 179.5(a) (1961).

<sup>65</sup> 49 C.F.R. § 179.5(d) (1961).

<sup>66</sup> 49 C.F.R. § 179.5(b) (1961).

<sup>67</sup> 49 C.F.R. § 179.5(c) (1961).

established the Transfer Board,<sup>68</sup> staffed by Commission employees, to handle the vast number of applications under 212(b), which rarely reach formal hearings.<sup>69</sup> The great majority of applications under this section involve transferees who are not carriers.<sup>70</sup> Thus new enterprises can and do expeditiously enter the motor carrier industry.

#### B. Section 5 Transfers

Transfers to existing carriers involving more than twenty vehicles are governed by section 5.<sup>71</sup> The basic statutory test for approval of such acquisitions is consistency with the "public interest."<sup>72</sup> The ICC has stated that cases under 212(b) do not control applications under section 5.<sup>73</sup> Nevertheless, many of the same considerations apply. For example, the Commission has denied, under section 5, transfers of dormant rights as creating what is in effect a "new service."<sup>74</sup> The "public interest" as construed by the ICC is, in the main, the striking of a balance between the interests of shippers and the parties to the proposed transfer on the one hand, and the interests of competing carriers on the other. In *McLean Trucking Co. v. United States*,<sup>75</sup> the Supreme Court sustained the Commission in its approval<sup>76</sup> of the consolidation of seven large motor carriers of property into the largest single carrier of property in the United States. Reviewing the statutes, the Court concluded:

"In short, the Commission must estimate the scope and appraise the effects of a curtailment of competition which will result from the proposed consolidation and consider them along with the advantages of improved service, safer operation, lower costs, etc., to determine whether the consolidation will assist in effectuating the overall transportation policy."<sup>77</sup>

The Court also granted the Commission broad discretion in resolving these considerations.

#### C. End-to-End Mergers

End-to-end mergers of routes are generally approved by the Commission where there has been substantial "interlining" between the parties prior

<sup>68</sup> See 72 ICC ANN. REP. 122 (1958).

<sup>69</sup> See Morton, *Carrier Consolidation*, 30 ICC PRAC. J. 425, 437 (1963).

<sup>70</sup> ICC, INTERSTATE COMMERCE COMMISSION ACTIVITIES 1937-1962, at 200 (1962).

<sup>71</sup> See notes 57, 58 *supra*.

<sup>72</sup> Interstate Commerce Act § 5(2)(b), 54 Stat. 905 (1940), as amended, 49 U.S.C. § 5(2)(b) (1958).

<sup>73</sup> C. H. Hubert, 45 M.C.C. 717, 725 (1947).

<sup>74</sup> See McFarland & Stample Trucking Co., 36 M.C.C. 459 (1941); FULDA, COMPETITION IN THE REGULATED INDUSTRIES: TRANSPORTATION 139-42 (1961); *Hearings Before the Senate Select Committee on Small Business on Trucking Mergers and Concentrations*, 85th Cong., 1st Sess. 280-303 (1957).

<sup>75</sup> 321 U.S. 67 (1944).

<sup>76</sup> Associated Transp., Inc., 38 M.C.C. 137 (1942).

<sup>77</sup> *McLean Trucking Co. v. United States*, 321 U.S. 67, 87 (1944).

to acquisition. Interlining is a practice by a carrier of transporting property to points outside his route area by arrangement with a carrier with routes going to the destination. Usually the arrangements provide for physical transfer of the goods to a truck operated by the connecting carrier, or for lease of the loaded truck by the connecting carrier. In a case where there is substantial interlining between the parties, acquisition results in better service to the shipper, greater economies of operation, and minimum diversion of traffic from competing carriers.<sup>78</sup> On the other hand, where there is substantial interlining between the acquiring carrier and carriers not parties to the transaction, the Commission is reluctant to approve an acquisition which will divert the interlining traffic from the connecting carriers. This principle was illustrated by the *Pacific Intermountain Express* proceeding.<sup>79</sup> P.I.E. was a large carrier operating between the west coast and Chicago and St. Louis. Keeshin, a slightly smaller carrier in terms of revenue, operated between the midwest and points east. The two firms involved had little interchange traffic; in fact, P.I.E. interlined most of its freight with Keeshin's competitors in the east. Twelve motor carriers and several railroads appeared in opposition to approval. The Commission denied the application for approval of the acquisition, stating that the proposal "goes beyond a mere unification of the operations of two going concerns, with the elimination of interchange formerly carried on between them."<sup>80</sup> It would create a "new service" depriving existing carriers of transport and interchange now carried.<sup>81</sup> The outcome of later cases before the Commission seems to have hinged on the success of competitors in convincing the Commission of the adverse effects upon them which would result from the proposed acquisition.<sup>82</sup> The support of shippers for the transaction is similarly important in obtaining approval.<sup>83</sup>

