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General Session 8: AIRPORT INCENTIVE AGREEMENTS

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OVERVIEW

- Airports are under increasing pressure to preserve and enhance air service.
- Airports of all types and sizes have considered air service incentives to:
 - induce carriers to provide service where none existed or existing service was lost
 - obtain service to selected markets, at home or abroad.

OVERVIEW

- Airlines are becoming increasingly aggressive in seeking incentives to provide service.
- FAA's standards for evaluating air service incentives programs should:
 - realistically consider the environment in which airports operate, and
 - ensure that airports comply with their federal obligations.
- FAA should not unduly restrict airport prerogatives.

LEGAL STANDARDS

- Incentives Guidebook can be helpful, but incentives must be assessed against the federal legal obligations imposed on airports:
- Statutory and grant obligations prohibiting unjust discrimination/ exclusive rights (49 U.S.C. §47107(a), Grant Assurance 22; §§ 40103(e), 47107(a)(4), Assurance 23);
- Self Sustaining Requirement (Assurance 24);
- Policy and Procedures Concerning the Use of Airport Revenue (“Revenue Use Policy”) (§§47107(b) & 47133, Assurance 25;
- The Policy Regarding Airport Rates and Charges (“Rates and Charges Policy”); and
- The Airline Deregulation Act (ADA) (§41713).

OVERALL CONCERNS

- Incentives Guidebook sometimes states what airports may or may not do in offering incentives, without providing the underlying legal support.
- If airports can show FAA that there is no legal prohibition to a particular incentive approach, FAA has indicated it will be flexible in evaluating the incentive.

OVERALL CONCERNS

- Incentives Guidebook sometimes appears to set forth absolute requirements, but it actually may only be describing a safe harbor.
- This can be misunderstood and unduly inhibit airports from finding creative solutions to address real-world air service concerns.
- Ask FAA if there may be other ways to comply with applicable federal obligations.

OVERVIEW

- The Guidebook opens with this statement:

“A properly structured and administered Air Carrier Incentive Program may enhance air carrier service at an airport and may create an opportunity to increase traffic.”

Creative approaches to achieving this goal may be given serious consideration by FAA.

SPECIFIC CONCERN: NEW SERVICE

- **In Guidebook, New Service is defined to include only new flights.**
- This is at odds with past FAA practice, which has allowed incentives to retain existing service.
- While the Revenue Use Policy refers to “new service” in discussing the duration of the “promotional period” in which incentives may be provided
 - it never indicates that “new service” is limited only to “new flights.”

NEW SERVICE: CAPACITY OR FLIGHTS?

- Incentives cannot be restricted to new service that adds a certain number of seats to the market. (Q&A 10)
- Incentives may not be limited to aircraft with at least a certain number of seats. (Q&A 11)
- Incremental discounts based on increased weight for existing flights are not allowed because
 - this “does not qualify as new service,”
 - appears to be “based on aircraft type, since the carrier would be changing the aircraft to add seats on an existing scheduled flight,” and
 - “could be discriminatory to those airlines that do not have different sizes of aircraft.” (P. 22 Q&A 35 and fifth bullet point)

EFFECTIVENESS OF INCENTIVES?

- Guidebook says that “Incentives must be based on destinations the airport sponsor wishes to support, not equipment the air carrier chooses to use or the number of passengers who choose to use the new service.”

NEW SERVICE/UPGAUGING

- **Guidebook would disallow incentive for a 76-seat increase due to upgauging, while allowing incentive for a 50-seat increase due to a new flight. (P. 11)**
- Airports should not have to favor smaller capacity increases provided with entirely new flights.
- For passengers, as well as airports, added capacity is beneficial regardless of how it is provided.
- Federal law does not require the Guidebook position.

SEAT/WEIGHT-BASED INCENTIVES

- An upgauged flight would be considered “new service” by both the airport and the traveling public.
- An airport’s incentive program should not be constrained by the fleet decisions that any particular airline has made.

AIRLINE BUSINESS MODELS

- Many incentives are allowed by FAA, for which a particular carrier may not qualify due to the aircraft it flies or its business model.
 - Incentives for overseas markets, which cannot be reached by airlines that fly regional jets or other small aircraft.
 - Even an airline that flies one type of aircraft (e.g., 737) has various options to increase the size of aircraft it operates based on different models, e.g. 737-200 vs. 737-800.

