REDETERMINATION OF MAIL RATE COMPENSATION

HEARING

BEFORE THE

SUBCOMMITTEE ON AVIATION

OF THE

COMMITTEE ON PUBLIC WORKS AND TRANSPORTATION

HOUSE OF REPRESENTATIVES

NINETY-FOURTH CONGRESS

SECOND SESSION

ON

H.R. 12349

TO AMEND THE FEDERAL AVIATION ACT OF 1958 TO LIMIT UNDER CERTAIN CIRCUMSTANCES THE DISCRETION OF THE CIVIL AERONAUTICS BOARD IN DETERMINING THE RATE OF COMPENSATION TO BE PAID TO AN AIR CARRIER FOR THE TRANSPORTATION OF MAIL BY AIRCRAFT

AUGUST 31, 1976

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94TH CONGRESS
2D SESSION

H. R. 12349

IN THE HOUSE OF REPRESENTATIVES

MARCH 4, 1976

Mr. TAYLOR of Missouri (for himself, Mr. PICKLE, Mr. ICHORD, Mr. SYMINGTON, and Mr. WRIGHT) introduced the following bill; which was referred to the Committee on Public Works and Transportation

A BILL

To amend the Federal Aviation Act of 1958 to limit under certain circumstances the discretion of the Civil Aeronautics Board in determining the rate of compensation to be paid to an air carrier for the transportation of mail by aircraft.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) section 406(b) of the Federal Aviation Act of 1958 (49 U.S.C. 1376(b)) is amended by adding at the end thereof the following new sentence: "In determining compensation for any local service air carrier for the year 1966 in accordance with the provisions of this subsection, the Board shall apply Local Service Class Subsidy Rate III-A as set forth in Board order E-23850 (44 CAB 637 et

seq.), except that the Board shall not apply that part of such order which requires the Board to take into account any decrease in the Federal income tax liability of such carrier for such year resulting from any capital loss carryback pursuant to section 1212 of the Internal Revenue Code of 1954.".

(b) In the event that the Civil Aeronautics Board in determining the amount of compensation to be paid to any local service air carrier for the year 1966 in accordance with the provisions of section 406(b) of the Federal Aviation Act of 1958 took into account any decrease in the Federal income tax liability for such air carrier for such year resulting from any capital loss carryback pursuant to section 1212 of the Internal Revenue Code of 1954, the Board shall redetermine the compensation to be paid to such air carrier in accordance with such section 406(b) as amended by this Act, and shall make payment to such air carrier of any amount owed to such carrier as provided in such redetermination.

REDETERMINATION OF MAIL RATE COMPENSATION

TUESDAY, AUGUST 31, 1976

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON AVIATION
OF THE COMMITTEE ON PUBLIC WORKS AND TRANSPORTATION,
Washington, D.C.

The subcommittee convened at 9:45 a.m., pursuant to notice, in room 2253 Rayburn House Office Building, Hon. Glenn M. Anderson (chairman of the subcommittee) presiding.

Mr. ANDERSON. The hearing of the Aviation Subcommittee will come to order.

At today's hearings we will consider H.R. 12349, a bill introduced by Mr. Taylor, Mr. Pickle, Mr. Ichord, Mr. Symington, and Mr. Wright. H.R. 12349 is designed to equalize the treatment afforded to tax loss carrybacks in determining regional air carrier subsidy for 1966.

The background of this legislation is complicated, but the end result has been that two regional carriers have been required to make 1966 subsidy refunds based on tax loss carrybacks, while six other carriers, which also had tax loss carrybacks, have not been required to make subsidy refunds.

Under the CAB's procedures for determining subsidy for 1966, subsidy payments were adjusted by a profit-sharing formula. Profit-sharing for each carrier was determined on the basis of the facts existing at the time the CAB was ready to close a carrier's case.

In the years following 1966, a number of regional carriers incurred losses which they carried back to reduce their 1966 taxes. These tax loss carrybacks were treated differently for subsidy purposes.

In the case of some carriers the CAB had completed its subsidy proceeding before the carrier became entitled to a tax loss carryback and there was no adjustment in subsidy. In the case of other carriers the CAB had not completed action until after the tax loss carryback had been recognized, and the CAB required these carriers to make subsidy repayments.

Four of the carriers which had to make subsidy repayments challenged the CAB in the U.S. court of appeals. Again there was a split in results. In two cases the courts upheld the CAB, while in two other cases, brought in different circuits, the courts reversed the CAB.

The end result of these administrative and judicial proceedings has been that two regional carriers have been required to make 1966 subsidy refunds for tax loss carrybacks, while six other regional carriers have not.

H.R. 12349 would end this difference and allow two carriers, Texas International and Ozark, to obtain repayment of their subsidy refunds.

Our first witness today is our colleague, Congressman J. J. Pickle, a cosponsor of H.R. 12349.

TESTIMONY OF HON. J. J. PICKLE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS

Mr. PICKLE. Thank you, Mr. Chairman and members of the subcommittee.

This is not my committee, but I feel like it is in a sense, because for 9 years I served on the Transportation Subcommittee of the Commerce Committee of the House, before you people were given that jurisdiction.

I know then, I think, some of the problems that you have and some of the excitement I think you feel about trying to handle some of these problems facing our aviation industry.

Mr. Chairman, I am going to present my testimony, inasmuch as I am the first witness, and I will try to answer questions at the end of my testimony, if you wish.

I particularly appreciate the fact that you allowed me to be the first witness. I have to appear before the Rules Committee in about 15 minutes or thereabouts, so this is a courtesy to me, and I thank you for it.

Mr. ANDERSON. The full text of your prepared statement will be made a matter of record at this point.

[The statement referred to follows:]

STATEMENT OF HON. J. J. PICKLE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS

Mr. Chairman and friends of the Avitation Subcommittee, I know this isn't my old committee, but I feel like it is.

As you know, for nearly 9 years I worked on avitaion matters when the Commerce Committee had jurisdiction in this area. So I understand your problems, and I understand the excitement you feel in working with aviation.

Because of my experience in this field, Texas International, a regional airline based in Houston, Texas, came to me regarding the CAB action being discussed today. I could use stronger language, but I'll instead just say that this is the doggonedest thing I've ever seen the CAB do. For that matter, I would venture to say that it's the most unusual thing any regulatory agency has done about which I have first-hand knowledge.

Basically, the situation is this: Two regional airlines out of eleven such carriers have been treated differently from the other nine. Of the nine, the CAB had a direct role in seven receiving the treatment they received and, passively, a role in the decision made on the other two.

What is it that would cause two airlines to be treated differently from their competitors in the same class?

Even though I will yield to the airline and CAB people on all the legalities, the crux of the matter boils down to the way the CAB figured the 1966 subsidies.

In 1966 the CAB gave subsidies to regional carriers based on their profits and expenses. The money was paid and each month those payments were subject to post-fiscal year audits. Under this system income taxes were viewed as an expense in computing whether or not an airline company had excess profits.

Due to administrative hang-ups, slowness, or whatever, the CAB took more than four years to audit Texas International, Ozark, Allegheny, Airwest, and Piedmont Airlines. The other six airline companies had their 1966 subsidies settled and closed.

Meanwhile, in the intervening four years, a recession had set in, the CAB was using a new subsidy payment system, and the local air carriers were losing money hand over fist.

As we all know, when a company loses money it can carry back the losses on its income tax returns.

When the five companies did that, the CAB jumped up and said, "Aha, your profits for 1966 are now excessive since your income taxes are lower, and since we have not closed the books on 1966, please give us our subsidies back."

I do not deny the loss carryback helped the money situation of the carriers. On the other hand, the CAB caused the losses, and the CAB had already settled the 1966 subsidies for six carriers.

In any event, the CAB billed four of the remaining five for their 1966 subsidies in the early 1970's. With justification, the four airline companies went to court. Since the decision involved a regulatory agency, the cases were heard in Federal Circuit Courts. Each airline filed in a different circuit. Texas International filed in the D.C. Circuit. Ozark filed in the 8th Circuit. In both of these cases the airlines lost. In other words, the Federal Courts said, "Pay up."

Texas International did not appeal to the Supreme Court. Ozark did, but was denied *certiorari*.

If the matter had ended there, neither I nor anyone else would be here pleading the case. Unfortunately for a logical regulatory process, the controversy did not end there.

Allegheny and Airwest went ahead and pursued their court cases. Allegheny, in the Fourth Circuit, and Airwest, in the Ninth, won their cases. The Circuit Courts stated firmly that the regulatory process would be shambles if members in the same class were differently treated in an arbitrary manner.

The CAB's claim against Allegheny and Airwest was nearly $2 million, while the claims against Texas International adn Ozark amounted to around a half-million dollars.

Based on the money figures alone, one would think the CAB would appeal the Allegheny and Airwest decisions to the Supreme Court. The CAB instead chose to ignore the dichotomy among the circuits and allowed Allegheny and Airwest to keep their money.

The fifth airline, Piedmont, finally settled its 1966 subsidy problem in 1974. The CAB treated Piedmont as it had to treat Allegheny and Airwest. It is interesting to note that the CAB could have taken the same line against Piedmont as it used against Texas International and Ozark; but the CAB did not.

So, today we are looking at a 1966 subsidy program that treated nine airlines one way, and two another way.

One would normally presume the CAB would administratively correct this inequity. One, the CAB doesn't want to, a position I will let the agency try to explain; second, there is legal theory holding that the CAB cannot unilaterally nor legally reverse final orders. Since the orders against TI and Ozark were final orders, the CAB cannot reverse them.

Also, the CAB has maintained that the way the 1966 subsidies were paid and figured is correct, and still stands by this.

The bill before you, H.R. 12349, does not order the CAB to drop its claim against Ozark and TI. Such a bill would not cure the policy error of the CAB. The bill goes right to the heart of the matter, and legislatively expresses Congress' sentiment on using operating loss carrybacks.

In talking to people about this, they have asked me why TI and Ozark don't appeal to the Supreme Court since Allegheny and Airwest beat the CAB. Unfortunately, the time for appeal passed by before the Airwest and Allegheny cases were decided.

As you study H.R. 12349, please take note of two drafting errors. On Page 2, lines 4 and 5, substitute the words "not operating" for the word "capital," and the number "172" for "1212." The same correction should be made on line 13 of page 2.

In the final analysis, H.R. 12349 is designed to bring logic to a chaotic situation. The CAB totally missed the mark in figuring the 1966 subsidies.

When I served on the Commerce Committee, I was always very leary of Congressional action correcting an administrative wrong by an independent regulatory agency. At the same time, some agency actions become so overwhelming in their wrongness that we have to set aside our general rule to bring about specific justice.

This is my appeal here today. H.R. 12349 brings logic out of chaos, and simple justice where legal injustice now resides.

Your consideration of H.R. 12349 is appreciated.

Mr. PICKLE. Thank you, Mr. Chairman.

Perhaps, because of my background in this field, Texas International, a regional airline based in Houston, Tex., came to me regarding the CAB action being discussed here today, and which you have outlined.

Now, I could use a stronger language in trying to analyze what has happened, but I think I would say in summary this is one of the doggonedest cases that I have run across in some time.

At least, this represents a very unusual procedure that any regulatory agency has done, of which I have some firsthand knowledge.

This was the situation: Two regional airlines out of the 11 such carriers have been treated differently from the other 9. Of the nine, the CAB had a direct role in seven receiving the treatment they received and, passively, a role in the decision made on the other two.

The question is, What is it that would cause two airlines to be treated differently from their competitors in the same class?

Now, of course, I will yield to the people who are going to testify here on behalf of their own airlines to answer many of the legal and technical questions that might arise, but I do want to present to you what I think was the crux of the matter.

In 1966 the CAB gave subsidies to regional carriers based on their profits and expenses. Monthly, the money was paid, and each month those payments were subject to post-fiscal-year audits. Under this system income taxes were viewed as an expense in computing whether or not there had been excess profits.

Due to administrative hang-ups, slowness, or whatever, the CAB took more than 4 years to audit Texas International, Ozark, Allegheny, Airwest, and Piedmont Airlines. The other six airline companies had their 1966 subsidies settled and closed.

Meanwhile, in the intervening 4 years, a recession had set in, the CAB was using a new subsidy payment system, and the local air carriers were losing money hand over fist.

As you well know, when a company loses money it can carry back the losses on its income tax returns.

Well, those companies, because of the severe recession, did that, and then the CAB jumped up and said:

> Now, your profits for 1966 are excessive since your income taxes are lower, and since we have not closed the books on 1966, please give us our subsidies back.

Now, I do not deny the loss carryback helped the money situation of the carriers. That is why it was put on the books, to help them and similar companies.

On the other hand, the CAB caused the losses, and the CAB had already settled the 1966 subsidies for six carriers.

In any event, the CAB billed four of the remaining five for their 1966 subsidies in the early 1970's, and with justification these four airlines companies went to court. Since the decision involved a regulatory agency, the cases were heard in Federal circuit courts. Each airline filed in a different circuit, which is customary. Texas International filed in the District of Columbia Circuit, and Ozark filed in the eighth circuit. In both of these cases the airlines lost. In other words, the Federal courts said to them, "pay up."

Texas International did not appeal to the Supreme Court. Ozark did, but was denied certiorari.

Now, if the matter had ended there, neither I nor anyone else would be here pleading the case. Unfortunately for a logical regulatory process, the controversy did not end there.

Allegheny and Airwest went ahead and pursued their court cases. Allegheny, in the fourth circuit, and Airwest, in the ninth, won their cases. The circuit courts stated firmly that the regulatory process would be shambles if members in the same class were differently treated in an arbitrary manner.

The CAB's claim against Allegheny and Airwest was nearly $2 million, while the claims against Texas International and Ozark amounted to around a half-million dollars.

Now, based on the money figures alone, one would think the CAB would appeal the Allegheny and Airwest decisions to the Supreme Court.

The CAB instead chose to ignore the dichotomy among the circuits and allowed Allegheny and Airwest to keep their money.

The fifth airline, Piedmont, finally settled its 1966 subsidy problem in 1974. The CAB treated Piedmont as it had treated Allegheny and Airwest.

It is interesting to note that the CAB could have taken the same line against Piedmont as it used against Texas International and Ozark; but the CAB did not.

So today we are looking at a 1966 subsidy program that treated nine airlines one way, and two another way.

One would normally presume the CAB would administratively correct this inequity.

First, the CAB does not want to, a position I will let the agency try to explain.

Secondly, there is a legal theory holding that the CAB cannot unilaterally nor legally reverse final orders.

I think in that case they probably are waiting for an expression from the Congress. Since the orders against Texas International and Ozark were final orders, the CAB cannot reverse them.

Also, the CAB has maintained that the way the 1966 subsidies were paid and figured is correct, and still stands by this.

Well, the bill before you, H.R. 12349, does not order the CAB to drop its claim against Ozark and Texas. Such a bill would not cure the policy error of the CAB. The bill goes right to the heart of the matter, and legislatively expresses Congress' sentiment on using operating loss carrybacks.

In talking to people about this, they have asked me why Texas International and Ozark do not appeal to the Supreme Court, since Allegheny and Airwest beat the CAB.

Unfortunately, the time for appeal passed before the *Airwest* and *Allegheny* cases were decided.

Now, I want you to know, Mr. Chairman, also, there are two technical basic errors, and I would hope your members would correct them on the bill.

As you look at the bill, you know that there are two drafting errors on page 2, lines 4 and 5, we should substitute the words "net operating"

for the word "capital," and the number "172" for "1212." The same correction should be made on line 13 of page 2.

In my opinion, in the final analysis, H.R. 12349 is designed to bring logic to a chaotic situation. The CAB totally missed the mark in figuring the 1966 subsidies. That is my appeal to the subcommittee, Mr. Chairman.

It just seems to me, in summary, if nine carriers received this relief, then surely in the same given set of circumstances, these two carriers ought to be entitled to the same kind of treatment.

Now, your colleague, Mr. Taylor, has worked with me on this matter, and in effect has taken the lead in many respects, and I appreciate that help, because his area is served by Ozark, and mine is Texas International.

So that completes my statement, and I know you will want to hear from the representatives of the companies involved, Mr. Chairman, and I thank you for giving me a chance to testify.

Mr. ANDERSON. Thank you, Jake, for a fine statement on a very complex subject.

Are there any questions of anyone?

Mr. TAYLOR. Mr. Chairman, I would just like to thank Mr. Pickle for being here. I think that he has very succinctly pointed out the problem. I think that he has been very candid and very objective, and I am hopeful that this subcommittee will listen to the testimony of the CAB and the other witnesses, and make recommendations that will treat this matter with legislative fairness.

Mr. PICKLE. Thank you.

Thank you, Mr. Chairman.

Mr. HAMMERSCHMIDT. Mr. Chairman, I want to join my colleague in thanking Jake for coming before the subcommittee. This is a matter we discussed when his committee had this jurisdiction, and I hope we can arrive at an equitable solution as he has suggested.

Mr. PICKLE. Yes; I had discussed with Mr. Hammerschmidt this problem previously, and he has been very helpful.

Thank you, Mr. Chairman.

Mr. ANDERSON. Mr. Milford?

Mr. MILFORD. Mr. Chairman, I would join in support of my colleague, Mr. Pickle. I am very familiar with this problem.

The legal flukes that brought about this situation created an inequity that definitely needs correcting. I join with my colleague from Texas in urging subcommittee assistance in this matter.

Mr. PICKLE. Thank you, Mr. Milford.

Mr. ANDERSON. Thank you, Jake.

Our next witness is Mr. Frank Chabot, chief, Government Rates Division, Bureau of Economics, Civil Aeronautics Board.

TESTIMONY OF FRANK R. CHABOT, CHIEF, GOVERNMENT RATES DIVISION, BUREAU OF ECONOMICS, CIVIL AERONAUTICS BOARD, ACCOMPANIED BY LAWRENCE MYERS, STAFF COUNSEL

Mr. CHABOT. Mr. Chairman, members of the subcommittee, I am Frank R. Chabot, chief of the Government Rates Division, Bureau of Economics, Civil Aeronautics Board.

I appear before you today to present the Board's views with respect to H.R. 12349, a bill amending section 406(b) of the Federal Aviation Act. This bill would require the Board to recompute, in a specified manner, the subsidy compensation previously determined for, and paid to, certain local service carriers for the year 1966.

Specifically, the bill would preclude the Board from taking into account any decrease in Federal income tax liability resulting from capital loss carrybacks under section 1212 of the Internal Revenue Code in determining subsidy payments for 1966 under class rate III–A, and, to the extent that the Board has taken such carrybacks into account, to redetermine the amount owed.