#### D. Mergers of Routes Within an Area

Mergers between carriers operating in the same general area are less common than end-to-end mergers and present a somewhat different problem.<sup>84</sup> Such a merger cannot offer the advantages of the elimination of interchange traffic, and it would tend to depress the competitive level by eliminating a competitor in the area. Where the transaction involves common control of competing carriers, the Commission is reluctant to approve the application, often referring to a policy of corporate simplification and to adverse effects of interlocking interests on competition.<sup>85</sup> However, when

<sup>78</sup> See J. W. Ringsby, 58 M.C.C. 594 (1952).

<sup>79</sup> 57 M.C.C. 341 (1950), *aff'd on reconsideration*, 57 M.C.C. 467 (1951).

<sup>80</sup> *Pacific Intermountain Express Co.*, 57 M.C.C. 341, 379 (1950).

<sup>81</sup> *Id.* at 380.

<sup>82</sup> See *Navajo Freight Lines, Inc. v. United States*, 186 F. Supp. 377 (D. Colo. 1960), 109 U. PA. L. REV. 892 (1961); *FULDA, op. cit. supra* note 74, at 166 n.D (1961) (collecting cases).

<sup>83</sup> *Id.* at 132-33.

<sup>84</sup> *Id.* at 142.

<sup>85</sup> See *W. W. Brown*, 39 M.C.C. 373 at 377 (1943).

the transaction involves a simple merger or purchase, the problem is generally resolved by application of the general criteria outlined in the *McLean Trucking* case.<sup>86</sup>

#### E. *Significance of the Price Paid for the Transfer of Operating Rights*

The ICC has recognized that the price to be paid for any proposed transfer is a relevant factor in determining whether the transaction is in the "public interest."<sup>87</sup> In its capacity as overseer of the health of the industry, the ICC is concerned with the financial integrity of the carriers under its jurisdiction. Therefore, when the Commission feels that the price will overtax the resources of the acquiring carrier, the application is denied.<sup>88</sup> The problem of the financial integrity of the acquiring carrier can be mitigated by a showing of sounder route integration, prospective economies of operation, and other indicators of increased future efficiency.<sup>89</sup> In addition, the Commission is concerned with the medium of payment as well as the amount.<sup>90</sup>

Shippers pay directly for the service provided, and the ICC has the duty of supervising the setting of "just and reasonable" rates by the carriers.<sup>91</sup> The Commission has shown some, but very little, concern over the possible consequences the purchase price may have on rates.<sup>92</sup> Perhaps this is a reflection of the highly competitive nature of the trucking business. There is a great deal of competition between truckers, and from other modes of transportation, principally rail and water carriers.<sup>93</sup> Rate control is often directed toward the maintenance of minimum rather than maximum rates.<sup>94</sup> Because of the tendency of truckers to cut rates and the general availability of competitive service, shippers are not in great danger of having the price of an acquisition passed on to them.<sup>95</sup> The price agreed upon by the parties

<sup>86</sup> See text accompanying note 75 *supra*.

<sup>87</sup> *E.g.*, *DeCamp Bus Lines*, 58 M.C.C. 667 (1952); see Meck & Bogue, *Federal Regulation of Motor Carrier Unification*, 50 YALE L.J. 1376, 1397-404 (1941).

<sup>88</sup> See *Keeshin Transcontinental Freight Lines, Inc.*, 5 M.C.C. 25 (1937).

<sup>89</sup> See Meck & Bogue, *supra* note 87, at 1399.

<sup>90</sup> Section 5(2)(c) of the Interstate Commerce Act directs the Commission to give weight to the total fixed charges resulting from the transaction. 54 Stat. 905 (1940), 49 U.S.C. § 5(2)(c) (1958).

