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Unscrambling the Eggs: Eastern Air Lines, Delta Air Lines, and the Deregulated Era

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A thesis submitted to the Faculty of the Graduate School of Emory University
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Abstract

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By Benjamin van der Horst

This thesis examines two airlines during the first era (1978-1991) of airline deregulation. Before explaining the decisions of Eastern Air Lines and Delta Air Lines during this period and how these decisions led to Eastern's demise and Delta's success, a brief history of airline regulation and of each airline is given. A brief political history of how airline deregulation made it through Congress also precedes the chapters on each airline during the deregulated era.

I contend that four big decisions made by Eastern Air Lines in this period explain why the airline went from being the largest American airline in terms of passengers carried at the beginning of the deregulated era to a failed airline just over ten years later. These decisions are: 1) the purchase by Eastern of Braniff's South American Routes 2) Frank Borman's decision in 1983 to capitulate to Eastern's mechanics and give massive raises 3) the decision to sell Eastern to Frank Lorenzo in 1986 and 4) Lorenzo's decision to break the mechanics' union at Eastern. When put together, these four decisions tell the sad tale of Eastern Air Lines.

Likewise, I contend that four decisions made by Delta Air Lines in this same period explain why the airline went from being a mainly regional carrier at the beginning of deregulation to one of the three main American airlines by the end of this first era of airline deregulation. These decisions are: 1) continuing the Delta Spirit 2) building up new hubs 3) acquiring Western Airlines and 4) purchasing many assets from Pan Am. While Delta's story is not as interesting as Eastern's, it provides a useful foil for the chaotic decade Eastern faced. When the stories of these two airlines are put together, we see that the deregulated era forced airlines to make decisions that either they could not or did not have to make when regulated that determined the fate of each airline.

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I want to start by thanking Professor Joseph Crespino, who served as my advisor for this project. The idea for this thesis started in Dr. Crespino's seminar on Jimmy Carter's America in Spring 2008. For that seminar, I wrote a paper about President Carter's role in airline deregulation using the Carter Presidential Archives. From that research and paper, my interest in airline deregulation was born. Since I was a young child, airlines have always fascinated me, but it was not until this seminar that I started looking at airlines in an academic and historical manner. Dr. Crespino has been essential to me throughout this thesis process and his advice helped to shape many aspects of this thesis. I would also like to thank Dr. Fraser Harbutt and Dr. Jonathan Master for serving on my thesis committee.

My research for this thesis included visits to four archives, several libraries, and many hours on eBay tracking down old airline timetables. I have many people to thank from the various places I visited. Jana Lonberger, the American History reference librarian at Emory University's Woodruff Library, was amazingly helpful to me as always. Jana helped me on my very first research paper at Emory, a paper on the Atlanta airport four years ago, and she has always been a fantastic resource for me. I am so thankful for all of her help. For this project, Jana helped me track down periodicals and hard-to-find government documents among many other things.

I want to thank the entire staff of the Interlibrary Loan Office at the Woodruff Library who quickly tracked down dozens of books and articles for me from libraries around the nation. The last member of the Emory library staff to whom I owe a huge debt of gratitude is Marilyn Pahr of the Goizueta Business Library, who helped me find several important resources, most notably pointing me towards the thousands of pieces of microfiche containing annual reports that sit in the library's basement.

I spent several weeks researching in the Southern Labor Archives at Georgia State University, home to Frank Borman's papers and the most impressive collection of Eastern records in the country. Traci Drummond, the archivist of the Southern Labor Archives, was a tremendous help to my research and the documents I found in this archive were extremely valuable to my thesis. I also spent several days in the Delta Corporate Archives at the Delta Air Transport Museum and I want to thank archives manager Marie Force for all her help.

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Introduction

In 1978, Eastern Air Lines carried the second most passengers of any airline in the free world. The following year it would be the free world's largest airline. Thirteen years later, after the United States government deregulated the American airline industry, Eastern would be relegated to the history books. Today, many people have never heard of Eastern Air Lines.

In 1978, Delta Air Lines was still primarily a southern airline that was excited it had just launched its first European flight from Atlanta to London. Thirteen years later, it had acquired most of the assets of Pan American World Airways, the recently defunct de facto American flag carrier with routes across the globe. The once small southern carrier now had a hub in Frankfurt, Germany and planes with the Delta logo roaming the skies. Delta's experience with deregulation was much more favorable than Eastern's. Today, Delta Air Lines has just recently acquired Northwest Airlines, making Delta the world's largest airline.

Airline deregulation changed the airline industry forever. It brought air travel to the masses through increased competition that dramatically lowered airfares. Without it, Southwest Airlines, which carried more passengers in 2008 than any other U.S. airline, would most likely still be relegated to intra-Texas routes. Massive airline hubs in cities like Charlotte, Dallas, Chicago, Salt Lake City, Minneapolis, and many others would not exist. Airlines like JetBlue and AirTran would not be possible. Delta would not be months away from having service to every continent on earth except Antarctica. The airline industry would still be run from an office building on Connecticut Avenue in Washington, D.C., home to the Civil Aeronautics Board (CAB).

Airline deregulation was not clean and simple. It was chaotic and brutal for the airlines. They had been under regulation for fifty years, during which not a single carrier went bankrupt. The CAB took good care of the airlines, making sure competition would be very limited if it even existed, setting fares that would help to ensure profits, and playing matchmaker, arranging mergers in the case of airlines that were having troubles under its benign rule. Deregulation opened the floodgates. Hundreds of new airlines were started. Fare wars were launched. Suddenly, airlines had to compete.

Most of the airlines that started during the deregulated era did not last long. The vast majority went broke quickly. The more successful ones ended up being acquired by larger airlines. But these airlines changed the rules of the game forever with low prices and no-frills service. The old guard of the airline industry, headed up by the "Big Four," American, United, TWA, and Eastern, but also including smaller carriers such as Delta, Northwest Orient, and Pan Am, were put on notice. They had to adapt to the new deregulated environment or they would find themselves in the history books.

The 1980s was the era of airline chaos. Immediately a plethora of carriers flooded the market with the number of interstate airlines jumping from 36 in 1978 to 123 in 1983, creating fierce competition just as the American economy went into its worst recession since the Great Depression. [1] Because of the economy, airline deregulation got off to a tough start. Even after the economy improved and the industry started posting profits again, the increased competition made things tough for the legacy airlines. Robert

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[1] Eric M. Patashnik, Reforms at Risk: What Happens After Major Policy Changes are Enacted (Princeton: Princeton University Press, 2008), 115.

Crandall, the longtime President of American Airlines described his industry after deregulation as “legalized warfare” and called the airline business “nasty and rotten.” [2] And this came from the most successful leader of one of the most successful airlines. Many mainstays of the American airline industry would disappear during the decade through bankruptcy or mergers. This initial era of airline deregulation ended in 1991 with the liquidations of Eastern Air Lines and Pan American World Airways. Eastern and Pan Am were the two most prominent and the biggest airlines to succumb to deregulation.

After 1991, the industry would become more stable, as stable as the airline industry can be. Even though weaker airlines went in and out of bankruptcy, the United States did not see the demise of a major carrier until 2001 when American Airlines acquired TWA. This is notable because the airline industry is inherently unstable since it is so affected by outside influences such as fuel prices, wars, and the economy. Under the days of regulation, fares could be set to take these factors into account. The free market is not as generous.

Deregulation “scrambled the eggs” in the airline industry as Alfred Kahn would later say.[3] The rules had changed and the airlines had to adapt. Not all carriers came into the deregulated era on equal footing. But all of the carriers, including Eastern and Pan Am, the two weakest major airlines coming into deregulation, had a chance to succeed. In the deregulated era, each airline had to make many decisions about adapting to the new environment. These decisions determined whether an airline succeeded or failed.

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[2] Thomas Petzinger, Hard Landing: The Epic Contest for Power and Profits That Plunged Airlines into Chaos (New York: Times Business, 1995), 312 and x.

[3] “Remarks by Secretary Slater at the FAA's Commercial Aviation Forecast Conference (3/12/98)” 12 March 1998. <http://www.dot.gov/affairs/1998/31298sp.htm>

Going into deregulation Delta Air Lines and Eastern Air Lines were the two most similar airlines in the industry in terms of size and route structure. Both airlines had their largest hub at Atlanta's Hartsfield Airport. Eastern was slightly larger than Delta. Delta historically was the more profitable of the two airlines, although Frank Borman had turned Eastern into a profitable carrier in the late 1970s. Both Eastern and Delta were comfortable in the predictable CAB-ruled world and opposed deregulation vigorously. But deregulation took place, and both airlines were faced with a series of decisions over the next thirteen years that would end in Eastern's demise and Delta's success.

This thesis breaks new ground in several areas. All prior accounts of Eastern in the deregulated era were written by journalists who had been covering the story for publications such as *Business Week* and *The Wall Street Journal*. They wrote their books quickly, as extensions of their articles and lacked any historical distance. These books were written as journalism, not history as seen by the lack of any complete account of Eastern in the deregulated era, each focusing on just a particular event. In this thesis, a complete history of Eastern in the deregulated era is offered. Unlike the books written during or shortly after Eastern's demise, this thesis does not pursue an agenda of blaming labor or management, rather taking a dispassionate approach and focusing on decisions made by both sides. Also, this thesis makes use of Frank Borman's personal records while at Eastern, records that just became available in 2005, helping to provide a new insight into some of these decisions.

While Delta's story is not as exciting and therefore is much shorter than Eastern's, this thesis is the first attempt of looking at Delta's decisions in the first era of deregulation. Delta is important to this thesis because it provides a useful foil to Eastern.

This is the first time that Delta and Eastern have been used as a case study, which is surprising because they are so similar. The two airlines work well together to show the various effects deregulation had on the industry.

The study of airline deregulation is important because it was the first major industry to be deregulated. With airline deregulation, deregulation was no longer just an academic theory advocated by neoclassical economists and business leaders. It was a reality that sailed through Congress with overwhelmingly bipartisan support. Furthermore, airline deregulation was the most tangible deregulated industry for the American public. Even though the trucking and insurance industries were deregulated in short order, neither of them touched average Americans like low airline fares that brought flying to the masses.

This story is also interesting because it represents the first success of the modern conservative movement. The movement mainly consisted of pro-business individuals who had been influenced by Milton Friedman and other free market economists.[4] Ever since the New Deal, the modern conservative movement had been trying to push back against more government regulation and intervention in the economy. Through organizations such as the American Liberty League, Foundation for Economic Education, Mont Pelerin Society, American Enterprise Association, and National Association of Manufacturers, this movement in varying degrees of strength had been laboring unsuccessfully to push the pendulum of the economy away from regulation and more towards the free market.[5] The movement was especially weak in the 1960s and early

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[4] For more about Friedman and his theories see Eamonn Butler's Milton Friedman: A Guide to his Economic Thought (New York: Universe, 1985).
[5] Kim Phillips-Fein, Invisible Hands: The Making of the Conservative Movement from the New Deal to Reagan, (New York: W.W. Norton, 2009), 10, 19, 43, 60, and 13.

1970s after Barry Goldwater was crushed and the Vietnam War created an opportunity for the dissatisfied public to pin blame on business for helping the war effort. David Rockefeller, Chairman of Chase Manhattan Bank told *Newsweek* in 1971, "Some people are blaming business and the enterprise system for all the problems of our society."[6] The conservative movement was under attack and it did not seem likely it would have a major victory before the end of the decade.

But the movement came back stronger than ever in the 1970s, launched by a memo written by lawyer Lewis Powell (months before he would be nominated for the Supreme Court) for the United States Chamber of Commerce titled "Attack on the American Free Enterprise System." "Strength lies in organization," he wrote, "in careful long-range planning and implementation, in consistency of action over an indefinite period of years, in the scale of financing available only through joint effort, and in the political power available only through united action and national organizations."[7]

Seizing on this idea, the American Enterprise Institute focused on becoming stronger and the Heritage Foundation was created in 1973, both serving as conservative organizations trying to push the conservative agenda.[8] These organizations focused economic theories from people like Milton Friedman and Alfred Kahn. Friedman, in his preeminent work *Capitalism and Freedom,* wrote that "detailed regulation of industry" was one of many "activities currently undertaken by government" that could not "validly be justified."[9] Kahn in his two-volume work titled *The Economics of Regulation: Principles and Institutions* wrote, "Regulation itself tends inherently to be protective of

[6] Phillips-Fein, Invisible Hands, 154.
[7] Phillips-Fein, Invisible Hands, 160.
[8] Phillips-Fein, Invisible Hands, 171.
[9] Milton Friedman, Capitalism and Freedom, Fortieth Anniversary Edition, (Chicago: University of Chicago Press, 2002), 35-36.

monopoly, passive, negative, and unimaginative."[10] Pushing these anti-regulation ideas, the modern conservative movement got both Presidents Ford and Carter on board the deregulation movement and this created their first success: airline deregulation.

Since it was the first success of the modern conservative movement, looking at airline deregulation was the first opportunity to see the movement's free market ideas play out in reality rather than in policy papers and at conferences. Looking at the examples of Delta and Eastern in the deregulated environment shows what happened when these ideas were put into reality.

[10] Alfred E. Kahn, The Economics of Regulation: Principles and Institutions, Volume II (New York: John Wiley & Sons Inc., 1970), 325.

Chapter One: The Airlines Under Regulation

Airline regulation stemmed from the Great Depression and New Deal era. In the mid-1930s, the nascent airline industry begged the government for regulation to protect it from competition. The President of the Air Transport Association told Congress in March 1938 "there is nothing to prevent the entire air carrier system from crashing to earth under the impact of cut-throat and destructive practices."[11] The airlines would be sounding the same alarm fifty years later when the deregulation movement was gaining momentum.

During this era, airlines were especially important because they carried mail in addition to passengers. Airlines were also important to national defense as they would become a vital part of the war effort in the following years. With the Great Depression's obvious distrust of competition and a desire to develop a viable commercial airline industry, Congress passed the Civil Aeronautics Act of 1938, which set up the regulatory structure for the industry. With little exception, this structure would remain in place until 1978. This act empowered the agency it created to develop the air transportation system of the United States "properly adapted to the present and future needs of foreign and domestic commerce, of the Postal Service, and of national defense of the United States." It also ordered the agency to promote "adequate, economical and efficient service by air carriers at reasonable charges, without unjust discriminations, undue preferences or advantages, or unfair or destructive competitive practices."[12]

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[11] Richard H. K. Vietor, "Contrived Competition: Airline Regulation and Deregulation, 1925-1988," The Business History Review Vol. 64, No. 1 (1990), 67.
[12] Ivan L. Pitt and John R. Norsworthy, Economics of the U.S. Commercial Airline Industry: Productivity, Technology, and Deregulation (Boston: Kluwer Academic Publishers, 1999), 68.

The agency created from this act was the Civil Aeronautics Authority and would later be known as the Civil Aeronautics Board. It was ordered by the Civil Aeronautics Act of 1938 to operate the industry focusing on "public convenience and necessity" and not on competition, which was clear in the law. The CAB would not disappoint the members of 75th Congress, as it would focus on "public necessity" and stifle competition until its final days.

The CAB understood "public convenience and necessity" to mean there would be good and adequate air service across the United States with service to cities large and small. The service would be good meaning it would be safe, reliable, and of a high quality. The service also had to be adequate ensuring that each destination was served with enough frequency that it would be convenient for people to use. It was also in the "public necessity" for the United States to develop a strong commercial aviation industry. In order to develop viable commercial airlines providing good and adequate service, the CAB protected the airlines from competition and only approved profitable fares.[13] This was very similar to how many public utilities such as electric and water companies were regulated as air travel was also considered a public utility.

The regulated era of commercial aviation in the United States had many positive elements. Nearly every city with an airport across the United States enjoyed some commercial air service. Air service was of a generally high quality with on-time flights on new planes that were thoroughly cleaned between flights. Airlines competed with each other on service rather than price, so there were fewer seats on each plane ensuring plenty of legroom. Airlines provided piano bars and other amenities that are unheard of

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[13] Anthony E. Brown, The Politics of Airline Deregulation, (Knoxville: The University of Tennessee Press, 1987), 48 and 51.

today. However, for all of these positive factors, the major problem with the regulated era was that airfares were extremely expensive. Price competition was against "public convenience and necessity" according to the CAB. The CAB set high fares for flights so airlines would make profits, even on routes that should not have been profitable. So even though service was good and adequate as the CAB wanted, most Americans could not afford to fly.

The CAB consisted of five members, led by a Chairman, appointed by the President for a six-year term after Senate confirmation. No more than three members of the Board could be from the same political party. The CAB was extremely powerful as its decisions were considered law, and there was no appeal process outside of suing in Federal court. But even then, airlines would have to prove that somehow due process or a separate Federal statue was violated because the CAB was not required to defend its rationale for any decisions.[14] The members of the CAB were supported by a professional staff of civil service employees, who would help them run the airline industry.

The CAB's three major areas of power in the airline industry were entry to new airlines, route structure, and pricing. This gave it near complete control over the industry. In order to begin as an interstate air carrier, the airline had to obtain a certificate of "public necessity and convenience" from the CAB. The CAB slowly allowed some new airlines to enter the industry, but never granted a major route to any new carrier. Furthermore, it did not allow very many new carriers, denying 79 applicants from starting airlines between 1950 and 1974.[15]

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[14] Douglas H. Van Clief. "Airline Deregulation: A look at Changes in the Industry" (Master's Thesis, Northwestern University, 1988), 8.
[15] Pitt and Norsworthy, Economics of the U.S. Commercial Airline Industry, 69.

There were three types of carriers recognized by the CAB: trunk, local service, and commuters. The trunk carriers were the original sixteen airlines that were flying when Congress enacted the Civil Aeronautics Act of 1938, and the routes that they were operating at the time were grandfathered into their new route authority. Local service carriers mainly serviced short routes with little traffic, usually in more rural areas. Commuters were similar to local service carriers, but could only operate aircraft with 30 seats or less and were not subjected to CAB route authority. All of the airlines that the CAB allowed to enter service were either local service carriers or commuters. While these types of airlines were extremely important, since they brought air service to small communities around the country, they were never allowed to grow into large airlines.

The second area of CAB power was route authority. The CAB decided which airline could fly where. Airlines had to apply to the CAB for route authority between any two cities an airline wanted to serve. This process was time-consuming, costly, and put the airlines at the whim of the CAB. It made decisions based on an airline's current route structure and strived to keep the playing field even by taking into account current routes when awarding new ones to the disadvantage of bigger airlines. If the CAB denied an application, there was no recourse for the airlines.

The CAB often set conditions on route authority that would require additional stops. For example, if an airline wanted a route from Chicago to Miami, the CAB could grant it route authority as long as the flight stopped at Indianapolis, Memphis, and Tallahassee along the way. The routes approved by the CAB were often linear routes with several stops from the origin to the destination to pick up more passengers in an attempt to ensure profitability. The CAB generally favored point-to-point or direct service, rather than forcing passengers to connect to a second flight. During the regulated era, there were not many "hubs" as we know them today since hubbing was mainly a product of deregulation.

If an airline applied for route authority on a route that was already being served by another carrier, the CAB would go to the incumbent carrier and ask for comments about the new application. More often than not, the incumbent carrier would protest on the grounds that it would increase competition and it would be negatively affected by the new carrier on the route. The CAB took into account whether the incumbent carrier would be harmed by the competition.[16] As T.A. Heppenheimer has written, this process "was as if Kmart would have to win a lawsuit, and perhaps hold on to its victory through appeal, to win the right to compete with Sears in your local shopping mall."[17]

It was extremely difficult for airlines to get route authority on a route that was already being served. In fact, until right before deregulation in 1978, the CAB did not allow more than two airlines on any route in the United States.[18] Most routes were monopolies, but at worst airlines had a duopoly on their routes. In addition, if an airline wanted to eliminate a route, they would have to get permission from the CAB since it also controlled exiting of routes. If the CAB did not approve of the route elimination, an airline would have to continue operating the route regardless of any losses or other hardships the route was creating for the airline.

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[16] David R. Graham and Daniel P. Kaplan, United States Civil Aeronautics Board, Competition and the Airlines : An Evaluation of Deregulation (Washington, D.C.: CAB, 1982), 10.
[17] T.A. Heppenheimer, Turbulent Skies: The History of Commercial Aviation (New York: J. Wiley & Sons, 1995), 315.
[18] Steven A. Morrison and Clifford Winston, "Airline Deregulation and Public Policy," Science Vol. 245 No. 4919 (1989): 707.

Not only were entry and routes protected and regulated by the CAB, but so was pricing. In regulating fares, the CAB's primary objective was carrier profitability. The CAB was all about helping the airlines rather than passengers. For most of the regulated era, the CAB used distance as the primary factor in setting fares with a formula so that would earn a 12 percent return assuming a 55 percent load factor (meaning 55 percent of the seats on the plane were full) on each flight.[19] The formula was set up that longer flights would earn more money than shorter flights in an attempt to encourage airlines to set up long-haul flights. Essentially longer flights would subsidize shorter flights. Fares were set on industry-wide costs rather than route-specific costs, creating fares that were higher than necessary for most flights. The CAB would not actually set fares themselves, but the airlines would file for fares based on the formula and the CAB would approve or reject them. In 1970, the CAB began a formal investigation into fares called the Domestic Passenger Fare Investigation. The results of this investigation showed that the current formula was not adequate, but it was simply tweaked, resulting in little change.