The effect of the bill would be to require the Board to pay to Ozark Air Lines and Texas International Airlines a total of approximately $550,000 over the amount of subsidy previously paid.

At the outset, Mr. Chairman, I should point out what appears to be a technical error in the bill. As a practical matter, the Board is precluded by section 406(d) of the act from taking capital losses and, in most cases, capital gains, in the determination of subsidy need.

The loss "carrybacks" underlying this controversy are therefore not those governed under section 1212, but rather net operating loss deductions governed by section 172 of the Internal Revenue Code.

Turning to the merits of the bill, the Board opposes H.R. 12349 for two principal reasons. First, the Board's policy of determining subsidy need on the basis of actual aftertax profits is a sound one, long endorsed by the courts and the carriers themselves, and that policy was correctly applied to Ozark and Texas International for 1966 under the express terms of class rate III–A.

A failure to recognize that those carriers' 1966 tax liability was in fact reduced by loss carrybacks would understate their 1966 profits, overstate their subsidy need under section 406(b) of the act, and hence provide them with a windfall at the taxpayer's expense.

Second, as the Board sees it, adoption of this bill would preempt the orderly process of the Board's subsidy ratemaking policy, mandated by Congress and reviewed by the courts, and could open up Congress to a plethora of appeals from disappointed carriers.

A brief outline of the situation giving rise to this bill should serve to illustrate the first point.

As you may know, since 1961 the Board has fixed the subsidy to be paid to the local service carriers on the basis of a succession of class rate formulas, each designed to provide as closely as possible for the statutory need of the carriers under the circumstances then prevailing in the industry. Class rate III, which is of particular concern here, became effective on July 1, 1964, subsequently modified to class rate III–A, and continued through 1966.

Like the prior class rates, it required the carriers, under certain conditions, to refund to the Government a portion of any excess subsidy paid under detailed profit-sharing portions in the rate formula.

In keeping with the Board's longstanding policy, class rate III–A provided that the actual tax liability of each carrier for calendar year 1966, including specifically any operating loss carrybacks reported by the carrier on its tax returns filed as of the date of final determination of profit sharing for that year, was to be used in determining the amount of carrier profits to be shared with the Government.

For certain carriers, operating loss carrybacks for the years 1967, 1968, and 1969 eliminated most or all of their actual tax liability for 1966. This resulted in relatively large refunds due the Government when the subsidy compensation for each carrier was finalized during 1969 and 1970.

Four carriers took the Board to court over this method of subsidy determination. Both Allegheny Airlines and Hughes-Airwest were successful in their court actions. Allegheny in the fourth circuit and Airwest in the ninth circuit, thereby necessitating a redetermination of their subsidy refunds for 1966.

And because of Allegheny's victory in the fourth circuit, the subsequent determination of Piedmont's subsidy compensation for 1966 did not include provisions for loss carrybacks from the later years.

On the other hand, the eighth circuit, in the case of Texas International, and the District of Columbia Circuit, in the case of Ozark, refused to overturn the Board's final subsidy determinations. As the result of recognized loss carrybacks, Ozark's 1966 subsidy had been reduced by approximately $250,000, while that of Texas International had been reduced by approximately $300,000.

The bill now before the subcommittee, Mr. Chairman, H.R. 12349, would override the result of the decisions in these two court cases. It is the Board's understanding that a similar bill was sponsored in the last session of Congress, but it died in committee.

The Board believes that it would be a mistake to overturn the decisions of the eighth and District of Columbia Circuits and, in the process, to undermine the Board's policy of protecting the taxpayers against the danger of compensating the carriers for taxes which they in fact do not ultimately pay.

Indeed, as we read the decisions, what troubled the fourth and ninth circuits was not the Board's actual tax policy, but rather a perceived deviation from it. Both courts focussed on the fact that since the Board changed in 1967 from the profit sharing formula of class rate III to a revenue growth formula in class rate IV as a means of avoiding subsidy overpayments, the timing of the Board's finalization of the class rate III–A adjustments resulted in a permanent nonrecognition of tax refunds due to operating loss carrybacks for certain carriers and a recognition of such refunds for other carriers, including Ozark and Texas International.

In other words, those carriers which settled their 1966 subsidy claim under class rate III–A before subsequent operating losses available for carryback were revealed on returns filed with the Board, and did not have to share the attributable profit increase in 1966 or, because of the change in formula techniques, in any subsequent year.

Conversely, those carriers which settled after the existence of loss carrybacks became certain, did incur additional refunds to the Government. The fourth circuit found the Board's challenged orders invalid on a theory of accounting inconsistency, while the ninth circuit said they were "arbitrary" in that they lacked a procedure for insuring equal treatment for all carriers.

While recognizing that the Board had acted fully in compliance with class rate III–A with regard to all of the local service carriers, the two circuits could not harmonize the results reached under that procedure with the actual tax policy.

The answer to this concern, in the Board's view, was spelled out in the Board's explanation of the profit-sharing provisions in class rate III–A. This explanation was convincing to both the eighth and District of Columbia circuits in resolving the same contention in the cases which this bill seeks to overturn.

In recognizing the practical limits of the actual tax policy, the Board at the same time noted the fundamental fairness of the procedure established in class rate III–A. As the Board stated:

> The Board is here applying a policy it has consistently applied to all carriers similarly situated. That policy is to predicate the tax allowances on the basis of the carrier's actual income tax liability so far as it is known at the time of the Board determination.
>
> The Board has always been aware of the fact that in the normal course of administration of tax laws, a carrier's taxes for a given year are subject to change after our determination has been made final. But it would be totally infeasible to attempt to hold open each case until all possibility of amendment to the carrier's tax returns for that year had passed. Taxes can be affected by carryback credits, by voluntary amendments of returns by the taxpayer, and by deficiency assessment of the Internal Revenue Service, and were we to defer our final action on return and profit sharing matters until the various statutory limitation periods expired, it would be virtually impossible to maintain carriers on a current rate status and there would be continual uncertainty as to the Government's obligations under section 406, as well as uncertainty as to the carrier's revenues.
>
> It is for these reasons that the Board has followed the practice of relying upon the tax returns on file as the date of finalization of the rate or profit sharing case. In this manner, both the carrier and the Board are bound to the facts then existing.
>
> Subsequent changes in the tax allowance may work to the carrier's benefit or to its detriment, and the carrier takes the risk that a subsequent definciency assessment by Internal Revenue Service will occur in a closed rate period and will not be underwritten under section 406.
>
> By the same token, tax refunds for the year become beyond our reach if they occur during a closed rate period.

In other words, Mr. Chairman, the Board did follow its actual tax policy to the extent that it was reasonable to do so, and it applied that policy, and the express provisions of class rate III–A, in an evenhanded manner with all carriers.

Therefore, the bill before you, in the Board's view, does not correctly address the equities of the situation under any reasonable view of the circumstances.

As the court of appeals succinctly put it with regard to Ozark's claim of unfairness, "all that Ozark can say is that, had the formula provided for an earlier fixed date, or had there not been in this case another dispute, it would have received a windfall. We see nothing arbitrary about this loss."

Even the ninth circuit, which did find the different treatment among carriers to be "arbitrary," made it clear that the problem lies not with the Board's application of its principles and policies to Ozark and Texas International, but in the different result reached for other carriers.

The court's opinion ended with the statement that, and I quote:

> We would have no difficulty affirming an evenhanded order directing all the local airlines with later tax losses to rebate appropriate amounts of earlier subsidies.

Clearly, Mr. Chairman, the underlying rationale of H.R. 12349 is the equalization of subsidy treatment among the local service carriers for 1966.

However, it is important to distinguish between equality of treatment, in a procedural case, and equality of result. In none of the cases, has there been any allegation that the Board implemented the express provisions of class rate III–A and its actual tax policy under the facts as they were known at the time inconsistently.

There are no allegations that the Board was less than diligent and evenhanded in processing the carriers' profit-sharing computations for 1966, many of which were subject to complex methodological or factual disputes.

And finally, it must be recognized that the Board's procedure did not necessarily favor the carriers who settled quickly, because a subsequent increase in their 1966 tax liability would likewise have been ignored.

There is little or no case to be made for the proposition that the carriers as a whole, or Ozark and Texas International in particular, were treated unfairly.

Equality of result, on the other hand, was not recognized as being of prime importance by three of the four courts of appeal hearing the controversy, on the grounds that the carriers receiving different treatment do not compete with each other. And to the extent that equality of result might be desirable, three out of four courts stated as a general proposition that a windfall to one or several carriers does not entitle others to a similar windfall.

The equities, in other words, in the Board's view, do not favor Ozark and Texas International.

Accordingly, the Board recommends against enactment of H.R. 12349.

Thank you, Mr. Chairman.

Mr. ANDERSON. Thank you, Mr. Chabot.

Would you agree that Texas International and Ozark have no judicial or administrative remedy which would permit them to recapture their 1966 subsidy repayments?

Mr. CHABOT. I do not think they have any—no, I agree with that. I do not think they have.

Mr. ANDERSON. Are you aware of any other subsidy situation in which events occurring after a subsidy year have been treated differently depending on when a carrier's case was decided?

A memorandum attached to Texas International's testimony suggests that for 1965 tax loss carrybacks were treated differently, depending on whether a carrier's case was closed before it received a tax loss carryback.

My concern in asking this question is whether enactment of H.R. 12349 would create a precedent for other legislation in similar cases.

Mr. CHABOT. It could, Mr. Chairman. I believe that there are two cases that involve situations where the Board had used 1967 losses and carried them back into prior years—even back to 1964.

As I recall, I am just searching here for some notes, I think Frontier Airlines had a situation—Frontier, and I believe there was Mohawk—where the Board settled—I cannot seem to put my finger on it—yes, here it is.

Frontier Airlines' Subsidy Refund Order 69–1–99, dated January 24, 1969. In this case this order settled subsidy refunds for 1964,

1965, and 1966, and in 1964 the refund there was about $1,010,000, and the Board did adjust—did use some 1967 carryback losses, about $910,000 to adjust the taxes for 1964.

Again, in 1965, it looks as though for 1966, they had actually used up all of the losses, because there was no indication that there was any left to apply to 1966, even though there was a refund there.

In the case of Mohawk Airline Order 69–9–102, decided September 17, 1969, it looks like the Board used some tax losses in 1968 that carried back to 1965, and adjusted the 1965 tax refund so that there are only two that I know of, Mr. Chairman, that might open the door, so to speak.

Mr. ANDERSON. Four of the regional carriers challenged the CAB's 1966 subsidy policy in court.

In the first two cases the CAB won. In the last two cases, the CAB lost.

Why did not the CAB ask the Supreme Court to review the cases which CAB lost?

Mr. CHABOT. Mr. Chairman, the Board did ask, and I believe it was the Department of Justice, to appear before, or take this matter to the Supreme Court, and Justice decided that the workload at that time was such that they just could not handle this case, even though they agreed with us it probably had merit.

Mr. ANDERSON. Was part of the motivation for not appealing to the Supreme Court that you were afraid of losing and having to make additional refunds?

Mr. CHABOT. We had nothing to do with it, because it was up to the Solicitor General, as I recall. We wanted to and, as a matter of fact, we wrote the Solicitor General, is that right?

Mr. MYERS. Yes.

Mr. CHABOT. The Board wrote the Solicitor General and asked that this matter be taken to the Supreme Court. We could not work directly with the Court, as I recall, is that right?

Mr. MYERS. Yes.

Mr. ANDERSON. On the face of it, it seems unfair to require some carriers which obtained tax loss carrybacks to make a subsidy refund, and not to require other carriers which also had a tax loss carryback to make a refund.

Can you explain why you believe that this differing treatment is fair?

Mr. CHABOT. I am not sure that is a different treatment, Mr. Chairman. I think we treated them all the same.

I think what you have here is a situation where there were two courts that found for the Board, and two that found against the Board, and it is a matter that is—it is a sticky matter that I am not sure who is right at this point in time.

Personally, I have no reason to believe that the first courts that found for the Board were wrong.

Mr. WRIGHT. Mr. Chairman, would the gentleman yield?

Mr. ANDERSON. Mr. Wright.

Mr. WRIGHT. That is not a response to the question.

As I understood the chairman's question, he said do you think it makes sense for 9 out of 11 to be treated one way, or 2 to be treated the other way.

Your response was you were not sure two were wrong.

Mr. CHABOT. We treated them all the same, sir. The only time——

Mr. WRIGHT. Mr. Chabot, we are not here interrogating you in the sense that you are going to have to be defensive about what you have done here.

We are trying to correct any inequities, and we want to understand why you sit there doggedly defending the inequity.

Do you not agree that is an inequity?

Mr. CHABOT. I would only have to assume that the first two courts were wrong to the degree that it was an inequity.

Mr. WRIGHT. Well, no, would you not have to say that the nine were wrong?

Mr. CHABOT. I am not sure.

Mr. WRIGHT. If the two were right?

Mr. CHAROT. We treated them all the same.

Mr. WRIGHT. Mr. Chabot, we are not asking you how you treated them. We are asking you what is equitable and fair.

Is it fair for two airlines to be treated one way, and the nine airlines to be treated another way under the same fact situation?

Mr. CHABOT. Yes.

Mr. WRIGHT. Is that fair?

Mr. CHABOT. We followed the court decision in the case of Allegheny and——

Mr. WRIGHT. Let me pose the question again.

Is it, in your judgment, fair for two airlines under the same fact situation to be treated differently from nine airlines; is that fair?

Mr. CHABOT. I think it is unfair to have a situation that we have as——

Mr. WRIGHT. That is just what we think it is, and that is why we have got the bill, to try to correct the inequities.

Why are you opposing the correction, unless you think it is fair and equitable—treat two one way, and nine the other way?

Mr. CHABOT. I think it is unfortunate that we have court cases that involve a split decision, in other words, two for the Board, and two against it, and I think it is most unfortunate.

Mr. WRIGHT. You do not think it is equitable, do you?

Mr. CHABOT. I do not think it is equitable the way it stands at this time, Mr. Chairman.

Mr. WRIGHT. Do you know of any other way to straighten this out than by a bill of this type?

Mr. CHABOT. I suppose I would disagree with the method of straightening it out.

Mr. WRIGHT. Do you know of another way? Can you do it administratively through the CAB?

Mr. CHABOT. No; we cannot do it, sir.

Mr. WRIGHT. Well, then what other way is there, if you say it is not fair, it is not equitable, you say that it is not fair if this is the only way you can straighten out the inequity, and yet you sit there opposing this. I do not understand you.

Mr. CHABOT. I guess I do not understand the question, because you said——

Mr. WRIGHT. The question is very simple.

I asked the question, just as the chairman asked the question, is it fair, is it right, is it equitable for 2 out of the 11 to be treated one way, and 9 out of the 11 to be treated another way.

Now, you said it is unfortunate, and I gather from that you do not think it is completely equitable and fair.

I do not see how you can say that.

Mr. CHABOT. I think it is unfair to have this situation as it stands.

Mr. WRIGHT. Very good. That is what we think, and that is what the authors of this bill think.

Now, we are trying to correct it, and you tell us that there is not any other way to correct it, except by legislation, and you have already said it is not fair, you said it is not equitable, you said it is unfortunate.

Now, we are trying to correct that unfortunate inequity, unfair situation, and we ask you is there any other way to correct it, except by having it done by this legislation?

Mr. CHABOT. The answer is that the Board can do nothing at this time. It is final.

Mr. WRIGHT. Then the Congress must move in this direction and——

Mr. CHABOT. I am not so sure the Congress should move in.

Mr. WRIGHT. Leave the inequity stand, is that your solution? Just leave the inequities stand?

Mr. CHABOT. Well, in my own mind I do not think it is inequitable, unless I assume that the first two courts were wrong, and then——

Mr. WRIGHT. If you assume the first two courts were right, then you cannot assume the others were right, can you?

Mr. CHABOT. I personally have looked into this, and I cannot personally—well, I feel quite strongly that the last two courts, that found for Allegheny and Hughes Airwest were wrong. That is my personal opinion.

Mr. WRIGHT. Would you then ask the Congress to try to correct those and make Allegheny and the others pay this back to the CAB, is that what would be your solution?

Mr. CHABOT. No; I would not do that.

Mr. WRIGHT. No—well, what is your solution of how do you make it fair?

We are groping. You have admitted it is unfair. You have admitted it is unfortunate. You have admitted it is inequitable, so we are trying to make it fair and equitable and fortunate.

You say there is not any other way.

Mr. CHABOT. So far as I know, there is not.

Mr. WRIGHT. Why do you oppose our bill?

Mr. CHABOT. We do oppose it, because we do not think that the Congress should get involved in this matter.

Mr. WRIGHT. No more questions, Mr. Chairman.

Mr. ANDERSON. Mr. Taylor?

Mr. TAYLOR. Thank you, Mr. Chairman.

Mr. Chabot, I notice in a letter that I have here dated January 30, 1974, directed to our Congressman Bob Eckhardt of Texas, written by Robert E. Timm, Chairman of the Board, he says in his last paragraph:

The Board does not agree with the joint memorandum of this Administration of subsidy program in respect to Texas International-Ozark was unfair and inequitable.

Rather, the Board is of the view that its order in respect to the matters raised by Texas International-Ozark were in accordance with the law, and consistent with the public interests. Two Federal Courts of Appeals agree.

Nonetheless, as a result of the above decisions of the Fourth and Ninth Courts of Appeal, which reverses the Board's order in respect to refund owed to Allegheny and Hughes Air Corporation, Texas International-Ozark have received less favorable treatment than the other two subsidized carriers, notwithstanding substantially identical circumstances.

Under these circumstances the Board defers to the views of the Congress as to the desirability of legislation that would instruct the Board to return certain 1966 subsidy refunds paid by Texas International and Ozark.

Now, it seems the Chairman of the Board has a little different view on what is Congress' responsibility or its prerogative might be here than you have stated to the Chairman and to Mr. Wright.

Mr. CHABOT. Sounds that way, sir.

Mr. TAYLOR. And, you would be in disagreement with what the Chairman of the CAB stated in his letter to Mr. Eckhardt?

Mr. CHABOT. Yes.

Mr. TAYLOR. I see.

Mr. Chabot, were you with the Civil Aeronautics Board at the time these occurrences occurred?

Mr. CHABOT. No, sir.

Mr. TAYLOR. You were not?

Mr. CHABOT. No.

Mr. TAYLOR. How long have you been with the CAB?