<sup>91</sup> It is the duty of every common carrier to set "just and reasonable" rates. Motor Carrier Act §§ 216(a), 216(b), 49 Stat. 558 (1935), 49 U.S.C. §§ 316(a), 316(b) (1958). The Commission determines "lawful" rates. Motor Carrier Act § 216(e), 49 Stat. 558 (1935), 49 U.S.C. § 316(e) (1958).

<sup>92</sup> *Graves Truck Line, Inc.*, 59 M.C.C. 371, 375 (1953). *But see* *Middlewest Freightways, Inc.*, 58 M.C.C. 647 (1952).

<sup>93</sup> Williams, *The ICC and the Regulation of Inter-carrier Competition*, 63 HARV. L. REV. 1349 (1950).

<sup>94</sup> Hale & Hale, *Competition or Control III: Motor Carriers*, 108 U. PA. L. REV. 775, 814-15 (1960); see Note, *Minimum Rate Regulation by the Interstate Commerce Commission*, 73 HARV. L. REV. 762 (1960).

<sup>95</sup> A different situation prevails where the route transferred does not offer competitive service, or where the transfer eliminates competitive service. The Commission, however, has not adopted a distinction along these lines.

to the transfer is generally entitled to great weight and is ordinarily accepted as representing the "reasonable commercial value" of the properties and operations involved.<sup>96</sup> Only prices which are "excessive"<sup>97</sup> or inconsistent with "careful trading"<sup>98</sup> are disapproved. Although the Commission's position on the valuation of intangible properties is not plain, it is clear that such intangibles, including operating rights, are entitled to be included in the fixing of an exchange value.<sup>99</sup>

Compared to the investment of railroads and water carriers in tangible property, that of a motor carrier is small. Intangible property, chiefly operating rights, is relatively more important to the total value of a carrier's business.<sup>100</sup> The Commission plainly feels that strict control of the price of intangibles would discourage otherwise desirable transfers;<sup>101</sup> thus it is reluctant to disapprove a transfer merely because of price. The motor carrier industry is characterized by a great mass of routes which are often limited by inefficient restrictions and are not necessarily well integrated.<sup>102</sup> Much can be done through voluntary transfer of routes to improve the present route structure and to shift the route structure to meet changing transportation needs. A permissive Commission attitude toward transfers fosters these objectives.

### III. TRANSFER OF AIRLINE ROUTE AUTHORIZATIONS

Air carrier certificates and permits have not been as freely exchanged as broadcasting licenses and motor carrier authorizations. Section 401(h) of the Federal Aviation Act of 1958 provides that no certificate of public convenience and necessity may be transferred without approval of the CAB.<sup>103</sup> Consolidation, merger, or other transfer of tangible assets likewise requires approval of the Board under section 408(a) of the act.<sup>104</sup> For transactions involving transfers of tangible assets a formal hearing is required by statute.<sup>105</sup> Because most transfers of routes have involved transfer of physical assets in the same transaction, a formal hearing is typical. The standard both for transfer of certificate and for transfer of property is consistency with the "public interest." The act indicates that, for approval of the transfer of routes, consistency with the public interest must appear affirmatively, whereas, for transfer of assets, approval will be given except

<sup>96</sup> See, e.g., *Transport Co.*, 36 M.C.C. 61, 90 (1940).

<sup>97</sup> *Ibid.*

<sup>98</sup> *Keeshin Transcontinental Freight Lines, Inc.*, 5 M.C.C. 25 (1937).

<sup>99</sup> See, e.g., *Lee Transp. Co.*, 13 FED. CAR. CAS. 40306 (ICC 1958).

<sup>100</sup> *Meck & Bogue*, *supra* note 87, at 1398.

<sup>101</sup> See *William M. Graves*, 59 M.C.C. 60 (1953); *Southeastern Greyhound Lines*, 55 M.C.C. 543 (1949).

<sup>102</sup> See *FULDA*, *op. cit. supra* note 74, at 92-105.

<sup>103</sup> 72 Stat. 756, 49 U.S.C. § 1371(h) (1958) (formerly Civil Aeronautics Act of 1938, § 401(i), 52 Stat. 977).

<sup>104</sup> 72 Stat. 767, 49 U.S.C. § 1378(a) (1958).