Since the airlines could not compete on price, they were forced to compete on service and frequency, two things out of CAB control. In order to have the best service, the airlines constantly replaced their fleets with the newest aircraft and quickly moved into the jet era, replacing their turboprop planes with the first jets such as the Boeing 707, Convair 880, and the Douglas DC-8. While this was a boon to aircraft manufacturers and increased passenger comfort, it was not economically efficient for the industry to be competing so heavily on service without any price competition. But service competition between airlines did not stop with new planes. Airlines outfitted their aircraft with

[19] Steven Morrison, "Airline Service: The Evolution of Competition Since Deregulation," in Industry Studies: Second Edition ed. Larry L. Duetch (Armonk, New York: M.E. Sharpe, 1998),148.

lounges and pianos in an attempt to draw customers to their airline. The airlines also competed on food and the CAB was drawn into a food fight as Delta Air Lines filed a complaint with the CAB against Northeast Airlines, who claimed in advertisements their steaks were cooked to order. Delta countered that they were simply reheated and the CAB had to make a ruling on whether Northeast was engaging in false advertising.[20] This incident shows the level of service competition among the airlines since the CAB prevented price competition.

Airlines also engaged in frequency competition since they assumed that customers would be more likely to take their airline if it had more flights on a route. This was seen on the routes where there was a duopoly and airlines put more flights on these routes than the traffic would support in an attempt to gain passengers from the other airline. This backfired as the additional capacity ensured that each flight went out with fewer people and helped to make entire routes unprofitable.

Starting in 1969, the CAB made it even more challenging than before for airlines to grow and expand. In order for an airline to start a new route, the burden of proof had always been on the airline to show that the new route was in the public interest and that it would not harm another airline. This made it nearly impossible for airlines to get new routes. However, starting in 1969, the CAB imposed an informal route moratorium, basically killing applications for new route requests from the airlines. This was never officially announced, something Senator Kennedy would call "highly irregular and improper" during Congressional hearings in February 1975 on the CAB.[21] At this same

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[20] Barbara Sturken Peterson and James Glab, Rapid Descent: Deregulation and the Shakeout in the Airlines (New York: Simon & Shuster, 1994), 30.
[21] "Kennedy Denounces C.A.B. Moratorium On New Route Competition for Airlines," *New York Times,* February 27, 1975.

hearing, deregulation advocates produced evidence that no airlines were allowed to start service on any of the 100 busiest routes in the country from 1973-1975 and only eight percent of these applications were approved from 1965-1975.[22]

When Alfred Kahn took over the CAB as Chairman in 1977, he realized the many problems with the Board. He found it amazing how much power he had over the airlines. "No one could blow his nose without getting my permission," Kahn said, "It was insane."[23] Kahn would set out to quickly change the CAB even before the Airline Deregulation Act passed. He was not very impressed with airlines or airplanes as seen when Frank Borman of Eastern Air Lines asked him what he thought of the noise level coming from one of Eastern's new A-300 aircraft. "I really don't know one plane from the other," Kahn admitted, "To me they are just marginal costs with wings."[24] Kahn was an economist, not an airline junkie, and he looked at airline deregulation from that view. As he said, "Wherever competition seems feasible, my disposition is to put my trust in it much the same way I do in democracy—as a manifestly inefficient system that is better than any of the alternatives."[25]

Despite all the flaws in airline regulation, the airlines considered the CAB a benevolent dictator. During its fifty-year reign, not a single airline went bankrupt. The CAB would set up mergers for failing airlines so they would not fail. Furthermore, the CAB disapproved mergers that would harm other airlines even if they would have resulted in efficiency gains.[26] The airlines may not have always been happy with the CAB, especially with the route moratorium, but they knew the CAB and knew with the

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[22] "Kennedy Denounces C.A.B. Moratorium On New Route Competition for Airlines," *New York Times.*
[23] Peterson and Glab, Rapid Descent, 75.
[24] Peterson and Glab, Rapid Descent, 77.
[25] Heppenheimer, Turbulent Skies: The History of Commercial Aviation, 318.
[26] Morrison and Winston, "Airline Deregulation and Public Policy," Science 709.

CAB ruling the industry, competition would be limited. This is why almost all of the airlines (United was the notable exception) opposed deregulation and fought its passage in Congress.

Eastern Under Regulation

Eastern Air Lines had its start as Pitcairn Aviation in 1927. In February 1928, Pitcairn won a Post Office contract to fly Contract Air Mail Route 19 from New York to Atlanta via Philadelphia, Baltimore, Washington, D.C., and the Carolinas. In 1930, the company was renamed Eastern Air Transport.[27] President Hoover made confidant Walter Folger Brown his Postmaster General, which gave him control of the air system since it mainly served airmail at the time. He had complete control in awarding air contracts. So he got the biggest air carriers together in Washington, D.C. and divided up the most lucrative airmail routes between them in something that would later be known as the Spoils Conference. Four air carriers got the main routes: United Aircraft & Transportation, Transcontinental & Western Air, American Airways, and Eastern Air Transport. The Big Four, who would rule the airline industry under regulation, were created.[28]

When Brown's Spoils Conference was discovered, the routes were revoked and were bid on competitively. President Roosevelt said that none of the Big Four could bid on the contracts since they were involved in the cronyism that gave them the contracts in the first place. So each of the four slightly changed their names. Eastern Air Transport

[27] W. David Lewis, "Eastern Air Lines," in Encyclopedia of American Business History and Biography The Airline Industry ed. William M. Leary (New York: Facts on File, 1992), 160.
[28] Petzinger, Hard Landing, 9.

became Eastern Air Lines in 1935. Eastern tried to get the Atlanta-Dallas route to extend its routes from the eastern seaboard, but the government gave the contract to a small crop dusting operation named Delta Air Lines. What scholar W. David Lewis has termed “one of the classic wars in the history of American commercial aviation” was born.[29]

World War I fighter ace Eddie Rickenbacker took over control of Eastern in 1934. Some of Rickenbacker’s fame comes from his long tenure at Eastern, but he was a known public figure before Eastern, starting as a racecar driver and then became one of the more prominent fighter pilots from the First World War. Under the Civil Aeronautics Act of 1938, Eastern got to keep all of the routes it had been operating including the New York to Miami route that would become Eastern’s signature route until liquidation. By 1940, Eastern’s system covered about 5,400 miles and it was the dominant carrier in the Eastern half of the United States.[30] With buffed aluminum planes known as the Great Silver Fleet, Eastern ruled vacation traffic to Florida.

After World War Two, the CAB introduced competition to some of Eastern’s routes. National Airlines was awarded New York-Florida routes. And in 1945, the CAB awarded Delta Air Lines route authority on the valuable Chicago-Miami route. Eastern’s monopoly on traffic to Florida was over, and Delta emerged as Eastern’s biggest rival. In 1956, Eastern acquired Colonial Airlines giving it more routes in the Mid-Atlantic region. Since the CAB awarded routes based on an airline’s current route system, Eastern was not getting good routes from the CAB since they already had a strong system. This made

[29] W. David Lewis, “Eastern Air Lines,” 163.
[30] W. David Lewis, “Eastern Air Lines,” 163.

the merger with Colonial necessary because airlines with inferior route system such as Delta were gaining route authority on many of Eastern's routes.[31]

The late 1950s and 1960s were not good for Eastern as poor service and labor strife drove customers away. Rickenbacker cared little about passenger concerns. As Eastern Chairman Frank Borman described Rickenbacker's philosophy, "Eastern's sole job was to fly from Point A to Point B as frequently and safely as possible—let the other airlines do the pampering."[32] Eastern was so hated by customers that it spawned an anti-airline club known as WHEAL, for We Hate Eastern Airlines.

If Eastern was not having enough problems, Rickenbacker was too conservative when the jet era emerged in 1958 with the introduction of the Boeing 707. Eastern had ordered Douglas DC-8 jet aircraft and were set to get them ahead of Delta. But Rickenbacker overruled his executive staff and claimed that the Pratt and Whitney JT-3 engines that would be on the first DC-8s were underpowered and Eastern would wait for the JT-4 engines to be finished. Rickenbacker did not want to move into the jet era. So Delta got DC-8s a year before Eastern. Delta put their jets onto routes where they competed against Eastern and as Frank Borman writes "clobbered" Eastern for a year since passengers preferred to be on jets, which were much faster even though the prices were the same. This decision would continue to haunt Eastern as Borman later wrote, "Delta's dominance over Eastern, in fact, dated back to the assumption of those delivery positions."[33]

[31] W. David Lewis, "Eastern Air Lines," 163.
[32] Frank Borman with Robert J. Serling, Countdown: An Autobiography (New York: Silver Arrow Books, 1988), 269.
[33] Borman, Countdown, 270.

Meanwhile, Delta and National both were awarded transcontinental routes to the west coast in 1961 while the CAB continued to deny Eastern similar routes. Despite the tremendous success of the Eastern Air Shuttle that was introduced in 1961 and provided guaranteed seats without reservations on hourly flights between Boston, New York, and Washington, D.C., Eastern was doing so poorly that the Eastern Board of Directors forced Rickenbacker out in 1963 and replaced him with Floyd Hall, a veteran airline executive from TWA. Hall turned Eastern around, acquiring new DC-9 aircraft, getting transcontinental routes to Portland, Seattle, and Los Angeles and acquiring small Caribbean airlines that gave Eastern access to the Caribbean. He even was able to turn around Eastern's service so much that WHEAL was disbanded.

But Eastern was still having operational and financial troubles. The airline lost $77.2 million from 1968-1974.[34] Part of Eastern's problem was the division of administrative staff between New York City and Miami. Eastern maintained a plush corporate headquarters in Rockefeller Plaza in New York and operational headquarters in the more spartan Building 16 at Miami International Airport. Often the executives in the two headquarters had differing opinions that created a power struggle within the company.

By 1975, Hall was in failing health, so on December 16 the Board named Frank Borman, a famous astronaut who had been commander of Apollo 8 and had been serving as an Eastern Vice President, President and CEO of Eastern, hoping he could turn things around. Borman quickly changed many things at Eastern including moving the corporate headquarters to Miami, eliminating 31 of 69 vice president positions, eliminating corporate cars, selling the corporate jet ("We already have two hundred and fifty jets—

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[34] Eastern Air Lines, Inc., Eastern Air Lines 1975 Annual Report.

what the hell do we need it for?" Borman barked one day)[35] all in an effort to bring a new cost-cutting attitude to Eastern's management to save money. Borman got all employees, including its unionized flight attendants, pilots, and mechanics to agree to a wage freeze. In 1976, Eastern posted a $45.2 million profit, the largest in its history.[36] Borman seemed to be turning Eastern around.

After successfully securing wage freezes, Borman got his employees to agree to a new idea called the Variable Earnings Plan (VEP). Under this plan, employees got 96.5 percent of their salary. The company kept the last 3.5 percent to ensure Eastern would make a two percent profit. If Eastern did not make a two percent profit, the airline would use the money from the 3.5 percent they kept from salaries to make up the difference. If the airline did make the two percent profit, the employees would get money back up to 103.5 percent of their base salary. It made all employees share in both profits and deficits. Management also participated in the VEP, but contributed 5 percent instead of 3.5 percent.

The VEP was initially successful and Eastern flourished under Borman. Eastern made $27.8 million in 1977, $67.2 million in 1978, and $57.6 million in 1979.[37] Borman openly modeled his management style at Eastern on that of arch-rival Delta, much to the chagrin of many longtime Eastern employees. Borman waved off this criticism. "I didn't give a hoot," he wrote in his 1988 memoir, "Delta was one hell of an example to follow, successful and efficiently run with passenger loyalty almost as high as that of its employees. That outfit had to be doing things right."[38]

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35 Borman, Countdown, 277.
36 Eastern Air Lines, Inc., Eastern Air Lines 1976 Annual Report.
37 Eastern Air Lines, Inc., Eastern Air Lines 1979 Annual Report.
38 Borman, Countdown, 335.

Borman also started the process of modernizing Eastern's aging fleet. In April 1977, Borman signed an agreement with French-based Airbus to lease four A-300 aircraft for six months. This was extremely controversial because it was the first time any American carrier had obtained the European Airbus planes and a strong surge of protectionist spirit surged against Eastern. Borman demanded that the four A-300s be leased to Eastern at no cost because they wanted to try them out and see how big of a backlash Eastern would encounter. Eastern started flying the A-300s on December 13, 1977.[39]

The new planes were a big success for Eastern as they performed very well and were more efficient than other aircraft. On April 6, 1978, Eastern signed an agreement with Airbus for 23 A-300s worth $778 million. Not only did Eastern get a good price on the planes, but they also got European financing which made the deal even better. Before signing the deal Borman justified the purchase on efficiency grounds. It was "the finest machine available in its category in the world today," he said.[40] Five months after announcing the deal with Airbus, Borman signed a deal with Boeing for 21 Boeing 757 aircraft in a deal worth $560 million.[41] These deals ensured that Eastern would have a modern fleet for years to come.

Not all was good for Eastern, though, because deregulation was brewing. Borman saw this as a major challenge. "I knew if the industry was deregulated, Eastern with its high labor costs and huge debt was going to be the most vulnerable carrier of them all," he wrote.[42] Eastern had $1 billion of debt when Borman became CEO and had added

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[39] Borman, Countdown, 363.
[40] Carole Shifrin, "Airbus Debuts Here," *The Washington Post*, April 13, 1978.
[41] Borman, Countdown, 365.
[42] Borman, Countdown, 350.

another $1.4 billion in debt through the purchase of new aircraft. In 1980, long-term debt made up 78.5 percent of Eastern's total capitalization compared to only 10.6 percent at Delta.[43] Eastern was profitable, but its heavy debt load and made the airline vulnerable.

Internal documents showed the concerns of Eastern executives. Eastern opposed the abolition of protected route franchises. They proposed an alternative that consisted of giving the CAB more "direction" and "establish CAB route award criteria." Also Eastern acknowledged that "we could live with some reasonable pricing flexibility outside of CAB jurisdiction on fare regulation"[44] In reality, Eastern did not want anything to change at all and hoped it could just get Congress merely to tweak the CAB rather than dispense with it entirely.

In a letter to Senator Charles Percy of Illinois after deregulation had started, Borman wrote, "Early on I did oppose deregulation. It was going to make life hard for Eastern and I felt it was a rather dramatic departure from the sense of 'public utility' aspect of our air transport system."[45] As noted previously, the CAB treated airlines much like other public utilities such as water and electric companies where, in exchange for widespread service, regulators would ensure profits.[46] In this letter, Borman is correct in calling deregulation a "drastic departure" from being regarded as a public utility because under deregulation a government agency made sure there was good air service and that airlines were profitable. In the deregulated world, the airlines were no longer treated like public utilities, but rather like companies in any other competitive industry being forced

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[43] United States General Accountability Office, Airline Competition: Weak Financial Structure Threatens Competition (Washington, D.C.: GAO, 1991), 18.
[44] "Eastern Position On Current Issues," Box 6, Folder 34, Eastern Airlines Collection, L1986-27, Southern Labor Archives, Special Collections Department & Archives, Georgia State University, Atlanta, GA.
[45] "Letter to Senator Percy," Box 9, Folder 8, Frank Borman Papers, L2005-16, Southern Labor Archives, Special Collections Department & Archives, Georgia State University, Atlanta, GA.
[46] Brown, The Politics of Airline Deregulation, 53.

to compete on price and service. Deregulation was going to make life very hard for Eastern and force Borman to make tough decisions to adapt to deregulation.

Delta Under Regulation

Delta Air Lines got its start as Delta Air Service in 1928 in Monroe, Louisiana. Huff Daland Dusters was a small crop dusting company that Delta founder C.E. Woolman purchased in 1928 and changed the name to Delta Air Service. In early 1929, Woolman purchased Fox Flying Service, which gave him two Travel Air six-seat airplanes and Delta started passenger service on June 17, 1929 flying from Jackson, Mississippi, to Dallas, Texas, with stops in Monroe and Shreveport, Louisiana. The Travel Air plane made the trip at 90 miles an hour.[47]

Postmaster General Walter Brown's plan to divide the airmail routes up between four carriers, the same plan that was so beneficial to Eastern, was devastating to Delta. Delta applied for an airmail contract to help subsidize their bleeding passenger operations. Because of the Spoils Conference, Delta did not get it. From 1930-1934 with the Great Depression in full swing, Delta reverted back to solely crop dusting. Crop dusting was important to Woolman, and Delta continued to offer it until his death in 1966. After the Spoils Conference was exposed, bidding was reopened for the contracts and Delta got its old route back, now Route 24 operating from Dallas to Charleston. The airline became Delta Air Lines and restarted commercial service on July 4, 1934.

[47] R.E.G Davies, Delta: An Airline and its Aircraft (Miami: Paladwr Press, 1990), 10.

Delta's main operations base moved from Monroe to Atlanta in 1936 and the headquarters followed in March 1941.[48] In April 1941, Delta was given route authority from Atlanta to Cincinnati via Knoxville and Lexington. After World War II, the CAB gave Delta authority to fly from Chicago to Miami, putting it into direct competition with Eastern. Eastern was the nation's largest airline at the time, and Delta was just a regional airline. But this new route started the competition that would last until Eastern liquidated in 1991.

In 1953, Delta merged with Chicago & Southern Air Lines, another regional airline. The merger brought many new cities and routes into the Delta system including Detroit, St. Louis, Kansas City, Houston, and Memphis. It also gave Delta international routes from New Orleans to the Caribbean including Havana, San Juan, and Caracas.[49] Delta was now an international airline.

In 1955, Delta had been given enough route authorities to and from Atlanta to set up a hub in Atlanta flying people from smaller cities in the South to Atlanta where they would switch planes and be flown to other cities.[50] Delta created the first hub in Atlanta, a concept that would take off after deregulation.

Woolman decided to enter the jet age with the Douglas DC-8 rather than the Boeing 707. Delta was the first airline not in the Big Four to be the first customer for a new plane when on September 18, 1959 it started DC-8 service from Atlanta to New York via Washington. It was awarded this route in 1955, breaking Eastern's monopoly

[48] W. David Lewis and Wesley Phillips Newton, "Delta Air Lines," in Encyclopedia of American Business History and Biography The Airline Industry ed. William M. Leary (New York: Facts on File, 1992), 136.
[49] Davies, Delta: An Airline and its Aircraft, 58.
[50] Peterson and Glab, Rapid Descent, 120.

on the route. Delta introduced the Convair 880, another jet aircraft in 1960, deploying a second type of jet before Eastern got its first DC-8.

On March 11, 1961, the CAB awarded Delta route authority to California. Three months later Delta would start service from Atlanta to Los Angeles nonstop using their new route authority. The same CAB decision gave Delta authority to service San Diego, Las Vegas, and San Francisco.[51] The little crop duster from Monroe was now a transcontinental airline.

Delta was the first airline to launch the Douglas DC-9, a new short-range jet aircraft in 1965. Things were going well for Delta. But then the following year, Delta founder and leader C.E. Woolman died. He was the personification of Delta, and the airline was deeply affected by his death.[52]

In 1972, Delta merged with Northeast Airlines beating out other airlines including Eastern and TWA who also wanted Northeast's strong network in the northeast United States and their lucrative routes from the northeast to Florida. Delta also got its first Boeing 727 planes through the merger, a type that would become the backbone of the fleet. By acquiring Northeast, Delta put itself into even more direct competition with Eastern, since Northeast was one of Eastern's biggest competitors, especially on the Florida routes.

Delta had introduced Boeing 747 jumbo jet service two years before, but discovered that even with Northeast's Florida routes, it did not have routes that needed 370 seats. Over the 1970s, it phased its five 747s out and replaced them with Lockheed L-1011 Tristars starting in October 1973, the same plane Eastern had introduced the year

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[51] Davies, Delta: An Airline and its Aircraft, 76.
[52] Lewis and Newton, "Delta Air Lines," 148.

before as the "Whisperjet." [53] Even though Eastern had major problems with the engines in their L-1011s and did not like them, Delta really liked the aircraft and became the largest customer of the plane.

Going into deregulation Delta was in excellent shape. The airline had posted profits for 30 consecutive years and had a strong route structure. [54] Delta's corporate culture was legendary as Woolman's values still ran the company. All employees were part of the "Delta family" and employees were fiercely loyal to the company. Delta had never layed off any employees. Because of this culture, Delta was primarily a non-union company, with only the pilots being unionized.

