

GAO

Report to the Chairman, Subcommittee on Aviation, Committee on Public Works and Transportation, House of Representatives



LM140834

February 1990

AIRLINE COMPETITION

Key to the Study: Overhaul of the Airline Industry

RESTRICTED—Not to be released outside the General Accounting Office unless specifically approved by the Office of Congressional Relations.

547820

140834



United States  
General Accounting Office  
Washington, D.C. 20548

**Resources, Community, and  
Economic Development Division**

B-234830

February 23, 1990

The Honorable James L. Oberstar  
Chairman, Subcommittee on Aviation  
Committee on Public Works and  
Transportation  
House of Representatives

Dear Mr. Chairman:

On August 17, 1989, you asked us to review the responsibilities and activities of the Department of Transportation (DOT) and the Department of Justice (Justice) with respect to the Eastern Air Lines (Eastern) bankruptcy proceeding. In particular, you were concerned about whether DOT and/or Justice had any responsibilities to review the impact on competition of the proposals to restructure Eastern that had been submitted to the bankruptcy court. You also wished to know what actions DOT and Justice had taken in this regard. Finally, you asked us to provide our opinion on whether the two Departments had adequately fulfilled their responsibilities and whether legislation was needed to clarify or expand their participation in airline bankruptcy proceedings.

---

## Results in Brief

We found the following:

- Both DOT and Justice have broad responsibilities to protect and promote airline competition which they may exercise during the course of an airline bankruptcy proceeding; however, neither agency is required to participate in a bankruptcy proceeding.
- Both Departments acted during the Eastern bankruptcy proceeding to protect airline competition. For example, both DOT and Justice opposed the sale of Eastern's Philadelphia gates to USAir on the grounds that the sale would reduce competition in the Mid-Atlantic region. In addition, DOT helped promote competition by temporarily reallocating Eastern's take-off and landing slots at National and LaGuardia airports in a manner that assured new entrant airlines preferential treatment in obtaining slots.
- Neither Eastern nor a group of investors headed by Mr. Joseph Ritchie has filed a complete reorganization plan for the airline. Consequently, neither DOT nor Justice has been able to assess either plan to determine its impact on airline competition.
- Legislation is not needed to clarify or expand either Department's responsibility to participate in airline bankruptcy proceedings. Because

---

Justice already represents the United States in the Eastern bankruptcy proceeding, it can raise competitive issues for itself or on behalf of DOT. However, if Justice was not a party, our review of past cases suggests that either Department would not have difficulty becoming a party because of their regulatory responsibilities to protect and promote competition. Even if they were denied status as a party, DOT or Justice could take action outside the bankruptcy proceeding to protect or promote competition.

---

## Background

On March 9, 1989, Eastern filed for bankruptcy under Chapter 11 of the U.S. Bankruptcy Code (11 U.S.C. Sec. 1100 et seq.). Eastern's filing came five days after its machinists went out on strike. The machinists were followed by most of Eastern's pilots and flight attendants, initially causing the airline to cancel about 90 percent of its flights. Before the strike and subsequent filing for bankruptcy, Eastern was the nation's seventh largest airline, with 7 percent of the nation's air travel market, and with extensive operations on the East Coast. The strike and bankruptcy raised congressional concern about the impact of the bankruptcy on competition in the airline industry and about the actions DOT and Justice had taken to protect and promote competition.

By filing for bankruptcy, Eastern is temporarily protected from its creditors while it develops a reorganization plan to meet its commitments to creditors. Eastern has the exclusive right for 120 days to develop and gain court acceptance of its reorganization plan. The bankruptcy court can extend the 120-day deadline. This court will review and assess the plan submitted to determine whether it will allow for a successful reorganization and operation of Eastern. The bankruptcy court may not approve (confirm) a plan until the plan satisfies a list of statutory criteria. These criteria require, among other things, that (1) the plan disclose all payments to be made, (2) the plan show what assets will be sold and what funds will be used to operate the company, (3) confirmation of the plan is not likely to be followed by the liquidation or further financial reorganization of the company, and (4) the creditors whose claims will not be paid in full have approved the plan.