<sup>105</sup> Federal Aviation Act of 1958, § 408(b), 72 Stat. 767, 49 U.S.C. § 1378(b) (1958).



upon a finding that the transaction is inconsistent with the public interest. However, this distinction has not been treated as significant by the Board.<sup>106</sup>

The present domestic route structure is a conglomeration of original "grandfather" routes and various routes added by the CAB since 1938 as need for them developed. This has not resulted in the creation of an ideal system.<sup>107</sup> The Board may alter the route structure through new or additional route certifications, and through refusal to renew temporary certificates, for which re-application must be made. In addition, the CAB has authority to modify or suspend any certificate if the "public convenience and necessity so require,"<sup>108</sup> as well as the power to revoke certificates for intentional failure to comply with Board orders or regulations.<sup>109</sup> The power to suspend has been used sparingly against carriers reluctant to give up their routes,<sup>110</sup> and, because of procedural limitations, it cannot be considered an expeditious method of realigning the route structure. Furthermore, the Board has no power to order mergers, consolidations, or transfers of routes.<sup>111</sup> Thus the ability of carriers to transfer routes under the supervision of the Board is an important means of promoting a sound airline system.

The Board has passed on a number of cases where the consideration for the transfer approximately equaled the value of the tangible assets acquired. In such cases, the Board has focused on a number of public interest factors, not unlike those applied by the ICC. Of course, the buyer must be fit, willing, and able to provide the service.<sup>112</sup> Beyond that, the Board has considered the interest of the travelling public in the quality of the service to be provided<sup>113</sup> and the economic interest of competing carriers.<sup>114</sup> Always present is the issue of whether the route soundly integrates with the routes of the acquiring carrier.<sup>115</sup> None of the above factors is necessarily

<sup>106</sup> Byers Airways, Inc., 23 C.A.B. 428 (1956).

<sup>107</sup> See Landis, *Air Routes Under the Civil Aeronautics Act*, 15 J. AIR. L. & COM. 295 (1948).

<sup>108</sup> Federal Aviation Act of 1958, § 401(g), 72 Stat. 756, 49 U.S.C. § 1371(g) (1958).

<sup>109</sup> *Ibid.*

<sup>110</sup> In *New England Air Express, Inc.*, 14 C.A.B. 1132 (1951), a supplemental air carrier lost its letter of registration (supplementals are not issued certificates) for "complete disregard" of the rights and welfare of the traveling public. For the difficulties of altering certificates, see *CAB v. Delta Air Lines, Inc.*, 367 U.S. 316 (1961). On the power to suspend, see *United Air Lines, Inc. v. CAB*, 198 F.2d 100 (7th Cir. 1952).

<sup>111</sup> *United Airlines, Inc.*, 8 C.A.B. 298 (1947). The same applies to surface carriers under the jurisdiction of the Interstate Commerce Commission. Morton, *Carrier Consolidation*, 30 ICC PRAC. J. 425, 444 (1963).

<sup>112</sup> *Alaska Island Airlines, Inc.*, 9 C.A.B. 14 (1947). The Board also considers whether the transfer will result in a waste of the transferee's assets. *Wien Alaska Airlines*, 3 C.A.B. 207 (1941); see *Thomas E. Gordon*, 7 C.A.B. 429 (1946).

<sup>113</sup> *Wien Alaska Airlines*, 3 C.A.B. 207 (1941). The ability of the seller to operate the route will also be considered. *Alaska Island Airlines, Inc.*, 9 C.A.B. 14 (1947).

<sup>114</sup> *Cordova Air Serv., Inc.*, 4 C.A.B. 708 (1944).

<sup>115</sup> See *Ferguson Airways, Inc.*, 7 C.A.B. 769 (1947); *Western Airlines, Inc.*, 4 C.A.B. 654 (1944); cf. *Southwest-W. Coast Merger Case*, 14 C.A.B. 356 (1951). Other factors are whether the transfer frustrates the purpose of the original grant, *Resort Airlines, Inc.*, 1A AV. L. REP. ¶21214 (CAB 1961), and whether the type of route is consistent with the

determinative of a particular application, nor is there any known limit to the issues which may be relevant to a particular transaction. The broad range of public interest factors which may enter into the determination often appears in other cases before the Board, such as original certification cases and renewal cases. By applying the relevant factors to transfer cases, the Board may assure that transfers will further Board policies rather than subvert them.

