

Legal and regulatory developments in the USA

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FAA REAUTHORISATION — FUNDING

The airport industry and the aviation subcommittees in both chambers of Congress are beginning to debate legislation to reauthorize the Federal Aviation Authority (FAA) and its programmes. The prior reauthorisation was enacted in 2003, and the pending reauthorisation will be enacted in 2007. The essential function of the reauthorisation process is to ensure adequate funding for the national air transportation system. The present debate comes at a critical time; pressures on the airline industry, airports, and the Federal Government are acute and federal funds are scarce. The following are a few examples of critical topics that will be debated and determined in reauthorisation legislation.

Who pays for the federal system?

Currently, approximately one-half of the revenues paid in to the Airport and Airway Trust Fund come from a passenger ticket tax.¹ Commercial passengers contribute an even greater percentage of Trust Fund revenues as a result of other excise taxes.² The airline industry is calling for a new excise tax structure, one that requires users to pay into the system in proportion to their use of air traffic and other federal resources.³ The general aviation industry contends that this would upset the economics of general aviation and is developing its own position on whether and how to tax users to pay for the system.⁴

How will Congress protect the Trust Fund?

The Trust Fund currently has a surplus, referred to as the 'uncommitted balance', of almost \$2bn.⁵ When the uncommitted balance was higher (it has previously exceeded \$7bn at a few points), the Congressional debate tended to focus on how to make better use of the Trust Fund to pay for new infrastructure and other airport needs. In the current fiscal environment, the reauthorisation debate will focus on ensuring that the Trust Fund balance remains positive. The low uncommitted balance is due in large part to the fact that, while current law requires that appropriations from the Trust Fund must not exceed *projected* revenue, *actual* revenue in recent years has not approached projections.⁶ The lower revenue is itself a result of the fact that enplanements and average ticket prices were lower than predicted.⁷ If this trend continues, the Trust Fund's uncommitted balance may be eliminated altogether within a few years.⁸ There are multiple ways to ensure that revenues equal or exceed expenses, including adjusting and increasing the excise taxes, allocating a greater amount from the General Fund for FAA Operations and possibly other programmes, and recalculating the formula used to determine the level of expenditures from the Trust Fund. Congressional committees and industry groups will carefully examine these and other options in the coming months.

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Can we fund present and future needs?

The Trust Fund is used to support four separate FAA accounts: (1) the Airport Improvement Program (AIP); (2) Facilities and Equipment; (3) Research, Engineering and Development; and (4) Operations.⁹ Some of these accounts are used to address immediate needs, while others are focused on accommodating future demands. The Department of Transportation's recent budget requests emphasise immediate needs.¹⁰ The enormity of the cost to satisfy long-term objectives is beginning to crystallise as the result of a study prepared by the FAA identifying which airports will have capacity constraints in future years,¹¹ and recent reports from the inter-agency Joint Planning and Development Office (JPDO) identifying improvements needed to accommodate a doubling or tripling of air traffic by 2025.¹² It is far from clear where the funds will come from to support these long-term initiatives, while at the same time providing adequate funds for immediate operational needs.

FAA REAUTHORISATION — POLICY

The scope of reauthorisation will extend beyond funding and will undoubtedly address policy issues of national significance, as well as projects at individual airports. Major policy issues addressed in past reauthorisation legislation include environmental review for airport projects, noise control and funding eligibility. The following policy issues are likely to be examined in the pending reauthorisation.

Hazards to air navigation

Under current regulations, the FAA is called upon to advise whether proposed new structures in the vicinity of airports

would constitute a hazard to air navigation.¹³ However, the FAA decision is advisory only.¹⁴ It remains within the authority and discretion of the local government with control over land use to determine whether the proposed structure can be built. This division of responsibility can lead to considerable controversy where, for example, the FAA determines that a proposed structure would not constitute a hazard, but the local government disagrees. As a legal matter, the local government may be authorised to prohibit the construction; however, the FAA determination provides a powerful argument to the project proponent that the structure is appropriate. It may also expose the local government to allegations that private property is being 'taken' without just compensation. Although better communication and coordination between the airport proprietor and the FAA may help to resolve disagreements, the problem is sufficiently widespread that Congress may be called upon to design a new approach for addressing potential hazards.