Since Delta was prospering under the reign of the CAB, it is not surprising that the airline strongly opposed deregulation. Delta opposed the deregulation legislation because it would create additional competition. Delta's President W.T. Beebe wrote to presidential aide Mary Shuman, Jimmy Carter's lead aide on deregulation, that Delta's main problem with the working draft of the Airline Deregulation Act was "its discrimination against carriers in Delta's position."[55] Beebe later sent this letter to President Carter emphasizing how deregulation would conflict with Carter's goal of energy conservation. He wrote, "The executive branch and the legislative branch cannot on the one hand call for sacrifices to be made in the interest of saving energy and then enact legislation which will result in a far greater use of energy."[56] This argument was disingenuous at best since Delta was concerned about competition, not energy usage. It

[53] Davies, Delta: An Airline and its Aircraft, 96.
[54] "The Challenge of a New Year," *Delta Digest*, January 1978, Delta Air Lines Corporate Archives, Delta Air Transport Heritage Museum, Atlanta, GA.
[55] "Letter to President Carter from W.T. Beebe," Folder 33, Presidential File 1977-1981, Collection JC-1056: Records of the Office of the Staff Secretary, Jimmy Carter Library, Atlanta, GA.
[56] "Letter to President Carter from W.T. Beebe," Jimmy Carter Library.

showed how desperate Delta was to keep the industry regulated. Beebe argued that that CAB could create more competition under the existing law, which was, "highly flexible, always forward-looking, strongly pro-competition" even though it was the same old law that had been governing the industry for decades.[57] Beebe then started flying to Washington to tell Carter personally how terrible deregulation would be. Carter stood firm despite the pleas of one of the biggest companies in his home state.

CAB Chairman Alfred Kahn addressed Delta's opposition saying, "Delta wasn't ready when I was."[58] In the September 1978 issue of *Delta Digest*, Delta's General Attorney wrote about the current bill being considered, which was a different version than was passed, "Rather than see this bill passed, Delta would prefer to see the CAB abolished entirely."[59] At least in this regard, Delta would get its wish.

After the bill was passed, Delta put a better face on it in the November issue of *Delta Digest*, writing in its editorial, "It creates challenges but, of equal importance, new opportunities for Delta…Delta is ready."[60] Delta was more ready than many airlines. In 1978, Delta's first trans-Atlantic flight on April 30 provided service to London and the airline made a $131 million profit.[61] Delta was well prepared, but deregulation would create many new problems to address and decisions to make.

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[57] "Letter to President Carter from W.T. Beebe," Jimmy Carter Library.
[58] Peterson and Glab, Rapid Descent, 77.
[59] "An Update on Regulatory Matters…," *Delta Digest*, November 1978, Delta Air Lines Corporate Archives, Delta Air Transport Heritage Museum, Atlanta, GA.
[60] "Viewpoint," *Delta Digest*, November 1978, Delta Air Lines Corporate Archives, Delta Air Transport Heritage Museum, Atlanta, GA.
[61] Delta Air Lines Inc., Delta Air Lines 1978 Annual Report.

Chapter Two: The Eggs are Scrambled: How the Industry Became Deregulated

Even though the industry was broken, there was not initially major support in Washington or nationally for deregulation. This was not an idea that was created on Capitol Hill. Rather, it was created by a handful of economists at universities around the country and pushed by the modern conservative movement in the 1970s. While not the first economist to focus on airline deregulation, Cornell economist Alfred Kahn led the charge and was the most prominent member of the airline deregulation movement. In a 1971 book, *The Economics of Regulation*, Kahn railed against regulation as inefficient. He focused on the non-price competition the airlines were forced to engage in, arguing, "The airline industry is structurally suited for effective competition."[62]

According to Kahn, among all the aspects of non-price competition "the one most closely approaching destructiveness in character is scheduling," which created excess capacity.[63] He also pointed out that since airlines were not allowed to charge different rates based on the type of plane they operated on a particular route (turboprop versus jet), the airlines were forced into constantly purchasing the newest equipment to stay up with their competitors. Kahn acknowledged that service competition was not a bad thing since it made the air travel experience better for passengers. Yet he argued, "The defect, in short, has not been with service competition, as such, but the inadequate play of *price* competition along with it."[64]

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[62] Jagdish N Sheth, ed., Deregulation and Competition: Lessons from the Airline Industry (New Delhi: Response Books, 2007), 27.
[63] Kahn, The Economics of Regulation: Principles and Institutions, 211.
[64] Kahn, The Economics of Regulation: Principles and Institutions, 216.

Kahn based his argument on more than just economic theory. He focused, like most other deregulation advocates, on the success of the intrastate airlines in California and Texas. In both of these states there were airlines that only flew within the state and therefore were not subject to CAB regulation. These airlines had much lower fares than the CAB-regulated airlines that flew the exact same routes.

The comparison between intra-California routes and similar length flights on the east coast was striking. Kahn cited Michael Levine who showed that the lowest fare between Boston and Washington, which is about the same distance as San Francisco and Los Angeles, was more than double the non-CAB regulated fare in California. Furthermore, Pacific Southwest Airlines (PSA), one of the intra-California carriers, dropped its prices below the three trunk (CAB-regulated) carriers operating the Los Angeles-San Francisco route and within three years increased its market share from 13 to 43 percent.[65]

PSA put more seats in their planes than its competitors and also flew with load factors around 80 percent, compared to the 60 percent trunk carriers achieved under CAB regulation.[66] PSA's focus on price rather than amenities as well as their ability to fill their planes was the future of air travel in the United States, something that no one knew at the time. Southwest Airlines, now the largest American airline in terms of passengers carried, got their start as an intra-Texas airline, operating much like PSA in California. Dallas-Houston traffic increased 127.5 percent from 1970-1974 as Southwest undercut the CAB-mandated routes by between 40 and 65 percent.[67]

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[65] Kahn, The Economics of Regulation: Principles and Institutions, 219.
[66] A load factor is the term for the percentage of seats filled on a plane. For example, if a plane has 100 seats and 75 are taken, the load factor for that flight is 75 percent.
[67] Bailey, Deregulating the Airlines, 29.

The experience of the intrastate airlines also made a myth of the argument that airlines would not be profitable without regulation, something that economists often pointed to during this debate. In the mid-1970s, the trunk carriers were making about a six percent return on their investment when the three major intrastate carriers (PSA, Southwest, and Air California) were making profits in the double digits, over twenty percent in the case of Southwest. Clearly, regulation was not necessary for the industry.

The Ford Years

The economists pushing airline deregulation found a friend when President Ford took office in August 1974. The country's economy was weak and was battling high inflation. Ford wanted to reduce regulation as part of his anti-inflation plan, something that Carter would also focus on three years later. He created a National Commission on Regulatory Reform, and airline regulation became a target.

President Nixon had appointed Robert Timm to become Chairman of the CAB. Timm was a wheat farmer by trade and had no experience in government regulation.[68] He staunchly sat in the pro-regulation camp and many of the problems with the CAB increased during his tenure. Timm's anti-competitive stance made him a favorite of the airline industry, which during the Nixon administration unanimously opposed any deregulation.[69]

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[68] "Changed Forever," *Air Transport World* "http://www.atwonline.com/channels/airlineFocus/article.html?articleID=1159."

[69] Martha Derthick and Paul J Quirk, The Politics of Deregulation (Washington, D.C: Brookings Institution, 1985), 106.

Timm was a problem to Ford not only because of his opposition to deregulation, but also because he was one of Nixon's political cronies. Timm thwarted a CAB investigation into illegal campaign contributions to Nixon's re-election campaign from airlines and when this came to light he was engulfed in scandal. He refused to resign at the request of the White House, and so on December 10, 1974, President Ford stripped Timm of the chairmanship.

The first major effort at airline deregulation was undertaken not by Ford, but by an ambitious Senator looking to bolster his bipartisan credentials. Senator Edward Kennedy wanted to be President of the United States. This young, liberal Senator's resume was thin, and he needed an issue to pursue, especially with his signature issue of Vietnam winding down. He was the chairman of the Subcommittee on Administrative Practice and Procedure, which gave him license to pursue almost any issue involving the government. One close advisor of Kennedy's was a brilliant young Harvard Law School professor on sabbatical. Stephen Breyer, two decades before President Clinton would appoint him to the Supreme Court, offered Kennedy two options of issues to champion. One was to continue pounding on the Watergate scandal and the other was to look at the CAB. The choice was easy. As Thomas Petzinger writes, "An attack on the CAB would have wonderful populist ring, while exposing the labyrinth of federal airline regulation would give Kennedy at least a narrow conservative stripe; he could be seen as a champion of the growing movement to curb the size of big government."[70] Kennedy's choice to pursue airline deregulation would start the ball rolling in the Senate and jumpstart the entire debate.

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[70] Petzinger, Hard Landing 81.

Breyer recruited a former classmate from Harvard Law School, Phil Bakes, to serve as an investigator of the CAB for Kennedy's subcommittee. Bakes became just as instrumental as Breyer, helping to uncover the CAB route moratorium and illegal airline contributions to President Nixon that the CAB refused to investigate. Bakes was the driving force behind the bill. After the President signed the bill, Kennedy found himself in an elevator with President Carter and Phil Bakes. He said to Carter, "Mr. President, I want you to meet Phil Bakes. He and Mary Shuman are the people responsible for this."[71] By that time Bakes was serving as the General Counsel of the CAB. He would later become even more involved with deregulated airlines working for Frank Lorenzo, as the President of Continental and later Eastern.

In February 1975, Kennedy used his subcommittee to hold hearings on the CAB. These were the first Congressional hearings on airline deregulation, and they would put the industry on notice. Eight days of hearings took place, "carefully arranged by Breyer and Bakes to cast the regulators and the industry as evildoers."[72] The opponents of airline regulation were given every advantage in these hearings. The hearings were not meant to be an impartial investigation. They were intended as an indictment of the CAB and the airlines.

Kennedy made his views clear right away. He opened the hearings by saying, "regulators all too often encourage or approve unreasonably high prices, inadequate service, and anticompetitive behavior. The cost of this regulation is passed on to the consumer. And that cost is astronomical."[73] Using the economists' arguments, Kennedy presented the case of the intrastate airlines as an example against regulation. He

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[71] Petzinger, Hard Landing, 94.
[72] Petzinger, Hard Landing, 84.
[73] Brown, The Politics of Airline Deregulation, 107.

demanded that the Air Transport Association (ATA), the main lobbying group for the airlines, explain why his weekly flight from Washington to Boston cost twice as much as a flight of a similar length in California. "The difference between low air fares and high air fares," Kennedy argued, "should not be the difference between the absence and presence of federal regulation."[74]

Breyer worked very closely with the Acting Secretary of Transportation, John Barnum, to make sure his answers before the committee favored deregulation. The two of them actually met the night before Barnum's testimony to come up with specific questions and answers. Barnum told the committee that the current regulatory system "misplaces incentive and disincentive, distorts competitive advantage, protects inefficient carriers from effective competition, over-restricts market entry, artificially inflates rates, and misallocates our Nation's resources."[75]

The ATA was less than thrilled with the whole show because the industry opposed any sort of deregulation. They told Kennedy that flights would be eliminated and subsidies would have to go up if the industry was deregulated. Experts called by the committee disagreed with this assessment. The star witness was Alfred Kahn, the savvy and well-spoken Cornell economist. Kahn impressed the committee with his knowledge and humor throughout his testimony.

President Ford had not submitted any legislation on airline deregulation before the Kennedy hearings. But these hearings forced his hand, and he decided to get more involved. He named John Robson Chairman of the CAB in April 1975 and indicated his support for liberalization of the industry the same month. In May, he submitted the first

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[74] Jack Egan, "Kennedy Cites High Air Fares," *The Washington Post*, February 15, 1975.
[75] Brown, The Politics of Airline Deregulation, 108.

of three airline deregulation bills to Congress. Robson was in favor of more deregulation, and he reversed most of Timm's more stringent policies in his first year. Robson also allowed more promotional fares by the airlines. He allowed Texas International Airlines to offer "Peanut Fares" and American Airlines to offer "Super Saver Fares," which were both much lower than previously approved CAB rates.

There was one major issue over the momentum in the Senate. Senator Howard Cannon of Nevada was the chairman of the Senate Subcommittee on Aviation and was known as "Mr. Aviation" in Washington, D.C. He supported regulation mainly because it helped to preserve the charter airlines that served Las Vegas since they were subject to less control than traditional airlines. The CAB prevented new non-charter airlines from serving Las Vegas and this protected the charter airlines. Kennedy had encroached on Cannon's turf and he was determined to protect it. So in April 1976, Cannon's subcommittee held hearings on airline regulation and the CAB.

Robson had convinced the CAB members to endorse the deregulation of the industry. "Robson would go before Cannon to speak for a unanimous regulatory body," Petzinger writes, "arguing, stunningly, to gut his own agency."[76] Robson testified before Cannon that continuing the status quo would present "significant risks and uncertainties, and fewer potential benefits." Instead, the CAB wanted a system "which moves in the direction of relying fundamentally on competition and the operation of natural market forces—a system which minimizes government interference to the greatest extent possible and emphasizes greater management freedoms in entry, exit, and pricing."[77] Senator Cannon was visibly shocked when he heard the Chairman of the CAB asking him

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[76] Petzinger, Hard Landing, 90.
[77] Brown, The Politics of Airline Deregulation, 113.

to destroy the power of his agency. This marked the most significant turning point in the airline deregulation debate. Senator Cannon quickly endorsed deregulation and became its leading crusader, even more so than Kennedy. Cannon's shift occurred nearly overnight. There are no details on what led to his decision other than the impact of Robson's testimony. Nevertheless, after President Carter came into office, his main legislative contact was Cannon since Kennedy and Carter were bitter rivals stemming from the 1976 election.

Through his testimony, John Robson became another major reason the process of deregulation continued. However, President Ford appointed Robson and Jimmy Carter defeated Ford in 1976. Ford and Carter were similar on economic issues and they faced the same challenge of inflation. Robson agreed to stay on until Carter appointed a new Chairman.

The Carter Years

Carter wanted to reduce government regulation and airline deregulation fell into his lap. Carter appointed to his transition team for transportation matters a young lawyer named Mary Schuman. Normally, no one would notice the appointment of a 26-year-old lawyer to a transition committee, but in this case the airline industry took notice because Schuman came from the office of Senator Cannon.[78]

Schuman and her colleagues quickly produced a document for Carter that called airline regulation "inappropriate" and that the airlines were "heading the way of the railroads," which had recently gone broke. To make the matter even more urgent,

[78] Petzinger, Hard Landing, 86.

Carter's political rival, Senator Kennedy, was helping to lead this major issue. Schuman wrote to the President, "existing Congressional support…makes this an issue on which you may be able to score a relative 'quick hit.'"[79]

Carter was ready to jump on the bandwagon. He announced a month into his presidency that he was supporting airline deregulation. It was an issue with growing popularity stemming from the increase in influence from the modern conservative movement and Carter supported it for many of the same reasons Kennedy originally did. Days before Carter announced his support, a report from the General Accountability Office (GAO) report came out saying that airlines could have made more money and travelers could have saved about $1.5 billion per year if the industry was less regulated.[80]

Carter officially notified Congress of his support for airline deregulation in a March 4, 1977 message. Carter wrote, "As a first step towards our shared goal of a more efficient, less burdensome Federal government, I urge the Congress to reduce the Federal regulation of the domestic commercial airline industry."[81] He cited the GAO study that showed airline fares were higher and the airlines were less profitable because of regulation. "Regulation, once designed to serve the interests of the public, now stifles competition," Carter wrote, "It has discouraged new, innovative air carriers from offering their services and it has denied customers lower fares where it is possible."[82]

Most of the airlines still opposed reduced regulation, as did President Carter's own Transportation Secretary Brock Adams. Adams, a former Congressman from

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[79] Petzinger, Hard Landing, 87.
[80] William H. Jones, "Carter Backs Airline Regulation Reform; Carter Endorses Airline Regulatory Reform," *The Washington Post*, February 24, 1977.
[81] "Message to Congress," Folder 94, Lisa Bourdeaux's Subject Files 1977-1981, Collection: JC-CL: Office of Congressional Liaison, Jimmy Carter Library, Atlanta, GA.
[82] "Message to Congress," Jimmy Carter Library.

Seattle, thought deregulation was based on the "wrongheaded ideas of academic policy spinners."[83] Adams and other opponents of deregulation thought regulation was necessary to the survival of the industry. The CAB protected the airlines from competition, and some people thought the airlines were like a public utility and therefore had to be regulated. These opponents correctly predicted that deregulation would throw the industry into turmoil. However, these opponents almost exclusively were involved in the airline industry, and did not reflect public opinion.

The White House could not control Adams, and the Department of Transportation refused to turn over Adams's prepared testimony to the White House for review, as was the standard procedure. Furthermore, Adams requested to testify last and this again made the White House policy staff nervous since he was not on message. When the White House finally got Adams's testimony, Charles Schultze, Carter's Chairman of the Council of Economic Advisors, wrote, "The testimony employs bad economic reasoning and will prove embarrassing to the administration."[84] Carter was finally able to bring Adams on message with the White House, but this was very embarrassing for Carter and his administration, since Adams not only initially opposed the reform, but also was very vocal about his opposition.

Schultze testified before Cannon's committee on March 22, 1977. He told the committee his appearance was "an indication of the President's personal interest in the passage of an airline regulatory reform bill and soon."[85] First, it would help to eliminate government regulation. Secondly, it would help combat inflation and be a key cog in

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[83] "The odds look good for less airline regulation," *Business Week*, March 21, 1977.
[84] "Prepared Testimony," Testimony: Senate Commerce Committee (Air Bill) 3/22/77 Folder 137, Charles L. Schultze's Speech Files, Collection JC-CEA: Records of the Council of Economic Advisors (Carter Administration), Jimmy Carter Library, Atlanta, GA.
[85] "Prepared Testimony," Jimmy Carter Library.

Carter's anti-inflation plan. Carter supported airline regulation reform because it tackled two of his goals. The administration thought they would lose support if they called it deregulation because the term was linked to complete deregulation. The American people did not yet understand or accept the concept of deregulation. No one thought the efforts in Congress would result in complete deregulation, but that these efforts would reform the CAB. Kahn even told a House committee, "I am not suggesting we go all the way."[86] Things would quickly change and as the modern conservative movement gained momentum, Congress embraced deregulation.

Mary Schuman was the main White House staffer who focused on airline deregulation. She worked with her former colleagues in Senator Cannon's office as well as Phil Bakes in Senator Kennedy's office to advance this bill through the Senate. Bakes was a friend of Breyer, who had since returned to Harvard, and was now Kennedy's point man on airline deregulation.

By May 1977, support for airline deregulation was coming from every corner except the airlines. As early as November 1975, *Business Week* wrote about the CAB's problems, concluding that "the answer, therefore, is deregulation."[87] On May 12, a broad coalition of companies and interest groups from across the political spectrum endorsed airline reform including Sears, Roebuck & Co., the American Conservation Union, and Common Cause.[88] A *Washington Post* editorial compared the airlines to children who need to grow up. "We have been persuaded for some time," the *Post* wrote, "that the sacrifice of some comfort and convenience in exchange for lower air fares, even if

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[86] Derthick and Quirk, <u>The Politics of Deregulation,</u> 162.
[87] "Deregulate the airlines," *Business Week*, November 15, 1975.
[88] Carole Shifrin, "Broad Coalition Endorses Airline Regulation Reform," *The Washington Post*, May 13, 1977.

accompanied by a period of some dislocation and economic disorder, is one the nation ought to make."[89]

That same month, Carter made his greatest contribution to airline reform by appointing Alfred Kahn Chairman of the CAB. Schuman and Bakes both thought Kahn was the perfect choice based on his performance at the Kennedy hearings. In addition, he had regulatory experience as Chairman of the New York Public Service Commission. An aviation lawyer told *The Washington Post* that "Kahn is charming as hell, has a voracious appetite for work and has an enormous press following."[90]

Schuman had no doubts about the right person to head the CAB. When Hamilton Jordan asked her to give three people to be considered for the job, she offered Jordan three names: Alfred E. Kahn, A.E. Kahn, and Fred Kahn."[91] There was no real debate in the White House over this decision. When the White House circulated his name to top economists and regulators for comment, everyone praised him. Even the *New York Times* wrote an editorial praising the appointment calling him "among the best of the new breed of regulators."[92] Kahn was the rock star of economists and was perfect for the job. Unfortunately, it was not a job that he wanted, and it took private meetings with both Carter and Kennedy to persuade him to take the post.

Whatever reservations Kahn had about the job quickly disappeared and he started to deregulate the industry through administrative decisions. He purged from the CAB those who supported increased regulation and brought in those who supported deregulation like himself. Kahn constantly pushed the envelope, making decisions of

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[89] "Making Adults Out of Airlines," *The Washington Post*, March 1, 1977.
[90] Rudy Maxa, "CAB Chief Cuts Prices in Friendly Skies; Alfred Kahn," *The Washington Post*, June 18, 1978.
[91] David M. Alper, et al. "Carter's Kiddie Corps" *Newsweek*, April 10, 1978.
[92] "New Pilot at the Controls," *New York Times*, May 10, 1977.

questionable legality in an attempt to reduce the role of the CAB. He threw precedent out the window and let airlines fly new routes and charge lower prices. Kahn allowed multiple airlines to enter the same route and airlines only had to prove they were "fit, willing, and able" to serve the route, rather than the old standard of showing that it was in the public interest and would not hurt other airlines.[93]

Legislation that had been stuck in committee in the Senate started to emerge in late 1977. Members of Congress realized that if they did not take legislative action, Kahn was going to effectively deregulate the airline industry through his own power as CAB Chairman. The other major reason for the bill getting out of committee was that the united opposition from the industry started to crack. In March 1977, United Airlines, the largest American carrier, announced support for deregulation. Pan Am had always supported deregulation since the CAB would not give the airline any domestic routes. In March 1978 Western and Braniff joined the deregulation supporters. In June 1978, the ATA released a statement saying it now favored less regulatory control.[94] Many airlines still opposed deregulation and the ATA did not think complete deregulation was possible.