Mr. CHABOT. Well, this last time—I was with the CAB earlier, and left the Board about 1957, and came back in 1970, so I have been with them almost 6 years.

Mr. TAYLOR. Prior to your coming back who were you with?

Mr. CHABOT. When I left the Board in 1957 I went to Mohawk Airlines.

Mr. TAYLOR. They are the ones that preceded this?

Mr. CHABOT. That is correct, Mohawk.

Mr. TAYLOR. It was equitable at that time, that under the same circumstances they would be compensated?

Mr. CHABOT. Actually, the circumstances that we are saying here is that we follow the procedures as outlined in the class rates, and that is what I was trying to get across, it does not matter whether I am on the carrier side, or working for the carriers, I think that the procedures were followed the same throughout, sir, and it is unfortunate, as I said to Mr. Wright, it is unfortunate that we have a situation where you have two court cases for, and two against. It is unfortunate.

Mr. ANDERSON. Would the gentleman yield?

Mr. TAYLOR. Yes.

Mr. ANDERSON. Mr. Chabot, was your testimony cleared by CAB?

Mr. CHABOT. Yse, sir, it was.

Mr. ANDERSON. In other words, in light of this conflict of statement?

Mr. CHABOT. We have a new Chairman.

Mr. ANDERSON. Yes; I know, but your current position then has been cleared?

Mr. CHABOT. Yes.

Mr. ANDERSON. And it is obviously different from that of the previous Chairman?

Mr. CHABOT. Yes, Chairman Timm's letter. Yes.

Mr. ANDERSON. Thank you.

Mr. TAYLOR. Mr. Chabot, you stated that the reason you did not appeal to the Supreme Court in the case of Allegheny and Hughes Airwest was because the Justice Department said they were too busy.

Mr. CHABOT. The language was not quite that way. They said that there was relative unimportance of the case, I mean, I think is the way they phrased it.

May I read from this letter from the Solicitor General, and it is dated January 17, 1973, and I will just read the last paragraph of the letter:

> I want to make it clear that my decision not to file a petition rests solely upon my conclusion that the issues were not sufficiently important to justify seeking Supreme Court review, and in no way implies any disagreement with the Board's position on the merits, or any suggestion I consider the decision of the Court of Appeals for the Fourth Circuit to be correct.

He is talking about a petition for certiorari and this is, in essence, what he is telling us.

Mr. TAYLOR. As I understand the case, they felt the amount was not sufficient to justify the efforts they would have to take in making this appeal.

Mr. CHABOT. I think you could read that into it, sir.

Mr. TAYLOR. Did all airlines file amended 1966 tax returns to carry back subsequent losses?

Mr. CHABOT. I really do not know that. I am not sure of that.

Mr. TAYLOR. Well, what I want to know is did all airlines file amended 1966 tax returns in order to carry back subsequent losses or, basically, did all airlines do this?

Mr. CHABOT. To the extent that they have subsequent losses they have to go back so many years, sir, but I do not know who did and who did not.

Mr. TAYLOR. Really, is not the bottom line here, the fact that the determination was made based upon when these carriers actually had their field audit, is that not the reason we have a discrepancy between the airlines we are talking about?

Mr. CHABOT. No.

If I could just take a few minutes of the subcommittee's time to tell you the sequence of events.

There is a special report that is called a T–88 report that is filed by each and every carrier during this period. In other words, it goes back really to 1961 through 1966, when the Board had a type of formula—subsidy formula in which there was a profit-sharing feature to it.

Now, that is the only time that the taxes would become a real important issue.

In other words, if you had taxes, obviously the higher taxes the less profit you have to share, or vice versa. So the T–88 reports were filed by the carriers. They usually came in, probably 3 or 4 months after the end of the period.

For example, in 1966, they came in somewhere around April of 1967, at which time they were assigned a desk audit, just a general screening of the report, which is quite thick.

As a matter of fact, as I recall, the reports were numbered A through Z, and each one had probably four or five amendments attached to it. So they were quite thick, and then the final determination, of course, was not made until a field audit was completed.

Now, those field audits were not special audits. They really came along at the time the normal audit—back at that time the CAB performed an annual audit for each airline, and this was part of the audit, not a special audit, but a part of audit.

So theoretically, I suppose the audit would take place somewhere around August or September of that year.

So you can see the time interval, and in the meantime the auditors—if the auditors had any problem, you had correspondence going back and forth between the auditors, or the audit division and the carriers, and then the audit would be certified to the subsidy section, and they then would start their final subsidy determination.

Mr. TAYLOR. Well, you have really never had an actual cutoff date, have you?

Mr. CHABOT. No, sir.

As a matter of fact, Piedmont Airlines was the last one, as I recall, and that was just handled a few years ago, as a matter of fact. It was held up primarily because of the court cases, really.

Mr. TAYLOR. As I understand it, Mr. Chabot, and the case of Ozark Airlines, Their delay was caused by Ozark contesting the capital gains tax, which they were involved in at that time, which ultimately they won, and because of this delay, because they were involved with this capital gains controversy, is one of the reasons they might have been considered a target.

However, in other cases it seems this does not make much difference.

In the case of Frontier and, of course, Piedmont and Allegheny, I think there was a voluntary settlement among those, and they did not have to go through all of this, but it seems to me that we should have a definite cutoff date, because we have got a lot of flexibility here, and I think this is what has led to the inequities that obviously have occurred.

Mr. CHABOT. This was one of the problems, sir. There was no cut off date.

In other words, the determination as to whether or not to use carryback losses gave rise to these court cases, and was a factor that in the class rate formula itself, the language, indicated that when final determination was made, the actual tax situation would be used at the date of the final determination, whether it be 2 years, or 3 years.

Mr. SNYDER. Would the gentleman yield?

Mr. TAYLOR. Yes.

Mr. SNYDER. Do you mean your regulations were at fault—that this was CAB's fault?

Mr. CHABOT. I am not so sure.

Mr. SNYDER. Congress did not do this.

Mr. CHABOT. No, sir.

Mr. SNYDER. And you do not think Congress ought to get involved. Whoever received the field audit first was in a different position than whoever was last. You treated them differently; you did not treat them the same, as you testified earlier. Just how quickly you got there with your field audit was the determinant in this; is that not right?

Mr. CHABOT. Well, we treated them—did not treat them differently, sir.

There was a time lag.

Mr. SNYDER. You treated them differently by virtue of the fact that you did not have a cutoff date in your regulations. You said it was unfortunate. It is worse than unfortunate. It is negligence.

Mr. CHABOT. I think it is unfortunate, because it gave rise to what we are here for today.

Mr. SNYDER. Because you had faulty regulations—no cutoff date—we must go through this exercise.

I thank you for yielding.

Mr. CHABOT. I think that we were following, in each case—we were following the actual regulations as they were set out by the Civil Aeronautics Board.

The tax rate application——

Mr. TAYLOR. Do you know of any other cases that are pending where they are pending claims, such as Ozark and Texas International?

Mr. CHABOT. No, sir.

Mr. TAYLOR. You stated there it might open a Pandora's box or something, but there are actually no others in contest now, or——

Mr. CHABOT. No, sir. The only two cases I cited were the cases that actually involved settlement where the Board did use 1967 losses and carried them back to settle the case.

Mr. TAYLOR. Does it not seem reasonable to you that we should do something to take care of these other obvious inequities that we are talking about, $550,000, and there is already about $3 or $4 million paid out to the others, as Mr. Timm said in his letter, and if you are a part of the reference to the identical circumstances, and forgetting the words he used, indicates they were practically that, that maybe we should do that then in the future, and the CAB should take a look at the regulations, and establish a regular cutoff date, and have a little bit more of a framework to operate within these controversies so that this will not occur again in the future?

Mr. CHABOT. Well, I am not sure that they will occur again, because we do not have that kind of a formula.

As a matter of fact, the formula was changed in 1967.

In other words, it was changed so that you do not have that situation occurring right now.

My answer to your question, if the Congress feels so inclined to change that, perhaps the change should be made not with an amendment to the Civil Aeronautics Act, but perhaps a special bill.

Mr. TAYLOR. I believe that is all.

Thank you, Mr. Chairman.

Mr. ANDERSON. Mrs. Lloyd?

Mrs. LLOYD. Thank you very much, Mr. Chairman.

Your statement that Congress should be involved, who do you think should be involved?

Mr. CHABOT. Well, I stated that in the context to a question as to whether or not there should be some—whether it was inequitable in these situations, and I do not know who should be, Mrs. Lloyd.

If the Congress feels that this is an inequitable situation, then obviously we have no recourse, and I indicated that, but there is no recourse at the Board to correct this situation.

Mr. TAYLOR. Would the gentlelady yield?

You mean the CAB?

Mr. CHABOT. The final order is out, sir, on that.

Mr. TAYLOR. There is a final order up to the CAB, and they cannot at this time administratively do anything to correct this inequity?

Mr. CHABOT. No, sir, that is correct.

Is that correct?

Mr. MYERS. No.

Mr. CHABOT. The final order is out, and the Board cannot do anything about it.

Mr. TAYLOR. I assume it is going to be done. And it is Congress who is going to have to do it.

Mr. CHABOT. If Congress so feels that way about it, obviously that is the only alternative.

Mr. TAYLOR. Thank you.

Mrs. LLOYD. I understand this is a role for the Congress, and you cannot do anything about the cutoff date in the courts.

Mr. CHABOT. Mrs. Lloyd, as I said before, I feel disturbed about this matter, for the simple reason that you have a situation where the facts are the same, and the two courts found for the Civil Aeronautics Board, and two found against us, and I do not know—my personal feeling is that if I assume that the first two were wrong, then obviously something should be done about it, but I am not that sure that the first two courts were wrong in this, and that is what hopefully my testimony was about.

I cannot personally see where the two courts were wrong.

Mr. ANDERSON. One of them would be wrong, would they not?

I cannot understand your thinking here. It is very difficult.

Mr. CHABOT. Well, for example, here you have a set of facts, Mr. Chairman, and two courts say, "Look, Mr. Civil Aeronautics Board, you are right in these two"——

Mr. ANDERSON. If you say they are not, then the other two have to be wrong.

Mr. CHABOT. That is right.

Two of them are wrong, I guess.

Mr. ANDERSON. Someone is wrong, and you say it is unfortunate, yet you say no one should do anything. I cannot understand your philosophy here.

Mr. CHABOT. My philosophy is that I cannot, in my own mind, assume that the two courts that found for Allegheny and Airwest are right. That is the essence of it, Mr. Chairman.

Mr. ANDERSON. In other words, you are still fighting those cases in your mind, even though you have lost them.

Mr. CHABOT. Even though the courts found, and said that the Civil Aeronautics Board was wrong.

Mr. ANDERSON. So because you feel the courts are wrong in their decision, even though they decided against you, you are going to hold against these other people?

Mr. CHABOT. I just feel that if—that is the way I feel, yes, personally.

Mr. TAYLOR. Evidently the Justice Department did not feel very strongly that they were wrong, or they would have been more anxious to pursue an appeal on it.

Mr. CHABOT. I did not hear you.

Mr. TAYLOR. Evidently the Justice Department did not feel they were very wrong, or they would have been anxious to pursue an appeal in this matter, but seeing it was an insignificant amount, if that was an insignificant amount, then what we are talking about today is a lot less significant. Evidently they did not feel that way, or they would have pursued it. I wonder, Mr. Chabot, if you think maybe in your own mind, and I certainly would respect your opinion—maybe you think the tax law created, and the theory itself is wrong, but it is the law, so——

Mr. CHABOT. I do not think that the carryback is wrong.

Mr. TAYLOR. If it is not wrong, then we have two carriers that have obviously been discriminated against, and they do not think there is any question about that.

Now, if it is wrong, there are nine others who were wrong, because basically we have almost an identical circumstance when they filed their returns, and also these things might come into being, but still this is not consistent because you have an identical situation with Frontier, as you have with Ozark, for example, so I mean I just cannot see how you can delineate the differences to any substantial degree, of these cases.

I just do not think there is very much difference—technicalities, maybe, but basically we have got the same problem to deal with.

Mr. CHABOT. You have got the same set of circumstances, no doubt about it.

Mr. ANDERSON. Mr. Snyder?

Mr. SNYDER. Mr. Chabot, you say in your statement that there are no allegations the Board was less than diligent and evenhanded in processing the carrier profit-sharing computations for 1966 which were subject to complex methodology and factual disputes.

Why did those issues go to court?

Mr. CHABOT. The reason they went to court, as I understand, that was the next logical step, because there is nothing—it was a final order on it.

Mr. SNYDER. Well, they were disputing the Board's diligence in evenhandedness when they went to court; were they not disputing your diligence and evenhandedness?

Mr. CHABOT. They were disputing the results.

Mr. TAYLOR. And is not a court case an allegation?

Mr. CHABOT. Yes.

Mr. TAYLOR. Do you have some trouble with that? Do you?

Mr. CHABOT. Yes, I do, yes.

Mr. SNYDER. That a court case is an allegation of a wrong?

Mr. CHABOT. Well, I think the court case is supposed to settle some differences, which——

Mr. SNYDER. Now, let me ask you this. You say that:

> Policies predicate the tax allowances on the basis of the carrier's actual income tax liability so far as it is known at the time of the Board determination.

How many did you ask to file subsequent tax information; how many airlines?

Mr. CHABOT. I do not know that, sir.

Mr. SNYDER. Well, I would like to find out, or you can supply it for the record.

Mr. CHABOT. Let me see if I understand the question.

I am not sure that I quite—what were you trying to get at?

Mr. SNYDER. Let me pursue this—let me ask you this.

Did the Board base Ozark's profit sharing for 1966 on Ozark's 1966 tax returns on file as of the date of its final determination?

Mr. CHABOT. I do not believe so.

Mr. SNYDER. Why not?

Mr. CHABOT. Because, as I recall, the Ozark's final determination was made—they had subsequent losses available to them.

Mr. SNYDER. Is not Ozark the only one that you required to come back and file a subsequent statement?

Mr. CHABOT. I do not know.

Mr. SNYDER. Well, I want you to find out, and supply it for the record.

Mr. CHABOT. Well, as I recall, I think I mentioned earlier here there was a case of Frontier, where we had used 1967 losses at the time of computing 1966, 1965, and 1964 results, and in the case of Mohawk——

Mr. SNYDER. Let me ask you about that.

Did the Board know at the time of Ozark's final determination for 1966, that Frontier Airlines wanted to amend its 1966 tax return to show a loss carryback?

Mr. CHABOT. I do not know the answer to that.

Mr. SNYDER. I would like you to find out the answer and supply it for the record. Along that same line, I want to know if Frontier filed its final report with the Board at the same time Ozark did.

Do you know that now, or do you have to look it up?

Mr. CHABOT. I would have to look it up, but——

Mr. SNYDER. I would like you to look it up and supply it for the record.

I have the question typed here and will give it to you.

Mr. CHABOT. All right, we will supply it, sir. I do not know.

[See letter of response, p. 28.]

Mr. SNYDER. We have known that Frontier would file an amended 1966 tax return?

Mr. CHABOT. I do not know the answer to that.

Mr. SNYDER. I want you to find out. I want to know if the Board required Frontier to file a pro forma 1966 return?

Mr. CHABOT. As I recall, sir, and following the special reports, T–88 reports, which determine the amount of profits to be shared at the time of filing of that T–88 report which came in usually around April of the following year, most of the carriers would probably only have pro forma reports, because as I recall, most carriers actually get an extension of filing their income taxes for April until September. It is just an automatic extension so that they would probably only have pro forma returns.

We will find out, sir—find out. I do not know.

Mr. SNYDER. Was the final determination for any other carrier's 1966 profit sharing still pending at the time of the court decision in the *Allegheny* and *Airwest* cases?

Mr. CHABOT. Yes. There was the *Piedmont* case.

Mr. SNYDER. Was it resolved on the same basis as those two cases, or on the same basis as the *Ozark* and *Texas International* cases?

Mr. CHABOT. It was resolved on the same basis as the *Allegheny* and *Hughes Airwest* cases.

Mr. SNYDER. Why?

Mr. CHABOT. No. 1, Piedmont Airlines' home base is in the same circuit court as Allegheny. As I recall, that is the fourth circuit, and the staff recommended to the Board, and the majority agreed with it, that rather than force Piedmont to go to court, in other words to process their profit sharing on the same basis as Ozark and Texas International, and then, in essence, to force them to go to court to reverse that.

The staff felt that the realistic approach would be to process them the same as Allegheny, along with the the *Allegheny* and *Hughes Airwest* court cases.

Mr. SNYDER. So, notwithstanding your conviction as to principle, you decided this case based upon where these firms were based?

Mr. CHABOT. I think really the question was based realistically.

Mr. SNYDER. And this is the fairness and evenhandedness you come before us and talk about, correct?

Mr. CHABOT. I think I should say in all fairness, sir——

Mr. SNYDER. Wait a minute. We want to give you the same degree of fairness you gave these folks.

Mr. CHABOT. No; I think it is just practical. It is a practical situation, I mean, that and, actually——

Mr. TAYLOR. You decided on what circuits people are really——

Mr. CHABOT. That is right.

Mr. SNYDER. You are talking about a technical proposition. As a Government agency you treated some of these people one way because of where they are based and you took care of other people because they are based in the right place.

Mr. CHABOT. I do not think so, sir.

I am not sure I agree with that.

Mr. SNYDER. Well, you say that is why you did it. You think it is right, and you do not want us to give these people relief.

Mr. CHABOT. We recommended that to the Civil Aeronautics Board.

All the Civil Aeronautics Board members did not agree with the staff. There were two that dissented on that position in all fairness, in this matter.

I think that should be on the record, too, that there were two Board members that felt we should actually force Piedmont to go to court in this matter.

Mr. SNYDER. Maybe, if you feel that way you ought to be here asking for legislation requiring the others to refund portions of their subsidies so they would be treated alike. Since you think the courts were wrong when they decided those other two cases, maybe you ought to be here advocating legislation to correct the errors.

Mr. CHABOT. That is my personal feeling, sir.

Mr. SNYDER. Well, you personally agree with your own testimony?

Mr. CHABOT. Yes; I do. Yes, I do.

Mr. SNYDER. Then, if that is your personal feeling, you just disagree with the Board in this regard?

Mr. CHABOT. I think so, yes. I could disagree with the Board in that regard.

Mr. SNYDER. Now, back to the question somebody asked you earlier, when you said it is unfortunate that there is not a cutoff date.

Mr. CHABOT. Yes, sir.