---

## DOT and Justice Responsibilities

Both DOT and Justice have broad authority to protect and promote competition in the airline industry. DOT has the authority to halt unfair and deceptive trade practices (49 U.S.C. App. Sec. 1381(a)). This authority has been construed broadly to include acts that do not yet constitute

---

antitrust violations, such as the regulation of airline computerized reservation systems (*United Air Lines v. CAB*, 766 F.2d 1107 (7th Cir. 1985)). DOT also has authority to pursue administrative remedies against mergers that violate the Clayton Act (15 U.S.C. Sec. 21). Furthermore, under the Federal Aviation Act, DOT has the broad responsibility to “assure a more effective, competitive airline industry” and prevent “unfair, deceptive, predatory, or anticompetitive practices in air transportation” (49 U.S.C. App. Sec. 1302(a)). Finally, DOT must certify airlines as financially fit in order for them to provide service (49 U.S.C. App. Sec. 1371). Justice is charged with enforcing the nation’s antitrust laws (15 U.S.C. Sec. 1-7 and 12-27).

These Departments’ oversight responsibilities do not end when an airline files for bankruptcy. Both DOT and Justice could bring actions outside a bankruptcy proceeding. Although the Bankruptcy Code generally prevents the commencement or continuation of administrative or judicial proceedings against a bankrupt company, a governmental unit may commence such actions to enforce its police or regulatory power. The term “governmental unit” is defined to include a department of the United States Government.<sup>1</sup>

Although there is no statute or Bankruptcy Rule that requires either Department to participate in a Chapter 11 bankruptcy proceeding, they may intervene to protect competition in the airline industry. Unlike the Securities Exchange Commission and State Attorneys General, no bankruptcy statute or rule grants either DOT or Justice a specific right to participate. Thus, each department would have to show that it was either (1) a party in interest with a right to intervene under the Bankruptcy Code, or (2) an interested entity under the Bankruptcy Rules which the court, in its discretion, would allow to intervene generally or specifically on a particular issue.

Those cases where Federal or state agencies charged with regulating an industry have been considered parties in interest with a right to intervene under the Bankruptcy Code suggest that in an airline reorganization proceeding, DOT, for example, would be considered a party in interest because of its many airline regulatory responsibilities involving,

---

<sup>1</sup>The drafters of the Bankruptcy Code evidently contemplated the possibility of antitrust actions. Section 363(b)(2) of Title 11 of the United States Code shortens the time Justice has to review a proposed sale of assets under the Hart-Scott-Rodino Act (amendment to the Clayton Act).

among other things, airline certification and airline competition.<sup>2</sup> In any event, Justice already represents the United States as a party in interest in the Eastern bankruptcy proceeding. For example, Justice represents the Federal Aviation Administration (FAA) for the collection of fines levied against Eastern.

## DOT Actions to Protect and Promote Competition

Officials in DOT's Office of General Counsel and Office of Aviation Analysis have monitored Eastern's actual and proposed activities during the strike and bankruptcy proceedings. Since the strike, Eastern has proposed several asset sales and has consummated two major sales. DOT reviewed the proposed sales, supported one, but opposed the other because it believed the sale would reduce competition. DOT also acted to promote competition by temporarily reallocating Eastern's take-off and landing slots.

In May 1989, DOT opposed Eastern's proposed sale of gates and routes at Philadelphia's International Airport. Under the proposed asset sale, Eastern planned to sell to USAir 8 of its 10 Philadelphia gates for \$70 million, as well as 2 Canadian routes—from Philadelphia to Montreal and Toronto—for \$15 million. DOT's Office of Aviation Analysis studied the competitive impacts of the proposed sale. DOT concluded that the sale would increase USAir's existing dominance in the Mid-Atlantic Region and reduce competition in that region's short-haul markets (up to 400 miles). In a May 30, 1989, letter to the U.S. Attorney General, the Secretary of Transportation stated that the sale would reduce the potential for new competition in Philadelphia markets. The Secretary also stated that the sale could give USAir the ability to charge airfares above competitive levels in the markets affected by the sale.

Justice subsequently also opposed the sale, causing Eastern to cancel the proposed sale to USAir and to open negotiations with Midway Airlines. In June 1989, Eastern agreed to sell Midway Airlines the 8 Philadelphia gates and the 2 Canadian routes. The final sale agreement also included provisions for Eastern to sell to Midway aircraft, facilities, and spare parts, as well as two slots each at Washington's National and New York's LaGuardia airports. Following their review, DOT and Justice raised no competition-based objections to this sale and concluded that it would enhance competition in the region.