On April 19, 1978, the Senate passed an airline deregulation bill by a vote of 83-9. The House was behind the Senate and the bill was still in the subcommittee in the House at that time. The Senate bill did not eliminate the CAB, rather it gave it much greater deregulatory powers. Kahn told an industry opponent that Congress was "not about to give us a charter to go all the way, even gradually, to deregulation."[95] That was in the spring of 1978, and it seemed like Kahn would be correct.

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[93] Brown, The Politics of Airline Deregulation, 119.
[94] Brown, The Politics of Airline Deregulation, 119.
[95] Derthick and Quirk, The Politics of Deregulation, 155.

The House passed a similar airline deregulation bill on September 21, 1978, by a vote of 363 to 8. Airline deregulation, despite the vocal opposition of a majority of airlines, led by Delta, had support from nearly everyone else. Only 17 of the 535 Members of Congress voted against the bill. The House version of the bill was much weaker than the Senate bill. It made some of the increased CAB powers temporary and limited automatic route entry. Representative Elliott Levitas, an Atlanta "Deltacrat" was deeply involved in the House bill since he was trying to protect Delta Air Lines and weakened the bill, but introduced a sunset clause that would eliminate the CAB at the end of 1985 unless Congress voted to reauthorize the CAB in 1982.[96] He thought this would do two things. First, he thought it would be a poison pill that could sink the bill. Secondly, even if it made it into the bill and the bill passed, he was certain Congress would vote to reauthorize the CAB. No one other than Levitas was a big supporter of the sunset clause, but no one was vigorously opposed to it. It made it into the bill the House brought to the conference with the Senate to create the final bill.[97]

The Senate, led by Howard Cannon, won the debate in the conference. Carter's Congressional Liaison, Frank Moore, asked Carter to give Cannon a congratulatory phone call, writing that the passage of the conference report were "due almost exclusively to the tenacity and perseverance of Senator Cannon" especially in light of the House side almost walking out of the conference.[98] Several sections of the Senate bill were weakened to come closer to the House version of the bill, but the Senators successfully pushed to keep the sunset clause in the final bill, but without the renewal section.

[96] Peterson and Glab, Rapid Descent, 86.
[97] Peterson and Glab, Rapid Descent, 86.
[98] "Memo, Frank Moore to President Carter," Civil Aeronautics Board 1978 Folder 166, Stephen Selig's Subject Files 1977-1981, Collection JC-1005: Office of the Chief of Staff Files 1977-1980, Jimmy Carter Library, Atlanta, GA.

In the House-Senate Conference the bill went from airline reform to complete deregulation and the bill was renamed the Airline Deregulation Act of 1978. Levitas' strategy backfired spectacularly; because of his sunset clause, the CAB would cease to exist on January 1, 1985. Throughout this entire process, no one thought there would be complete airline deregulation. After the Kennedy hearings in 1975 the *New York Times* wrote "Total deregulation would allow anyone to fly any route, a situation that is unlikely ever to occur."[99] Many observers of Congress thought it would take many years for complete airline deregulation to be passed by Congress. Instead of years, it took a few days in conference committee.

On October 24, 1978, President Carter signed the Airline Deregulation Act of 1978, which gradually deregulated the airline industry. Under this law, the CAB's ability to regulate routes ended on December 31, 1981, its ability to regulate fares ended on January 1, 1983, and the agency would cease to exist at the beginning of 1985. The industry, other than safety which was never deregulated, would be free of regulation by government. Any airline would be able to fly any route and charge any price.

[99] Petzinger, Hard Landing, 85.

Chapter Three: Airlines in the Deregulated Era

Even though the Airline Deregulation Act of 1978 set a gradual course for deregulation, in reality, deregulation had started before Carter even signed the bill. Alfred Kahn, as Chairman of the CAB, had wide power over the industry and he had already started to deregulate the industry before the bill was passed allowing airlines new routes and new fares. Kahn knew he had this power in 1977 saying, "I have only to open my mouth and the fares come tumbling down."[100] Even though Kahn left the CAB as the Airline Deregulation Act was being finalized to serve as the Chairman of the Council on Wage and Price Stability and as President Carter's inflation czar, he would go down in history as the father of airline deregulation.[101] Don McKinnon, who followed Kahn as CAB Chairman, would accelerate the deregulation process even more, so much so that by Spring 1980 airlines were nearly completely free to choose the routes they served and the prices they charged.[102]

The first CAB deregulatory decision was announced on February 25, 1977 when the Board approved the "Peanuts" fare proposed by Frank Lorenzo's Texas International Airlines. The Peanuts fare decision allowed Texas International to price some tickets on some flights at fifty percent of the normal price. This decision was followed up less than a month later by another CAB decision to allow American Airlines to offer "Super Saver" fares, which again were highly discounted. In Spring 1978, the CAB allowed

[100] Peterson and Glab, Rapid Descent, 74.
[101] Carole Shifrin, "Alfred Kahn Comes to His New Post With Top-Grade Career Credentials," *The Washington Post*, October 26, 1978.
[102] Graham and Kaplan, Civil Aeronautics Board, Competition and the Airlines, 22.

airlines to set fares as much as 70 percent below and as much as 10 percent above the current fares allowed by the CAB's formula.[103]

When President Carter signed the Airline Deregulation Act, several of its provisions took effect immediately. The most important of which was that it shifted the burden of proof in route authority cases. Instead of an airline having to show that it was in "the public convenience and necessity" for the airline to start a route, now opponents of the airline getting new route authority had to show that the new airline getting authority was inconsistent with public convenience and necessity. This meant that an airline only had to show that it was fit, willing, and able in order to get a new route. This was a rapid departure from the old system in which airlines had to go through long and costly procedures to gain new route authority.

The Act also established a procedure for airlines to terminate service to a destination. Previously, airlines could only do this with CAB approval, which was often refused, forcing airlines to serve destinations they did not wish to serve. It created the Essential Air Service (EAS) program, through which the government would give subsidies to airlines serving small communities. The goal of the program was to continue a minimal level of air service to small communities in the deregulated environment. The EAS program continues today, but even with these subsidies, small communities were one of the biggest losers of airline deregulation. Many small communities have completely lost their air service and those that still have air service have fewer choices and are often forced to connect through hubs rather than have direct service.

The creation of hubs by airlines was one of the most immediate effects of deregulation. Prior to deregulation, airline hubs as we know them today really did not

[103] Graham and Kaplan, Civil Aeronautics Board, Competition and the Airlines, 18.

exist, and the only airports that could be called true hubs were Atlanta, Chicago, Denver, and Los Angeles. This was because the CAB wanted airlines to provide point-to-point service and would give route authorities accordingly. The hub and spoke system features flights from many cities (spokes) to a single city (the hub) where passengers get on other flights to their destinations. This allows the airlines to get more passengers on each flight since everyone from a spoke will have to fly to a hub to get to their destination and from the hub there will be people from the many spokes on flights to the other spokes. Airlines rapidly opened hubs in cities across the country. Delta added Dallas/Ft. Worth and Cincinnati to their Atlanta hub. Eastern created a true hub operation at Atlanta and also created hubs in Miami and Kansas City. Piedmont created hubs at Charlotte, Dayton, and Baltimore. TWA made St. Louis a hub. Republic established hubs in Minneapolis, Detroit, and Memphis. This is just a partial list. All of the major American airlines opened at least one and in most cases several hubs in the early deregulation era.

Before deregulation and the creation of hubs at nearly every airport in a major city across the United States, passengers not only would have to switch flights at another airport, they would also switch airlines. This was called interlining and the practice almost completely disappeared in the deregulated era. In 1977, interline connections made up about half of all airline connections. By 1996, it was only two percent.[104] Hubs were mainly responsible for this drop along with the rise of commuter airlines.

Major airlines became partners with commuter airlines who provided service from smaller cities to the hubs of major airlines in a coordinated and seamless experience. Many of the routes commuter airlines started had previously been operated by major airlines, but had been abandoned in the deregulated era since the routes were not

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[104] Morrison, Airline Service, 164.

profitable with large planes. Commuters, which could operate many of these routes profitably with their smaller planes, rapidly expanded. Deregulation created the commuter (later called regional) airline as a major player in the airline industry.

The first years of deregulation were tumultuous. In fact, it is hard to judge deregulation by the first few years because the multitude of external factors that came into play in addition to all of the new competition both on routes and prices and by new airlines. With or without deregulation the early 1980s would have been tough years for the airline industry because of a recession, a spike in oil prices, high interest rates, and inflation. And because of deregulation, there was more competition than ever before, which did not allow airlines to adjust their prices for the rising cost of oil and inflation. Furthermore, there were fewer people flying because of the economy. In addition, the air traffic controllers went on strike in August 1981, and then were fired by President Reagan, causing further disruption as the Federal Aviation Administration limited the number of flights each airline could operate based on the number they operated before the strike.[105] All of these factors made the first few years of airline deregulation very tough for airlines before any of the elements of airline deregulation are even considered. The U.S. airline industry as a whole lost money from 1980-1982 for the first time in over 30 years.[106]

Airline deregulation opened the floodgates for new airlines to enter the industry. But there were already many airlines operating in the United States that had new freedom to operate more broadly. Not only could the major trunk carriers operate any route they wanted, greatly expanding their networks and creating hubs, but also the former intra-

[105] The FAA was responsible for airline safety and was never deregulated.
[106] Melvin Brenner, et al., Airline Deregulation (Westport, CT: Eno Foundation for Transportation, 1985), 52.

state carriers and local service carriers could expand into larger airlines operating routes that the CAB would never have approved.

Former intrastate carriers such as AirCal, Air Florida, Pacific Southwest Airlines, and Southwest Airlines became regional airlines and rapidly expanded. These airlines used to only operate within their respective state because they were not CAB certificated and did not become so until the CAB started allowing new major carriers to enter the market during airline deregulation. The number of passenger miles served by Air Florida increased 903.3 percent between 1978 and 1983 and Southwest's increase in the same time period was 271.2 percent.[107] It is important to note that the entire industry was growing in terms of passenger miles during this time period because of deregulation, but the overall growth was only 20.8 percent, much smaller than the triple digit growth of PSA and Southwest.

Former local service carriers also expanded quickly since they could now operate major routes, something that the CAB always denied prior to airline deregulation. The most notable growth for a former local service carrier was Piedmont Airlines, which grew 257.7 percent between 1978 and 1983.[108] Frontier Airlines, Ozark Airlines, and U.S. Air also grew quickly. Two former local service carriers, North Central Airlines and Southern Airways merged into Republic Airlines in 1979. Republic became the largest of the former local service carriers and actually was larger than several of the former trunk carriers. The old CAB categories for airlines were clearly obsolete.

North Central and Southern were not the only airlines that merged in the early deregulation era. Merger fever hit the industry and airlines were looking for partners

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[107] Melvin Brenner, et al., Airline Deregulation.
[108] Melvin Brenner, et al., Airline Deregulation.

throughout the 1980s. Larger carriers constantly acquired smaller carriers. Of the four former intrastate carriers and the five former local-service carriers written about above, all nine would be involved in mergers during this time period with Southwest and U.S. Air being the only two surviving brands. The former trunk carriers also took part in mergers with Continental merging with Texas International, Delta with Western, Pan Am with National, and Northwest Oriental with Republic. Alfred Kahn did not understand this merger mania telling a reporter in the summer of 1978, "This is the last time in the world anyone needs to merge to gain new routes…But instead of grasping the opportunities we're offering, this disease, this psychology, is getting around that airlines ought to merge."[109] What Kahn did not understand was that airlines were no longer merging to gain routes like they had before, but now they were merging to achieve the critical mass they thought they needed to survive in the newly unstable airline industry.

Not only were carriers expanding and others merging, but many new airlines entered the industry. In 1979 alone, 22 new large certificated air carriers entered service. Considering there were only 43 total in 1978, this marked a large increase. By 1985, 120 new certificated carriers would enter service.[110] The vast majority of these airlines would fail within a few years as 119 air carriers would give up their certificates in the 1980s. The airline industry had been stable under the CAB, but 1979 brought the first four airline bankruptcies in more than 50 years and bankruptcies would continue throughout the next decade. The only major airline started in the first era of deregulation that still exists today is America West Airlines, which was started in Phoenix in 1983.

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[109] Peterson and Glab, <u>Rapid Descent</u>, 84.
[110] Morrison, <u>Airline Service</u>, 155.

The name no longer exists, but it was America West that took over U.S. Airways in 2005, and then took the U.S. Airways name. None of the others survived long term.

Airlines were springing up left and right. Everyone, it seemed, wanted to start an airline. As Kahn said in one of his characteristic quips, “Maybe it’s sex appeal, but there’s something about an airplane that drives investors crazy.”[111] Investors kept pouring money into new airlines and they took to the skies. Each airline had it’s own niche. Some airlines focused on specific markets, others tried all first-class service, but most tried to introduce cheap, no-frills service. The most notable of these new no-frills carriers, and the one most representative of the deregulation era, was People Express.

Don Burr, a former officer of Texas International under Frank Lorenzo, started People Express out of the under-utilized and ignored Newark Airport. He wanted to create a low-cost, high-volume airline, something that, while commonplace today, was a new idea in 1981 when People Express started. Burr had incredibly low labor costs and cross-trained his employees in different positions so they could perform different tasks depending on what was needed. People Express offered fares at fractions of the other airlines, and their planes quickly filled. The airline truly had no-frills service charging for soft drinks, snacks, and checked baggage. People Express rapidly expanded and within five years had flights to fifty cities including London and Brussels, Belgium.[112] Low prices, including $149 fares to London, drew people to Burr’s airline.

Burr managed to grow People Express into the United States’ tenth largest airline in four years.[113] The most amazing part of this was that he did this without a

[111] Peterson and Glab, Rapid Descent, 150.
[112] People Express, People Express Timetable 11/20/1986.
[113] Air Transport 1985: The Annual Report of the U.S. Scheduled Airline Industry (Washington: Air Transport Association of America, 1985).

Computerized Reservation System (CRS) and travel agents. People had to book their tickets on People Express by calling them or showing up at the airport. But the lack of a CRS started to hurt People Express as it grew larger. The airline allowed for passengers to pay for their tickets on the plane, so there was little incentive for people to honor their reservations. Because of both of these factors, the airline suffered from chronic overbooking of flights, selling more tickets than there were seats on the plane. The airline started to get a terrible reputation for poor service and constantly overbooked flights.

In 1985, People Express acquired Denver-based Frontier Airlines in an attempt by Burr to become a major national airline with hubs in Newark and Denver. He imagined a massive "air bridge" between the two cities and many flights in the east from Newark and the West from Denver. He also snapped up two of the largest commuter airlines in the country, Britt Airways that fed flights into St. Louis and Chicago, and Provincetown-Boston Airline, which operated in the northeast and Florida.[114] But the major airlines had finally figured out how to compete with People Express using their CRSs to sell some seats at a very cheap price and others at a more expensive price. Frontier was bleeding money when Burr acquired it and soon People Express was too. People Express was the ultimate deregulation airline. It started with big hopes, achieved them, and then failed in the ultra-competitive marketplace it helped create. In 1986, People Express went from profitable to insolvent in just nine months. That September, Frank Lorenzo and his Texas Air Corporation acquired People Express and merged it into Continental.

The lack of a CRS did bring down People Express. CRSs became extremely important in the deregulated era as more and more passengers booked their tickets

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[114] Petzinger, Hard Landing, 276.

through travel agents. By 1986, travel agents booked 86 percent of all tickets.[115] Each airline had its own CRS and marketed it to travel agents who would then lease the CRS to use when customers needed tickets. Each CRS could book tickets on any airline, but would charge the airline a booking fee. American with its Sabre system and United with its Apollo system dominated the CRS industry having about 75 percent of the market between them.[116]

These systems at first had display screen bias, listing the flights of the airline that owned the CRS first. This was a problem since 85 percent of bookings would be on flights that came up on the first screen and 50 percent of books would be the flight on the first line giving the big carriers that owned CRSs a major advantage.[117] The CAB banned this bias as its last regulatory act. However, the airlines that owned the larger systems still had a major advantage in knowing what flights people were booking and collecting revenue from other airlines. Both Eastern and Delta had CRSs, but they were both second-tier systems with low market shares, so neither airline had a real advantage over the other in this important area even though Eastern's CRS would improve and become a strong asset to the airline.

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[115] Morrison, Airline Service, 170.
[116] Pitt and Norsworthy, Economics of the U.S. Commercial Airline Industry, 84.
[117] Great Britain Civil Aviation Authority, Deregulation of Air Transport: A Perspective on the Experience in the United States (London: CAA, 1984), 29.

Chapter Four: Eastern and Deregulation

Eastern entered the deregulation era as a successful airline. Frank Borman had turned the airline around and the late 1970s were profitable for Eastern. Borman had also introduced the A-300 to the United States, brining the first Airbus planes to an American airline and ordered new Boeing 757 aircrafts ensuring that Eastern would have a modern fleet for the deregulation era. However, Borman increased Eastern's already high debt position to fund these new aircraft. The decision to buy these new planes and increase Eastern's debt would end up severely hurting Eastern in the deregulation era. This decision took place before deregulation, and Borman defends the decision to purchase the new A-300s and 757s as necessary to compete in the deregulation era since Eastern's fleet was outdated by the late 1970s. [118]

There are four major decisions made by Eastern Air Lines in the deregulation era that when put together explain why Eastern struggled and eventually died in the deregulated environment. Three of the decisions were made by Frank Borman, who served as Chairman of Eastern until 1986. The last major decision was made by Frank Lorenzo, whose one major decision would create many smaller decisions that ended up in Eastern's liquidation in 1991.

The first decision was Eastern's purchase of Braniff's South American Routes in 1982. The move was designed to make Eastern a more competitive airline. The South American routes would be one of two gems in Eastern's systems (the other being the Northeast Shuttle) that would be profitable for Eastern until the end and for which

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[118] Borman, Countdown, 366.

American Airlines paid Eastern $330 million in 1990.[119] These routes still make up the bulk of American Airlines' South American operations today.

The second decision was made in an attempt to keep Eastern running and to prevent a strike. Instead, it was one of the biggest reasons Eastern ended up dying. In 1983, the International Association of Machinists (IAM), who represented mechanics and others at Eastern including baggage handlers, ramp workers, and airplane cleaners, demanded a 32 percent raise in their next contract. This was after Borman came to them asking for a wage reduction in light of huge losses at Eastern. After securing wage reductions from Eastern's pilots, flight attendants, and non-unionized employees, Borman gave in to the IAM and gave them the raise they demanded. This decision not only severely harmed Borman's standing with most of Eastern's employees, but also put Eastern in a financial position from which the airline would never be able to recover.

The third critical development was the decision of Frank Borman and the Board of Directors to sell Eastern to Frank Lorenzo, owner of Texas Air Corporation, in 1986. Unable to secure wage concessions from the unions that represented Eastern's pilots, flight attendants, and mechanics, Borman and the Board of Directors sold Eastern to Texas Air instead of putting the company into Chapter 11 bankruptcy. Lorenzo would end up using Eastern as a piggy bank, selling off various assets until the airline was too weak to stand on its own. Labor relations at Eastern were bad under Borman, but got even worse under Lorenzo. Once he had control of Eastern, the hopes of Eastern surviving dimmed significantly.

The final decision made by Eastern that ended up in its death was Frank Lorenzo's decision to break the IAM at Eastern. Charlie Bryan, the same IAM leader

[119] David Field, "American gobbles up Eastern's Latin lines," *Washington Times*, July 2, 1990.

who bested Borman in contract negotiations in 1983, faced off with Lorenzo from October 1987 until March 4, 1989, when the IAM went on strike, crippling Eastern for several months. Lorenzo had an elaborate plan to break the union if the IAM did not agree to significant wage concessions. Bryan would not budge and when the IAM went on strike, to Eastern's surprise, the pilots and flight attendants refused to cross the picket lines. Lorenzo's gamble to break Charlie Bryan failed. Less than two years later, so did Eastern.