Mr. SNYDER. Now, how do you decide who is going to get a field audit first, and who is going to get one later?

Mr. CHABOT. I do not know how it was decided in those years, sir. The people who are responsible for the work assignment at the time have retired, and gosh knows where they are at this point.

Mr. SNYDER. They do extend over a considerable period of time; that is the big problem.

Mr. CHABOT. Yes.

As a matter of fact, we were in looking—looking back into the workload that we were processing in 1962 and 1963, back in the 1966 period.

Mr. SNYDER. You said it would not be unfeasible to hold each case open until all possibility of amendment to the tax return for a given year had passed.

But, by having the field audits cover a long period of time, some coming earlier, some coming later, you do, in effect, hold some open longer than others, by the normal course of events?

Mr. CHABOT. Just by time, yes, sir. Some of them have to, because you cannot actually process them all at the same time.

Mr. SNYDER. And that is evenhanded and equitable?

Mr. CHABOT. To that extent, yes.

In other words, you have to have, obviously, someone who has to be ahead of someone else.

Mr. SNYDER. You mean to that extent, yes, it is equitable, or to that extent, yes, it is not equitable?

Mr. CHABOT. To the extent that you have to handle one ahead of the other is inequitable, I believe, and I suppose you cannot handle them all at the same time.

Mr. SNYDER. That is right, and so the reason we have this problem is because you did not have a cutoff date.

Mr. CHABOT. We did not have one.

Mr. SNYDER. Do you have one now?

Mr. CHABOT. We do not have that type of formula.

As a matter of fact, the formula was changed.

Mr. SNYDER. That is right.

Mr. CHABOT. In 1967.

Mr. SNYDER. The formula was changed, and so why are we not setting a precedent?

Mr. CHABOT. There are only two carriers that could be affected if the Congress agrees with this. There are only two carriers that I know of, sir.

Mr. GOLDWATER. Would the gentleman yield?

Mr. SNYDER. Sure.

Mr. GOLDWATER. Mr. Chabot, what would this legislation do? What would it upset? Why does CAB oppose it?

Mr. CHABOT. I think the CAB opposes it, No. 1, that this does change the policy that the Board has had for a long period of time, that is, the actual tax policy would change.

And, No. 2, as I indicated, it really amends the Civil Aeronautics Act retroactively, and it has very little application prospectively, that I know of.

Mr. GOLDWATER. So it has no application to existing procedures?

Mr. CHABOT. No.

Mr. GOLDWATER. Existing formula, and it is sort of a post mortem cleanup?

Mr. CHABOT. That is right. That is right.

Mr. GOLDWATER. So it really does not affect CAB's procedures or existing regulations?

Mr. CHABOT. No; we think——

Mr. GOLDWATER. It is just going back and righting a wrong, or making something equitable that you admit is inequitable, just because of procedure?

Mr. CHABOT. We think perhaps if the Congress feels inclined to pass this bill, that it should be a private bill, rather than an amendment to the Civil Aeronautics Act. That is about the essence.

Mr. GOLDWATER. But it does not really affect the existing procedures as they are processed today?

Mr. CHABOT. No, sir, not one bit.

Mr. GOLDWATER. So why the objection to the amendment?

Mr. CHABOT. Well, we do not think we should amend an act that has been in existence for many years, retroactively, I mean, the amendment should presumably be prospective, and——

Mr. GOLDWATER. If it was a private relief act would you object to it?

Mr. CHABOT. I think that the Board would object to it the same way, sir, whether it was private or not, such an amendment.

Mr. GOLDWATER. Really, what you are saying is that this piece of legislation in all practicality would have no adverse effect upon the CAB?

Mr. CHABOT. No, sir. If the legislation is passed, as the bill has been corrected, what it would mean is the Board would have to redetermine the calculations back in those periods and put out a new—new order, really—two new orders.

Mr. SNYDER. Just one last question.

You quote from the court's opinion wherein the court says—

> We would have no difficulty in affirming an evenhanded order directing all the local airlines with later tax losses to rebate appropriate amounts of early subsidies.

Is not the court telling you what it deems to be an evenhanded order?

Mr. CHABOT. I suppose you could read that into it, Mr. Snyder.

Mr. SNYDER. Suppose I could read into it, but is it not as plain as the nose on your face?

Mr. CHABOT. I think they are saying just the opposite here.

Mr. SNYDER. You do? They say you order all to pay, then it would be evenhanded. Does it not necessarily follow that if some of them pay, and others do not, then it is not evenhanded?

Mr. CHABOT. To that extent, that is right.

Mr. SNYDER. Thank you.

You have been a good witness.

Mr. ANDERSON. Mr. Milford?

Mr. MILFORD. Mr. Chairman, I think the testimony clearly points out there has been an inequity through questioning by Mr. Wright and Mr. Snyder, and I will not pursue it any further, except for one technical point. As you were reading the statement you stated that "as a result of loss carrybacks, 1966 subsidy has been reduced by approx-

imately $300,000." "And while that of Texas International has been reduced," and then you verbally stated "$350,000," but your statement lists $250,000.

Mr. CHABOT. The statement is wrong. I should have made a correction here. That is a typo.

Mr. MILFORD. $300,000 is the proper figure?

Mr. CHABOT. $300,000, that I read, yes, sir.

Mr. MILFORD. Is the proper figure?

Mr. CHABOT. It is really the way it should read is that $250,000 should be in place of the $300,000, and then the $300,000 in place of the $250,000.

In other words, just the reverse. It is a transposition.

Mr. MILFORD. We want to get that corrected for the record.

Mr. CHABOT. I am sorry.

I meant to make that correction.

Mr. MILFORD. Mr. Chairman, I have no further questions.

Mr. ANDERSON. Mr. Goldwater?

Mr. GOLDWATER. Mr. Chairman, Mr. Chabot, if I understand the situation, you had 11 original airlines in 1966, and you are programed to pay them the subsidy based on profits and expenses?

Mr. CHABOT. Yes, sir.

Mr. GOLDWATER. Seven of those airlines settled reasonably quickly, but for those four, the decision of final determination, for one reason or another, was delayed some 4 years.

As a result of this, taking into account tax carryback, the subsidy was washed out, and there was money owed by the airlines. Two of these airlines went to court, and one of them lost.

It appears to me that what you have as a result of that is a judicial limbo.

Mr. CHABOT. Yes, sir.

Mr. GOLDWATER. In other words, there is truely not a final disposition of this conflict.

Now, you are saying that nothing should be done, that this state of limbo should not be resolved.

It appears to me the CAB is affected adversely by having the lack of clarity in this confused circumstance, and somebody should decide this conflict once and for all. It appears to me the Congress is the only body that can do that, and I think that is, in essence, what we are trying to do with this legislation.

I am concerned, as I think the CAB is, that Congress may arbitrarily intervene in the regulatory process, but if we are looking at this sort of postmortem, and the conflict still has not been resolved, and some airlines have been affected adversely, then something should be done.

Do you disagree with that?

Mr. CHABOT. No; I cannot, because at this point——

Mr. GOLDWATER. You just do not like the Congress to be meddling in the CAB process?

Mr. CHABOT. Actually, Mr. Goldwater, I think that this should be resolved by the courts, I mean, the Supreme Court.

Obviously, it is water over the dam now, and we cannot do that, so the next step is up to the Congress, and then obviously Congress is the only one that can do it at this point in time.

Mr. GOLDWATER. I thank you, Mr. Chairman.

Mr. ANDERSON. Mr. Johnson?

Mr. JOHNSON. I have no questions, Mr. Chairman.

Mr. ANDERSON. Mr. Fary?

Mr. FARY. Mr. Chabot, I—thank you, Mr. Chairman.

Mr. Chabot, in your testimony you suggest passage of H.R. 12349 would result in a windfall for Texas International and Ozark.

I wonder why you call it a windfall.

Do carriers who had heavy losses in 1967 and 1968, which were not met by subsidies, these losses which led to the 1966 tax refund, it seems to me that overall the carriers have suffered a loss, and would you care to comment?

Mr. CHABOT. Yes, sir. The reason we say that is that the rates that were fixed are actually on an annual basis, and we are talking about the rates for 1966, whether or not they are fair and reasonable rates, and the fact that they had losses in 1967 and 1968 would not have a bearing on whether the rates in 1966 were fair and reasonable. That is all we are trying to get across there.

Basically, we found the rates fair and reasonable, at least in our ratemaking, under our ratemaking standards, and we found them fair and reasonable, and to the extent they are disturbed now, then obviously it is really going to be a windfall to some, and not to others, and that is the only reason I made that statement.

Mr. FARY. I thank you.

Mr. ANDERSON. Mr. Chabot, I was a little confused by your answer to my second question on whether enactment of this measure would create a precedent in light of your answer to Mr. Goldwater.

You said there are no similar situations.

Now, did I understand you to testify that for 1965 some carriers had to make refunds based on tax loss carrybacks, and some carriers had tax loss carrybacks but did not have to make refunds, is that correct?

Mr. CHABOT. Well, if this bill is passed by Congress, there are only two carriers that I know of who had a similar situation where the Board used some prior losses.

In other words, subsequent losses, and carried them back into 1964 and 1965. There are only two carriers, and as I mentioned——

Mr. ANDERSON. Which were they?

Mr. CHABOT. Frontier and Mohawk.

Mr. ANDERSON. I was going to ask, Is it your position that this bill—if this bill is passed, it may be necessary to pass a similar bill for 1965?

Mr. CHABOT. It could, it could. You asked could it open the door. It might, for Frontier, and as a matter of fact, for Mohawk, and not only Mohawk, but Allegheny.

Mr. ANDERSON. I realize that.

There would still be——

Mr. CHABOT. Yes, Allegheny could then come in, I suppose, Mr. Chairman, and so could Frontier, and that is all I am saying, is that there are two carriers that——

Mr. ANDERSON. Are they the only two?

Mr. CHABOT. The only two that we know of. This is Mohawk Airlines and Frontier.

Mr. ANDERSON. Mohawk Airlines when it was an independent company, and then Frontier in 1965, that is what he is telling us.

Mr. CHABOT. 1965 and 1964, as a matter of fact.

Mr. ANDERSON. 1965 and 1964.

Mr. SNYDER. This bill only specifies 1 year, for the year 1966.

Mr. CHABOT. I know that we are only talking about 1966 here, but the fact is that it was only 1966 that affected Frontier—I mean, Ozark and Texas International.

Mr. SNYDER. Could I have one more question?

Mr. ANDERSON. Yes.

Mr. SNYDER. Has there been any other instance when the airlines, various airlines, were treated differently?

In other words, if you treated them all the same in this particular year, I probably would not be for the bill.

Mr. CHABOT. I think that——

Mr. SNYDER. So, were there other years when they were treated different?

Mr. CHABOT. Yes. As a matter of fact, I believe it was either Texas or——

Mr. SNYDER. Were there other criteria under which you gave some the benefit and others not?

Mr. CHABOT. In the case of Texas, it was Texas International, where the case was handled, and—let me say—I believe it was in their 1965 case, here it is Texas International subsidy refund order 68–11–15, decided November 4, 1968, it has to do with the 1965 profit sharing refund which was finally determined in November 1968, prior to the filing of their 1968 tax return.

Therefore, no adjustment was made for 1965 profit sharing as a result of loss carrybacks from 1968.

Mr. SNYDER. How was the rest of the industry treated that year?

Mr. CHABOT. For 1965?

Mr. SNYDER. Yes.

Mr. CHABOT. The same way that Texas International was treated.

In other words, Mr. Snyder, they were treated the same.

In this case, the tax returns had not been filed for 1968, so obviously there was no loss carrybacks from that year, and that was the situation with other carriers.

In other words, at the time of final determination of the tax status, in this case the 1968 taxes——

Mr. SNYDER. But in 1965, what was the net result, the bottom line of whether or not Texas International was treated the same as the rest of the industry with regard to whether they receive the benefit of their carryback?

Mr. CHABOT. I do not know, because I do not have——

Mr. SNYDER. You do not know? There ought to be a claim.

Mr. CHABOT. No; I do not know—all I am saying, it depends on the circumstances and the timing of the final determination as to whether or not tax loss carrybacks were used.

Mr. ANDERSON. Is not what you are saying that in 1965 you did have a different—Texas International had to make the tax refund, whereas the other two did not?

Mr. CHABOT. No. As a matter of fact, the——

Mr. ANDERSON. Or the other way around?

Mr. CHABOT. That is right.

Mr. ANDERSON. So there was a difference in 1965?

Mr. CHABOT. Yes.

Mr. SNYDER. He has been all over the field on this. I do not know——

Mr. CHABOT. Well, it is different than 1966. That is what I am saying.

Mr. SNYDER. I want to know if the entire industry was treated the same in 1965.

Mr. ANDERSON. He just said no, he said they were not.

Mr. SNYDER. I know he did, but a minute ago he said yes, so I do not know.

Mr. CHABOT. I am not sure—all I am doing is stating what happened in 1965.

Mr. SNYDER. At one time, he said he did not know.

Did you get an answer, Mr. Chairman?

Mr. ANDERSON. He just said in 1965 they did not treat them the same.

Mr. CHABOT. This is the research that was done. It is difficult.

Mr. ANDERSON. Frontier and Mohawk had to make subsidy refund, and Texas International did not, isn't that what you just told us?

Mr. CHABOT. That is right.

Mr. ANDERSON. In that year, the Board obviously did not treat them the same.

Mr. CHABOT. This is the research that was done in this case and, in other words, whatever the tax determination was made at the time of final subsidy profit sharing.

Mr. ANDERSON. Yet, if we were to pass this bill, and I think obviously something has to be done, if we were to pass this bill, and then if we are to establish a precedent and Frontier would be able to come in, what would they be entitled to?

Mr. CHABOT. It is difficult to say at this time, because, No. 1, in the case of Frontier for 1964, the Board used $910,000 of loss carrybacks from 1967 to apply against 1964. So at that time, their subsidy refund after applying the $910,000, subsidy refund was $1,010,000.

I do not know what that is going to do to them, Mr. Chairman.

Now, again, in 1965, the Board used—in order to determine the refund, which was $1,524,000 that year, the Board used $248,000 of 1967 carryback losses. There would have to be a recomputation, and I do not have it at the moment, Mr. Chairman.

Mr. ANDERSON. Further questions?

Mr. SNYDER. No.

Mr. ANDERSON. Any further questions from other members?

Mr. MILFORD. No.

Mr. ANDERSON. Thank you, Mr. Chabot.

Mr. CHABOT. Thank you.

[Subsequent to the hearing, the following was received for the record:]

CIVIL AERONAUTICS BOARD,
Washington, D.C., September 8, 1976.

Hon. GLENN M. ANDERSON,
Chairman, Subcommittee on Aviation, Committee on Public Works and Transportation, House of Representatives, Washington, D.C.

DEAR MR. CHAIRMAN: During the CAB testimony August 31, 1976 on H.R. 12349, Congressman Snyder requested Mr. Chabot supply answers to specific questions which are submitted herewith.

Sincerely,

JAMES L. KOLSTAD,
Director, Community and Congressional Relations.

CAB RESPONSES TO QUESTIONS FROM CONGRESSMAN SNYDER

Question: Was any airline other than Ozark and Texas International required to pay 1966 profit sharing based on any such loss carryback?

Why not?

Answer: Ozark and Texas International are the two remaining carriers who had loss carrybacks used to reduce taxes for the 1966 profit sharing period.

Frontier had 1967 loss carrybacks used to determine its profit sharing for both 1964 and 1965. Moreover, the 1967 loss carryback was exhausted in 1965 and thus unavailable for Frontier's 1966 profit sharing determination.

Mohawk had no excess profits to share in 1966. The CAB did use Mohawk's 1967 and 1968 loss carrybacks to determine the profit sharing for both 1964 and 1965.

In calculating Lake Central's profit sharing for 1965, the Board used 1966 and 1967 loss carrybacks, thus eliminating the tax provision for 1965.

Question: Did the Board base Ozark's profit sharing for 1966 on Ozark's 1966 tax return on file as of the date of its final determination?

Why not?

Answer: No, the Board did not use Ozark's 1966 tax return for its final determination.

Ozark's final determination for 1966 was adopted on May 21, 1970 at which time the Board used a pro forma 1969 tax return indicating losses which were carried back to 1966. In using the 1969 losses to offset 1966 taxes, the CAB was following the provisions of Class Rate III–A which required the Board to reflect the actual tax liability as of the date of final determination.

Question: Did the Board's orders require the use of a carrier's tax return actually on file as of the date of that carrier's final determination?

Answer: Yes, but it was an established practice in the profit sharing determination to use a pro forma return reflecting a carrier's best estimate of its tax liability which was relied on by the Board. This practice came about because of the filing extensions granted by Internal Revenue, the first of which was nearly automatic, i.e., the one extending the filing date from April to September.

Question: Did the Board follow this procedure so far as Ozark was concerned?

Why not?

Answer: No, the Board did not follow the precise procedure as set out in the Class Rate.

In profit sharing determinations, it had been established practice for the Board and the carriers to rely on pro forma returns whenever the carrier received extensions in filing actual returns.

Question: Did the Board know at the time of Ozark's final determination for 1966 that Frontier Airlines would likely amend its 1966 tax return as to show a loss carryback?

a. Didn't it file financial reports with the Board at the same time Ozark did?

b. Wasn't it apparent that Frontier would file an amended 1966 return?

c. Did the Board require Frontier to file a pro forma 1966 return?

d. Why did the Board treat Ozark and Frontier differently?

Answer: Ozark's final profit sharing determination for 1966 was adopted May 21, 1970, sixteen months after the Frontier profit sharing order for 1966, which was adopted January 24, 1969. The Frontier order also included the profit sharing years 1964 and 1965 which were both affected by 1967 carryback losses.

a. Financial reports in final form for a calendar year are filed with the Board on March 31. Both Ozark and Frontier are required to file such reports on the same date unless extensions are granted.

b. Frontier's final profit sharing determination for 1964, 1965, and 1966 was adopted January 24, 1969. The Board used 1967 carryback losses and exhausted them in calculating profit sharing for 1964 and 1965. The Board had no official notice of Frontier's 1968 financial results until preliminary reports were received on February 10, 1969.

c. This question should probably read amended 1966 return rather than "pro forma". The Board exhausted the 1967 losses which were applied against profit sharing years of 1964 and 1965. On January 24, 1969, the date the Board determined profit sharing for 1966, it did not have official notice of the preliminary financial results for 1968, which were filed on February 10, 1969.

d. It was a matter of when such information was filed with the Board. For example, in Ozark's 1966 profit sharing case which was adopted May 21, 1970, the Board would have had official notice of the 1969 final operating results on March 31, 1970 and the carrier's tax return for 1969 should have been filed April 15, 1970 but was probably extended to September 1970.