Since passengers and shippers pay directly for the service provided, the CAB regulates the rates of carriers under its jurisdiction,<sup>116</sup> and several carriers receive subsidies from the federal government,<sup>117</sup> the Board must direct its attention to the price to be paid to determine whether a transaction is in the public interest. Early in its history the CAB evolved three basic principles: (1) operating rights and other intangibles have an exchange value; (2) the CAB will scrutinize the reasonableness of the consideration; and (3) the portion of the purchase price which exceeds the value of the tangible assets transferred cannot be added to the investment base for purposes of rate or mail pay determinations. With minor variations, the Board has applied these general principles to all transfer cases.

The first major case to come before the Board was *Acquisition of Marquette by TWA* in 1940.<sup>118</sup> The purchase price of 473,000 dollars was about fifteen times the value of the assets involved. In refusing to approve transfer of the certificate, the Board stated: "it would clearly be adverse to the public interest . . . to allow a certificate of public convenience and necessity to be treated as if it were a speculative security, to be sold by the holder to the highest bidder . . . ." <sup>119</sup> Shortly thereafter, in the *Second Marquette Case*,<sup>120</sup> the Board withdrew its harsh language. The price had been reduced to 313,000 dollars, ten times the value of the assets, and the transfer was approved.<sup>121</sup> The Board stated: "Further reflection on the issues raised in this proceeding leads us to the conclusion that in passing on the reasonableness of the price the Board should take into consideration all types of value which are in fact elements in the fixing of the exchange value of the property."<sup>122</sup> This statement paved the way for the celebrated *United-Western* case.<sup>123</sup>

United had no route directly connecting Los Angeles with the East.

operations of the acquiring carrier, *Eastern-Mohawk Transfer Case*, 1A AV. L. REP. ¶21200 (CAB 1961).

<sup>116</sup> See Federal Aviation Act of 1958, § 1002(g), 72 Stat. 790, 49 U.S.C. § 1482(g) (1958).

<sup>117</sup> See note 139 *infra* and accompanying text.

<sup>118</sup> 2 C.A.B. 1 (1940).

<sup>119</sup> *Id.* at 14.

<sup>120</sup> *Acquisition of Marquette by TWA—Supplemental Opinion*, 2 C.A.B. 409 (1940); see Note, 61 HARV. L. REV. 523 (1948).

<sup>121</sup> Chairman Landis dissented.

<sup>122</sup> *Acquisition of Marquette by TWA—Supplemental Opinion*, 2 C.A.B. 409, 412 (1940).

<sup>123</sup> *United-Western, Acquisition of Air Carrier Property*, 8 C.A.B. 298 (1947); see Note, 48 COLUM. L. REV. 88 (1948); Note, 15 U. CHI. L. REV. 343 (1948).

United did have routes connecting Denver and the East, and Western's Denver-Los Angeles route provided a convenient hookup to Los Angeles for United's transcontinental traffic. In 1940, United's attempt to merge with Western was thwarted by the Board. The CAB felt that it was in the public interest to preserve Western as an independent carrier in the West.<sup>124</sup> In 1944 the route involved in the sale in question was awarded to Western.<sup>125</sup> United was a competing applicant for the route, and was again frustrated in its attempt to gain direct access to Los Angeles. The principal reason for denying United's application was that traffic carried on Western's Salt Lake City-Los Angeles route would be diverted by the award of the Denver route to United because much of the traffic that Western carried was interchange traffic with United's transcontinental passengers, and the preservation of Western as a strong independent carrier was in the public interest. Then, in 1947, United arranged to pay Western 3.75 million dollars for its Denver-Los Angeles route, along with less than two million dollars worth of equipment. This transfer was approved by the Board.<sup>126</sup> The obvious conclusion is that United paid nearly two million dollars to avoid the impact of earlier Board decisions.<sup>127</sup>

In decisions subsequent to *United-Western*, the Board has approved transfers where the value of intangibles could be calculated as 338,000 dollars (64.4 percent of the total price of the transaction),<sup>128</sup> 3,012,000 dollars (30.0 percent of the total),<sup>129</sup> 390,000 dollars,<sup>130</sup> and 480,000 dollars (96.0 percent of the total).<sup>131</sup> In one case, the Board approved a sale of routes and certificates unaccompanied by physical assets at a price of 25,000 dollars.<sup>132</sup> Plainly, the CAB has recognized the exchange value of route authorizations, but in almost every case the Board has closely examined the reasonableness of price and in general has not felt the approval of price is a routine matter. In *National-Caribbean-Atlantic Control*<sup>133</sup> the Board refused to approve the acquisition of Caribbean by National for stock worth 325,000 dollars when the net worth of Caribbean did not exceed 60,000 dollars. It stated: "We are convinced that an excessive price paid by an air carrier, in one form or another and in the long run, comes out of the pockets of the travelling and investing public."<sup>134</sup> In the *TWA*,

<sup>124</sup> United Air Lines Transp. Corp., 1 C.A.A. 739 (1940).