<sup>2</sup>In re Co Petro Mktg. Group, 680 F.2d 566 (9th Cir. 1982) (The Commodity Futures Trading Commission was allowed to intervene for limited purposes); see, In re Public Service Company of New Hampshire, 88 B.R. 546 (D. N.H. 1988); In re Citizens Loan and Thrift, 7 B.R. 88 (N.D. Iowa 1980); see also, In re South Park Land & Livestock Co., 6 B.R. 479 (C.D. Cal. 1980) (dictum).

---

Before the strike and bankruptcy, Eastern had negotiated the sale of its Washington-New York-Boston shuttle operation (Shuttle) to Mr. Donald Trump. After the strike occurred, there were delays in finalizing the contract. In 1989, DOT reviewed the sale of the Shuttle for \$365 million to Mr. Trump and found that the purchase would enhance competition in the Northeast corridor markets.

In conjunction with the sale, DOT conducted an air carrier fitness review of the new Trump Shuttle operation to ensure that it could operate safely and support its operations with sufficient resources. As part of the fitness certification, DOT examined the Trump Shuttle's financial resources, the experience and background of the airline's management team, and the airline's proposed operating plans. DOT also checked with FAA to verify that the Trump Shuttle met the safety requirements of that agency. DOT concluded that the Trump Shuttle operation was fit, willing, and able to provide service on the Shuttle routes.

Before the strike, Eastern held almost 200 take-off and landing slots, mostly at LaGuardia and National airports—two of the four high-density traffic airports where FAA restricts take-offs and landings to allocate operations through the use of slots.<sup>3</sup> Because these slots are so scarce they have been difficult for any airline to obtain. Since Eastern was not using all of its slots, FAA, in May 1989, conducted a lottery to allocate temporary slots identical to the times of Eastern's unused slots. To promote competition, new entrants at the airports received preferential treatment in obtaining these slots. For example, in the first round of slot selection new entrants could select four slots while other airlines could select two slots. In all, 89 slots were selected, but only one-half of the slots were used. America West was the only new entrant to use the slots it selected. As Eastern expanded its operations and began using its slots, FAA has recalled the temporary slots. FAA has implemented procedures for the recall, giving the temporary slot users at least seven days to discontinue service.

As part of its reorganization, Eastern has expressed interest in selling its international routes from Miami to various Central and South American destinations. On June 13, 1989, DOT sent a letter to 28 airlines with substantial international route systems, stating that the sale of international routes might devalue the public benefits DOT sought to create

---

<sup>3</sup>For a further discussion of slots and how they can create a barrier to entry, see our Sept. 21, 1989 testimony Barriers to Competition in the Airline Industry (GAO/T-RCED-89-66).

---

when it awarded the routes. Public benefits include maintaining competition and quality of service. The letter also stated that international route transfers were subject to DOT review. A DOT attorney told us that the purpose of the letter was to inform airlines that sales of international routes are not simply commercial transactions but carry public interest concerns as well. In December 1989, American Airlines agreed to a proposed purchase of Eastern's Central and South American route network, as well as its route authority from Miami to Madrid, from Miami to Toronto, and from Tampa to Toronto.<sup>4</sup> DOT attorneys told us that they will review this proposed purchase to ensure that the public benefits of the routes remain as intended.

---

## Justice Actions to Protect Competition

Justice's Antitrust Division has monitored the Eastern bankruptcy proceedings and has intervened when it believed that asset sales would violate the antitrust laws. In addition, Justice's Civil Division has protected creditor financial interests by reviewing the preliminary reorganization plans submitted to date for accuracy of data and realistic financial projections.

Justice's Antitrust Division examined the proposed sale to USAir of Eastern's Philadelphia gates and Philadelphia-Toronto route and opposed this sale. On April 21, 1989, the Antitrust Division filed a brief with the bankruptcy court asking the court not to approve the sale until Justice had completed an investigation of the antitrust issues involved. Subsequently, Justice concluded that the proposed sale would lessen competition in the airline industry. On June 7, 1989, Justice notified Eastern and USAir that it would file an antitrust suit seeking to prohibit the asset sale. The Antitrust Division also reviewed the subsequent sale of the Philadelphia gates and routes to Midway Airlines and found that the sale could increase competition and therefore was acceptable. In addition, the Antitrust Division reviewed and did not oppose Mr. Donald Trump's purchase of Eastern's Shuttle. Justice concluded that Mr. Trump was an independent purchaser, able to provide service and competition as a new carrier in existing markets. The Antitrust Division is currently investigating a proposed sale of Eastern assets (international routes, slots, and various facilities) to American Airlines. According to a Justice attorney, the Department will address any potential antitrust issues involved in the proposed sale and whether such a sale would have

---

<sup>4</sup>As part of this proposed asset sale, American would also purchase 42 slots at the nation's 4 slot-controlled airports as well as various facilities at the New York Kennedy, Miami, and San Juan airports.