Question: Was the final determination for any other carrier's 1966 profit sharing still pending as of the time of the court's decisions in the *Allegheny* and *Airwest* cases?

Was it resolved on the same basis as those two cases or on the same basis as the *Ozark* and *Texas International* cases?

Why?

Answer: Piedmont was the only carrier which had a 1966 profit sharing determination still pending at the time of the court's decision in the *Allegheny* and *Airwest* cases.

Piedmont's 1966 profit sharing determination was not resolved on the same basis as Ozark and Texas International.

Piedmont's principal place of business is in the Fourth Circuit, which Court found for Allegheny. Although the CAB has not acquiesced in this decision, a majority of the Board agreed that the Court's determination establishes the law and therefore the carryback losses were not used in the *Piedmont* case. However, two Board members disagreed with such tax treatment and felt the carryback losses should have been applied.

Mr. ANDERSON. Our next witnesses are Francisco A. Lorenzo and Paul Bradshaw.

TESTIMONY OF FRANCISCO A. LORENZO, PRESIDENT, TEXAS INTERNATIONAL AIRLINES, INC., ACCOMPANIED BY PAUL L. BRADSHAW, SENIOR VICE PRESIDENT, AND GENERAL COUNSEL, OZARK AIRLINES; EMORY ELLIS, GENERAL COUNSEL, TEXAS INTERNATIONAL AIRLINES; AND EDWARD J. CRANE, PRESIDENT, OZARK AIRLINES, INC.

Mr. SNYDER. Mr. Chairman, this is a voluminous statement, and you announced that one of these fellows is a lawyer, Mr. Bradshaw. If he practices as much as I think, he knows that when you are far ahead, you do not belabor the point.

You could say something to hurt yourself.

I wonder if you and Mr. Lorenzo would file your statements and then summarize them.

Mr. LORENZO. Congresman Snyder, I was actually going to propose that—I was going to summarize and just add that Texas International is a carrier whose last year of profit before 1972 was in 1966. During the interview we accumulated about $20 million of loss. Further, while the $300,000 Texas International is seeking, as I understand, has been considered by some people as a pretty small sum, I did want to remind the subcommittee that this sum in fact represents about 10 percent of the equity basis that the CAB was using when computing the return for Texas International this year.

It is a big sum for us, and therefore this bill is important to us, and there are a couple of points from the CAB's testimony that I would like to ask Mr. Ellis, counsel to Texas International to make comment or two about to you.

Mr. SNYDER. I ask unanimous consent, Mr. Chairman, that the prepared statements by Messers Bradshaw and Lorenzo appear in the record in full, as if read.

Mr. ANDERSON. So ordered.

Mr. Bradshaw's and Mr. Lorenzo's statements will be made a matter of the record at this point.

[The following was received for the record.]

STATEMENT OF FRANCISCO A. LORENZO, PRESIDENT, TEXAS INTERNATIONAL AIRLINES, INC.

I am Frank Lorenzo, President of Texas International Airlines, Inc., Mr. Chairman. We appreciate the opportunity of appearing before you today in support of H.R. 12349—a bill which has great importance for Texas International.

H.R. 12349 is intended to cure a quirk in the Federal Aviation Act of 1958, which is preventing the Civil Aeronautics Board from treating all of the federally certificated, local service carriers in a like and equitable manner with regard to their subsidy payments for 1966. Because of this quirk, and because of the way the Board's staff administered the subsidy program two of the eleven locals—Texas International and Ozark—were treated differently from the other carriers in their class and were improperly deprived of substantial sums of subsidy money which were needed to maintain and develop services to the smaller points on their systems. The bill would permit the Board or place all of the carriers, including Texas International and Ozark on the same subsidy payment basis for 1966. For Texas International it would authorize the Board to pay a net amount of about $296,000 in additional subsidy for 1966—a sum which we believe has been withheld improperly and far too long.

The subject of subsidy rate-making is complex. In the interest of helping the Committee understand the problem involved here in the context of the class rate system used by the Board in paying local service carriers subsidies, Texas International and Ozark asked their attorneys, Mr. Emory Ellis, and Mr. Thom Field to prepare a memorandum on the subject. The memorandum is included as an attachment to my testimony. It is self-contained and readable; and I see no purpose in reading it into the record. But, with your permission Mr. Chairman, I will give a brief summary statement.

Please bear in mind, however, that an intimate understanding of subsidy rate-making is not necessary to understand the reasons for adoption of H.R. 12349. The important factors are (1) under the subsidy class rate in effect during 1966 the local service carriers were treated inequitably by the Board (we believe that even the CAB will admit to this fact); (2) two U.S. Courts of Appeals have found that this inequitable treatment was improper and unlawful; (3) the Board itself has already cured the inequity with regard to all but two of the carriers affected; (4) the Board does not have the power under the Act to cure all of the inequity, and adoption of H.R. 12349 is necessary for that purpose.

Texas International and Ozark Air Lines are federally certificated local service airlines which receive subsidy from the federal government under rates set by the Civil Aeronautics Board for service over unprofitable routes to small and medium sized communities. Since 1961 these two carriers have received subsidy under a local service class subsidy rate which is applicable to all of the local service carriers. There have been seven essential amendments to the class rate, each amended version replacing its predecessor, and each amendment numbered consecutively. The rate now in effect is called Class Rate VII. The rate with which we are concerned here is Class Rate III.

Class Rate III provided for the payment of subsidy monthly on the basis of a formula, and for a repayment by each carrier to the government at the end of the calendar year if an audit of the carrier's books for the year, and a post audit review by the CAB's staff, showed excess profits.

One of the items considered in the determination of excess profits was actual income taxes shown on the carrier's tax returns. In 1966 both Texas Inter-

national and Ozark had profits for income tax purposes, and these taxes were considered an expense item in determining excess profits for that year. The CAB audits for 1966 were completed in 1967 and showed no excess profits and no payback for either Texas International or Ozark.

However, because of administrative lag, the post audit review and final determination of 1966 excess profits for Texas International, Ozark and three other local service carriers (Allegheny, Airwest, and Piedmont) were not made until 1970 or later. By this time the carriers were operating under a new class rate concept—Class Rate IV—a rate which the Board itself later admitted was deficient. A combination of Class Rate IV's deficiencies and the general economic torpor which affected the country in the late 60's and early 70's, caused serious losses for all of the locals. Under the tax laws the airlines carried back losses from 1968 and 1969 to 1966, and to other years for offset against taxable profits in those years.

The Board did not get around to a final determination of 1966 excess profits for Texas International; Ozark, Allegheny and Airwest until 1970, and it did not set Piedmont's profit sharing until 1974. By this time the loss carry-backs to 1966 had already been taken and the Board recognized the amended tax figure rather than the taxes shown on the original 1966 returns. This had the effect of constructing profits for the five carriers where before they had been less or non-existent, as in the case of Texas International and Ozark. Texas International and Ozark were required to refund $296,792 and $245,579 respectively. Allegheny and Airwest were also required to make refunds related to this same loss carry-back problem (because of other problems, Piedmont's final determination was not made until 1974).

Ironically, losses from the bad years were being used retroactively to require a refund, and thereby denigrate the profit position of the carriers, in an earlier year. The Fourth Circuit Court of Appeals has found that this was "unreasonable and arbitrary". To make matters even worse, this occurred not because of a well thought-out plan or design by the Board or its staff, but, by accident because the CAB's staff was dilatory in making its post audit review. If the determinations for the five carriers had been made earlier, when those of North Central, Frontier, and Southern were made, the problem would not have arisen. The U.S. Court of Appeals for the Ninth Circuit described the situation as follows:

"Whether a carrier would be forced to return or allowed to keep hundreds of thousands of dollars would turn on fortuitous circumstances, including the order in which the CAB decided to process paper work and the dispatch with which it was processed. The facts of this case failed to demonstrate any reasonable justification for continued adherence to a procedure which did not treat all members of the class equally."

Each of the four carriers petitioned for judicial review to different United States Courts of Appeals—Texas International to the D.C. Circuit; Ozark to the Eighth Circuit; Allegheny to the Fourth Circuit; and Airwest to the Ninth Circuit. The issues in each of these cases were virtually identical.

Ozark's and Texas International's cases were filed first and were decided in 1971. In both cases the Court upheld the Board. *Ozark Air Lines, Inc.* v. *C.A.B.*, 441 F. 2d 892 (8th Cir. 1971); *Texas International Airlines, Inc.* v. *C.A.B.*, 458 F. 2d 782 (D.C. Cir., 1971). Ozark petitioned for certiorari to the Supreme Court, but its petition was denied because clear grounds were lacking.

In September of 1972 the Fourth Circuit Court reversed the Board in the Allegheny Case (*Allegheny Airlines, Inc.* v. *C.A.B.*, 465 F. 2d 778 (4th Cir. 1972)); and in May of 1973 the Nineth Circuit reversed the Board in the *Airwest* Case (*Hughes Air Corp. d/b/a Airwest* v. *C.A.B.*, 482 F. 2d 143 (9th Cir. 1973)). In spite of the fact that there was at this point a clear dichotomy of decisions on the same issue among federal circuit courts (clear grounds for a petition for certiorari) the Board chose not to go to the Supreme Court. Rather it paid Allegheny and Airwest a combined sum of over $1.8 million in additional subsidy. This is well over three times the combined total at issue for Texas International and Ozark.

Moreover, when the Board finally settled the Piedmont Case in 1974, it treated Piedmont's taxes in the same way it treated Allegheny's and Airwest's.

This means that of all of the eleven local service carriers operating during 1966 only Texas International and Ozark ultimately had their losses from later years used against them in determining excess profits for 1966.

This was clearly unfair and inequitable. However, because of the well-established principle favoring finality of rates, our attorney's have told us that, the Board has no power to remedy the injustice. *Transcontinental and Western Air Inc.* v. *C.A.B.*, 169 F. 2d 893 (D.C. Circuit 1948), aff'd 336 U.S. 601 (1949).

We believe that the only way that the equities can be balanced so that all of the local service carriers can be placed on the same footing, and Texas International and Ozark can be reimbursed for the money which has been improperly withheld from them is by an Act of Congress. H.R. 12349 is designed for that purpose, and we wholeheartedly support it Mr. Chairman.

JOINT MEMORANDUM OF TEXAS INTERNATIONAL AIRLINES, INC., AND OZARK AIR LINES, INC., CONCERNING INEQUITABLE TREATMENT UNDER CLASS SUBSIDY MAIL RATE

I. INTRODUCTION

Texas International Airlines, Inc. (hereinafter sometimes referred to as TXIA) and Ozark Air Lines, Inc. (hereinafter sometimes referred to as Ozark) are local service air carriers holding certificates issued by the Civil Aeronautics Board under the Federal Aviation Act of 1958, as amended. [49 U.S.C. 1301 et seq.] The carriers' primary obligation is the provision of short-haul, local or feeder air transportation.[1] TXIA's system includes nine states and extends from Memphis and New Orleans in the East to Los Angeles in the West; but 25 of the 48 points it serves are in the State of Texas. Ozark's system includes service to 62 cities in some 15 states and the District of Columbia and extends from New York City to Denver and from Minneapolis-St. Paul to Dallas-Fort Worth. The bulk of its service is concentrated, however, in the Midwest. TXIA and Ozark receive public service payments, or subsidy, from the Government for providing service to smaller communities within their respective areas where air transportation is not self-supporting.

In 1970, Ozark was required by the Civil Aeronautics Board to return $245,579 in subsidy money paid originally by the Board to the carrier for services performed in 1966. In 1971, TXIA was likewise required to refund subsidy paid in 1966, in the amount of $296,792. It is the position of TXIA and Ozark that the Board's action in ordering these paybacks resulted from an uneven and inequitable application of subsidy rate principles by the Board as between Texas International and Ozark and other carriers in their class and that these paybacks, which came at a time of serious financial distress for both carriers, had an adverse effect on their ability to provide service as required by their certificates. TXIA and Ozark submit that justice requires the return to them of the $296,792 and $245,579, respectively, free and clear of any Federal income tax impact.

A. The Federal Aviation Act provides for subsidy payments for service by certified carriers to smaller communities

There are presently eight certificated local service carriers operating within the continental United States. Their certificates of public convenience and necessity, which are issued by the Board, obligate them to provide service to many small communities which otherwise could not support a self-sustaining air service. In order to compensate the carriers for fulfilling their obligation to serve these loss points the Congress of the United States included in Section 406(b) of the Federal Aviation Act [49 U.S.C. 1376(b)] the provision that, in fixing mail rates for the carriers, the Board shall consider:

". . . the need of each such carrier . . . for compensation for the transportation of mail sufficient to insure the performance of such service and together with all other revenue of the air carrier, to enable the air carrier under honest, economical, and efficient management to maintain and continue the development of air transportation to the extent and of the character and quality required for the commerce of the United States, the Postal Service, and the National Defense."

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[1] The certificates of Texas International, Ozark and other local service carriers contain the following clause:

"Services authorized by this certificate were originally established pursuant to determination of policy by the Civil Aeronautics Board that in the discharge of its obligation to encourage and develop air transportation under the Civil Aeronautics Act, as amended, it is in the public interest to establish certain air carriers who will be primarily engaged in short-haul air transportation as distinguished from the service rendered by trunkline air carrier. In acceptance of this certificate the holder acknowledges and agrees that the primary purpose of this certification is to authorize and require it to offer short-haul, local, or feeder, air transportation service of the character described above."

It is under this provision in the Federal Aviation Act, and its predecessor, the Civil Aeronautics Act of 1938, that Texas International and Ozark received subsidy for services over their respective systems throughout the history of their operations.

B. The background of the subsidy problem, as it affected Texas International and Ozark

Prior to 1961 the Board fixed subsidy rates for local service carriers on the basis of the individual need of each carrier considered alone. The basic elements of those rates included an allowance for breakeven need (which may be defined for our purposes here as the carrier's net loss before interest and taxes,) an allowance for return on investment, and an allowance for income taxes.

In 1961 the Board changed its subsidy policy with regard to local service carriers and instituted a subsidy rate which was applicable to all of the carriers as a class.[2] Class Rate I provided for a uniform rate of subsidy payment related to the service and route characteristics of each carrier.[3] Subsequent class rates, while they modified and refined Class Rate I contained similar subsidy payment provisions; that is, subsidy payments made monthly on the basis of a formula applied to actual operations of each carrier.

To insure that the monthly subsidy payments totaled a sum which was reasonably consistent with the carriers' needs, Class Rate I through III[4] included a profit-sharing plan under which a portion of earnings in excess of the prescribed rate of return would be repaid to the Government. The procedure on profit-sharing involved an audit by the CAB's audit staff at the conclusion of each annual period; a post audit review by the CAB's subsidy staff; and a determination on the basis of this review as to each carrier's profit position under recognized standards set forth in the class rate. In determining profit-sharing the class rate provided that income tax actually paid by each carrier as shown on its income tax returns for the year under review would be allowed as an expense.[5]

Effective January 1, 1967, the Board adopted Class Rate IV.[6] The new rate contained a provision which the Board called a "salient departure from the preceding class rates . . . [by] the substitution of a revenue growth sharing feature for the more cumbersome profit-sharing provisions of the previous class rates." The "revenue-growth adjustment" provided for automatic subsidy reduction equal to 15 percent (net of certain costs) of each carrier's experienced growth in passenger revenue. Thus, Class Rate IV provided for automatic reduction of subsidy otherwise paid under the formula, based solely on revenue increases without regard to the possibility of cost increases or a carrier's overall net profit or loss position.

The change came at the end of a period of rapid traffic growth and considerable route expansion for the local service carriers, and it appeared to the Board that the revenue growth adjustment would give "explicit recognition of growth

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[2] Local Service Class Subsidy Rate Investigation, 34 CAB 416 (1961). The class rate adopted in this order was commonly referred to as Class Rate I. Subsequent class rate amendments have been referred to consecutively by Roman numerals. Class Rate VII is the current rate and has been effective since July 1, 1973.

[3] Each carrier was to receive monthly subsidy based on the carrier's (1) available seat miles during the month, times (2) its revenue plane miles per station per day, times (3) a fixed unit rate to be determined from the Appendix of the class rate itself. This unit rate varied inversely with the revenue miles per station; thus as station density increased, the amount of subsidy paid per unit decreased.

[4] Class Rates II and III may be found in 39 CAB 65, 69 (1963) and 41 CAB 138, 139 (1964). From time to time the Board modified various features of the formula without changing the basic concept of each particular formula. Some of these modifications were commonly known by subclassifications such as Class Rate III–a, III–b, IV–a, IV–b. For our purposes here, it will generally suffice to refer only to the basic Roman numeral class rate.

[5] The Class rate provided, in pertinent part, as follows:

"Federal and state income taxes shall be determined on the basic of the carrier's actual income taxes, including the reduction of taxes resulting from loss carrybacks and carryovers, as reported on its income tax returns submitted to taxing authorities for each year, with such amendments and revisions as may have been filed as of the final determination of profit-sharing hereunder; *Provided*, however, that, for the purpose of this order, the carrier's actual income taxes for a given review year will be adjusted to exclude taxes related to income which is not otherwise considered in the profit-sharing determination, hereunder, for that review year; *Provided, further*, that where a final profit-sharing determination for a prior period has been made and the tax basis relied upon in that final determination has been amended or revised subsequently, the effect of the change in taxes will be considered as income or expense for profit-sharing purposes in the year in which the change is made."

[6] Order E–25162 (1967).

in passenger revenue as an increasingly important aspect of local service development." The Board believed that this new method would "serve the purpose, among others, of moving the subsidy levels substantially downwards consistent with the anticipated financial improvement of the industry stemming from continuing favorable revenue growth."

However, instead of continued growth, a period of general economic recession occurred during the late 1960's. The local carriers were caught in a pincer between rapidly inflating costs and rapidly declining subsidy payments related to a formula based on revenue-growth which did not take into account the effect of the increasing costs. The results are dramatically illustrated by Table I below.

TABLE I

Year	Subsidy received	Net income or (loss) before income taxes
Class rate III:		
1965	$66, 012, 000	$20, 952, 000
1966	54, 924, 000	17, 050, 000
Class rate IV:		
1967	50, 961, 000	(7, 587, 000)
1968	40, 950, 000	(38, 779, 000)
1969	35, 981, 000	(67, 008, 000)

In the three full calendar years under Class Rate IV the local service carriers experienced net losses of $113,374,000. The extent of the deterioration of Texas International's subsidy position is presented in the table below.