<sup>125</sup> Western Air Lines, 6 C.A.B. 199 (1944).

<sup>126</sup> *United-Western, Acquisition of Air Carrier Property*, 8 C.A.B. 298 (1947).

<sup>127</sup> However, several months prior to the decision in the *United-Western* case, the Board authorized United to fly between Los Angeles and Chicago and points east. *Transcontinental & W. Air*, 8 C.A.B. 28 (1947). This would seem not only to moot the diversion issue, but also to achieve United's main purpose for acquiring Western's route.

<sup>128</sup> *West Coast-Empire Merger Case*, 15 C.A.B. 971 (1952).

<sup>129</sup> *Delta-Chicago & So. Merger Case*, 16 C.A.B. 647 (1952).

<sup>130</sup> *Continental-Pioneer Acquisition Case*, 20 C.A.B. 323 (1955). The price of the tangibles involved was not disclosed in the report.

<sup>131</sup> *Mackey-Midet Acquisition Case*, 24 C.A.B. 51 (1956).

<sup>132</sup> *Byers Airways, Inc.*, 23 C.A.B. 428 (1956).

<sup>133</sup> 6 C.A.B. 671 (1946).

<sup>134</sup> *National-Caribbean-Atlantic Control*, 6 C.A.B. 671, 682 (1946). In an earlier case,

*Route 38* case the CAB harshly criticized TWA for attempting to sell the certificate for an unprofitable route to a local carrier for 100,000 dollars.<sup>135</sup> In 1958, TWA was again the victim as the Board refused to approve the sale of the Cincinnati-Detroit route to a local carrier for \$10,000 dollars.<sup>136</sup> Thus, there are limits to the tolerance of the CAB in approving transfers.

The Board has had a longstanding policy of encouraging improvement of the route system through voluntary transfer of certificates.<sup>137</sup> The Board has felt that failure to allow an exchange value to be placed on route certificates would undermine the implementation of this policy.<sup>138</sup> Sound as these propositions may be, there remains the question of who pays the ultimate price for transfer of certificates which are originally issued for the "public convenience and necessity." At the outset, a distinction must be drawn between subsidized and non-subsidized carriers. At present, all "local service" carriers are on subsidy, whereas only one "trunkline" carrier receives a direct subsidy from the government.<sup>139</sup> Prior to 1961, local service carriers often had an incentive to lower rates to appeal to a greater market in order to enlarge their investment and thereby their subsidy. The main focus of rate regulation was to maintain rates at a sound level to keep the subsidy within reasonable bounds, since the subsidy was determined on the basis of the individual needs of the carrier involved.<sup>140</sup> Businessmen do not invest without expectation of profit, and, if the price paid is a sound investment, a return must come from (1) the travelling public through

Mayflower Airlines, Inc., 4 C.A.B. 680 (1944), the Board refused to approve an acquisition of operating routes and assets worth \$8,300 for a price of \$17,500, stating that "the sale of certificates at inflated prices is inconsistent with the public interest and is not conducive to the maintenance and development of an economically sound air transportation system." *Id.* at 684. However, in a supplemental decision the Board relented and allowed the purchase for \$17,500. Mayflower Airlines, Inc., 6 C.A.B. 139 (1944).

<sup>135</sup> Transcontinental & W. Air, Inc., 10 C.A.B. 455 (1949).

<sup>136</sup> Trans World Airlines, Inc., 27 C.A.B. 440 (1958).

<sup>137</sup> See West Coast-Empire Merger Case, 15 C.A.B. 971, 973 (1952); Southwest-W. Coast Merger Case, 14 C.A.B. 356, 357 (1951). In one case the Board suggested that TWA transfer an unprofitable route to a local service carrier. Additional California-Nevada Service, 10 C.A.B. 405 (1949). TWA did so but attached a right of reverter and a restraint on alienation. The Board reluctantly approved the transfer. Bonanza Air Lines, Inc., 10 C.A.B. 873 (1949). A majority of the Board has never discussed the meaning of § 401(i) of the Federal Aviation Act, which provides that no certificate shall confer any "proprietary" or "property" right in the use of any air space.