Getting Braniff's South American Routes

Going into deregulation, Frank Borman was hailed as the savior of Eastern by the media. "His associates say that he alone resuscitated a dying airline," *The Miami Herald* wrote.[120] "In the profit and loss column, Borman's first five years running Eastern were pages from an executive storybook," wrote Thomas Petzinger, "Borman turned the losses of the Hall regime in the greatest profits Eastern had ever (or would ever) report."[121] But as Borman predicted, deregulation was not kind to Eastern. As noted, the first few years were rough on every airline. In 1980, Eastern lost $17.3 million, compared to a $57.6 million profit in 1979.[122]

But Eastern had weathered the year better than most, being one of only two trunk airlines with an operating profit and it received a $37.3 million contribution from the VEP program making up for the overall loss for the year. Eastern's traffic was declining at a much slower rate than other airlines, and it was the largest airline in the country by

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[120] Petzinger, Hard Landing, 169.
[121] Petzinger, Hard Landing, 169.
[122] Eastern Air Lines, Inc., Eastern Air Lines 1980 Annual Report.

number of passengers.[123]

The following year Eastern's financial performance was even worse, with the airline posting a $65.9 million loss even though it was once again the free world's largest airline.[124] The economy, rising fuel prices, and the strike by the air traffic controllers took a toll on Eastern's bottom line. Part of Eastern's problem was that it was more susceptible to new competition than other airlines because many airlines decided to compete on its lucrative northeast to Florida routes that formally were duopolies. Because of the competition Eastern had to discount more and more of its tickets, and by 1981, 70 percent of its tickets were discounted.[125] In addition, Eastern had new planes arriving because of the orders Borman placed in the late 1970s and had no good place to use these new larger planes.

In an attempt to diversify Eastern and make it less reliant on the vacation traffic that was being poached from Eastern by the no-frill upstarts, Borman first tried to get into the transcontinental market with flights from New York to Los Angeles. This had long been the domain of American, United, and TWA and Eastern's attempt to break into this market did not last long before these airlines forced Eastern from the route. Not succeeding in that market, Borman made his smartest decision in the deregulated era.

Braniff Airlines was one of the original sixteen trunk carriers. It had the most spectacular failure in deregulation, rapidly over-expanding to the point where by 1982 it was on life support. In the mid-1960s, it bought half of Pan Am's South American routes, the ones that ran along the Pacific side of South America.[126] It was extremely

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[123] Eastern Air Lines, Inc., Eastern Air Lines 1980 Annual Report.
[124] Eastern Air Lines, Inc., Eastern Air Lines 1981 Annual Report.
[125] Eastern Air Lines, Inc., Eastern Air Lines 1981 Annual Report.
[126] Petzinger, Hard Landing, 173.

profitable for Braniff, just like it had been for Pan Am before it and Eastern after it. In an attempt to stay afloat, in April 1982 Braniff sold these routes to Eastern for the paltry sum of $30 million.

Borman had just made Eastern a major international airline through the purchase of these routes at a very discounted price. It gave Eastern a new profit center that was nearly immune from competition since international routes were never deregulated. Eastern was set to take over Braniff's routes on June 1. But Braniff failed on May 12 and within 48 hours Eastern had started to fly the South American routes. "Latin America has made money for us almost since day one," Borman told *Business Week.*[127] Eastern was even more successful on these routes than Braniff because it had a strong hub in Miami from which it could funnel passengers from around the United States to South America. Eastern served 33 U.S. cities nonstop from Miami before the routes were acquired and quickly set the times of many of these flights to provide easy connections.[128]

The quick decision by Borman to buy the South American routes from Braniff was a decision that put Eastern in a better position to compete in the deregulated era. These routes were extremely valuable to Eastern until nearly the end and shows how the failure of some airlines in the deregulated era meant opportunities for others. Even though the first couple of years of deregulation had been tough, Eastern in 1982 still was a strong carrier and was poised to continue as a strong carrier. Unfortunately for Eastern, the purchase of the South American routes would be the last major decision made by the airline that was a success.

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[127] "Eastern's Smooth Latin Landing," *Business Week*, 12/13/1982.
[128] Eastern Air Lines, Inc., <u>Eastern Air Lines Timetable 1/11/82.</u>

Borman Caving into Bryan

Borman made a of couple smaller decisions over the following years that were successful for Eastern. In an attempt to further diversify the Eastern route map, in December 1983 Eastern established a hub in Kansas City to serve east-west traffic rather than their north-south Atlanta hub or the South American Miami hub. While never a huge hub, at its peak in Kansas City, Eastern and its commuter partner Air Midwest served 42 cities with 129 daily flights.[129] Kansas City was generally successful for Eastern until it was closed in summer 1988 as part of Lorenzo's war with Eastern's unions. John Nelson, Eastern's Senior Vice President for Marketing told *Aviation Week and Space Technology* in 1986 that Kansas City was "doing very well from the standpoint of generating traffic, having a good local market, and presenting a good alternative to Chicago, Denver and St. Louis."[130]

The other good decision Eastern made was one of the most creative adaptations to the deregulated environment by any airline. In April 1985, Eastern made a deal with CF AirFreight to lease the cargo compartments of Eastern aircraft that would make flights in the middle of the night to help facilitate an overnight cargo delivery service. Eastern introduced the Moonlight Special through which passengers could fly on these middle of the night flights that were primarily meant for cargo at very low prices ($49 per flight). Most of the Moonlight Special flights went through an overnight cargo hub at Houston where passengers could connect from one flight to another getting from cities on the east

[129] Eastern Air Lines, Inc., Eastern Air Lines Timetable 7/2/1986.
[130] Edward H. Kolcum, "Eastern Expects Texas Air Buy To Improve Its Economic Problems," *Aviation Week and Space Technology*, May 26, 1986.

coast including Philadelphia, Boston, and New York to cities on the west coast such as Seattle, Portland, and San Francisco. Eastern not only made money from the cargo, but also from the passengers. This creative approach to increase utilization of Eastern's aircraft was "an unqualified success" according to Frank Borman and boasted load factors of about 95 percent.[131]

Because of the Moonlight Special and the hub in Kansas City, 1985 was the best year Eastern had in many years. After losing a staggering $183.7 million in 1983 and $37.9 million in 1984, Eastern was able to post a $6.3 million profit in 1985.[132] But Eastern made $73.8 million in the first nine months of 1985, and lost over $65 million in the last three months of the year.[133] Eastern would never post another profitable year.

Eastern's financial trouble stemmed a great deal from Frank Borman's decision to cave in to IAM leader Charlie Bryan in 1983 and agree to 32 percent wage increase for IAM members. Borman in his autobiography writes, "History will record that Eastern lost its battle to remain independent in 1983." He wrote that 1983 was the "one year in my life I would not want to live over."[134]

In January 1983, Eastern was locked in bitter and tough contract negioations with the IAM. Bryan, the IAM leader who was elected in 1980 as President of IAM District 100 on a promise to eliminate the VEP that was so important to Eastern's profitability, killed the VEP and would become a pain to Eastern until its final day of operation. Bryan believed strongly in fighting for every penny for his union workers. The IAM not only represented highly skilled mechanics, but also represented low skill workers such as

[131] Carole A. Shifrin, "Eastern Records First-Quarter Net Profit," *Aviation Week and Space Technology*, April 22, 1985.
[132] Eastern Air Lines, Inc., Eastern Air Lines 1985 Annual Report.
[133] Borman, Countdown, 411.
[134] Borman, Countdown, 384.

janitors and baggage handlers. By grouping all of them together, the IAM had all of their members on the same wage scale. More than once in Bryan's battles with Eastern, the airline would complain about how because of the IAM, Eastern was paying baggage handlers more than double that of other airlines. The average compensation of baggage handlers at Eastern was $47,000 per year in 1987.[135]

Charlie Bryan became the personification of the IAM at Eastern, and he and Borman developed a toxic relationship. He made the decisions on behalf of the union and never backed down from his demands. Bryan worked hard for his union and because of this work the IAM had obtained favorable contracts. Because of work rules in the union contract, Eastern had to have three mechanics present for each aircraft pushback from a gate. One was to drive the tractor that pushed the plane back and one would walk alongside each wing. Every other airline had baggage handlers walk the wing, but at Eastern the contract said it had to be mechanics, adding tremendous cost since there had to be more mechanics to handle pushbacks. So in 1981, Borman mandated that pilots start using the reverse thrusting ability of their engines to push back from the gate, eliminating the need for any mechanics. Bryan threw a fit and actually stood in front of the first aircraft to use the reverse thrust in an attempt to stop it. Borman ordered the plane to push back anyway, and Bryan only avoided being run over by a Boeing 727 with a last second dive out of the way. This incident shows the hatred these two men had for each other. Bryan became one of the principal players in the destruction of Eastern Air Lines starting in 1983.

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[135] "Comments of Phil Bakes, President and Chief Executive Officer Eastern Air Lines, Inc. to the Rotary Club of Atlanta March 7, 1988," Box 31, Folder 1, Eastern Airlines Collection, L1986-27, Southern Labor Archives, Special Collections Department & Archives, Georgia State University, Atlanta, GA.

In February 1983, a federal mediator could not bring Eastern and Bryan to an agreement, so the mediator released both parties and Bryan set a strike date for March 13.[136] Bryan and the union membership then rejected a contract from Eastern that would give them the 32 percent increases they were demanding, but not make them retroactive to January 1982 when their contract expired. Borman told the IAM members "Eastern cannot and will not improve this offer." Bryan set a second strike date for March 23. Eastern was prepared to take the strike. Borman asked his bankers to allow him to tap $110 million of Eastern's $200 million line of credit so Eastern would have the cash to survive the strike. The banks refused because it would have technically put Eastern at default due to other agreements.[137]

Borman decided to give in instead of filing for bankruptcy. With little cash on hand, it is not clear if Eastern could have restructured in bankruptcy or if it would have been forced to liquidate. Borman claims that if the strike had lasted more than twelve days Eastern would have been forced to liquidate. This is not necessarily the case because other funding could have been made available. Furthermore, Borman wrote to employees that he thought this contract could be funded based on three assumptions: "1) the recession would end and the airline industry would recover by the summer 2) fuel prices would decrease 3) discount fare policies would stabilize and Eastern would be able to raise its fares."[138] Unfortunately for Eastern, two of these things did not happen and fuel prices only dropped slightly.

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[136] Borman, Countdown, 388.
[137] Petzinger, Hard Landing, 178.
[138] "3/14/1983 Letter to IAM-Represented Employees," Box 9, Folder 2, Frank Borman Papers, L2005-16, Southern Labor Archives, Special Collections Department & Archives, Georgia State University, Atlanta, GA.

By giving in to all of Bryan’s demands, Borman put Eastern on the path to financial ruin. This contract added $170 million each year to Eastern’s expenses. When asked by a female reporter who had come the door of his house about the contract, he just yelled, “We were raped!” before closing the door on the reporter.[139] This was Borman’s raw emotion, but was not the case. Borman did not explore other avenues to raise money to prepare for the strike that could have prevented him from giving into Bryan’s demands. Borman told the rank and file members of the union that if they rejected Eastern’s first offer “it will mean the end of Eastern as we know it.”[140] Frank Borman was right. Eastern would never be the same.

Selling Eastern to Lorenzo

Borman’s decision to give in to Bryan’s demands was just the first of many poor decisions Borman would make from 1983 to 1986 culminating with the decision to sell Eastern to Frank Lorenzo. If Borman would have made better decisions in this time period, he would have never have found himself in the position where he would be able to make the bad decision to sell to Lorenzo.

Borman’s capitulation to Bryan enraged Eastern’s pilot and flight attendants, both of whom had already agreed to wage cuts. This would make Borman’s life difficult the next time he needed their help, which would not be too far in the distant future. Both

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[139] Borman, Countdown, 389.
[140] Borman, Countdown, 389.

unions were also mad at Bryan, for putting the entire company at risk by not wavering in his demand for a significant raise for his members.

The first quarter of 1983 was disastrous for Eastern with loses of $60.7 million dollars.[141] By May, the airline's credit line was frozen. Eastern had a severe liquidity problem and Borman had to go to his employees begging for a 10 percent wage cut. The pilots, flight attendants, and non-unionized workers all agreed. Bryan and the IAM refused the cuts. In a June 20 letter to the employees who had accepted the wage cuts, Borman wrote, "By unselfishly agreeing to accept a portion of your salary in debentures or loans, you have insured our access to our bank line of credit…all of us who labor at Eastern Airlines thank you for your action."[142]

By the fall of 1983, Eastern was in big trouble. Borman was given an ultimatum by the banks that held Eastern's tremendous debt, which had blossomed to 93.2 percent of Eastern's total capitalization.[143] The banks demanded that Eastern cut $200 million per year from labor costs, or they would be declared in default of their loans, almost certainly sending Eastern into bankruptcy.[144] Furthermore, Eastern's financial trouble was causing people to book tickets on other carriers, driving business away from the struggling airline. In a September 16 letter to employees, Borman wrote, "It's quite clear that all of the trunks, including Eastern, will have to reduce unit costs dramatically if we are to stop the flow of red ink and effectively meet the challenge laid out to us by the aggressive newcomers who have only one advantage—extremely low labor costs. Labor

[141] Borman, Countdown, 393.
[142] "6/20/1983 Letter to Flight Officers and Non-Contract Personnel," Box 9, Folder 3, Frank Borman Papers, L2005-16, Southern Labor Archives, Special Collections Department & Archives, Georgia State University, Atlanta, GA.
[143] U.S. GAO, Airline Competition, 18.
[144] Borman, Countdown, 396.

costs are the largest single factor in unit costs. We must simply reduce our labor costs."[145]

After months of talks, finally in January 1984 Eastern and its three unions reached an agreement. The deal was only for 1984 and would save $367 million that year. It took 18 percent of each employee's salary (22 percent of pilots' salaries) and invested it into Eastern stock, giving employees a 25 percent stake in the company. This saved the company $292 million. The company also got a promise from the unions for $75 million in productivity gains. Not only did the employees get 25 percent of the company, but they also got four seats on the Board of Directors, one for each union and one for the non-unionized employees.[146] The IAM not surprisingly appointed Charlie Bryan to the Eastern Board of Directors. Frank Borman now had to deal with Bryan as one of his directors.

Amazingly, at least for a short time, the partnership between Eastern's employees and management was a wild success. Eastern became a darling of the media because of the labor peace that had been achieved suddenly compared to the labor wars that had been raging. A team from Harvard was given a contract by the Department of Transportation to study how Eastern's experience could be a model for other companies.[147] *The Wall Street Journal* wrote, "Labor's big new role inside Eastern Airlines seems to be succeeding."[148] Eastern and its unions, especially the IAM, worked

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[145] "9/16/1983 Letter to Eastern Employees," Box 9, Folder 4, Frank Borman Papers, L2005-16, Southern Labor Archives, Special Collections Department & Archives, Georgia State University, Atlanta, GA.
[146] Borman, Countdown, 397.
[147] Petzinger, Hard Landing, 247.
[148] Gary Cohn, "Labor's Big New Role Inside Eastern Airlines Seems to Be Succeeding," *The Wall Street Journal*, October 31, 1984.

closely together to save money and make the airline more efficient. And at first it was a big success. But the success was short lived.

In December 1984, Borman wrote to the employees that the wage investment program (the official name of the partnership) would be continued in 1985 even though the original agreement only stated it would be for 1984. The unions revolted and Borman was forced to give the full wages back to the employees later that month even though as things turned bad in early 1985, the unions agreed to continue the wage cuts and program.

In his end of the year letter to Eastern employees, Borman wrote, "We are headed in the right direction and our financial performance shows it…If we continue the progress we've made in 1984, we'll do just that."[149] Borman might have been a little punch drunk from his success especially when the partnership started to scuffle, but it did not negatively affect Eastern as a surge in airline traffic propelled Eastern to record profits in summer 1985. In September, Borman restored the mechanics pay cuts and even threw in an 8 percent increase through 1987. Then the following month he restored full pay to the pilots.[150] Less than a year removed from demanding the continuation of wage cuts, Borman was not only restoring full pay, but also was giving raises.

This was a terrible decision. Eastern had major debt that should have been paid down instead of giving raises. It is unexplainable how an airline that had lost $379.8 million since 1980 all of a sudden felt comfortable giving raises on top of restoring full pay after these concessions and cuts had made Eastern profitable. The lack of any decent

[149] "Letter to Employees 12/31/1984," Box 10, Folder 2, Frank Borman Papers, L2005-16, Southern Labor Archives, Special Collections Department & Archives, Georgia State University, Atlanta, GA.
[149] Borman, Countdown, 397.
[150] Aaron Bernstein, Grounded: Frank Lorenzo and the Destruction of Eastern Airlines (New York: Simon and Shuster, 1990), 31.

explanation for this decision is probably the reason why Borman ignores this decision in his autobiography. In less than six months, Borman would be begging for wage concessions once again. This decision created the circumstances under which Borman made another terrible decision to sell the airline to Frank Lorenzo.

Part of the reason that Eastern made $78.3 million in the first nine months of 1985 and only made $6.3 million for the year is these pay increases caused Eastern to bleed money during the fourth quarter. The other reason was a massive fare war that was launched in the fall of 1985. Pan Am needed cash so they slashed fares to $99 from the northeast to Florida, forcing Eastern to match. Not to be outdone, People Express then offered $69 fares. Frank Lorenzo's New York Air then offered $39 fares. Eastern had to match these extraordinarily low fares.[151] In a memo Borman sent to the Board of Directors in late December, Borman admits that Eastern had to give refunds to passengers who had purchased more expensive tickets and that matching these fares cost Eastern $5.5 million in just sixteen days.[152] It hurt Eastern's revenue and the silly raises Borman had given out when Eastern felt flush increased expenses. Once again, Eastern found itself on the verge of death.

Borman went back to the three unions and demanded twenty percent wage cuts. This took place less than four months after he had just given out raises to these same employees. Eastern's tremendous debt once again came into play. The airline's lenders gave Borman until February 28 to secure wage concessions nearing $500 million,

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[151] Petzinger, Hard Landing, 249.
[152] "Letter to Eastern Board of Directors, 12/20/1985," Box 8, Folder 6, Frank Borman Papers, L2005-16, Southern Labor Archives, Special Collections Department & Archives, Georgia State University, Atlanta, GA.
[152] Borman, Countdown, 397.

otherwise they would find the airline in default.[153] The unions were not interested in giving Borman any more concessions and for the first time united together in opposition to Eastern's management.

Eastern went over the heads of the unions straight to its employees imploring them to accept the salary cuts. They sent colorful pamphlets to all of the employees with the theme that Eastern was under attack and was being invaded by competitors. The slogan on each page of the pamphlet was "Our World Has Changed…Let's Fight Back." One page pointed out that in the New York to Miami market the average fare was $105 in 1976. Ten years later, with seven airlines competing the average fare was $69.[154] In addition, each day employees were sent a newsletter titled "Something to Consider…" which contained a different letter from a top-level Eastern executive trying to rally employees behind the cuts. Borman penned the letter on January 8, 1986 and wrote in part, "It is our mission, indeed our duty, to make certain that Eastern is one of those survivors. In order to succeed we must undergo the cost restructuring that is causing concern today."[155] This effort by Eastern not surprisingly failed and many employees sent these newsletters and pamphlets back to Eastern and in some cases to Borman himself.

Eastern also tried to rally public opinion to its side through advertisements. In one ad, the question "What's going on at Eastern?" was posed at the top. The answer below was "Facing Reality." The ad noted that employees at many other airlines had

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[153] "Letter and Attachments to John Simmons," Box 9, Folder 4, Frank Borman Papers, L2005-16, Southern Labor Archives, Special Collections Department & Archives, Georgia State University, Atlanta, GA.

[153] Borman, Countdown, 397.

[154] "Our World Has Changed Packet to Employees," Box 3, Folder 9, Frank Borman Papers, L2005-16, Southern Labor Archives, Special Collections Department & Archives, Georgia State University, Atlanta, GA.

[155] "Our World Has Changed Packet to Employees," Frank Borman Papers.

accepted pay cuts and that other airlines had drastically lower employee costs, listing the airlines by name and their comparative lower costs. The add closed with "Isn't it time Eastern and its unions face the reality of the new 'industry standard?'"[156] Compelling as the advertisements might have been to outsiders, it did not change the fact that Eastern still had unions that were refusing to accept wage cuts.

Borman decided there were only three alternatives: "Fix it, sell it, or tank it."[157] Fixing the airline would mean getting the concessions from the unions. Selling it would be to sell Eastern. Tanking it would be bringing Eastern into bankruptcy for restructuring. Borman wanted to fix it and if that failed was reluctantly willing to sell it. He did not want to tank it under any circumstances.

As the February 28 deadline rapidly approached, Eastern was negotiating with both its flight attendants and pilots about the wage cuts, but Bryan and the mechanics refused to even come to the table. Fixing it looked increasingly unlikely, so Borman started to focus on selling it. No airline was willing to merge with Eastern with Northwest's President telling Borman "I just looked over your balance sheet. With your labor situation, there's no use in our even having lunch."[158] But luckily for Borman, there was one man willing to buy Eastern outright. That man was Frank Lorenzo.

In just over a dozen years, Frank Lorenzo went from owning a tiny intra-Texas carrier to controlling the world's largest airline. To say he was controversial was an understatement. He was incredibly ambitious and in some ways visionary, but this came at a tremendous price to the airlines he controlled and the people who worked for them.

[156] "Facing Reality Ad," Box 3, Folder 10, Frank Borman Papers, L2005-16, Southern Labor Archives, Special Collections Department & Archives, Georgia State University, Atlanta, GA.
[157] Petzinger, Hard Landing, 250.
[158] Borman, Countdown, 420.

In 1989, Barbara Walters called him in an interview “the most hated man in America.”[159] He was willing to acquire Eastern Air Lines so when combined with his other carriers, he would have the world’s largest airline. But his acquisition of Eastern would end up being his downfall, and he would lose control of all of his airlines.