TABLE II.—TXIA

Year	Subsidy received	Net income or (loss) before income taxes
Class rate III:		
1965	$5, 842, 000	$1, 113, 000
1966	5, 304, 000	1, 335, 000
Class rate IV:		
1967	4, 211, 000	(654, 000)
1968	3, 705, 000	(2, 492, 000)
1969	3, 331, 000	(5, 144, 000)

Ozark's subsidy position was not unlike that experienced by TXIA. This downward trend is shown by Table III below.

TABLE III.—OZARK

	Subsidy received (thousands)	Net Income or (loss)
Class rate III: 1966	$5, 318, 177	$904, 157
Class rate IV:		
1967	4, 213, 000	1, 342, 000
1968	4, 109, 000	(650, 000)
1969	2, 755, 000	(3, 993, 000)

By the end of 1969, TXIA was receiving subsidy at the rate of $2,511,000 less than it received in 1965, and had experienced losses totaling $8,290.00 for its three calendar years under Class Rate IV. Similarly, by 1969 Ozark had suffered subsidy reductions of $2,562,678 from 1966 levels, while experiencing net losses of $4,642,248 for those two years. The level of losses was significantly influenced by paybacks under the Class Rate IV revenue-growth adjustment in the 1967–1969 period. These paybacks amounted to approximately $37,000,000 for all local

service carriers, $4,665,000 for Texas International and $4,878,000 for Ozark.[7] If there had been no revenue-growth adjustment, TXIA would have lost only $3,625,000 instead of $8,290,000. Ozark would have made $1,578,000 instead of losing $4,878,000.

It was obvious that Class Rate IV was failing to provide the subsidy required by the carriers, and the Board found it necessary to issue a number of orders during the period of the Rate's existence modifying various of its features including the revenue-growth adjustment.[8]

By Order 70–3–161, March 31, 1970, the Board finally discontinued the revenue-growth adjustment factor. It listed as its reasons the depressed financial condition of the local service carriers and the "wide discrepancy between subsidy payments approximating $36.3 million and the industry reported system subsidy need of approximately $100 million for 1969." The Board acknowledged that the effect of the revenue-growth adjustment "during the past several years appears to have been disproportionate to the actual profits related to the growth in revenues due to the lag of traffic development on newly awarded routes, to higher inflationary trends experienced in the operating costs and a slacking off of the rate of normal traffic growth."

Four months later in July 31, 1970, (Order 70–7–148) the Board abandoned Class Rate IV altogether because "of the depressed financial condition of the industry." It instituted an investigation which ultimately resulted in the establishment of Class Rate V and an annual increase of about 53 percent in the subsidy payments to all of the carriers.

C. Not only did TXIA and Ozark suffer almost devastating losses in the 1967–1969 period, but those very losses were also used to obtain paybacks from the carriers of subsidy paid in 1966

As a matter of course the Board did not get around to settling the profit-sharing under Class Rates, I, II, and III until several years after the review period had passed. Therefore, profit-sharing determinations for 1966 were not made until two or three years after Class Rate IV had already gone into effect. The table below shows the dates on which the profit-sharing determinations for 1966 were made for the respective local service carriers.

TABLE IV

Carrier	Date	CAB order
North Central Airlines	Jan. 15, 1969	69–1–62
Frontier Airlines, Inc	Jan. 24, 1969	69–1–99
Southern Airways, Inc	Mar. 20, 1969	69–3–75
Mohawk Airlines, Inc	Oct. 2, 1969	(1)
Texas International Airlines, Inc	May 21, 1970	70–5–108
Ozark Air Lines, Inc	May 21, 1970	70–5–107
Allegheny Airlines, Inc	June 1, 1970	70–6–9
Hughes AirWest (Bonanza, Pacific, West Coast)	June 15, 1970	70–7–3
Piedmont Aviation, Inc	(2)	

[1] Deficiency letter. Where it was found that a carrier had no excess profits to share the carrier was notified of this by letter indicating the deficiency rather than by official CAB order.
[2] Not yet concluded.

The following chronology shows that TXIA's profit-sharing determination for 1966 could have been made much earlier than May of 1970, three and one half years after the review period had closed.

On April 19, 1967, Texas International filed its required report of its profit position for the year 1966. The report showed a subsidy deficiency (rather than

[7] A rough approximation of the dollar amount involved in the revenue-growth adjustment has been made by totaling the differences between the subsidy received for 1966 and the amounts received for each year from 1967 through 1969. In addition to the revenue growth adjustment, the Board reduced subsidy in some cases for particular carriers because of the award of profitable routes. These ad hoc adjustments did not however substantially affect the subsidy level during the period above.

[8] Orders E–25694, Sept. 8, 1967, E–25914, Nov. 2, 1967; E–26310, Feb. 2, 1968, E–26627, Feb. 23, 1968, E–26991, June 27, 1968, 68–12–62, Dec. 12, 1968, 69–3–98, Mar. 26, 1969, 69–5–125, May 27, 1969; 69–7–121, July 23, 1969; 69–7–168, July 31, 1969, 69–8–20, Aug. 4, 1969; 69–10–95, Oct. 20, 1969; 69–10–134, Aug. 28, 1969; 69–11–9, Nov. 4, 1969; 69–11–50, Nov. 13, 1969; 70–2–70, Feb. 17, 1970.

excess profits) of $232,710. A field audit by the CAB of the Company's records was conducted during August and September of 1967 and was followed by discussions between the carrier's representatives and the Board's audit staff. On January 22, 1968, the Board's Bureau of Accounts and Statistics wrote Texas International informing it that adjustments to the subsidy reports had been recommended by the audit staff. It stated that if all of these adjustments were accepted by the Board the 1966 subsidy deficiency would be approximately $159,000 rather than the $232,710 originally reported by the carrier. On February 1, 1968, Texas International wrote the Board's audit staff accepting the recommendations in the January 22 letter. In the meantime the Board's Bureau of Accounts and Statistics forwarded its audit findings to the Board's subsidy staff for consideration and processing. If the profit-sharing determination had been made at that point or at any time during 1968, TXIA would have had no payback.

It was not until 15 months later, on April 18, 1969, that the Board's subsidy staff advised TXIA by letter that it had reviewed TXIA's profit-sharing picture for 1966 and tentatively determined that a refund of $320,255 was required as compared with the subsidy deficiencies computed by the Company and the Bureau of Accounts and Statistics. The substantial difference was related to a tax credit which the staff anticipated would be available to Texas International from the carryback against 1966 income taxes of losses incurred in 1968. The subsidy staff's letter of April 18, 1969, requesting a copy of Texas International's 1968 federal tax return, or if that was not available, a pro forma return. Texas International had not yet filed its tax return for 1968 and had not yet claimed a refund of 1966 taxes related to loss carrybacks from 1968.

On June 26, 1969, TXIA advised the subsidy staff by letter that it did not oppose other minor adjustments to its profit-sharing determination for 1966 but that it could not accept the tax carryback adjustment proposed by the staff.

In September, 1969, TXIA filed its federal income tax return for 1968, showing a pre-tax loss of $1,722,067. It also filed an application for refund from the carryback of a net operating loss or unused investment tax credit totaling $1,714,808 of which $532,106 was applicable to taxes paid in 1966 and the remainder to 1965 under the requirements of the Internal Revenue Code.[9] Copies of the income tax returns were furnished to the subsidy staff.

On November 25, 1969, the subsidy staff wrote TXIA referring to the tax returns and restating that a refund was due. By letter dated December 8, 1969, Texas International responded to the staff rejecting the consideration of the carryback loss in the profit-sharing determination of 1966. On December 15, 1969, TXIA filed a formal memorandum with the Board urging that TXIA's class rate for 1966 be closed without refund.

Ozark's subsidy problem evolved in a manner quite similar to that of TXIA's. Ozark submitted its required subsidy reports for 1966 on April 10, 1967. These reports indicated a 1966 subsidy deficiency of $33,404. A field audit was conducted by the Board's staff. On March 17, 1969, Ozark was notified that its subsidy refund had been tentatively determined to be $96,788 for 1966. At the request of the Board's staff a copy of Ozark's 1968 income tax return was forwarded to the staff, at which time Ozark pointed out that the net operating loss for 1968 would be carried back in its entirety against 1965 taxes paid and would not affect the 1966 determination.

On June 22, 1969, Ozark was notified that the proposed settlement for 1966 had been increased from $96,788 to $299,532. This revision resulted from the staff's interpretation of Section III–E of Class Rate III–A, concerning the handling of certain capital gains realized from the sale of equipment in 1968. This interpretation increased Ozark's net operating loss for 1968, resulting in a larger tax loss for that year, a portion of which the staff applied to reduce Ozark's 1966 taxes and thus increasing its 1966 profit.

Ozark objected to this interpretation and ultimately prevailed but only after the Board itself determined by Opinion 70–3–92, dated March 18, 1970, that its staff was in error.

In the intervening months, however, the staff was asserting subsidy refund claims for 1966, based upon 1969 net operating losses, which, by this time had became evident. Moreover, this belated determination of 1966 subsidy refund was

[9] TXIA's profit-sharing position for 1965 had been finally determined in November of 1968 prior to the filing of the 1968 tax return. Thus, no adjustment was made to 1965 profit-sharing as a result of the loss carrybacks from 1968.

based upon a pro forma tax return submitted by Ozark and CAB Form 41, although Ozark had not, at that time filed a tax return with federal taxing authorities. Because 1969 losses would be used to offset 1966 taxes (thus increasing Ozark's profit), the Board issued Order 70–5–107, dated May 21, 1970, in which it ordered Ozark to refund $246,579 of the subsidy paid to it in 1966.

Because of the error of the Board's own staff, Ozark's subsidy determination for 1966 was delayed some fourteen months, at which time its 1969 losses had become evident. Over two years elapsed between the time Ozark submitted its initial reports to the staff before the staff made its initial determination, and it was some three years before the Board finally undertook to determine Ozark's subsidy matters for 1966. Thus the lapse of time, compounded by the staff's error, was the sole reason that Ozark was ordered to refund subsidy, a fact which would not have occurred had 1966 subsidy been determined expeditiously, and had the Board not sought to burden Ozark's 1966 subsidy with the unfortunate results of its subsequently adopted Class Rate IV.

TXIA and Ozark were not the only carriers having the same problem. Of the twelve local service carriers operating in 1966, nine (Allegheny, Frontier, Mohawk, North Central, Ozark, Piedmont, Southern, Texas International and West Coast) experienced losses in later years which they were able to carryback against 1966 taxes and obtain a refund. However, the Board considered the refund as an offset against 1966 expenses (thereby producing excess profits for 1966) only with regard to Allegheny, Ozark, TXIA, and West Coast.[10] Other carriers— Frontier, North Central and Southern—had no adjustment made to 1966 profit-sharing on this basis, and were allowed to retain their tax refunds totaling $2,219,687.[11]

The difference in treatment had nothing to do with carrier needs or the standards of Section 406 of the Federal Aviation Act. It was, purely and simply, the result of the time at which the profit-sharing determination was made. As to Frontier, North Central and Southern the determination was made prior to the year in which the carryback losses were experienced. Therefore those carriers were permitted to retain the full amount of the tax refunds. As to Allegheny, Ozark, TXIA and West Coast the profit-sharing determinations were made after carryback losses in later years had been established. Thus, the refunds were used as an offset against expenses in the profit-sharing year—1966.

On March 4, 1970, the Board had afforded Texas International, Ozark and the two other local service carriers, against which the Board's staff was also pressing a claim for refund based on carryback losses (Allegheny and Air West), the opportunity to make an oral presentation to the Board members on the issues involved in the 1966 profit-sharing computation. As we have said, by this time the staff was asserting 1966 subsidy refund claims based on carryback of the carriers' 1969 net operating losses as well.

On March 18, 1970, the Board issued Order 70–3–92 upholding the Bureau's position on the carryback of both 1968 and 1969 net operating losses. However the opinion did not order any specific action. On May 21, 1970, the Board issued Orders 70–5–108 and 70–5–107 directing Texas International and Ozark to refund $296,792 and $246,579 respectively, of the 1966 subsidy the two carriers had been paid. This was a newly recomputed figure and was attributable entirely to income tax carrybacks. Similar orders were in turn issued dealing with 1966 profit-sharing for Allegheny and Air West.

Subsequently, each of these carriers petitioned for judicial review to a United States Court of Appeals. TXIA filed in the D.C. Circuit; Ozark in the Eighth Circuit; Allegheny in the Fourth Circuit; and Air West in the Ninth Circuit. On June 2, 1971, the Eighth Circuit handed down its decision affirming the Board in the *Ozark* Case.[12] On December 28, 1971, the D.C. Circuit issued its decision affirming the Board in *Texas International's* Case.[13] Texas International did not petition the Supreme Court for certiorari, since it appeared at the time that clear grounds for a petition were lacking and there was little chance that it would

[10] West Coast Airlines later merged with Pacific Airlines and Bonanza Airlines to form Air West. Air West was then acquired by the Hughes Tool Co. and is now known as Hughes Air Corp., doing business as Hughes Airwest.

[11] Mohawk was a deficiency position for the year notwithstanding its tax refund. Piedmont's profit-sharing position was not finally determined until 1974; after two U.S. Courts of Appeals had, determined that Board's treatment of loss carry-back was inconsistent with provisions of the Federal Aviation Act of 1958.

[12] *Ozark Air Lines, Inc.* v. *CAB*, 441 F.2d 892 (8th Cir. 1971).

[13] *Texas International Airlines, Inc.* v. *CAB*, 458 F.2d 782 (D.C. Cir., 1971).

have been granted. Ozark, however, filed its petition for certiorari on October 30, 1971 alleging as grounds therefore the potential conflict between the Circuit Courts of Appeal in the event that any of the other cases were decided in favor of the appealing carriers within the appeal period. Unfortunately the conflicting decision between the Courts of Appeal did not arise until after the certiorari period had expired and Ozark and been denied certiorari by the Supreme Court.

On September 12, 1972, the Fourth Circuit issued its decision setting aside the Board's order in the *Allegheny* Case.[14] Then, on May 29, 1973, the Ninth Circuit set aside the Board's order in the *Air West* Case.[15] Although at this point there is a clear case of conflicting decisions among Federal judicial circuits—grounds which undoubtedly would have insured grant of a petition for certiorari to the Supreme Court—the Government chose not to file such a petition.

On March 13, 1973, the Board issued Order 73–3–36 in the *Allegheny* Case directing additional payments in the approximate amount of $800,000 to Allegheny as a result of the Court's decision. By Order 73–9–90, dated September 25, 1973, the Board reduced Air West's refund by over $1,000,000 as a result of its Court case.

The profit-sharing determination for Piedmont Airlines was made in 1974 (Order 74–10–145, October 29, 1974). Following the *Allegheny* and *Air West* Cases the Board did not use the tax refund of 1966 taxes resulting from carrybacks against the carrier. Thus, of all the local service carriers, only Texas International and Ozark are in the position of having their 1968 and 1969 losses used against them in the determination of 1966 profit-sharing.[16]

II. THE BOARD'S ACTION ON THE 1966 PROFIT-SHARING FOR TXIA AND OZARK WAS INCONSISTENT WITH THE NEED STANDARDS OF SECTION 406(b) OF THE ACT

As shown above the subsidy received by the local service industry and by Texas International and Ozark under Class Rate IV fell far short of the "need requirements" of the Federal Aviation Act of 1958. TXIA and Ozark recognize that when the Board fixes a final future rate, such as Class Rate IV, the rate may provide too little or too much subsidy and that the principle of rate finality precludes TXIA or Ozark from seeking additional subsidy even though the rate is admittedly inadequate. TXIA and Ozark are not seeking additional subsidy payments under Class Rate IV.

We do contend, however, that it is eminently unfair and unconsistent with the need provision of Section 406(b) of the Act for the Board to use losses experienced under the inadequate provisions of Class Rate IV to generate a reduction in subsidy payments made for a prior period under an entirely different Class Rate concept. We are willing to accept our losses of $4,642,248 and $8,290,000 experienced for the period 1967–1969, even though they were caused in large part by the inadequate provisions of Class Rate IV. But, we cannot accept a principle which would compound the effect of these losses by using them to construct profits, and a corresponding subsidy refund for an earlier year.

The problem arose from an unreasonably harsh interpretation of Section III.E. of the profit-sharing provisions of Class Rate III.[17] The Board deemed this language to mean that actual income taxes including loss carryback and carryovers will be used to compute profit-sharing regardless of the time at which the profit-sharing determination is finally made. TXIA and Ozark believe it should have been interpreted as applicable only to the tax loss carrybacks produced by losses experienced during the life of the profit-sharing provisions of Class Rate III. This controversy did not arise at the time Class Rate III was originally adopted and was not considered then by the Board.

When a final future rate is promulgated, there is always the possibility that it will prove to be either too much or too little in relation to the carrier "need." Under Class Rates I through III covering years 1961 through 1966 the Board utilized profit-sharing as a device to avoid excessive payments to individual carriers. In Class Rate IV the Board switched to a new method which is described as "a salient departure from preceding Class Rates. . . . [by] the sub-

[14] *Allegheny Airlines, Inc.* v. *CAB*, 465 F.2d 778 (4th Cir. 1972).

[15] *Hughes Air Corporation, doing business as Airwest* v. *CAB*, 482 F.2d 143 (9th Cir. 1973).

[16] Frontier and Mohawk also had tax refunds from carryback losses during the Class Rate IV period used against them in profit-sharing determinations for 1964 and 1965. Neither carrier challenged the original Board orders which made the determination.

[17] See footnote 5 above for language of section III.E.

stitution of revenue growth sharing feature for the more cumbersome profit-sharing provisions of the previous Class Rates."

Profit-sharing and revenue growth adjustments have functionally comparable roles. Both were designed to reduce subsidy payments by recapturing a portion of the profits of carriers with successful operations. As long as Class Rate III remained in effect the application of its profit-sharing provisions were characterized by what Judge Haynsworth called in the *Allegheny Case* a "rough justice." [18] The carriers expected that as long as the rate continued in existence they would expect to share the profits of the good years. They knew that tax refunds from carryback losses could be used as revenue to increase their profit-sharing for the good year.[19] But, they also knew that the profit-sharing determination for the later loss year would fully recognize the losses and consequently would not require a payback of subsidy that year.