---

an anticompetitive effect on the air industry market. This investigation was ongoing as of February 1990.

---

## Status of Eastern Reorganization Plans

Since filing for bankruptcy and falling under the protection of the bankruptcy court, Eastern has attempted to develop a plan for reorganizing its operations. However, as of February 1990, Eastern was still revising its reorganization plan to include the financial information, such as key provisions for paying creditors, necessary to be considered a complete plan.<sup>5</sup> The bankruptcy court has granted Eastern several extensions to provide its financial disclosure statement and complete reorganization plan. On December 28, 1989, Eastern asked for and was granted another extension—until February 12, 1990—to provide this information. The most recent extensions allowed Eastern to (1) adjust parts of the reorganization plan in light of creditor comments and a recent unfavorable court decision that requires Eastern to pay \$60 million in back pay to its pilots and (2) revise the plan to account for changes that could occur if American's proposed purchase of Eastern's international route structure, some take-off and landing slots, and various facilities is approved. On February 5, 1990, Eastern requested another extension—until March 12, 1990—to provide a complete reorganization plan that includes a financial disclosure statement. The bankruptcy court has granted Eastern only an 8-day extension beyond the February 12th deadline. See appendix I for a chronology of Eastern's effort to develop a reorganization plan.

In June 1989, a group of investors led by Mr. Joseph Ritchie, a Chicago commodities broker, submitted the first of several proposals to reorganize Eastern. The bankruptcy court's examiner told us that he did not accept any of the Ritchie plans for Eastern's reorganization as a legitimate option because they lacked concrete financial information.<sup>6</sup> For example, procedures and price for buying Eastern's stock were missing. As of February 1990, DOT, Justice, and bankruptcy court officials have not received any additional information or a completed plan from Mr. Ritchie.

---

<sup>5</sup>In late January, Eastern presented to its creditors a proposed reorganization plan with payment provisions that did not meet with their approval.

<sup>6</sup>Under certain circumstances the bankruptcy court may appoint an examiner. The examiner's duties include investigating (1) the acts, conduct, assets, liabilities and financial condition of the debtor, (2) the operations of the debtor's business, and (3) the desirability of continuing the business. The examiner then files a report with the court detailing the findings.



---

## Future Review of Reorganization Plans

DOT officials said that they will follow the progress of these reorganization plans and any others that may develop. According to officials in DOT's Office of General Counsel, DOT cannot fully evaluate such plans without the required financial disclosure information. Once complete reorganization plans are submitted, DOT will review the plans and advise the bankruptcy court on any competitive issues the plans may raise. The Deputy Assistant Secretary for Policy and Program Development told us that DOT does not intend to compare multiple plans, if there are any, to determine which one is the most beneficial to competition.

The Justice attorney told us that the Department will also review any completed reorganization proposals submitted to the bankruptcy court. If more than one plan is submitted, the attorney told us that the Department would consider making its views known on the competitive aspects of each plan.

---

## Conclusions

Since Eastern filed for bankruptcy in March 1989, both DOT and Justice have acted to fulfill their responsibilities to protect airline competition. Most notably, both Departments opposed the sale of Eastern's Philadelphia gates to USAir on the grounds that such a sale would reduce competition in the Mid-Atlantic Region. Their opposition led to the ultimate sale of the gates to Midway Airlines, which provided an additional competitor in the region. Furthermore, DOT took what we believe were procompetitive actions in reallocating Eastern's take-off and landing slots by providing preferential treatment for new-entrant airlines. Although neither Department is required to take any action to protect or promote competition within the context of an airline bankruptcy proceeding, both have acted when opportunities have arisen. Further, officials at both Departments have indicated that they will review any reorganization plans for their competitive impact when they are complete. Consequently, we believe that both Departments have adequately fulfilled their responsibilities.

Regarding the broader question of whether legislation is needed to clarify DOT's and/or Justice's responsibilities, we do not believe that legislation is needed. Because Justice already represents the United States in the Eastern bankruptcy proceeding, it can raise competitive issues for itself or on behalf of DOT. However, if Justice was not a party, our review of past cases suggests that either Department would not have difficulty becoming a party. Even if they were denied status as a party, DOT or Justice could take action outside the bankruptcy proceeding to protect or promote competition.