Lorenzo graduated from Columbia, where he was nicknamed “Frankie Smooth Talk,” and from Harvard Business School.[160] He started work at TWA as a financial analyst and then briefly worked at Eastern before starting a holding company with a partner called Jet Capital Corporation in 1969. When a small intra-Texas airline Texas International Airlines (TXI) was in trouble in 1971, Lorenzo managed to acquire it, outwitting another intra-Texas airline named Southwest as well as Howard Hughes whose Hughes Airwest also made a bid for the tiny Texas carrier.[161]

In 1972, Lorenzo had an airline of his own. Texas International had previously been named Trans-Texas Airways, but was better known as Tinker Toy Airways or Tree Top Airways, both making fun of the small airline with a lousy reputation. Don Burr, who was recruited by Lorenzo to help run TXI and would later start People Express said, “Everyone in Texas had had their bag lost by us at least once. It was a thoroughly disregarded airline.”[162] The name had been changed as soon as the airline started a weekly run across the border to Mexico. But that did not change the fact that its schedule was dominated with flights to cities such as Wichita Falls and Texarkana.[163]

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[159] Bernstein, Grounded, 125.
[160] William P. Barrett, “Top Gun,” *Texas Monthly*, March 1987, 100.
[161] Petzinger, Hard Landing, 40.
[162] Peterson and Glab, Rapid Descent, 66.
[163] Texas International Airlines, “Texas International Airlines 7/1/1970 Timetable,” from <http://www.departedflights.com/TI070170intro.html>

Lorenzo turned Texas International around from a small failing airline into a profitable carrier. In 1977, TXI applied for and received permission from the CAB for Peanut Fares, the first drastically discounted airline fares. This changed the industry forever as it introduced the low-fare, no-frills service model. It also helped to turn around TXI's fortunes as all of a sudden their planes were full and they gained a tremendous amount of free publicity. In the first week of Peanut Fares, TXI's load factors increased 600 percent.[164]

Frank Lorenzo's experience with TXI was also remarkable because of his relationship with labor at the airline. In December 1974, TXI was grounded because of a strike by one of the airline's unions. The employees wanted to be paid salaries similar to the trunk carriers. Lorenzo let the strike go on for five months, collecting more than $10 million dollars from a mutual aid pact the airlines had set up for strikes and the unions capitulated.[165] He was willing to fight labor and willing to take strikes in order to create a lower cost structure for his airline. This would not be the last time Lorenzo would use strikes to lower his airline's cost structure.

Texas International was a successful airline, but it was still only the eighteenth largest carrier in the country in 1978.[166] Lorenzo had greater ambitions and started buying up stock in the struggling National Airlines. National was a trunk carrier more than five times the size of TXI and Lorenzo launched the first hostile takeover of an airline in American history. Lorenzo lost out to Pan Am, who desperately needed a domestic route system to feed its international flights, but made $46 million in selling the

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[164] Petzinger, Hard Landing, 47.
[165] Bernstein, Grounded, 39.
[166] Air Transport 1978: The Annual Report of the U.S. Scheduled Airline Industry (Washington: Air Transport Association of America, 1978).

stock he had bought to Pan Am.[167] Lorenzo may have lost his first takeover fight, but he had burst onto the national scene. *Forbes Magazine* dubbed him, "Lorenzo The Presumptuous."[168]

In June 1980, Lorenzo created Texas Air Corporation as a holding company.[169] Texas Air would become his vehicle through which he would take on the airline industry. Six years later, Texas Air was the world's largest airline. Texas Air was controlled by Lorenzo's Jet Capital Corporation through a special voting class of stock and acted as an umbrella for his Texas International Airlines as well as New York Air. In October 1980, Lorenzo created New York Air as a non-unionized carrier to take on Eastern Air Lines' lucrative Shuttle operation between New York and Washington, D.C. New York Air was the country's first non-unionized carrier and further established Lorenzo as an enemy of organized labor. New York Air lifted off on December 19, 1980, creating the second air shuttle operation on the east coast, one that still operates today under the auspices of Delta, which bought it from Pan Am, which had acquired it from Texas Air, which was forced to sell it as part of the deal for Texas Air to buy Eastern in 1986.

But between TXI and New York Air, Lorenzo only owned 37 jets.[170] So he made another hostile bid, this time for Continental Airlines. Both the airline and its employees bitterly opposed the takeover. The takeover was long and was marked by legal and legislative battles. Al Feldman, Continental's President, committed suicide in the midst of the hostile takeover, at least in part because of it according to the coroner's report.[171]

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[167] R.E.G. Davies, Rebels and Reformers of the Airways (Washington, D.C.: Smithsonian Institution, 1987), 142.
[168] Barrett, "Top Gun," 185.
[169] Davies, Rebels and Reformers of the Airways, 142.
[170] Petzinger, Hard Landing, 192.
[171] Petzinger, Hard Landing, 199.

The airline's employees failed in an effort to takeover the airline. In October 1982, Texas Air completed its takeover of Continental. He merged it into Texas International and kept the Continental name. Texas International no longer existed, but Lorenzo and his team were now running the country's eighth largest airline when the new Continental and New York Air were combined.[172]

At one of the annual meetings of Continental when Lorenzo's hostile takeover was in progress a Texas International pilot named Dennis Higgins addressed the meeting telling the crowd, "Lorenzo is a brilliant man, perhaps a market manipulator without peer. We are here, however, to tell you that he is also a man who has done nothing to show that he cares one whit for the 3,400 Texas International employees who work for him."[173] This would foreshadow events to come at Continental. Once Lorenzo took over, Continental was bleeding money, so in a familiar pattern he demanded wage concessions from its employees. Continental's mechanics were the first to go on strike on August 13, 1983, after Lorenzo refused to give them the same raises that Borman gave to the mechanics at Eastern. The airline kept operating as Lorenzo hired replacement workers making $10 an hour compared to the $16 an hour the unionized mechanics were making. Next, Lorenzo demanded longer working hours and 27 percent wage cuts from the pilots.[174]

When the pilots balked, Lorenzo made a shocking move. He put Continental into Chapter 11 bankruptcy on September 24 as a financially healthy company, with more

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[172] Air Transport 1983: The Annual Report of the U.S. Scheduled Airline Industry (Washington: Air Transport Association of America, 1983).
[173] Petzinger, Hard Landing, 196.
[174] Bernstein, Grounded, 15.

than $60 million in the bank and furloughed nearly all of Continental's employees.[175] Three days later Continental began operating a much smaller schedule and Lorenzo hired non-union employees as well as union employees who were willing to work on a new pay scale. Senior captains now made $43,000 compared to $89,000 they were making before the bankruptcy. On October 1, the pilots and flight attendants went on strike, but many of them crossed the picket lines and the airline continued to operate. Lorenzo went into bankruptcy so he could end the labor contracts that he opposed and impose new terms on his employees. It was a radical gamble and it worked even though the following year Congress would close the loophole he exploited to unilaterally end union contracts in bankruptcy.

Lorenzo succeeded in breaking the unions at Continental through the bankruptcy process and on August 26, 1985 more than 90 percent of Continental's pilots petitioned to decertify their union.[176] Continental was now a non-union, low-cost carrier. Continental emerged from bankruptcy paying creditors 100 cents on the dollar. In September 1986, Lorenzo and Texas Air would snap up People Express, which had struggled since it had acquired Frontier Airlines. On February 1, 1987, Continental, New York Air, People Express, and Frontier all merged into a single airline.[177] But this was only one half of the Texas Air Empire.

In December 1985, Frank Lorenzo called Frank Borman and asked about the possibility of buying System One, Eastern's computerized reservations system. It was the third biggest system in the industry, behind leaders Sabre and Apollo, but was highly

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[175] Bernstein, Grounded, 15.
[176] Davies, Rebels and Reformers of the Airways, 148.
[177] Continental Airlines, "Continental Airlines Timetable 2/1/1987," from <http://www.departedflights.com/CO020187intro.html>

regarded and very valuable. On the call Borman brought up the possibility of Lorenzo buying all of Eastern if he could not get a deal with the unions. Lorenzo told him to call him if he wanted to sell Eastern. [178] Lorenzo wanted to be a national player and Continental still was not nearly as large as the Big Four. As Lorenzo liked to say "We are airline builders."[179] Earlier that year in June, Lorenzo had tried to take over TWA mainly for PARS, its reservation system. TWA's unions loathed Lorenzo so much after what he did at Continental, they gave huge concessions to corporate raider Carl Icahn to allow him to takeover TWA instead.[180] So the idea of getting Eastern, one of the Big Four and its System One CRS was very appealing to Lorenzo.

Frank Borman regarded Lorenzo as his "ace in the hole" and thought the idea of selling Eastern to the union-busting Texas Air would force Eastern's unions to capitulate to his demands.[181] However, he forgot that he was dealing with Charlie Bryan, who would have nothing of the concessions Borman demanded. Eastern was negotiating with its other unions, but was not making much progress with them either. On February 21, 1986, Borman asked Lorenzo to make a bid for Eastern to put pressure on the negotiations and to bring Bryan to the table, who had refused to negotiate. Lorenzo made an offer and gave Eastern 48 hours to reach a decision on whether to sell. At midnight on Sunday, February 23, Lorenzo would withdraw his offer unless it had been accepted. By late Sunday night, both the pilots and flight attendants had agreed to the 20 percent cuts. If the mechanics would agree to the cuts, Eastern would be saved and not sold.

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[178] Borman, Countdown, 420.
[179] Petzinger, Hard Landing, 310.
[180] Petzinger, Hard Landing, 243.
[181] Borman, Countdown, 421.

Near midnight, no deal had been reached with the IAM and Eastern's Board was about to vote on the offer. But then Lorenzo extended his offer until 4am, giving Eastern a little more time.[182] Bryan finally offered 15 percent wage cuts arguing that the other 5 percent was made up in productivity increases. This offer was contingent on Borman leaving Eastern and a new Chairman hired. The Board refused Bryan's offer because they were not going to allow a union leader to tell them how to run their airline. Eastern's Board countered that they would hire a new vice chairman to serve alongside Borman and even give Bryan input on choosing this new vice chairman if he took the 20 percent cuts. Neither side would give in. As Thomas Petzinger writes, "The 5 percent was meaningless. *Of course* the company could survive without it. The company could even make money without it. But the directors had really boxed themselves in. Emotions had overwhelmed everyone, on all sides. Charlie Bryan couldn't give the board 20 percent, and the board couldn't give him 5 percent."[183] Just before 3am early Monday morning, the Eastern Board of Directors sold their airline to Texas Air by a vote of 15-4. The four union directors, who were still on the Board from the 1984 labor agreement, were the only votes against it.

The decision to sell Eastern to Texas Air was a poor one and ended up building Eastern's coffin. Even though Eastern's Board made the decision, Frank Borman was the man behind the decision with the Board following his advice.[184] Frank Lorenzo would nail the coffin shut. Lorenzo managed to create even worse labor strife at Eastern and ended up focusing more on beating Bryan than running an airline. Just like the night that Eastern was sold, neither Lorenzo nor Bryan would give in and Eastern ended up dying

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[182] Borman, Countdown, 433.
[183] Petzinger, Hard Landing, 259.
[184] Borman, Countdown, 431-437.

because of it. In his attempt to break Eastern's labor unions, Lorenzo would sell off every valuable piece of Eastern so the airline was a shell of its former self. Even though Borman professed to believe that Eastern would thrive under Lorenzo writing in a June 1986 letter, "I believe that Eastern, under the Texas Air umbrella, has a great future," Borman knew Lorenzo's track record and had to believe Eastern was in trouble as an airline.[185] Lorenzo had shown no qualms in shifting assets between his airlines so that they were most profitable in the past and Eastern had strong assets and high labor costs that made these assets less profitable.

Borman did not have to sell Eastern to Lorenzo. The other two options from his "Fix it, sell it, tank it" mantra were still in play until the end. To start, let's look at the fix it option. Eastern could have been fixed. The personal rivalry between Borman and Bryan prevented Eastern from being fixed. Borman, as Eastern's Chairman, should have been the bigger person and put this rivalry aside to save the airline. He could have decided to accept the 15 percent cuts that Bryan offered and figure out a way that Bryan would accept Borman's continued tenure as Chairman. The 15 percent would have been enough to save Eastern. But instead he demanded 20 percent cuts negating any possibility for a deal. The two hated each other as seen by a hostile exchange the night of the sale. Borman yelled at Bryan "I'm going to tell the world you destroyed this airline." Bryan shot back "I'll tell them you did, so where will that get us?"[186] Borman's inability to rationally deal with Bryan prevented him from securing the cuts so necessary to Eastern's survival as an independent airline.

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[185] "Letter to Colonel William Bonneaux," Box 13, Folder 1, Frank Borman Papers, L2005-16, Southern Labor Archives, Special Collections Department & Archives, Georgia State University, Atlanta, GA.
[186] Bernstein, Grounded, 47.

The tank it option was one never seriously considered because of Borman's own pride. "I've never gone into a mission without at least three alternatives," Borman wrote in his memoir, "If the primary goal can't be attained, you go to an alternate mission. If that's out of reach, you abort, which is a failed mission but at least you're alive. This time fixing the airline is the primary mission, selling it is the alternative mission and Chapter 11, God forbid, is the abort."[187] He considered Chapter 11 a failure and Frank Borman, the famous astronaut, refused to be associated with failure. As it would turn out, Borman was wrong. Failure was selling the airline. Just like in 1983 when he gave in to Bryan instead of going into Chapter 11, Borman once again made a major mistake. Chapter 11 bankruptcy would have given Eastern an opportunity to restructure its massive debt and renegotiate union contracts under court supervision where Bryan would have much less leverage. Eastern was in a decent cash position and would still have been able to operate while in bankruptcy. This would have saved Eastern as an independent airline and given Eastern a better chance of surviving in the deregulated environment. Continental had done it under Lorenzo, and Eastern could have done it under Borman. But not wanting to achieve "failure" Borman decided to sell the airline instead.

Lorenzo's Decision to Break Bryan

On Monday morning, Frank Lorenzo no longer needed to dream about being a Big Four airline for not only did he own one in Eastern, but also Texas Air was now larger than any airline in the free world. Buying Eastern had tripled the size of Texas Air overnight and Lorenzo now counted 451 planes, 50,000 employees, and nearly $7 billion

[187] Borman, Countdown, 428.

in yearly revenue as part of his airline empire. Lorenzo had bought Eastern, the airline of the Great Silver Fleet and the free world's largest airline just years before, for only a little more than $600 million, and about half was money borrowed from Eastern through issuing new preferred stock, so Lorenzo only had to pay around $300 million.[188] Lorenzo defended his acquisition of Eastern despite all of the airline's troubles saying "Eastern had substantial assets—financial, marketing, and route assets—and it was one of the original trunk airlines. It was a massive resource, and it was selling in the marketplace for next to nothing."[189] And then there was the sentimental value to Lorenzo of owning an airline he once worked for as seen by his beaming on Tuesday morning as he boarded an Eastern flight from Miami to New York. "They really do a nice flight—just look at how clean it is up there," he said staring at the ceiling. Touching the cloth seats, "I like the feel of this cloth" and then grabbing the plastic headphones from the seat pocket, "Aren't these just the greatest headphones?"[190] Lorenzo was infatuated with his new airline. But his loyal number two man was sounding the alarm bells.

Phil Bakes was one of the unknown heroes of getting the Airline Deregulation Act passed when he worked as Kennedy's top aide on the issue. When Lorenzo was starting New York Air and needing airport slots at New York LaGuardia's Airport and Washington's National Airport, he came to Bakes asking him to help secure these slots for New York Air. Bakes signed on and got the slots.[191] Bakes later served as Lorenzo's point man on the hostile takeover of Continental and then served as President of Continental, rebuilding it into a major carrier after the strike and subsequent bankruptcy

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[188] Peterson and Glab, Rapid Descent, 179.
[189] Peterson and Glab, Rapid Descent, 180.
[190] Pete Engardio, et al., "Frank Lorenzo—Highlifter" *Business Week*, March 10, 1986.
[191] Petzinger, Hard Landing, 110.

of the company. Continental had just emerged from bankruptcy when Lorenzo came to Bakes asking him what he thought about buying Eastern. Bakes replied, “I think it’s a swamp from which we will never return.”[192] Bakes was completely correct. Texas Air, as the airline that broke unions at Continental and started the first non-unionized airline in New York Air was the wrong airline to inherit Eastern’s poisonous labor relations. But Lorenzo overruled Bakes and then installed him as the President and CEO of Eastern Air Lines over Bakes’ objections.

Even though Eastern’s unions, including Bryan, voted against the deal to sell Eastern to Lorenzo, Bryan was optimistic that he could work with Lorenzo. Bryan said, “For all his faults, Lorenzo is a business man who has demonstrated that he knows how to run a successful company. I can work with Frank Lorenzo.”[193] In fact, he even sent a telegram to Lorenzo the day after the sale that ended with “I am at your disposal to schedule a meeting to begin exploring the challenges and opportunities that lie ahead.”[194] Lorenzo never responded. Their relationship was off to a rocky start and it would only get worse.

Before the sale to Texas Air even closed, Eastern was already under the influence of Lorenzo and he demanded that Bryan give up the 20 percent cuts that he refused the night the company was sold. When he refused, 1,500 employees were laid off, 500 of them machinists. Bryan’s complaints that the machinists were being singled out unfairly fell on deaf ears. When repair warranties expired on 70 engines on planes in Eastern’s fleet in September, Eastern outsourced work on the engines to the manufacturer costing 300 more mechanics jobs. Eastern was playing hardball with Bryan and there was little

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[192] Petzinger, Hard Landing, 252.
[193] James Woolsey, “Editorial: The Eastern Strike,” *Air Transport World*, May 1989.
[194] Petzinger, Hard Landing, 261.

he could do but protest. "We are in the midst of an all-out war," Bryan wrote in October to his members.[195]

The problem at Eastern for Lorenzo and Bakes was that the mechanics' contract went through the end of 1987 and there was little they could do to change the contract without Bryan's consent until then. Eastern's goal under Lorenzo was to bring its costs on par with Continental, which had some of the lowest costs in the industry. When this happened, Continental and Eastern could merge creating one large airline under Lorenzo. Eastern's Toronto station manager wrote a memo after hearing about the new strategy, "If we can't cut out costs, our aircraft will go to Continental."[196] Lorenzo had the ability to shift planes between his airlines and had in the past. The threat was real. In February 1987, Eastern transferred six A-300 aircraft to Continental.[197]

Lorenzo wanted to slash labor costs and Bakes announced in January 1987 that Eastern was going to cut labor costs by $490 million during the year. The mechanics were going to be the hardest hit with the total payroll of the mechanics decreasing from $566 million to $301 million.[198] Lorenzo had called the salaries of the mechanics "absurd" and wanted to slash them especially for the low skilled employees that made up most of the mechanics union. He was appalled at the fact that his average bag handler at Eastern was making $47,000 a year and set out to change this. In October when the contract negotiations started with Bryan and the mechanics according to the normal

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[195] Bernstein, Grounded, 58.
[196] Petzinger, Hard Landing, 317.
[197] "Eastern Will Transfer Six A300s to Continental," *Aviation Week and Space Technology*, February 16, 1987.
[198] Edward H. Kolcum, "Eastern Will Slash Labor Costs By $ 490 Million This Year," *Aviation Week and Space Technology*, January 26, 1987.

bargaining schedule, Lorenzo demanded 40 percent wage cuts for the baggage handlers. Bryan was outraged and countered with a 10 percent increase in salaries.[199]

The negotiations went nowhere and Eastern prepared for a strike by the mechanics, something Lorenzo wanted all along so he could replace them with non-unionized workers. Eastern set aside $70 million for a strike to hire enough mechanics and other employees to keep the airline running if the IAM went on strike. The airline paid outside companies to recruit strikebreakers. Lorenzo even transferred $22 million from Eastern to Continental for Continental to provide services for Eastern in the event of a strike. He was confident he could keep the pilots from walking out through a deal that guaranteed a certain number of planes that would stay in the Eastern fleet, but just in case he hired Orion Air to train 400 nonunion pilots on Eastern planes in the event of the pilots also going on strike. Elaborate plans were put in place for Eastern's operations during a strike. They launched a public campaign explaining what they were doing to prepare for the strike. Lorenzo was convinced that by April 1988 at the latest Bryan would call a strike.[200] Frank Lorenzo was out to break Bryan and his union. All he needed was for them to go on strike so he could replace them. This would be the final decision Eastern made in the deregulated era that ensured its demise.

The problem for Lorenzo and Eastern was that Bryan would not take the bait. Bryan knew he was trying to be goaded into a strike that Lorenzo would then break. Until a new contract was reached, his members were still paid under the old contract, so Bryan was in no hurry. To make matters worse for Lorenzo, the National Mediation Board (NMB) refused to declare an impasse in contract negotiations, which would start

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[199] Bernstein, Grounded, 67.
[200] Bernstein, Grounded, 68-69.

the mediation process that preceded the 30-day cooling off period, which had to take place before a strike could be declared or management could impose new contract terms. The battle royal Lorenzo had geared up for continued to be delayed, at great cost to the company because he had to continue to maintain the expensive strike preparations he had started.