With the advent of Class Rate IV, and the entirely new revenue-growth adjustment, the "rough justice" existing in the continuing Class Rate III was broken. Under the Board's interpretation tax loss carrybacks from the later years were still to be included as revenue in the earlier profit-sharing years. However, the carriers could no longer expect that their profit-sharing in the later loss years would be limited by the losses. The revenue growth adjustment under Class Rate IV produced the severe reduction in subsidy based solely on increases in revenues experienced by the carriers with no relation whatsoever to the rapidly increasing costs of the later period. It was for this reason that the Fourth Circuit found:

"When the Board abandoned profit-sharing and turned to a new subsidy recapture in which profits and losses were irrelevant, it could no longer reasonably insist that an item of income, accruing in a later year when income was irrelevant for subsidy purposes, be attributable to an earlier year in which it was. It was unreasonable and arbitrary for the Board to conclude, as it did, that Allegheny was accountable in 1966 for income items which demonstratively had not accrued by the end of that year and were not to accrue until much later." [20]

While use of either profit-sharing device may have been defensible, the use of the combination resulted in substantial subsidy reductions for Texas International and Ozark in excess of those that would have been possible under either rate standing alone. If the revenue-growth adjustment had been used as the only method there would have been no profit-sharing and no question of tax carrybacks. Texas International would have been able to keep the $296,000.00 which it was required to pay back for 1966, and Ozark would likewise have retained $246,579 which it paid back for that year. On the other hand, if the Board had continued profit-sharing into Class Rate IV instead of instituting the revenue-growth adjustment, Texas International's subsidy payments between 1967 and 1969 would have been increased by $5,665,000 and Ozark's by $5,750,125,[21] and there would have been no profit-sharing since the profits of Texas International and Ozark would have been below the profit-sharing level.

The use of heavy losses under Class Rate IV to force the reduction of subsidy payments under Class Rate III is not consistent with the basic "need" standard of Section 406 and the responsibility of the Board under Section 102 of the Act to foster "sound economic conditions" in air transportation. The Board's failure to make adequate provision in Class Rate IV for subsidy sufficient to meet the "need" as required by the Act is serious enough. It is completely unreasonable for the Board to go one step further and utilize the tax effect of the losses created, at least in part, by its unreasonably low rate to force a further reduction in subsidy already paid under Class Rate III.

III. THE BOARD'S ACTION DISCRIMINATED AGAINST TEXAS INTERNATIONAL AND OZARK

A. The Board treated different carriers within the same class in a different manner and thus favored some and discriminated against others

During 1967 and 1968 the Board conducted its review of revenue and expenses of all of the local servce carriers to determine their profit-sharing positions for calendar year 1966 under Class Rate III. The local service carriers generally

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[18] 465 F.2d 778 at 772.

[19] Assuming that the carry backs were readily ascertainable at the time profit-sharing for the earlier year was finally determined.

[20] 465 F.2d 25, 782.

[21] See footnote 7 above.

had a good year in 1966, and most of them experienced profits. By 1968, all of them were sustaining substantial losses. These losses were reported to the Board, and the Board was aware of them well before the end of 1968. It could have been readily anticipated that these 1968 losses would produce tax refunds for 1966. Nevertheless, the Board proceeded to close out 1966 profit-sharing for some carriers. The determinations for other carriers were withheld until 1968 losses for tax purposes had been established.[22]

The result, as shown in Table V below, was that some carriers were able to retain the full carryback loss refund, and others had the carrybacks used as a revenue item in the 1966 profit-sharing determination. As the situation now stands, after completion of four court cases, it appears that only TXIA and Ozark will have the carrybacks used against them with regard to 1966 profit-sharing.

TABLE V.—1966 PROFIT-SHARING AND RELATED FEDERAL INCOME TAX DATA

Carrier	Taxes paid	Carryback losses	1966 taxes recognized for profit-sharing
Allegheny	$750,021	$750,021	(1)
Bonanza	132,774	0	[2]$414,638
Central	143,432	62,025	[3]81,408
Lake Central	0	0	0
Frontier	806,444	806,444	806,444
Mohawk	707,202	707,202	(3)
North Central	764,367	764,367	764,367
Ozark	386,522	386,522	0
Pacific	0	0	(3)
Southern	648,876	648,876	648,876
TXIA	500,842	500,842	
West Coast	773,227	773,227	(2)

[1] Board order on 1966 profit-sharing set aside by USCA 4th Cir. 465 F. 2d 778.
[2] Merged to become Air West April 17, 1968; Board order on 1966 profit-sharing for West Coast set aside by USCA 9th Cir., 482 F. 2d 143.
[3] Carrier in profit deficiency position regardless of tax refund.

Frontier's case presents a dramatic example of the disparity of treatment. At the time Frontier's 1966 subsidy was closed out it had reported to the Board a 1968 operating loss of about $5,400,000. Nevertheless the Board settled Frontier's profit-sharing for 1966 of January 24, 1969, without any provision for, or reference to, tax carryback refunds for 1966 attributable to the net operating loss from 1968. Frontier was required to make a refund of $787,195 for 1966 but no part of the refund was attributable to any net operating loss carryback from 1968.

Even though the U.S. Court of Appeals for the District of Columbia affirmed the Board's decision in the Texas International Case it expressed reservations with regard to the differences in treatment given to the several local service carriers by the Board, and it had particular difficulty with regard to the handling of the Frontier Case.[23]

The reason for the difference in treatment among the local service carriers was purely administrative lag. As the Ninth Circuit put it in the Air West Case:[24]

"Whether a carrier would be forced to return or allowed to keep hundreds of thousands of dollars would turn on fortuitous circumstances, including the order in which the CAB decided to process paper work and the dispatch with which it was processed. The facts of this case failed to demonstrate any reasonable justification for continued adherence to a procedure which did not treat all members of the class equally."

B. *The Board's action subsequent to the court cases on 1966 profit-sharing magnifies the discrimination.*

If the Board's action as between the various members of the local service class was originally discriminatory, the evidence of the discrimination has been

[22] It has never been adequately explained as to how some carriers were selected for profit-sharing evaluation ahead of others. Certainly, no standards for the selection were published. However, TXIA and Ozark do not charge wrongdoing on the part of the Board. Rather, we are prepared to accept the theory that the selection was determined by fortune or misfortune as the case may be.
[23] 448 F.2d 782, 784.
[24] 482 F.2d at 145.

emphasized by what has taken place since the two court decisions in the *Allegheny* and *Air West* Cases.

It is clear that the fact situations obtaining in each of the four court cases are for all intents and purposes identical. Thus, the decisions of the Court of Appeals for the District of Columbia and the Eighth Circuit affirming Board action on Texas International's and Ozark's determinations present a clear dichotomy from those in the Ninth and Fourth Circuits setting aside the profit-sharing orders for Air West and Allegheny. Moreover, the amount of money involved in the *Air West* and *Allegheny* Cases was over $1,800,000 as compared to a total of about $500,000 in the *TXIA* and *Ozark* Cases. There is little doubt that under these circumstances the Supreme Court would have granted *certiorari* and in the *Allegheny* and *Air West* Cases. However, the Government chose not to petition for certiorari and in the *Air West* Case it did not even ask for a rehearing in the Ninth Circuit. The *Piedmont* Case was not decided finally until October 29, 1974 (Order 74–10–145). In that case the Board followed the *Allegheny* Case decision in the Fourth Circuit and "ignored" the refund of taxes from loss carry-backs. This means that of the eleven local service carriers which were operating in 1966, only two, TXIA and Ozark, have their tax losses for the disastrous 1967–1969 period used against them in the computation of 1966 profit-sharing. The Board has been successful in recapturing about $500,000 from TXIA and Ozark while the other local service carriers have been allowed to retain a total of almost $4,500,000 in 1966 tax refunds which were derived under essentially the same circumstances.

IV. THE BOARD PROBABLY DOES NOT HAVE THE POWER TO REMEDY THE INEQUITY

Class Rate III has not been terminated. Profit-sharing for 1966 under that Class Rate has been finally determined by the Board for TXIA and Ozark and formal Board orders were issued which have been affirmed by the Court of Appeals for the District of Columbia and Eighth Circuits. There is a well-established principle that the mere fact that a carrier or utility realizes inadequate earnings or excess profits while operating under a final rate does not provide a basis for an adjustment of a subsequent rate to take back the excess profits or to remedy the earning deficiency. This basic principle of finality has been found specifically applicable to the determination of subsidy by the Civil Aeronautics Board in *Transcontinental and Western Air Inc.* v. *CAB*, 169 F. 2d 893 (D.C. Cir., 1948) affirmed 336 U.S. 601 (1949).

In that case the Supreme Court found:

". . . if the Board could redetermine rates for past period when the carrier has made less than an adequate profit, or no profit at all, it could do so when the carrier has made more than an adequate profit. The statute makes no differentiation. The financial confusion which would follow from the latter conclusion seems obvious. No rate order would be final. No dividend declaration would be secure. No large commitment would be conclusively feasible. No offering of securities would have a firm foundation." (169 F. 2d 896.)

In the light of this ruling it would appear that the Board does not have the power to remedy the inequities which have resulted from the administration of the profit-sharing provisions for the 1966 period. TXIA and Ozark submit that their only recourse is private legislation in the Congress.

V. CONCLUSION

As explained above the Civil Aeronautics Board has administered its subsidy program in an unfair and inequitable manner. As a result it has discriminated against two of the federally certificated local service carriers. Since "need" is the criterion for award of subsidy under the Federal Aviation Act of 1958, and the Board's action has produced payments which are below need, the airline services to the sections of the country which these carriers serve have been adversely affected.

At this state it would appear that only Congress can remedy the inequity.

Respectfully submitted,

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Counsel for Texas International Airlines, Inc.
THOM G. FIELD,
Counsel for Ozark Airlines, Inc.

STATEMENT OF PAUL L. BRADSHAW, SENIOR VICE PRESIDENT AND GENERAL COUNSEL, OZARK AIRLINES

Mr. Chairman and members of the subcommittee, my name is Paul L. Bradshaw, Senior Vice-President and General Counsel of Ozark Air Lines, Inc. We are most appreciative of this opportunity to appear in support of H.R. 12349.

Ozark's situation regarding 1966 subsidy is essentially the same as that of Texas International, and we agree fully with Mr. Lorenzo's explanation of the matter. Therefore, I will not repeat his testimony; but I should like to try to offer some further insight into the administration of the subsidy program generally in order that you can have a better understanding of how this problem arose.

Prior to 1961, subsidy payments were based upon the individual "need" of each carrier, and they were computed after the fact—which provided little incentive for efficiency, since the government was expected to make up any losses. Not surprisingly, both the C.A.B. and the industry became convinced that this rather haphazard method left much to be desired; so the Board undertook to adopt a formula-type approach which, it was believed, would result in proportionately equal treatment to all carriers and would encourage efficient operations.

The first such formula, known as Class Rate I, went into effect in 1961. Necessarily, it was quite complicated. Generally speaking, however, it computed subsidy payments on such factors as the miles operated, cities served and equipment used by each carrier.

While this approach was sound in theory, unexpected problems and unforeseen results soon became apparent. Therefore, the Board modified the formula from time to time by ordering new class rates; and effective January 1, 1967, it adopted its fourth class rate (plus other revisions) in slightly more than six years.

I mention these facts because they seem to indicate the state of uncertainty which understandably existed at that time as the Board sought to correct the deficiencies of one complex formula, only to find other deficiencies in the next formula. Under these circumstances it is not difficult to understand how wholly unintended results occurred.

A case in point is the profit-sharing provision of Class Rate III, which Mr. Lorenzo has explained. And at the risk of confusing the issue, I should like to comment on the matter in slightly more detail.

Under Class Rate III the amount of a carrier's profit sharing for one year could be increased by losses in a subsequent year, because the losses could be carried back and used (on an amended tax return) to reduce the amount of taxes owed for the earlier year—which, in turn, would increase the profit for that year and, hence, the amount of profit sharing. Obviously, there had to be some cut-off point for this determination, since the Board could not indefinitely delay its final subsidy orders on the chance that a carrier might file an amended return at some future time. But instead of providing for some uniform cut-off period which would apply alike to all carriers, it provided that a carrier's taxes for profit-sharing purposes would be:

". . . determined on the basis of the carrier's actual income taxes . . . as reported on its income tax returns submitted to taxing authorities for each year, *with such amendments and revisions as may have been filed as of the final determination of profit-sharing hereunder . . .* " (emphasis added) (Order E–23850, page 22.)

In order to appreciate the full significance of this, it must be borne in mind that while all of the carriers were required to submit information to the Board by the same specified date, no time limit was imposed with respect to the Board's order for each carrier, and there was no prescribed sequence in which the Board determined each carrier's profit sharing. The final subsidy determination as to one carrier might be issued very quickly, while the determination for another carrier might be several years later—as actually occurred in the case of Ozark and Texas International. But each carrier's taxes for purposes of profit sharing were to be computed on the basis of its tax return and amendments thereto actually on file as of the date of that carrier's final subsidy order.

Therefore, whether the Board considered a carrier's original tax return or a later amended return was wholly dependent upon the mere happenstance of when the Board issued its order with respect to that particular carrier and whether the carrier had filed an amended return by that date.

This approach, coupled with administrative lag, is the reason that some carriers were treated differently than others on their 1966 profit sharing. Although the entire local service industry realized profits in 1966 and sustained heavy losses in 1968 and 1969, those which were processed early did not have to pay added profit sharing for 1966 by reason of the carryback of their subsequent losses; whereas those processed at later dates had their 1966 profit sharing increased on that basis.

Perhaps the Board's general approach to this problem might have been somewhat more justifiable so long as Class Rate III remained in effect, because the order establishing that rate also contained the following provision:

" . . . where a final profit-sharing determination for a prior period has been made and the tax basis relied upon in that final determination has been amended or revised subsequently, the effect of the change in taxes will be considered as income or expense for profit-sharing purposes *in the year in which the change is made* . . ." (Emphasis added) (Order E–23850, June 23, 1966, p. 22.)

In other words, if a carrier's tax return was amended to show a loss carryback after its subsidy order for that year had become final, the effect of the change in taxes would be considered during the year in which the amendment was actually filed. Therefore, it might have been argued that, in the long run, this would result in more or less equal treatment for all carriers regardless of when the final subsidy order of each was issued, since the tax effect of the amended return would be considered in the latter year if it was not considered in the earlier year.

But if, in fact, such was the Board's rationale, it was repudiated by the adoption of Class Rate IV, effective January 1, 1967. For this new rate eliminated profit sharing altogether and, instead, calculated subsidy refunds on the basis of growth in passenger revenues, irrespective of a carrier's net profit or loss. Thus, the tax consequences of a loss carryback were immaterial for years beginning after January 1, 1967.

No longer, then, would such tax consequences for 1966 be considered in the year in which an amended tax return was filed (as provided in Class Rate III) in the event the return was amended after the carrier's final subsidy order for 1966. On the contrary, if these tax consequences were not considered before the 1966 order became final, they never could be considered at all due to the adoption of Class Rate IV on January 1, 1967.

This explains the unequal treatment afforded the various carriers in connection with their 1966 profit sharing. Those which had the matter resolved prior to filing amended returns were excused forever from any 1966 subsidy refund resulting from losses in 1968 and 1969; whereas, Ozark and Texas International—whose profit-sharing determination was not made until later—were required to pay 1966 profit sharing because of these same losses.

But whatever the reason, there certainly can be no doubt about the fact that Ozark and Texas International were treated entirely differently than the other nine carriers.

In Ozark's case, however, we feel the inequities were even more pronounced because of two additional facts which do not apply to Texas International:

First. By way of background, Ozark filed its necessary reports for 1966 in April, 1967, as required. When the Board's staff finally finished processing the matter two years later, it made an error in the tax treatment of capital gains on the sale of equipment and, consequently, increased Ozark's 1966 profit sharing to $299,532—instead of the staff's original calculation of only $96,788, which Ozark was willing to pay. Therefore, Ozark appealed the matter to the Board itself; and another year passed before the Board, on March 18, 1970, issued an order saying, in effect, that Ozark was right and the staff was wrong in connection with the capital gains matter.

In the absence of this error by the C.A.B. staff, the matter would have been settled by 1969 by Ozark's payment of $96,788 in profit sharing for 1966. So Ozark was penalized solely because the C.A.B. staff made a mistake.

Second. Even at that point, however, Ozark would have incurred no additional liability for 1966 profit sharing (over and above the $96,788 which Ozark itself admitted owing) if the Board had followed its own rule-making order (cited above) which clearly stated that taxes would be determined on the basis of tax returns (whether amended or not) actually then on file. Instead of doing this, however, the Board took the position that Ozark would later amend its 1966 tax return to reflect the carryback of losses which then were apparent for Ozark

(and the rest of the industry) for 1969, even though Ozark's 1969 return had not yet been filed or its 1966 return amended. This approach—clearly in violation of the Board's own order—was the basis upon which the C.A.B. made its final determination requiring Ozark to pay profit sharing for 1966 in the amount of $245,579.

Significantly, the very opposite approach was taken by the Board with respect to Frontier Airlines, in spite of the fact that Frontier and Ozark were in exactly the same position when their respective determinations were made. Both had made profits in 1966 and both had incurred subsequent losses which were shown by reports on file with the Board; but neither had yet filed tax returns for the loss year or had yet amended its 1966 return.

In the case of Frontier, unlike Ozark, the Board ignored the carrier's later losses and made no adjustment to its 1966 profit sharing on that basis. In other words, with respect to Frontier the Board followed its regulation requiring the use of tax returns then on file; whereas the Board totally ignored that requirement in making its subsidy determination for Ozark.

In connection with the figures I have just referred to, I should like to make one correction on page 2 of the Joint Memorandum attached to Mr. Lorenzo's testimony. There it states that Ozark is entitled to a refund of $245,579; but actually we claim Ozark is entitled to only about $148,000—or the difference between the amount the carrier was ordered to refund and the sum of $96,788 which it admits it owed and which would have been the amount of its refund in the absence of the delay resulting from the error by the C.A.B. staff.

Aside from these two additional facts which apply only to Ozark, we are in the same position as Texas International.

As Mr. Lorenzo already has told you, the Board attempted to charge only four airlines with added 1966 profit sharing because of losses in subsequent years; and the facts relating to each were substantially the same. Each of the four appealed to a different circuit of the United States Court of Appeals. The first two cases decided were those of Ozark and Texas International, and the Court decided against the carrier in each case. In the other two cases the decisions were in favor of the carrier.