---

With respect to the question of whether the Departments' responsibilities should be expanded to require participation, we would observe that requiring DOT or Justice to participate in airline bankruptcy proceedings may not ensure that protecting or promoting competition will be considered the most important factor in determining the outcome of the proceeding. According to DOT and Justice officials, the bankruptcy judge must ultimately balance the interests of creditors, as well as other issues that parties like DOT or Justice might raise, such as protecting and promoting competition, in confirming a reorganization plan. In any event, if DOT or Justice believed that the proposed reorganization plan might reduce competition, either Department could oppose the anticompetitive features of the plan outside of the bankruptcy process.

---

## Agency Comments

DOT and Justice Department officials provided oral comments on a draft of this report. These officials agreed with our conclusions and suggested some technical changes to the report which we incorporated as appropriate.

---

In conducting our review, we examined pertinent legislation relating to bankruptcy proceedings and the authority of DOT and Justice. We also reviewed pertinent documents and interviewed officials at DOT, Justice, and the U.S. Attorney's office in New York. Our review was conducted between August and November 1989. See appendix II for the scope and methodology used in compiling the report.

As agreed with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 15 days from the date of this letter. At that time we will send copies to the Secretary of Transportation, the Attorney General, and the Administrator of the Federal Aviation Administration. If you or your staff have any questions, I can be reached at (202) 275-1000. Major contributors to this report are listed in appendix III.

Sincerely yours,



Kenneth M. Mead  
Director, Transportation Issues

---

# Contents

---

Letter	1
Appendix I Chronology of Eastern Reorganization Plan Development	12
Appendix II Objectives, Scope, and Methodology	14
Appendix III Major Contributors to This Report	15

---

---

## Abbreviations

DOT	Department of Transportation
FAA	Federal Aviation Administration



---

# Chronology of Eastern Reorganization Plan Development

---

Reorganization plans, among other things, must provide adequate means for their execution. For example, plans must provide for disposition of assets, satisfaction of liens, cancellation or modification of indentures, and curing or waiving of defaults. To date, only Eastern and Mr. Joseph Ritchie, as representative of a potential investor group, have proposed significant reorganization plans.

Eastern submitted a preliminary reorganization plan in April 1989. This plan contained timetables for restructuring operations but did not contain detailed financial plans on exact sources of revenue or plans for payments of creditors. After filing this preliminary plan, Eastern had 120 days to submit a complete plan. Eastern asked for and was granted a 2-week extension to file a complete plan. On July 21, 1989, Eastern submitted a partial plan that contained operations plans and a broad statement that Eastern would pay its creditors in full but did not contain the required financial disclosure information to show how repayment would be accomplished. The financial disclosure portion of the reorganization plan is necessary for a completed plan because it explains where the necessary funds will come from and how payments will be made to creditors.

Although the financial disclosure statement was due on September 15, 1989, Eastern requested another extension until November 13, 1989, so that it could revise its financial information. According to DOT officials, Eastern requested the extension because its projected level of operations had changed. For example, Eastern said it needs to revise its proposal because it now plans to operate at 85 to 90 percent of its pre-strike capacity, versus the estimate of two-thirds made in the April 1989 preliminary plan. Eastern projected this increased level of service because it did not sell certain South American routes as originally planned and because some union pilots have crossed picket lines to resume work, while the original reorganization plan was based on none of the strikers returning. The sale of the routes would have provided funds for its operations, while the return of experienced pilots has allowed Eastern to increase its level of service and revenues beyond original projections.

In November 1989, Eastern asked for and received an extension—until December 29, 1989—for filing its financial disclosure statement and complete reorganization plan. The extension of deadlines was to allow Eastern to adjust parts of the reorganization plan in light of creditor comments and a recent unfavorable court decision that requires Eastern to pay \$60 million in back pay to its pilots.

---

**Appendix I**  
**Chronology of Eastern Reorganization**  
**Plan Development**

---

On December 28, 1989, Eastern asked for and was granted another extension; its financial disclosure statement and reorganization plan were due on February 12, 1990. Eastern requested this extension because it is proposing to sell, to American Airlines, its Central and South American route network, as well as its route authority from Miami to Madrid, from Miami to Toronto, and from Tampa to Toronto. In addition, American would purchase a total of 42 slots at the nation's 4 slot-controlled airports as well as various facilities at the New York Kennedy, Miami, and San Juan airports.