<sup>138</sup> In the Continental-Pioneer Acquisition Case, 20 C.A.B. 323 (1955), the Board decided not to charge Pioneer's profit from the transaction against its final mail pay because the deal would become "unattractive" to Pioneer. In *Western Air Lines, Inc. v. CAB*, 347 U.S. 67 (1954), the Supreme Court held that the CAB must include profit from sales of routes in the computation of mail pay. This case involved Western's profit from the 1948 sale to United, which the Board had excluded from the computation in order to encourage other voluntary route transfers. The Postmaster General, however, was unwilling to pay.

<sup>139</sup> Northeast Airlines, a "grandfather" carrier, has long been in financial trouble. In 1963 the Board refused to renew Northeast's certification on the New York-Miami run, *New York-Florida Renewal Case*, 1A Av. L. REP. ¶21396 (CAB 1963), and put Northeast back on subsidy. CCH Av. L. REP. Newsletter No. 326, Sept. 27, 1963, p. 4.

<sup>140</sup> See *Delta Air Lines, Inc. v. Summerfield*, 347 U.S. 74 (1954).

higher rates, (2) the general public through a higher subsidy, or (3) operating economies resulting from the creation of a sounder economic unit. Seemingly aware of these problems, the CAB has been reluctant, as in the TWA transfer cases, to approve the sale of certificates to local service carriers at high prices. Often, approval of the transfer has required a showing of significant savings by means of economy of operations.<sup>141</sup> In 1961, the CAB instituted class rates for the award of subsidies to local carriers.<sup>142</sup> One of the avowed purposes was to create an incentive to charge higher rates,<sup>143</sup> taking some pressure off the subsidy payments. Nevertheless, the problem of keeping the price paid from being passed on to passengers and shippers is more acute. Since the incentive now is to raise rates, the CAB must be as diligent in scrutinizing rate increases as it must be in requiring proof of the prospective economies of a proposed transfer.

Transfer of certificates to non-subsidized trunklines presents a somewhat different problem. Trunklines cannot expect to recover the price through government subsidy; so they must look to profit through better operation of the route, or through the greater efficiency of a better integrated route system. If the route transferred is highly competitive, concern over the transfer price is at a minimum. The acquiring carrier will have to match the rates of competing airlines. In this way, the transfer price cannot be directly passed on to the travelling public through higher rates;<sup>144</sup> it must be made up through more efficient operation. On the other hand, if there is no competing service on the route transferred, the purchase price may be passed on to the public directly by higher rates. However, this possibility may be minimized by diligent rate regulation, and by the insistence of the Board that, at least to a certain extent, the purchase price of certificates be justified by prospective operating efficiencies.

#### IV. CONCLUSION

The policies of the FCC and ICC on transfer applications have not hindered the entry, or rather the substitution, of new competition. However, transfer of certificates has not been a significant means of entry into the business of air carriage. No new air carrier has so entered.<sup>145</sup> Over the years, the number of original "grandfather" air carriers, which are the trunkline carriers, has diminished from eighteen to only eleven. At the

<sup>141</sup> See, e.g., Continental-Pioneer Acquisition Case, 20 C.A.B. 323 (1955).

<sup>142</sup> The subsidy which each carrier receives is based on available seat-miles flown, but the rate per seat-mile varies inversely with the density of operations expressed in terms of revenue plane-miles per station per day. Local Service Class Subsidy Rate Investigation, 1A AV. L. REP. ¶21134 (CAB 1961).

<sup>143</sup> *Id.* at 14455.

<sup>144</sup> This conclusion is somewhat weakened by the fact that airlines are in oligopolistic competition, with only a few carriers over most competitive routes. See CAVES, AIR TRANSPORT AND ITS REGULATORS 356-77 (1962).