Of course, had the latter two cases been decided first, Ozark and Texas International could have sought certiorari to the Supreme Court on the ground that there was a conflict between the decisions of the various Courts of Appeals. In fact, Ozark did attempt to do so on the theory that the other two cases were pending and there might *later* be a conflict. We knew that we were on tenuous grounds; and our petition for writ of certiorari was denied.

After the last two cases were decided there was a clear conflict which undoubtedly would have justified review by the Supreme Court; but the Board did not seek such review. Instead, the two carriers involved in those cases received a combined total of $1.8 million in subsidy payments which they would not have received had the same rule been applied to them as was applied to Ozark and Texas International.

So the end result is that Ozark and Texas International are the only two of the then 11 local service carriers which were required to pay profit sharing for 1966 on the basis of subsequent losses—in spite of the fact that all 11 of those carriers did, in fact, sustain such losses in 1968 and 1969.

In short, we are here because we believe an injustice has been done and we know of no way it can be corrected other than by Congress. We will be most grateful for yoru assistance.

Mr. ELLIS. Thank you, Mr. Chairman.

There is just one point that I want to bring out. There was some confusion as to whether this bill would affect the rates of other carriers in other years, and in my view, it would not.

In the memorandum accompanying Mr. Lorenzo's testimony, which Mr. Thom Field, of Ozark, and I prepared, the footnotes there, note that Frontier and Mohawk situation in 1964 and 1965, that Mr. Chabot was talking about. Obviously the law and the class rate that applied in those years were the same, however, the equities were considerably different in the case of Frontier and Mohawk, and for that reason I do not think you are going to be faced with them coming up to you asking for legislation.

In the case Frontier and Mohawk, they did not contest the Board's treatment of their rate.

Now, that might not seem important, except that you have to understand the process which these profit sharing determinations were made at the Board. It was a settlement process, not unlike the process of settling an automobile injury case between the plaintiff and the defendant.

There was a give and take, and various items under consideration for profit sharing. At the end of that give and take, Frontier and Mohawk obviously felt satisfied with what they got so that they did not object to it.

So through the settlement process they accepted this. I do not mean to indicate that it is right to apply the loss carryback provision to one year and not to another. It certainly was not, and if the equities were the same, it seems to me that it would be perfectly equitable and fair and necessary to pass a law for 1964 and 1965, just as we think it is for 1966, but that was not the situation here.

Mr. GOLDWATER. Did I understand you right in determining the subsidy they did take into consideration the carryback for Frontier and Mohawk in 1964 and 1965?

Mr. ELLIS. They did, yes, sir.

Mr. GOLDWATER. You do not see anything wrong with it?

Mr. ELLIS. I do see something wrong with it, yes, sir. I think—I do not think that that was proper for them to do that.

On the other hand, in the overall settlement of the case, including give and take on this item, as well as on various other expenses and revenue items that were considered in the settlement process, the two carriers involved, Frontier and Mohawk, were satisfied with the settlement, and did not oppose it.

Mr. GOLDWATER. Did they apply 1964 and 1965 carryback provisions to Texas, to the four airlines that are in dispute?

Mr. ELLIS. I do not know about the others. Texas International for 1965 was treated exactly the opposite of the way they were treated in 1966, because of administrative lag.

In 1965, the Board did not carry back 1968 losses because they happened to get the *Texas International* case a little bit earlier, and it had not yet experienced or reflected those losses in its tax returns, so the dichotomy there is exemplified just with respect to Texas International.

I mean, there is a different treatment of the one carrier in 2 succeeding years.

Mr. ANDERSON. Go ahead, Mr. Ellis.

Mr. ELLIS. Thank you.

That is all I have, Mr. Chairman.

Mr. ANDERSON. Mr. Lorenzo, does that complete your testimony?

Mr. LORENZO. With this testimony, and the memorandum attached.

Mr. ANDERSON. Mr. Bradshaw?

Mr. BRADSHAW. Mr. Chairman, members of the subcommittee, I am Paul Bradshaw, senior vice president and general counsel of Ozark Airlines, and we appreciate your courtesy here today.

I think that it is clear that what actually happened is that the Board has this rule, that as of the time of the final determination of a carrier's profit sharing it took into consideration, or it was supposed to do so,

under the rules, the tax returns then actually on file, if it had been amended by then, and then the amended return, if it had not been, then the original return, and this coupled with the administrative lag, of course, explains the reason why different carriers were not treated the same.

Now, that applies both to Ozark and to Texas International. In Ozark's case, though, we think it was aggravated by still another factor that does not apply to Texas, and has not been brought out here yet, and that is this—that as of the time of our final determination the Board staff made a mistake in the method of computing the capital gains from sale of equipment.

We thought they were wrong, because they were wrong, and we had to appeal it to the full Board, which took something more than a year. The full Board said its staff was wrong.

Now, the significance is this—in the absence of that mistake by the Board staff on Ozark's rate, would have settled a year earlier, and Ozark would have then been required, instead of paying about $240,000, to pay only some odd $90,000 that we admit we owed at that time.

We were willing to pay. The only reason it was not settled at that time is because the Board's own staff made a mistake, and that delayed it by something more than a year in addition to that.

Even at that time, however, we still would not have been penalized if the Board had followed its own rule, but instead of doing so, instead of going by the tax returns then on file, it was apparent, of course, in the case of Ozark, and the case of others, that we made money from 1966, we lost money in 1968 and 1969.

It was apparent that we would not, at some later date, file amended returns, and that is true, but instead of following the return we had to file it as the Board required us to file, with the pro forma return, and the Board then calculated our subsidy refund on the basis of that pro forma return, rather than the return then on file, and I think that Ozark was the only carrier where that was done and, in fact, at that time, the same situation existed with respect to Frontier's rate which hadn't been closed for 1966.

It was apparent that Frontier, too, had profits in 1966, losses in 1968 and 1969, and it was apparent that Frontier also would later file an amended return, and carry those losses back, but Frontier did not then do so.

In the case of Ozark, we were required to file the pro forma return, and then base our rate on, not on the rate on file, or whether Frontier had the same situation, and they based Frontier's calculation on their unamended return then on file.

So that, while I think it is an unfair situation with respect to both these carriers, there are those additional aggravating circumstances so far as Ozark.

I would make one correction to the memorandum that is attached to Mr. Lorenzo's testimony and, incidentally, we are in complete agreement with his testimony, and that memorandum, except for one phase—that memorandum states that Ozark would be entitled to about some odd $240,000.

I do not find the exact $245,579, but——

Mr. SNYDER. What page is that?

Mr. BRADSHAW. It is page 4 of the memorandum attached to—no, it is on page 4 of Mr. Lorenzo's testimony. It is also included in the joint statement someplace.

On page 2 of the joint statement it is also there, and instead of $245,579, actually that figure ought to be about $148,000 for Ozark.

I mentioned a minute ago that if this had been settled in a timely manner we would have owed $96,788, which we admit we owed, that we offered to pay it, and in fact, that was the staff's original and initial determination of what we owed, until they made the mistake on capital gains, so we are not asking for the full $245,000, but we are asking for the difference between that and the $96,000 we admit owing, and that we were willing to pay at that time, and do not complain because we were required to pay that particular amount.

I just want to make one other observation. The CAB witness was asked a number of times which court was right—which court was wrong, and it seems to me it does not really matter who was right or wrong.

The question is, is the end result wrong because they were not all treated the same, in the same manner? I do not think the CAB witness' testimony says there is not contention that they did not act in a diligent and evenhanded manner.

I do not think they were diligent, and I do not think they were evenhanded.

They admitted themselves they were not evenhanded in the results that turned out differently, and insofar as diligence is concerned, as I pointed out a minute ago, it was only because of their own mistake, and their own delays that we are even here in the first place today.

I would be glad to answer any questions, but I do not care to say any more now, Mr. Chairman.

Mr. ANDERSON. Do you believe that the CAB's decision in your cases is basically unfair, or is it only unfair because similarly situated carriers were treated differently?

In other words, if all carriers had been required to make subsidy refunds, would it still be desirable to enact legislation along the lines of H.R. 12349?

Mr. BRADSHAW. I think probably under the present class rate it would be immaterial.

You may remember, up until 1961 we had no class rates, and then from 1961 to 1967 we had a different one almost every year during that period of time when the Board was trying to find an appropriate formula on which to base subsidy payments.

Prior to 1961 it was done on an individual carrier approach after the fact.

Certainly, it did not encourage much efficiency by the industry, so the Board, I think, has properly went to their formula-type approach, and we are now on what is known as class rate VII, is it not, and in addition to the 1967, there have been various modifications, so that we had III, and then we had III–A, and that sort of thing.

My point is, over the last 12 or 14 years we have had about 8 or 10 different class rate formulas. I think the one we have now is a whole lot better than some of the earlier ones we had then, and as I understand it, and Mr. Lorenzo can correct me if I am wrong, as I under-

stand it, the present rate—this really would not be a problem or a question one way or the other, Mr. Chairman.

Mr. ANDERSON. I do not quite follow that, because——

Mr. BRADSHAW. No longer is profit sharing calculated by that.

Mr. ANDERSON. In other words, you are claiming now it was unfair because you had to make subsidy refunds, and they did not. If the other firms had to make the subsidy refunds like you did, then would you be coming in with that same thing?

Mr. BRADSHAW. No; I do not think—I personally do not find anything wrong with the philosophy of it.

We could argue only because of the gross inadequacy of the class rate IV which occurred again in 1967, that we had these losses in the first place, but that, of course, is a different question.

Mr. ANDERSON. Now, since you and the other regional carriers are not in direct competition, is it correct that your carriers are not competitively disadvantaged by having to make subsidy refunds when other regional carriers have not been required to make these refunds?

Mr. BRADSHAW. I think generally speaking that would be true, that there is some competition among us, but generally speaking that would be true, and it would be even more true in 1966, than it is now.

Mr. MILFORD. Would the gentleman yield on that point?

Mr. ANDERSON. Yes.

Mr. MILFORD. When one talks about competition in air carriers, it is not necessarily a situation where two air carriers are running along the same route that makes them competitive. Their financial condition, and their ability to bid on additional routes also makes them competitive, even though they do not operate over the same route; is that correct?

Mr. BRADSHAW. Yes; I would agree with that.

Mr. ANDERSON. What actual rates of return have Ozark and Texas International realized in the years since 1966?

Mr. BRADSHAW. Oh, at the present time, the Board says we are entitled, and Ozark, to an allowable rate of 12.35 percent. There has only been one time, from 1966 through 1975 that we achieved that.

In 1966 our return was 6.09 percent. In 1967, 6.37; 1968, 2.69; 1969, negative 0.87 percent; 1970, 2.35 percent. In 1971, 12.79; 1972, 7.61; 1973 is 3.36; 1974, 12.02; and 1975 is 4.90.

Now, I would say in connection with those figures we computed those on the same basis that the CAB currently uses for rate fixing purposes, and it actually overstates what the return is—is that we reported to our shareholders, for example, in 1973, I just read you the figure of 3.36 percent, and actually we lost money in 1973. We had no return at all.

So my point is that these figures are somewhat overstated, but there are a lot of different ways that you can compute that, and we did this the way that the CAB now does it for ratemaking purposes.

The returns to our shareholders that we would report in our annual report would be several percentages less than these figures I have just given.

Mr. ANDERSON. When I asked for actual rate of return, how do you determine what is an actual rate of return?

Mr. BRADSHAW. The CAB has a formula they use for rate-fixing purposes. The person—when somebody asked us yesterday afternoon

for the figures, the person in St. Louis who computed them chose to use the current ratemaking method.

Now, if you would like us to do so, we could go through our annual report, and supply it for your records.

Mr. ANDERSON. Is there any simple way you could do it for 1973? You have a 3.36 percent return where you lost money.

Mr. BRADSHAW. I do not know of any rational reason that that should be true.

Mr. ANDERSON. What are you using for one rate that you are not using for the other?

Mr. BRADSHAW. If I may, Mr. Chairman, here on the front row is Mr. Edward J. Crane, who is president of Ozark Airlines, and was the airline's chief financial officer, who knows a lot more about the details of subsidy formula and CAB practices than I do, and if I may, I would like to refer that question to him.

Mr. ANDERSON. Yes.

Mr. CRANE. Mr. Chairman, there is a very distinct feature between calculated rate of return and net income of carrier.

What Mr. Bradshaw is saying is that we could have a net loss reported to our shareholders for 1 year, and net loss for year, but the CAB calculated method of rate of return, we would have a rate of return which I think, basically, the CAB formula is—you take your net income before taxes and you add your interest expense, in other words, if your interest expense exceeds your net income before taxes you could be in loss position, but I think the method of calculation on the rate of return is your net income before taxes added back to your interest expense, and then subtract your actual taxes to it, and again our subsidy formula, which we are being paid on is based on a calculated rate of return in the figures we have—Mr. Bradshaw has indicated to you—are the similar figures used in computing our subsidy.

Mr. ANDERSON. Then all of these years then that you show a plus, with the exception of 1 year, where you show a minus, would you probably have lost money in those years, with the possible exception of 1 or 2 fairly large years?

Mr. CRANE. I do not have the exact figures with me, but I believe we showed minor profits from the years 1965 to 1966 and almost breakeven in 1967.

The years 1968 and 1969 and 1970, we lost almost $9 million combined for the 3 years, and 1971 we have returned to a minor profit position, except for our strike year in 1973, where we have been in a profit position since, but—and this is the crux of the whole matter, in 1967, 1968, and 1969 we lost almost $9 million, and I think we were penalized by going back and applying these losses carried forward to adjust to a prior year's subsidy.

Now, adding to what Mr. Bradshaw said in direct answer to your question, yes, we do believe if all the carriers were required to carry back their loss carrybacks, we feel it was a penalty for that particular year.

We felt that the subsidy was based on a given formula for 1 year, and it should have been settled on the prompt basis, based on the audit, and the schedule we filed, and negotiated with the staff for certain

disallowances, and so forth, and it should be settled, but the fact that the time lag entered into it, we go back because you lose money 4 years later, why should it be applied back to reduce your need for a previous year that should have been settled under a given formula?

Mr. ANDERSON. Mr. Lorenzo, do you want to tell us what your rate of return—actual rate of return is, whatever that means?

Mr. LORENZO. Well, Mr. Chairman, again these numbers, as in the case of Ozark, that I will give you, are numbers based on CAB methodology.

In 1966, 8.73.

Mr. ANDERSON. 8.——

Mr. LORENZO. 8.73 in 1966; 1967, 4.76; 1968, 2.79.

Both, by the way, both 1967 and 1968, the carrier reported net losses.

In 1969, minus 4.83; 1970, minus 8.58; in 1971, minus 8.26; and in 1972, 4.0.

Mr. ANDERSON. That was positive?

Mr. LORENZO. A positive, 4.0. In 1973, positive 10.2; in 1974, positive 8.51; and in 1975, minus 7.3.

I point out that in 1973, in fact, the carrier reported a profit of about $300,000 at a time when its net equity was probably around $8 million, but because of the way the CAB computes it, because of their disallowances, for example, in the area of depreciation, where we have accelerated the depreciation on our Convair turboprop aircraft the CAB does not recognize that for regulatory purposes.

The CAB had a rate of return of, again, 10.2 percent, while a rate of return for us would have obviously materially been less.

Mr. ANDERSON. Any further questions, Mr. Taylor?

Mr. TAYLOR. One question.

The methodology that is used—I am quite interested in this, between what the CAB uses in their calculation and what you use in reporting to your stockholders, and you have indicated one of them is your depreciation.

Am I correct in that interest is not allowed in the calculations of CAB—CAB does not allow the interest rate?

Mr. LORENZO. Interest is subtracted, and then it effectively comes back as part of the rate of return as part of your capital.

The answer is "yes."

Mr. TAYLOR. One other question.

I would like to ask Mr. Bradshaw, if I could, Mr. Chairman, I believe he mentioned the Board charter Ozark lost carryback, even though Ozark had not filed its amended 1966—tax return. Do you mean that the Board treated you as though you had filed your 1966 amended return, even though you had not yet done so?

Mr. BRADSHAW. That is correct, and if you will notice in my testimony, we set out the particular provision of the Board's order, which just clearly states there is supposed to take into consideration a particular return actually on file.

Now, in Ozark's case, they did not take the return then actually on file.

Mr. TAYLOR. Thank you, Mr. Chairman.

Mr. SNYDER. Mr. Chairman, I do not want to pursue the matter at the length we did with the CAB as to why they did not try to obtain final resolution of the issue in the Supreme Court.

But I guess it is only fair to ask you the same question—did you apply for certiorari?

Mr. BRADSHAW. We had the misfortune of being the first two cases. If we had been the last two cases decided by the court, then we would have clearly been entitled to writ of certiorari before the Supreme Court.

Now, after our case was we knew that these other two cases, or at that time, other three cases were pending, and I believe ours was the first of the four, as I recall.

I know Texas and ourselves were the first two, and at the time ours was over we knew these other two cases were pending, and we knew that there might be a conflict.

We actually tried on a writ of certiorari then, and we knew we were on tenuous grounds, but we could not really allege a conflict, and all we could allege was that there might be in the future a conflict, and so we were not too very surprised when the Supreme Court turned us down on it.

I think probably Texas was more realistic than we were in not even trying.

Mr. SNYDER. But you did try?

Mr. BRADSHAW. Yes; we tried, and we knew we were on tenuous grounds, and we hoped the Court would rule on some of the other cases, and might decide in the meantime, and unfortunately, that was the nine cases, so by the time that the other cases were decided the conflict existed, and then the only person I suppose who could have taken it to the Supreme Court was the CAB, because they were a party adversely affected in the last two cases.

Mr. SNYDER. Just one other question.

In the summation of your statement, when you were talking about the mistake by CAB and your appeal to the full Board, it all boils down to the fact that if they had not made the mistake, you would not need to be here. Is that correct?

Mr. BRADSHAW. That is exactly 100 percent right—until they made that mistake they calculated we owed them $90,000, the figure in my testimony, and we agreed to pay them that.

We agreed we owed them that, and the only reason it then was not settled for that is because they then made the mistake on the treatment of capital gains from the sale of flight equipment, and that delayed it a year or so. So the answer to your question is 100 percent, yes.

Mr. SNYDER. Thank you.

Mr. ANDERSON. Any more questions?

If not, I thank you gentlemen for being here before us.

That completes our hearing on this part of the meeting.

[Whereupon, at 11:35 a.m., the subcommittee proceeded to other business.]

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