While waiting for D-Day with Bryan, Lorenzo needed money to keep Eastern and its strike preparations going. So he used the airline as a piggy bank, selling off assets to raise cash all the while weakening the airline so it would never be able to recover. By trying to break Bryan, he was mortgaging any future Eastern had. Selling off Eastern assets, especially to other divisions of Texas Air at sub-market prices, was nothing new for Lorenzo. In March 1987, a new Texas Air subsidiary bought System One, Eastern's CRS. The system had been appraised at as much as $450 million by an outside company, but Lorenzo moved it to another one of his companies for a $100 million note that was not to come due until 2012.[201] Eastern went from making money from System One to paying $130 million a year in order to use it in exchange for no cash.[202] Those six A-300s transferred to Continental got Eastern $162 million, $67 million in a near worthless promissory note. Continental then sold the planes for $169 million in cash. Eastern sold Continental 11 gates at Newark Airport for an $11 million note even though the gates were worth more than twice that price.[203] Eastern's assets were being stripped and deployed elsewhere in the Texas Air system. Eastern also had to pay Texas Air a $6 million per year "management fee" and a penny to Texas Air for each gallon of fuel it

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[201] Bernstein, Grounded, 74.
[202] Thomas Petzinger Jr. and Paulette Thomas, "House of Mirrors: Lorenzo's Texas Air Keeps Collecting Fees From Its Ailing Units," *The Wall Street Journal*, April 7, 1988.
[203] Petzinger and Thomas, "House of Mirrors," *The Wall Street Journal*.

was forced to purchase through another Texas Air subsidiary.[204] These are just a few of the examples of how Lorenzo was using Eastern as a piggy bank and these took place before he needed money to keep his strike preparations in place.

In the first six months of 1987, Eastern was profitable, but with the loss of so many assets, Eastern soon started bleeding money once more. Once the year ended with a huge loss of $182 million,[205] Lorenzo was becoming distraught that Byran would not strike and the NMB would not declare an impasse. "If I had known these negotiations were going to drag on and on like this, I never would have bought Eastern," he said.[206] Bakes' prophecy that buying Eastern would ground Texas Air was becoming more and more likely as Eastern started threatening to take down not only itself, but also Texas Air. In June 1988, Lorenzo lowered his demands for concessions from the mechanics to $150 million from the $265 million he had demanded the year before in an effort to get an impasse declared from the NMB. Lorenzo declared it his final offer and Bryan delayed bringing the offer to his membership, in an effort to prevent an impasse from being declared. He was successful and on July 22, Eastern announced it was closing its Kansas City hub, eliminating flights to 14 destinations, and laying off another 4,000 employees.[207] Eastern was struggling to stay afloat because Bryan was outsmarting Lorenzo. When Bryan finally brought Lorenzo's proposal to his membership, it was overwhelmingly rejected.

Ever since Lorenzo bought Eastern, the unions had been trying to buy Eastern themselves with the help of a major investor. Many prominent businessmen were

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[204] Petzinger, Hard Landing, 317.
[205] Eastern Air Lines, Inc., Eastern Air Lines 1987 Annual Report.
[206] Bernstein, Grounded, 85.
[207] Bernstein, Grounded, 90.

involved at one point or another including Carl Icahn, T. Boone Pickens, Jay Pritzker, and Peter Ueberroth. Icahn got within hours of purchasing the airline with the employees, but the deal fell through because Lorenzo did not want to sell Eastern. This is an example of how Eastern could have been saved, but Lorenzo wanted D-Day with Bryan more than he wanted Eastern to survive. Peter Ueberroth, who was just finishing up his term as commissioner of Major League Baseball reached a deal to buy Eastern after the mechanics went on strike, but this deal fell through because of demands from Lorenzo. Once again, Lorenzo wanted to break Bryan more than save Eastern.

Eastern's reputation continued to be dragged through the mud. In March 1987, Eastern's pilots started a program called MaxSafety through which they would send postcards to the FAA whenever there was a maintenance issue Eastern refused to address. That summer the FAA held a special investigation into Eastern to see if the labor war was affecting safety.[208] Congress got involved and a subcommittee held hearings on the FAA report that came out of the investigation. The 1988 presidential campaign was in full swing and almost all of the candidates took verbal swings at Lorenzo and his management of Eastern. Michael Dukakis flew into Miami just to hold a press conference attacking Lorenzo. Bakes said after this event, "That's really something when they come into your hometown just to throw dirt at you."[209] Even Congress got involved. More than 130 members of Congress sponsored a bill encouraging the Department of Transportation (DOT) to look into the fitness of the ownership of Texas Air and Eastern to "conduct a full investigation into the management of the Texas Air Corporation and Eastern Air Lines since the acquisition to determine the past and

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[208] Bernstein, Grounded, 124.
[209] Perterson and Glab, Rapid Descent, 244.

probable future effect of such management on the public interest."[210] In April 1988, the DOT launched such an investigation, and found Lorenzo "fit" to the run Eastern, but it was another embarrassing episode for the once proud airline. Doug Bosco, a Representative from California quipped that Lorenzo was "the neutron bomb of the airline industry—he kills all the workers and leaves the planes."[211]

In early January 1989, the talks were going nowhere and on January 31, the National Mediation Board officially declared an impasse. Eastern rejected mediation within hours and the 30-day "cool down" clock was started. The mechanics could go on strike and Lorenzo could impose new contract terms at 12:01am on March 4. During this sixteen month period from when negioations started until the impasse was declared Eastern continued to shrink as Lorenzo sold chunks of Eastern to finance his strike-survival plan. In early 1988, he decided to sell the Eastern Shuttle, one of the airline's two gems, to another Texas Air subsidiary where he could have lower costs. The unions went to court and won an injunction preventing Lorenzo from stripping the Shuttle from Eastern and "selling it" to another Texas Air subsidiary for a note. So Lorenzo looked for an outside buyer and billionaire Donald Trump stepped up to the plate. In October 1988, he sold the Eastern Shuttle to Trump for $365 million.[212] But once again the unions went to court and while this time their complaints were ultimately rejected, the sale did not take place until May 24, 1989 because of union lawsuits.[213]

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[210] United States House of Representatives, Investigation into the Management of Texas Air Corporation and Eastern Air Lines (Washington, D.C.: U.S. House of Representatives, 1988), 5.
[211] Peterson and Glab, Rapid Descent, 244.
[212] "Countdown to a Showdown," *Miami Herald*, February 26, 1989.
[213] Michael Huber, "Pilots End Eastern Walkout 'Time Has Come To Get On With Our Lives,'" *Miami Herald*, November 23, 1989.

Eastern lost $335.4 million in 1988 even with revenue coming in from asset sales.[214] Lorenzo was not feeling this personally because of the complex corporate structure he had created. *The Wall Street Journal* broke the story about his web of companies in an article titled “House of Mirrors.” “Imagine a house of many rooms,” the article began, “Every room has a paying tenant. A bank can foreclose on an individual room, but not on the whole house. The landlord has many partners, but no one can challenge his management of the property. This is the house Frank Lorenzo built.”[215] The article describes how he insulated himself and Texas Air from the mountains of debt his various airlines were accumulating. In 1987, his airlines had to pay $623 million just to service their debt, but Texas Air was only responsible for less than ten percent of that total.[216] The article concluded that Texas Air and Lorenzo were safe, even if Eastern were to fail.

When asked in an interview in January 1989 by *Airline Business* if he was trying to bust unions at Eastern like he had at Continental Lorenzo replied, “That’s utter bullshit.”[217] But when March 4 came and the IAM went on strike, he was ready to continue operating with new mechanics he hired at a much lower rate, essentially union breaking. Lorenzo finally had the fight he had been gearing up for. The two “scorpions in a bottle” as Alfred Kahn described them, would have their face-off.[218] It was time to break Charlie Bryan.

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[214] David Lyons, “Will Eastern Strike Out? Survival at Stake in Fateful Week,” *Miami Herald*, February 26, 1989.
[215] Petzinger and Thomas, “House of Mirrors,” *The Wall Street Journal*.
[216] Petzinger and Thomas, “House of Mirrors,” *The Wall Street Journal*.
[217] “Lorenzo: Being Frank,” *Airline Business*, January 1989.
[218] Bridget O'Brian, “The Eastern Strike: Feud Between Bryan, Lorenzo Explains Much, But Not All,” *The Wall Street Journal*, March 6, 1989.

Frank Lorenzo had a problem on the morning of March 4. Eastern was virtually grounded. He was confident that the pilots would cross IAM picket lines and Eastern could rid itself of Bryan and continue to operate normally. He even enticed the pilots with a new contract, which guaranteed a minimum number of planes that would stay with Eastern. Not only did the pilots reject the contract, but they honored the picket lines, in what *Aviation Week* described as an "stunning" show of union solidarity.[219] "It was pilot solidarity," a pilots' union official said, "We couldn't ask for anything more. It was a total success."[220] Phil Bakes of Eastern took a different view saying the pilots' action "is professional suicide. It defies explanation."[221] Indeed, many of these pilots would never fly again because other airlines had no interest in hiring older pilots. On March 4, Eastern managed to operate 84 flights barely covering its Shuttle schedule, using management pilots and a handful of union members who crossed the picket lines. Keeping the Shuttle operating was extremely important because it needed the Trump's money from the sale of the shuttle, a sale that would have been scuttled if the Shuttle stopped operating. On March 9, Eastern was forced to file for Chapter 11 bankruptcy. The following week *Aviation Week's* editorial was titled "Eastern Airlines' Demise" and commented, "Lorenzo has lost his chance to be a leader at Eastern, and whatever happens to the carrier, he has yet to prove his business formula either benefits passengers or rewards investors."[222]

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[219] "Union Solidarity Stuns Eastern, Strands Thousands of Passengers," *Aviation Week and Space Technology*, March 13, 1989.
[220] "Union Solidarity Stuns Eastern, Strands Thousands of Passengers," *Aviation Week and Space Technology*.
[221] "Strike Forces Eastern Into Bankruptcy Court," *Aviation Week and Space Technology*, March 13, 1989.
[222] "Eastern Airlines' Demise," *Aviation Week and Space Technology*, March 13, 1989.

Lorenzo and Bakes were able to slowly rebuild Eastern and by August 1 the airline was operating 350 daily flights. Pilots were crossing the picket lines and agreeing to work at a fraction of their prior pay. By November, Eastern had 1,800 pilots, 1,000 who were newly hired and 800 who had crossed the picket line. The airline was operating 775 daily flights.[223] Lorenzo had won. Charlie Bryan was broken. Eastern was operating as a non-union carrier just like Continental. But the victory was hollow.

Eastern was in trouble with its creditors. After originally proposing 100 cents on the dollar payment to its creditors and then following that up with a 50 cent offer on April 2, 1990, Eastern told its creditors that it would only pay them 25 cents on the dollar with 5 cents being in cash and the other 20 cents in Eastern and Continental notes. This was too much for the creditors to put up with. On April 10, Eastern's creditors asked for a trustee to be appointed to run Eastern citing "gross incompetence" on the part of Lorenzo and his management team.[224] The creditors also demanded that Eastern sell its South American routes to American Airlines. Eastern had negotiated a deal to sell the profitable South American routes to American for $349 million the prior year, but Lorenzo called the sale off because a dispute over Sabre, American's CRS. The creditors now wanted the cash from this sale to pay Eastern's debts.

On April 18, U.S. Bankruptcy Judge Burton Lifland appointed Martin Shugrue, a veteran airline manager, as Eastern's trustee, removing Lorenzo from Eastern Air Lines. He wrote, "The current management, as personified by the chairman of the parent and the

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[223] Huber, "Pilots End Eastern Walkout 'Time Has Come To Get On With Our Lives,'" *Miami Herald*.
[224] James T. McKenna, "Ruling Lorenzo Team 'Incompetent,' Judge Orders Trustee to Run Eastern," *Aviation Week and Space Technology*, April 23, 1990.

debtor Lorenzo, is not competent to reorganize."[225] Lorenzo was out from Eastern and Bakes followed two days later. Lifland had been extraordinarily generous to Lorenzo and Eastern throughout the bankruptcy process with the judge saying he wanted "planes in the air" and called Eastern a "wasting asset" at one point during the process, showing his frustration with the strike.[226] But enough was enough and Lorenzo had gone too far in abusing the process. In August 1990, Lorenzo left the airline industry all together, selling his stake in Continental. His battle with Bryan not only cost him Eastern, but his ability to successfully run Continental as well. As for Eastern, Shugrue admirably tried to revive the airline, but it was too weak. The decisions of Borman and Lorenzo had killed Eastern and Shugrue was trying to operate with the airline's ashes. The shuttle and the South American routes, Eastern's two gems, were gone. Shrugrue never had a chance. The outbreak of the Gulf War hastened Eastern's demise and on January 18, 1991, Eastern stopped flying and started to liquidate.[227]

When Frank Lorenzo bought Eastern in 1986, it was the country's third largest airline. By the time he was kicked out, Eastern was the ninth largest airline, the smallest of the major carriers.[228] A *Business Week* editorial published after Lorenzo sold Continental titled "How to run an airline into the ground," offered a harsh assessment of Lorenzo's leadership. Lorenzo "kept fighting the unions, particularly at Eastern Air Lines, which Texas Air absorbed in 1986," *Business Week* wrote, "This is no way to run

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[225] McKenna, "Ruling Lorenzo Team 'Incompetent,' Judge Orders Trustee to Run Eastern," *Aviation Week and Space Technology*.
[226] "Eastern Is Rapidly Losing Market Share," *Aviation Week and Space Technology*, April 17, 1989.
[227] Ted Reed and David Satterfield, "Eastern Folds Its Wings," *Miami Herald*, January 19, 1991.
[228] Air Transport 1986: The Annual Report of the U.S. Scheduled Airline Industry (Washington: Air Transport Association of America, 1986) and Air Transport 1990: The Annual Report of the U.S. Scheduled Airline Industry (Washington: Air Transport Association of America, 1990).

an airline. More important, this is no way to run a company."[229] Lorenzo's fight with the unions, specifically his decision to break Bryan's union, ensured whatever small chance Eastern had of surviving after Borman's poor decisions was zero.

Judge Lifland appointed an inspector to investigate Eastern and its financial situation. He found that in the fifteen asset sales Eastern had done since Lorenzo took over the airline, improper action took place in twelve of them. Lorenzo had deprived Eastern of between $250 and $400 million through these improper asset sales.[230] The grudge match versus Bryan was obviously more important to Lorenzo than making Eastern profitable. As Aaron Bernstein wrote in his book about Lorenzo and Eastern, "Lorenzo had become so obsessed with beating the unions that rational economic decisions went out the window. Eastern had lost about a million dollars a day for two straight years while Lorenzo waited to break the machinists. The savings Lorenzo expected from the machinists, however, came only to $150 million a year."[231] Lorenzo could have explored other avenues for reducing costs at Eastern other than breaking Charlie Bryan. But breaking Bryan was what Lorenzo wanted to do at any cost. Otherwise Lorenzo would not have sunk over $700 million into his strike fund over two years when he only wanted concessions worth less than twenty percent of the strike fund. "But I can't support Lorenzo's fight now," one of his close associates said, "He's fighting a war of attrition, that's all."[232] John Backe, a former CBS president who explored

[229] "Editorial: How to Run an Airline Into the Ground," *Business Week*, August 27, 1990.
[230] Bernstein, Grounded, 218.
[231] Bernstein, Grounded, 167.
[232] Bernstein, Grounded, 167.

buying Eastern said, "Lorenzo killed an airline. If he did it just to kill a union, that's unthinkable. And I think he did."[233]

[233] Bernstein, Grounded, 230.

Chapter Five: Delta and Deregulation

Delta Air Lines during the first era of deregulation was a much more boring company than Eastern. Delta featured neither the colorful characters of Charlie Bryan, Frank Borman, and Frank Lorenzo nor the drama these people brought to Eastern. The story of Delta in this time period is the story of a southern conservative company that did not act like one of the largest airlines in the United States. The decisions Delta made were measured and generally on the conventional side. There are four main decisions to focus on with Delta in the early-deregulated era.

The first was not so much a particular decision, but rather the decision to continue Delta's company ethos. Ever since C.E. Woolman, the company had operated under the "Delta Spirit." This meant that the company's executives were only hired from within so that they would be well versed in how Delta did things, which was conservatively. Delta was a follower in the industry rather than a leader. And most importantly, Delta was a family. Delta took care of its employees and had not laid an employee off in more than three decades.[234] There were no labor wars and most of Delta's employees (with the exception of its pilots) were very happy not being represented by a union.

The second decision was to build up hubs in Dallas/Ft. Worth and Cincinnati. The hub and spoke model was the biggest route structure change to come out of deregulation and several airlines including Piedmont and American were building hubs in the southeast trying to divert traffic from Delta in Atlanta. While at first Delta was too conservative in building hubs other than Atlanta, it eventually adapted building a

[234] James Ott, "Delta Faces Expansion and Competition Challenges," *Aviation Week and Space Technology,* March 24, 1980.

balanced route structure around four hubs, allowing the airline to compete effectively in the deregulated era.

Delta's third major decision in deregulation was to acquire Western Airlines in September 1986. This decision was not expected by industry watchers since Delta had always been conservative and because Western was a unionized company when Delta was mainly non-unionized. But with merger mania raging in the airline industry, Delta pulled the trigger and most likely survived as an independent airline because of it.

The final decision Delta made was to become a strong international airline. Even after its purchase of Western, it had a very weak international network. Delta first launched service to Asia, using Portland, Oregon as its international gateway, something that would have been nearly impossible before it acquired Western. Then as Pan Am was failing in 1991, it bought the airline's European operations giving Delta Pan Am's Worldport at JFK airport in New York City, a hub in Frankfurt, Germany and flights as far as India. Delta was a true international carrier. This decision solidified Delta as a member of the Big Three and a winner of the first deregulated era, but caused financial troubles for Delta from which it would take years to recover. Delta eventually would give up most of the former Pan Am routes.

The Delta Spirit

It made sense that Delta opposed deregulation because it would change the industry. Delta had been profitable as long as anyone could remember and it was afraid that deregulation could change this. Deregulation changed everything, but Delta was relatively unaffected by it at first, as the new low-cost carriers stayed away from most of Delta's routes. Unlike Eastern, Delta did not face immediate competition from the new carriers.

The Delta Spirit was legendary in the airline industry. When Delta's CFO Bob Oppenlander was asked to describe the Delta Spirit he said, "It's the attitude of the people towards their jobs, their company, and their associates, basically. And most of all, because of that, towards the customers…The Delta Spirit is a job attitude which supports a customer service-oriented industry."[235]

Delta did not have Eastern's labor problems. Petzinger wrote, "Delta delivered for its employees. Delta people got jobs for life."[236] Even in the 1973 fuel crisis, it shifted its employees to different jobs rather than handing out pink slips. Delta did not press its employees for concessions and did not make rash decisions to give massive raises just because they had a profitable quarter. The company acted paternalistically compensating its employees well and treating them like family. The "Delta Family" was a strong one with an employee loyalty unmatched in corporate America. When Delta started to struggle because of the external factors of the early 1980s combined with deregulation, three Delta flight attendants came up with an idea: Delta's employees would buy Delta's first Boeing 767 aircraft. Project 767, as it was dubbed, raised the $30 million cost of the plane through voluntary payroll deductions. On December 15, 1982, Delta's first 767, christened The Spirit of Delta, was unveiled before 6,500 employees at a Delta hanger at Hartsfield International Airport.[237] This action is unmatched to this day

[235] "Delta Air Lines: Proving Nice Guys Can Be Winners Too," *Lloyd's Aviation Economist*, June 1985, 26.
[236] Petzinger, Hard Landing, 390.
[237] "The Spirit of Delta," *Delta Digest*, January 1983, Delta Air Lines Corporate Archives, Delta Air Transport Heritage Museum, Atlanta, GA.

by employees of any American airline. While Charlie Bryan was fighting Frank Borman, Delta's employees were giving up chunks of their paychecks to buy Delta a new plane.

Even though Delta was the darling airline of Wall Street, posting 36 consecutive years of profits, it struggled with the rest of the airline industry in 1982 and 1983.[238] It lost $17 million in calendar year 1982 and nearly $87 million in financial year 1983.[239] As the *Miami Herald* wrote "When Eastern Airline or Pan American World Airways loses money it doesn't raise many eyebrows. Deficits for them are commonplace. But when Delta loses money, that's news—a real man bites dog story."[240] People were surprised at Delta's financial problems. But they should have seen them coming.