<sup>145</sup> But see R. D. Fenno, 11 C.A.B. 1029 (1950). Changes in the form of business organization have been approved. Turner Airlines, Inc., 10 C.A.B. 695 (1949).

same time, no non-grandfather carrier has been certified to operate over the better trunkline routes.<sup>146</sup> This diminution of the number of trunkline carriers is but one consequence of the Board's solicitous attitude toward the health of existing trunklines.<sup>147</sup> Perhaps airlines are unwilling to sell their routes to prospective purchasers, but CAB general policies on entry of new carriers have no doubt discouraged any attempt to enter air carriage by transfer of routes. This result, if unfortunate, is at least consistent.

With respect to the entry of established firms into new markets, the policies of the ICC and the CAB do not differ radically. Both agencies have duties to promote the well-being of the industries they regulate,<sup>148</sup> and thus are always interested in the effects of a proposed transfer on competing carriers. On the other hand, the promotional duties of the FCC are somewhat less distinct; and the history of radio and television broadcasting has not been characterized by financial difficulties resulting from "destructive" competition.<sup>149</sup> It is not surprising, therefore, that the only effective limitations on the expansion of broadcasters through purchase of other licenses are the multiple ownership rules coupled with the "duopoly" rules.<sup>150</sup> The FCC does not consider the effects on competitors to be an important factor in passing on applications for transfers.<sup>151</sup>

It is in regard to the price to be paid that the contrast among the respective policies of the three agencies is most distinct. The FCC makes no attempt to control the price of transfer. The public does not pay directly for the service provided, nor is any question of subsidy involved. On the other hand, the ICC is reluctant to approve transfer at a price well beyond the value of the tangible assets involved. Most often, this reluctance is rooted, at least ostensibly, in the willingness of the ICC to second-guess carrier management as to the advisability of the price to be paid. Less often perhaps, the ICC is concerned lest a large investment in routes be reflected in higher rates, for trucking is a highly competitive business, and this tends to minimize chances of a direct passing-on of the price to shippers through higher rates. The CAB is probably more careful than the ICC about approval of transfer price. The subsidy problem has been partly responsible, but more important is the greater danger of higher rates. The impetus for

<sup>146</sup> But see Cincinnati-Detroit Route Suspension Investigation, 31 C.A.B. 63 (1960).

<sup>147</sup> See generally RICHMOND, REGULATION AND COMPETITION IN AIR TRANSPORTATION (1961).

<sup>148</sup> Federal Aviation Act of 1958, § 102(a), 72 Stat. 740, 49 U.S.C. § 1302(a) (1958); Declaration of the National Transportation Policy, 54 Stat. 899 (1940), 49 U.S.C. preceding § 1 (1958).

<sup>149</sup> The tendencies of thought which the use of the term "destructive competition" implies were significant in the passage of both the Motor Carrier Act and the Civil Aeronautics Act. See FULDA, COMPETITION IN THE REGULATED INDUSTRIES: TRANSPORTATION 7-23 (1961).

<sup>150</sup> See notes 41, 42 *supra*.

<sup>151</sup> See Camden Radio, Inc., 9 P & F RADIO REGS. 359 (1953), *rev'd*, 220 F.2d 191 (D.C. Cir. 1954); *cf.* Southeastern Enterprises, 22 F.C.C. 605 (1957). See also 22 FCC ANN. REP. 113 (1956).

rate changes comes from the airlines, with the CAB controlling changes principally through its power to suspend new tariffs.<sup>152</sup> Most trunkline routes offer competitive service,<sup>153</sup> which inhibits a carrier's raising of rates. Competition for passenger traffic also comes from railroads, buses, and private automobiles. However, airline rates are substantially higher,<sup>154</sup> and thus airline rates are not particularly responsive to competition from other modes of passenger transportation. Competitive controls over airline rates must come principally from other air carriers, and in an oligopolistic setting, the airlines have not been vigorous in price competition. The dangers of higher rates, or the lack of initiative to lower rates, is greater in regard to airlines than in regard to truckers. It is therefore to be expected that the CAB would be more sensitive than the ICC to the purchase prices paid for routes.

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<sup>152</sup> Federal Aviation Act of 1958, § 102(g), 72 Stat. 790, 49 U.S.C. § 1482(g) (1958).

<sup>153</sup> See MEYER, PECK, STENASON & ZWICK, COMPETITION IN THE TRANSPORTATION INDUSTRIES 229 (1960).

<sup>154</sup> See 23 AIR TRANSPORT ASSOCIATION OF AMERICA, FACTS AND FIGURES ABOUT AIR TRANSPORTATION 10 (1962).