On February 5, 1990, Eastern requested another extension—until March 12, 1990—to provide a complete reorganization plan that includes a financial disclosure statement. The bankruptcy court has granted Eastern only an 8-day extension beyond the February 12th deadline.

In June 1989, Mr. Joseph Ritchie and a group of investors filed the first of several preliminary plans to reorganize Eastern. Unlike Eastern's preliminary plan that would have substantially reduced the size of the company, Mr. Ritchie's plans called for full restoration of Eastern's operations with wage concessions from Eastern's employees. The bankruptcy court's examiner told us that he did not accept any of Ritchie's plans for Eastern's reorganization as legitimate options because they lacked concrete financing information. For example, procedures and price for buying Eastern's stock were missing. As of February 1990, DOT, Justice, and bankruptcy court officials have not received any submission from Mr. Ritchie supplying this information.

# Objectives, Scope, and Methodology

---

On August 17, 1989, Chairman James L. Oberstar, Subcommittee on Aviation, House Committee on Public Works and Transportation, asked us to examine the responsibilities and activities of the Departments of Transportation and Justice with respect to the Eastern bankruptcy proceeding. In particular, the Chairman requested that we determine (1) the responsibilities of Justice and DOT in the Eastern bankruptcy proceeding, (2) the actions Justice and DOT have taken, (3) whether DOT and Justice have adequately fulfilled their responsibilities, and (4) whether there is a need for legislation to expand or clarify the Departments' participation in bankruptcy proceedings.

To address the Chairman's concerns, we reviewed DOT's and Justice's responsibilities, authority, and actions regarding Eastern's bankruptcy proceeding. We obtained and analyzed relevant documents and legislation for information on DOT's and Justice's authority and actions regarding bankruptcy proceedings. These documents included correspondence between DOT officials and Members of Congress, the U.S. Attorney General's office, and Eastern officials. We also reviewed pertinent legislation relating to bankruptcy proceedings.

At DOT, we interviewed officials from the Office of General Counsel, the Office of the Assistant Secretary for Policy and International Affairs, and the Office of the Assistant Secretary for Governmental Affairs. Within these offices, we spoke with officials for Environmental, Civil Rights, and General Law; Litigation; Policy and Program Development; Aviation Analysis; and Consumer Affairs. We also met with FAA officials from the Office of Chief Counsel and Office of Flight Standards. At Justice, we interviewed officials in the Antitrust and Civil Divisions.

We also interviewed the Assistant United States Attorney assigned to the Eastern bankruptcy case and held discussions with the attorney appointed by the bankruptcy court as the Examiner for the Eastern case.

The views of responsible agency officials were sought during the course of our work and are incorporated where appropriate.

Our review was conducted between August 1989 and November 1989.

---

# Major Contributors to This Report

---

Resources,  
Community, and  
Economic  
Development Division,  
Washington, D.C.

Kenneth M. Mead, Director  
James Noel, Assistant Director  
Nancy E. Oquist, Evaluator-in-Charge  
Larkin K. Jennings, Evaluator

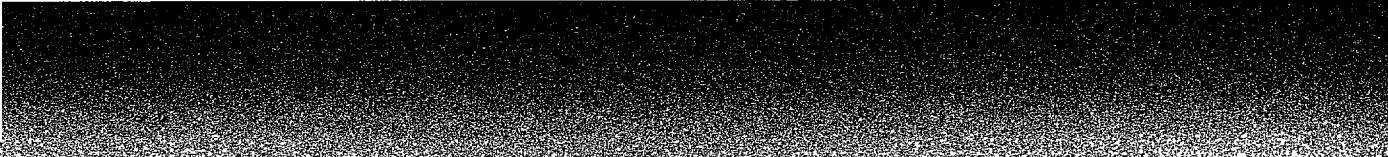
---

Office of the General  
Counsel

Richard Kasdan, Senior Attorney  
Michael G. Burros, Attorney







[The following text is extremely faint and illegible due to heavy noise and low contrast. It appears to be a list or table of contents with several lines of text.]

United States  
General Accounting Office  
Washington, D.C. 20548

Official Business

Penalty for Private Use

First-Class Mail  
Postage & Fees Paid  
GAO  
Permit No. G100