Delta's conservative nature was hurting them in deregulation. The airline had fallen behind the competition as Piedmont and Republic built new hubs and stole traffic in the southeast from Delta and Atlanta. Deregulation forced airlines to market themselves unlike before and Delta was caught flat-footed. W. Whitley Hawkins, Delta's Vice President for Marketing told *Air Transport World* in 1983, "We found ourselves in a retail environment and we were not used to it."[241]

Even worse for Delta, it was behind in building a computerized reservation system. These systems were increasingly important, especially as travel agents started booking more and more airline tickets. Delta did not introduce its DATAS II system until late 1982, six years behind American Airlines' Sabre system and United Airlines' Apollo system. Delta would never catch up with its competitors in the CRS race. Not

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[238] "Delta is awesome," *Air Transport World*, June 1985, 22.
[239] Air Transport 1983. and Delta Air Lines Inc., Delta Air Lines 1983 Annual Report.
[240] James Russell, "Delta Looking Like It's Ready For New Takeoff," *Miami Herald*, March 13, 1983.
[241] "Delta is awesome," *Air Transport World*, 23.

only would DATAS II languish with a market share in the low teens, but also technologically it was inferior to Sabre, Apollo, and Eastern's System One. The lack of a CRS prevented Delta from effectively discounting tickets since it was unable to discount some and leave others at full fare like the other airlines. This cost Delta millions of dollars in revenue as it ended up selling all tickets on some flights at a discounted rate when it could have gotten a full fare from some of the passengers.

But the Delta Spirit prevailed as the company rallied together following the tough years of 1982 and 1983 in more ways than just buying Delta's first 767. Delta started taking advantage of deregulation and posted a $175 million profit in 1984.[242] Its percentage of debt dropped to 30.4 percent in 1984 from 45.0 percent in 1983. Delta hated borrowing money and its debt would not reach above 33 percent of its total capitalization for the rest of decade.[243] The airline was back on a roll. One of the ways Delta embraced deregulation was the development of several hubs.

Building Hubs

Delta created the original airline hub in Atlanta in the 1950s. Therefore, it is a bit surprising that Delta was slow to embrace additional hubs at the beginning of deregulation even as Piedmont was developing Charlotte and Republic was developing Memphis, both in Delta's backyard. This can be attributed to Delta's corporate conservatism especially in the early years of deregulation. At least concerning hubs this

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[242] Delta Air Lines Inc., Delta Air Lines 1984 Annual Report.
[243] U.S. GAO, Airline Competition, 18.

conservatism would change and Delta would start developing two additional major hubs in a decision that helped to make the airline stronger in the deregulated era.

Delta's second hub was created at Dallas/Ft. Worth in 1981 as Braniff was failing. Dallas had been served by Delta since the airline's earliest days and even under regulation, Delta had a decent sized operation with around 50 flights per day.[244] As Braniff was dying both Delta and American swooped in to Dallas/Ft. Worth and established hubs. By September 1982, Delta was up to 91 daily flights, which made it the second biggest hub in Delta's system after Atlanta. Most of Delta's flights from Dallas/Ft. Worth at that time were to western destinations such as Los Angeles, Seattle, San Francisco, and Las Vegas. Delta also had many flights from small cities in the southeast and southwest to Dallas/Ft. Worth.[245]

Delta would continue to grow Dallas/Ft. Worth, announcing a major addition to its terminal in September 1985.[246] But Delta never came close to being Dallas/Ft. Worth's largest carrier. American Airlines made Dallas/Ft. Worth its headquarters and constantly controlled 60 percent of the market share. Even by December 1987 when Delta would have over 200 mainline flights and nearly 100 commuter flights out of the airport, it still would still not have more than a one-quarter share of the passengers carried from the airport. American also challenged Delta closer to home establishing hubs in Nashville in 1986 and in Raleigh-Durham in 1987.[247] Both of American's southeastern hubs would be relatively short-lived, but Delta would continue to operate a strong hub in Dallas/Ft. Worth until 2004, making it an integral part of the Delta route system.

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[244] Delta Air Lines, Inc., Delta Air Lines Timetable 4/24/1976.
[245] Delta Air Lines, Inc., Delta Air Lines Timetable 9/8/1982.
[246] "Major Passenger Expansion Planned at DFW," *Delta Dispatch*, September 1985, Delta Air Lines Corporate Archives, Delta Air Transport Heritage Museum, Atlanta, GA.
[247] Scott Hamilton, "Delta Set To Take On American," *Airfinance Journal*¸ October 1986, 9.

Delta's third hub was created in Cincinnati. In 1981, Delta increased the number of daily flights to 46 establishing it as a minihub.[248] The minihub grew stronger when Delta partnered with commuter airline Comair, based out of Cincinnati, and then could add Comair's 72 flights to its Cincinnati schedule on September 1, 1984.[249] With this partnership, Delta could add its airline code to the Comair flights, giving Delta 121 flights out of Cincinnati. Cincinnati became a full fledged Delta hub on December 15, 1986 as Delta added 55 flights overnight bringing the mainline total to 105 in addition to 129 commuter flights.[250] This massive overnight expansion was called "one of the largest air service increases in one city in one day by any airline in aviation history," by David Garrett, Delta's Chairman.[251] Cincinnati would continue to grow into Delta's second biggest hub. Comair, Delta's commuter airline partner would be very important to Delta's growth in Cincinnati, having more flights than Delta itself.

Comair was one of several Delta Connection carriers. The Delta Connection banner was used for the commuter airlines that partnered with Delta funneling passengers from smaller cities to Delta hubs where they could connect to Delta flights. The Delta Connection began in 1984 with Ransome Airlines feeding Delta flights in Philadelphia and Boston, Atlantic Southeast Airlines (ASA) feeding Delta flights at Atlanta and Rio Airways feeding Delta flights at Dallas/Ft. Worth.[252] When Rio left the Delta Connection systems, ASA took over commuter operations at Dallas. The Delta

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[248] "Cincinnati and Dallas/Ft. Worth Add Major New Service in Spring/Summer Schedule Change," "Major Passenger Expansion Planned at DFW," *Delta Digest*, May 1981, Delta Air Lines Corporate Archives, Delta Air Transport Heritage Museum, Atlanta, GA.

[249] James Ott, "Comair Advances Delivery Of Saab-Fairchild 340s," *Aviation Week and Space Technology*, July 30, 1984.

[250] Delta Air Lines, Inc., Delta Air Lines Timetable 12/15/1986.

[251] "Delta Adds 55 Flights to Cincinnati Hub," *Delta Dispatch*, September 1985, Delta Air Lines Corporate Archives, Delta Air Transport Heritage Museum, Atlanta, GA.

[252] "The Delta Connection: An Alliance For Excellence," *Delta Digest*, July 1984, Delta Air Lines Corporate Archives, Delta Air Transport Heritage Museum, Atlanta, GA.

Connection would continue to grow during this era and was very important in the growth of Delta's hubs.

Delta added a fourth hub in Salt Lake City once it bought Western Airlines. Delta also operated larger stations that today would be called focus cities, but at the time were not quite hubs in Boston and Orlando and almost created a hub at Memphis before deciding to go with Cincinnati instead in the face of a Republic hub being created there. And of course, Atlanta was still Delta's dominant hub. Delta was growing in Atlanta at Eastern's expense. Delta and Eastern was bitter rivals, at one point competing on 85 percent of routes, and this was most clear in Atlanta where the two airlines battled on a daily basis. Delta increased its market share in Atlanta from 49.7 percent in 1978 to 58.4 percent in 1988.[253] In March 1989, Delta and the Delta Connection operated 552 daily flights from Atlanta.[254] After the IAM went on strike, Delta clobbered Eastern in Atlanta even more, but according to an airline official "Delta was killing Eastern at Atlanta…before the strike."[255]

Delta's four hubs in Atlanta, Cincinnati, Dallas/Ft. Worth, and Salt Lake City were extremely effective and served as Delta's four hubs for almost twenty years before the airline decided to close down Dallas/Ft. Worth in the travel downturn after the September 11 attacks. David Sylvester, an airline analyst for Montgomery Securities said at the time that Cincinnati became a hub, "Delta is setting up a textbook example of a

[253] Andrew R. Goetz and Christopher J. Sutton, "The Geography of Deregulation in the U.S. Airline Industry," *Annals of the Association of American Geographers*, Vol. 87, No. 2 (1997), 245.
[254] Delta Air Lines, Inc., Delta Air Lines Timetable 3/2/1989.
[255] "Eastern Is Rapidly Losing Market Share," *Aviation Week and Space Technology*.

well-rounded route system."[256] This analysis was correct. Delta's decisions to establish these hubs was an excellent decision that helped Delta grow in the deregulated era.

Delta's Purchase of Western

Delta was still known as the conservative airline in 1986. The prior year was the most successful in the airline's history with a $259.4 million profit.[257] But other airlines were quickly encroaching on Delta's southern domain with new hubs in the South. In addition to new American hubs in Nashville and Raleigh-Durham and a very strong Piedmont hub in Charlotte, United was opening a hub at Washington's Dulles Airport. Delta had a strong route map, but there was a glaring hole in it: the western United States. The closest thing Delta had to a western hub was Dallas/Ft. Worth and it did not penetrate very deep into the west.

In September 1986, after a failed bid for the tiny western carrier Jet America, Delta announced that it was going to purchase Western Airlines for $860 million.[258] Western had enjoyed a resurgence over the past two years under Seattle lawyer Gerald Grinstein who fifteen years later would be called in to save Delta as he had Western. This purchase shocked the industry since Delta was not known to be aggressive. Conservative Delta was coming out of its shell and with this acquisition would become the country's third largest airline. "We've demonstrated we're aggressive. We just do it a little more slowly, a little more carefully, and a little more intelligently than others,"

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[256] Bob Deans, "Strong presence in Cincinnati called essential to Delta's 4-hub strategy," *Atlanta Journal*, November 25, 1986.
[257] Delta Air Lines, Inc., Delta Air Lines 1985 Annual Report.
[258] Bruce A. Smith, "Delta Agrees to Acquire Western for $860 Million," *Aviation Week and Space Technology*, September 15, 1986.

argued Delta's Vice Chairman Robert Oppenlander.[259] Western was not a huge airline, ranking tenth in the country, but it gave Delta two new hubs in Salt Lake City and Los Angeles and significant route penetration in the west. The merger added 34 new cities to Delta's route map and 11,000 employees. Delta was truly a national airline.[260]

Business Week headlined a story "Delta Comes Out Swinging" arguing Delta's "genteel days may be ending."[261] Before the Western merger, Delta had insisted it would only grow internally. But competition was taking its toll on Delta after its record 1985 with profits down 87 percent in the first six months of 1986.[262] In addition, 1986 and 1987 were years of great consolidation in the airline industry with TWA taking over Ozark, Northwest Orient taking over Republic, American taking over Air California, Texas Air taking over Eastern and People Express, and U.S. Air taking over both Piedmont and Pacific Southwest.

If Delta did not takeover Western, it may have been taken over by another carrier. Delta's decision to acquire Western helped to ensure that Delta would remain a strong independent airline and survive the deregulation shakeout. It was the perfect merger since Delta and Western had complimentary route structures with very few overlapping routes.

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[259] Scott Ticer et al., "Delta Comes Out Swinging—The Western Deal Makes It A Megacarrier—And Most Likely a Survivor," *Business Week*, September 22, 1986.
[260] "Delta Air Lines: The Sprit Lives On," *The Avmark Aviation Economist*, September 1988, 19.
[261] Ticer et al., "Delta Comes Out Swinging," *Business Week.*
[262] Ticer et al., "Delta Comes Out Swinging," *Business Week.*

Delta and the World

After Delta had successfully consummated the Western merger, the airline wanted to become an international player. While Delta had always been strong domestically and very profitable, it had the smallest international network of any airline except Eastern. Coming into 1987, it served only seven European destinations: London, Paris, Frankfurt, Dublin, Shannon, Munich, and Stuttgart.[263] In 1987, Delta launched its first Asian service with flights from a new Asian gateway in Portland, Oregon to Tokyo and the following year launched service from Portland to Seoul continuing on to Taipei. Delta looked for additional opportunities to expand internationally, but since international routes were still regulated by governments on both sides of the ocean, new routes were not easy to obtain. In late 1989, Delta added service to Bangkok from Taipei.[264]

In January 1991, Eastern finally died and Delta increased its market share in Atlanta to over 90 percent as its biggest competitor no longer existed. This helped Delta financially in what otherwise was a terrible time for airlines because of the Gulf War and the economy. Even with the demise of Eastern, Delta lost $324.4 million in 1991 and $506.3 million in 1992.[265]

Despite the economy, Delta saw an opportunity to expand internationally in 1991 and it aggressively seized the opportunity. Pan Am, the United States de-facto flag carrier, was struggling to stay alive even after it had sold its Pacific route system and valuable London Heathrow routes. In July, Delta made a bid for Pan Am's Atlantic route system and the Pan Am Shuttle (which formally was Frank Lorenzo's New York Air) for

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[263] "All Change in Atlanta," *Airline Business*, February 1989, 25.
[264] Delta Air Lines Inc., <u>Delta Air Lines Timetable 12/15/1989</u>.
[265] Delta Air Lines Inc., <u>Delta Air Lines 1992 Annual Report</u>.

\$260 million.[266] However, a bidding war emerged and Delta won, but at a much greater cost. Not only would Delta pay \$416 million in cash for the Shuttle and its 24 Boeing 727 planes and for Pan Am's extensive Atlantic route system and 21 A-310 aircraft, but it would also invest up to \$455 million into a revived Pan Am operating its remaining South American routes out of Miami.[267] On September 1, Delta took over the Pan Am Shuttle. On November 1, Delta took over Pan Am's international routes in what *Aviation Week & Space Technology* called "perhaps the greatest one-time expansion of a carrier in the volatile history of commercial aviation."[268]

On that day Delta added 23 new international destinations, 6,600 former Pan Am employees, 60 new daily flights, and 21 new aircraft to its fleet. Delta now served 215 cities and had 195 transatlantic round-trips each week. The airline went from being twenty-third in the world in international flying to one of the top five overnight.[269] Delta added the two new hubs, at JFK airport in New York City and in Frankfurt, Germany. New cities like Bucharest, Warsaw, St. Petersburg, Istanbul, Bombay, and New Delhi were added to the Delta route map. The former crop duster from Monroe now served most of the world.

This decision to acquire the Pan Am routes cemented Delta as one of the world's largest airlines. However, most of the routes were not profitable and this was part of the reason Delta had several poor years in the early 1990s, losing money. By the late 1990s, the Frankfurt hub had closed, the JFK hub was a fraction of its old size, and most of the

[266] James T. McKenna, "Pan Am Selling Europe Routes, Hubs and N. Y. Shuttle to Delta," *Aviation Week and Space Technology*, July 15, 1991.
[267] James T. McKenna, "Delta Wins Pan Am Bidding, Gains on Larger Competitors," *Aviation Week and Space Technology*, August 19, 1991.
[268] James Ott, "D-Day Due for Delta Takeover Of Most Pan Am Operations" *Aviation Week and Space Technology*, October 14, 1991.
[269] Ott, "D-Day Due for Delta Takeover Of Most Pan Am Operations" *Aviation Week and Space Technology*.

exotic destinations Delta got from Pan Am were no longer being served. Not only did the routes not turn out to be profitable for Delta, but Delta also invested lots of money into the smaller Pan Am, just to pull the plug in early December 1991 as Pan Am bled money and had no chance of a recovery. This shows that even a well-run airline like Delta that generally made good decisions in the first era of deregulation could make poor decisions that would have a serious effect on the airline's future. Delta made too many good decisions to let the Pan Am decision kill Delta, even though it made the first half of the 1990s rather difficult. This is a prime example how decisions made in the deregulated era had severe effects on the airline that made these decisions.

Conclusion

Alfred Kahn has called airline deregulation "a mixed bag" before going on to call it "a clear success nevertheless."[270] This is a fair assessment even if it is coming from a rather biased source. Airline deregulation was good or bad depending on who you were. For the vast majority of American people, airline deregulation was a wild success, bringing flying to the masses. Between 1976 and 1990, airline fares dropped 30 percent in inflation-adjusted terms.[271] In 1978, U.S. carriers enplaned 275 million passengers.[272] By 1990, that number had jumped to 465 million passengers.[273] But if you were an employee of Eastern, Braniff, or Pan Am, you would probably consider it a bad thing since you lost your job because of the new freedoms airline deregulation created for airlines.

Airline deregulation was the first time the neoclassical economic theory advanced by the modern conservative movement pushed itself into America's economy. The freedoms of the free market were traumatic to the airline industry, especially when coupled with the economic downturn of the early 1980s. The new freedoms of entry, route structure, and pricing forced airlines to make tough decisions in order to compete in the competitive deregulated marketplace. Many of these decisions revolved around creating a cost structure that was competitive with new carriers. This often involved negotiating pay cuts with employees and their unions to bring legacy airlines closer to the

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[270] Alfred E. Kahn, "Airline Deregulation—A Mixed Bag, But A Clear Success Nevertheless," *Transportation Law Journal*, Vol. 16 (1987-1988), 229.
[271] Alfred E. Kahn, "Airline Deregulation," *The Concise Encyclopedia of Economics*, < http://www.econlib.org/library/Enc/AirlineDeregulation.html>
[272] Air Transport 1979.
[273] Air Transport 1991: The Annual Report of the U.S. Scheduled Airline Industry (Washington: Air Transport Association of America, 1991).

lower cost structure the new start-up airlines were achieving without unions. This certainly was the case with Eastern. Kahn wrote, "The turbulent entry of new, much lower-cost carriers, and their ability to quote much lower fares than the incumbents—typically across the board—were a clear reflection to which the latters' cost had become inflated behind the protective wall of regulation, and an illustration of competition doing exactly what we hoped and expected it to do."[274]

Eastern, under Borman and Lorenzo, could not convince labor leaders to accept contracts that would make the airline's cost competitive with other airlines. Borman missed two opportunities to use bankruptcy in order to restructure labor costs, and Lorenzo was so set on destroying unions, he ended up destroying Eastern in the process. With better labor relations, Eastern could have been saved. Delta had the luxury of only having one major union to deal with. Delta kept its pilots union happy through negotiations and fair contracts, and therefore did not have the labor strife that plagued Eastern. The relationship between management and labor became extremely important in the deregulated era as the free market increased competition in the industry.

Deregulation did not kill Eastern Air Lines. Phil Bakes said in a 1988 speech that deregulation had "demonstrable benefits" even to Eastern as it now carried more leisure passengers than it had before deregulation. But in the same speech he said deregulation "had been a struggle for Eastern" because of labor costs.[275] Labor costs were only part of the story though, because Eastern faced high labor costs due to poor decisions made by Frank Borman and later Frank Lorenzo. Borman wrote, "I've never blamed Eastern's

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[274] Alfred E. Kahn, "Surprises of Deregulation," *AEA Papers and Proceedings* Vol. 78 No. 2 (1988): 316-317.
[275] Comments of Phil Bakes, President and Chief Executive Officer Eastern Air Lines, Inc. to the Rotary Club of Atlanta March 7, 1988," Eastern Airlines Collection.

problems on deregulation. Granted it made our task more difficult and our lives more demanding, but we still could have lived with it if our unions had recognized that high labor costs were incompatible with a free-market environment."[276] Lorenzo also was not blaming Eastern's woes on deregulation especially since he had taken advantage of deregulation to build his empire. He too put the blame on the unions. The unions certainly made life difficult for both Borman and Lorenzo, but neither of these leaders made good decisions regarding the unions.

While labor relations were vital to an airline's success in this period, other decisions such as route structure, establishment of hubs, starting overseas routes, merging with other airlines, and buying new planes played essential roles in determining the fate of airlines in the 1980s. If an airline was not growing like Delta, it most likely either would be acquired like Piedmont and Republic or it would be going down the path of financial ruin like Eastern and Pan Am.

Similarly to how deregulation did not kill Eastern, it did not make Delta a member of the Big Three that would emerge from the first era of deregulation (along with United and American). Delta made good decisions with its generally conservative strategy, the creation of new hubs, the merger with Western, and buying many of Pan Am's assets. But deregulation was not always easy even for Delta as 1982 and 1983 brought its first annual losses in thirty years before bouncing back. Delta's acquisition of most of Pan Am's transatlantic routes also caused turmoil for the airline. But overall, Delta made itself one of the winners of deregulation through a sound strategy and good labor relations.

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[276] Borman, Countdown, 357.

It is easy to make airline deregulation a kind of boogeyman because of the chaos it created and the airlines that went broke taking many jobs with them. The quality of airline service has declined as the industry was deregulated. Yet all of these things happened because the free market was at work and airlines were free to make decisions that would impact their future just as the modern conservative movement advocated. As conservatives took over more power in the years following the Airline Deregulation Act similar scenarios played out in other industries that were deregulated.

Deregulation gave airline executives the opportunity and responsibility to truly run their airlines without government inference. As Dan McKinnon, the final Chairman of the CAB, said before Congress in 1984, "[Airline executives] want to win or lose on their own – without government regulation. They want their skills, talents, energies, and employees to be the determining factor in their successes."[277] The ideas of Milton Friedman, Alfred Kahn, and countless others ruled the airline industry as the government left the airline business and in the following years would be extended to other industries with the modern conservative movement increasing its influence under President Ronald Reagan. Airline deregulation put the ball firmly into the hands of the people who ran airlines and for better or worse, the decisions they made in the deregulated environment determined the fate of their airline.

[277] "Testimony Before The House Subcommittee on Aviation of Dan McKinnon, Chairman, Civil Aeronautics Board, May 24, 1983," Civil Aeronautics Board Files, Box 31, Folder: Testimony Before House Subcommittee on Aviation 5/24/83, National Archives and Records Administration, College Park, MD.

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