AIRCRAFT SIZE/UPGAUGING

- Allowing incentive based on upgauging to add seats or aircraft weight does not specify the type of equipment that must be used.
- Additional seats/weight to a market can be provided by adding flights, increasing the size of aircraft currently serving the market, or a combination of the two.
- This gives carriers flexibility and does not violate any federal obligations.

NEW SERVICE

- The Guidebook provides no policy basis for the position that that “new service” must be limited to “new flights”.
 - Countervailing federal policies– e.g., fuel consumption, ATC capacity-would encourage, rather than discourage, upgauging.
- An airport should be allowed, *but not required*, to provide an incentive only for new flights.
- FAA now says it will consider such incentives

PASSENGER BASED INCENTIVES

- Basing incentives on the number of new passengers brought to the market, is not prohibited by federal obligations.
- Providing opportunities for air travelers is the fundamental purpose of air carrier airports.
 - An airport should be able to fund incentives based on how successful those efforts are, i.e., how many new passengers actually use the new service.

POLICY CONSIDERATIONS

- Adding new passengers increases airport revenues from concessions and rental car and ground transportation fees, and increases PFC revenues.
- Increasing revenues generated at the airport is a legitimate airport goal which provides tangible benefits to airports and is consistent with self-sustaining requirement.

JET SERVICE

- Airports should be able to require jet service for incentives.
 - Jet service is qualitatively different from turboprop service, both for airports and air travelers.
 - Airports should not be forced to include service they do not desire in their incentives programs.
 - Virtually all air carriers have some type of jets, and, as noted earlier, airport prerogatives should not be constrained by airline fleet decisions.
 - Airline Deregulation Act prohibition against local governments affecting airline rates, routes and services does not apply to voluntary incentive agreements. (FAA letter to Wichita)
 - FAA has not agreed to this, but it is worth exploring with them.

IMPACT ON OTHER CARRIERS' FEES

- **Guidebook says that “An airport’s rates and charges for air carriers not participating in the incentive program may not be impacted negatively by any incentive program without the carriers’ express permission” (P. 17), and**
- **“The cost of providing incentives cannot affect the rate base for air carriers not participating in the incentive program without their express permission.” (Q&A 37)**
- These are two different things
- Fundamental point – airport must make up waived fees from non-airline revenue source

RESIDUAL AIRPORTS

- In a residual airport, an incentive can adversely affect signatory carriers' rates without increasing the rate base.
 - The rate base is the sum of all costs charged to the air carriers in a cost center.
 - In a residual airport, net concession revenues are applied to reduce signatory airline rates and charges to *below* those that would be applied if all costs in the rate base were charged to the airlines (i.e., below compensatory rates).

RESIDUAL AIRPORTS

- The use of concession revenues to make up for a shortfall due to an incentives program simply reduces the amount of non-airline revenues used to subsidize airline fees below the rate base costs.

RESIDUAL AGREEMENT ISSUES

- Federal law expressly provides that airports may use a residual, compensatory, or hybrid ratesetting methodology at the airport's option, not the carriers' nor the FAA's option. (49 U.S.C. 47129).
 - Thus, FAA has no authority to require airports to credit air carriers with all net concession revenues or any specific amount of concession revenues.

RESIDUAL AGREEMENT ISSUES

- DOT has recognized this restriction
- DOT “will not require cross crediting of nonaeronautical revenues to aeronautical users, *because section 47129 does not permit us to do so.*”
 - Rates and Charges Policy, 61 Fed. Reg. 31994, 31999 (June 21, 1996) (Emphasis added).

RESIDUAL AGREEMENT ISSUES

- FAA is thus prohibited by law from precluding airports with residual methodologies from using net concession revenues to make up for fees that are foregone due to an incentives program.

RESIDUAL AGREEMENT ISSUES

- However, an airport may still be precluded from doing so by the terms of its residual agreement.
 - Specific terms of agreement must be examined to determine whether the airport has latitude to spend concession revenues on incentives.

INFLUENCE ON AIR FARES

- **Guidebook says airports cannot tie incentives to ticket price. (Q&A 30)**
- Under the Airline Deregulation Act, Airports may not, by regulation or agreement akin to regulation, force carriers to adjust their rates, routes, or services.
- Yet all incentive programs are designed to affect airline routes – so assertion of ADA prohibition is curious

ADA IS NOT APPLICABLE

- FAA has recognized that the ADA does not apply to voluntary incentives programs.
 - Such programs are not a regulation or agreement that has the effect of regulation
 - FAA Letter to Wichita
- Thus, an airport should be able to provide incentives only to air service that meets its goals for low fare service.

LOW FARE SERVICE

- FAA does not accept distinction between low-fare carriers and legacy carriers in criteria for incentives. (Wichita case)
- If you seek to attract low fare carriers, try to develop objective criteria that they can meet
 - Recognize that legacy carrier may qualify for incentive if they meet the fare requirement

THIRD PARTY INCENTIVES

- **The Guidebook indicates that community organizations or non-sponsor local governments may offer a subsidy to one air carrier without making the same offer available to all similarly situated air carriers.**
- **But, the sponsor “cannot be a party to the agreement and must not be involved in negotiating, implementing, or monitoring the program in any manner.” (P. 18 and Q&A 40).**

MONITORING ON-AIRPORT ACTIVITY ALLOWED

- In informal discussions, FAA has clarified that airport sponsors may monitor activities (air service) on their airport, even if this comes about as a result of decisions by an outside incentive provider.

THIRD PARTY INCENTIVES

- Moreover, airport sponsors may provide technical assistance and expert analysis of things such as:
 - the facilities that would be available for new service at the airport;
 - the levels of service those facilities could support, and
 - the legitimate costs that may be incurred by a carrier, either to start up or maintain air service,
- so that the outside body may properly assess what items it chooses to subsidize and the appropriate levels for the subsidies.

THIRD PARTY INCENTIVES

- **The Guidebook states that, if an airport is a member of the Chamber of Commerce, grant assurances are applicable to incentives offered with non-airport revenue by Chamber, even if the airport abstains from voting on the incentives. (Q&A 41)**
- “[T]he sponsor is not removed from an incentive program simply because the sponsor refrains from voting.”

- The real issue is whether the sponsor takes any action that violates its federal obligations, because the FAA has no authority over Chamber of Commerce actions.
- The notion that, because a sponsor “has influence, however limited,” in a decision, the grant assurances apply, is hard to fathom.
- What if the sponsor voted **against** the proposed subsidy?
 - What grant assurance violation could FAA find?

THIRD PARTY INCENTIVES

- Guidebook states that if the sponsor has even limited influence in negotiations or planning of an incentive program, “it is obligated by the grant assurances to offer the same incentives to all similarly situated air carriers.”
 - How can the actions of the Chamber in subsidizing a single air carrier obligate the airport to offer an incentive to other carriers?
 - Guidebook position has Assurance 5 implications (ceding to the Chamber the power to control airport actions).

INTERNATIONAL AIR SERVICE CONCERNS

- Bilateral or multilateral agreements
 - Typically cannot discriminate against flag carriers of other country or group of countries
 - Provisions may be similar to, but somewhat different from, Grant Assurance requirements
 - New entrant vs. incumbent distinction may raise potential bilateral/multilateral agreement concerns.

LEASE AND USE AGREEMENT CONCERNS

- Most favored Nations clauses:
 - Here “nations” refers to “airlines”
- Could be a problem for incentives targeted only at new entrants.
 - May need to structure more objectively, e.g., new service to X destination, open to incumbents and new entrants
 - Other provisions may limit airport flexibility
 - Particular challenges for airports with residual agreements

LIMITED NUMBER OF INCENTIVES

- Can an airport limit the number of incentives per year if all carriers have a fair chance to obtain them?
 - Split in Guidebook
 - *“A small airport that can support only one carrier is encouraged to use a Request for Proposals (RFP) to give every carrier an equal opportunity to be that one carrier.”*
 - *Larger airports may cap total costs for incentives, but “should include a sufficient level of incentives to cover a number of carriers that may qualify.”*

- How small is “small”
 - Informally, FAA says “very small.”
- Does the distinction make sense?
 - To date, FAA has not allowed larger airports to use RFP for a single incentive
 - Should larger airports be precluded from using this process?

TAKEAWAY THOUGHT

- If you are contemplating an incentive program and it appears to be precluded by the Guidebook
 - Don't abandon the approach
 - Work with FAA to see if it can be accepted or modified in a way acceptable to you and the FAA.
 - Or, you can implement a program you think is compliant, without verifying with FAA
 - Be sure to include clause subordinating the incentives agreement to your federal obligations

QUESTIONS?

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