Next generation air transportation system

In the last FAA reauthorisation legislation enacted in 2003 (known as Vision 100), Congress created the inter-agency JPDO to develop and implement the next generation air transportation system (NGATS).¹⁵ In the two years since its creation, the JPDO has been defining its vision and identifying the capabilities that would be needed to accommodate a doubling or tripling of air traffic by 2025. The desired capabilities strongly emphasise emerging technologies for air traffic management, communication, security and navigation. As indicated above, implementing these capabilities will be a

massive and expensive undertaking. JPDO is responsible for providing annual reports to Congress and provided its most recent report in March 2006.¹⁶ While Congress almost certainly will have to tackle NGATS funding in the reauthorisation, it is possible that Congress also will revisit the NGATS vision and JPDO's approach for implementing this vision based on the recent report.

FINANCIAL DISPUTES INVOLVING AIRPORTS AND AIRPORT USERS

Just as financial pressures dominate the national debate, disputes over airport finances are also evident at individual airports. The following are a few examples of recent disputes at individual airports regarding rates and charges and airline bankruptcy.

Airport rates and charges programmes

The proper allocation of rates and charges among different aeronautical users at airports is a long-simmering debate. Many commentators have observed that the weight-based landing fee structure is not effective, in large part because it does not accurately capture the value of the services provided and because it is not always allocated in a manner commensurate with an airport's cost to provide services.¹⁷ The FAA has advised that peak period pricing and other forms of congestion pricing may be permissible if appropriately structured.¹⁸ Although very few airports have adopted such programmes to date, it is possible, perhaps probable, that airports will take a closer look at new pricing schemes in the near future. In addition, airports are looking closely at whether general aviation is paying its 'fair share' for use of airports under traditional rates and charges programmes. Although this debate

has not led to any recent litigation or regulatory reform, both are foreseeable.

Charges to air carriers

With continuing financial instability in the airline industry, air carriers are more aggressively challenging increases in rates and charges. One recent dispute, *Brendan Airways v Port Authority of New York and New Jersey*,¹⁹ involved proposed fee increases at Newark Liberty International Airport. Several foreign carriers filed an administrative complaint with the FAA challenging significant rate increases imposed by the Port Authority of New York and New Jersey for use of the international terminal. The FAA issued its final decision in June 2005 and found that certain elements of the fee increases were unreasonable and should be refunded to the airlines. Although the case did not establish any new precedent, it serves as an important reminder of the process and standards for resolving fee disputes and the fact that the FAA will closely scrutinise airport rates and charges once it finds sufficient cause to conduct an investigation. Both the air carriers and the Port Authority appealed the FAA's decision to the United States Court of Appeals for the District of Columbia. A consolidated appeal is pending.

Airline bankruptcy

A key issue in airline bankruptcy, as in any bankruptcy, is the extent to which an air carrier's assets may be retained and protected against creditors. Under the United States Bankruptcy Code, a debtor must fully perform under any lease or surrender the property, but may not have to fully perform under loans undertaken pre-petition. Because of the different treatment, distinguishing leases from loans may

be critical and particularly challenging in the context of airports because of how certain transactions for development projects are structured. In two recent cases, *United Airlines, Inc. v US Bank National Association, Inc.*²⁰ and *United Airlines, Inc. v HSBC Bank USA, N.A.*,²¹ the United States Court of Appeals for the Seventh Circuit addressed the lease-versus-loan distinction in the context of the United Airlines bankruptcy. Both cases involved transactions by which United Airlines paid a bond-issuing authority to refund the development of airport facilities (at San Francisco and Los Angeles International Airports). In both cases, the court held that the transaction was actually a loan, even though it was called a lease. The court focused on five aspects of both transactions indicating that the transaction was, in substance, a loan rather than a lease. For example, the so-called rent was based on the amount borrowed rather than fair market value, and United Airlines was required to make its payments regardless of whether the property was unusable.

AIRPORT COMPLIANCE

A seemingly perpetual subject of controversy is airport compliance with AIP grant assurances and other federal obligations. Here too, recent disputes involve financial issues and concerns, including airports' acquisition of property for noise mitigation, revenue diversion and exclusive rights.

Acquisition of property for noise

One way in which airport proprietors can promote land uses around the airport that are compatible with airport operations is to purchase land being used for incompatible purposes. Acquisition for this purpose may be eligible for federal funding through the AIP. Airports receiving federal

funding are obliged to transfer the noise compatibility land 'at the earliest time after the land no longer is needed for a noise compatibility purpose'.²² Among the many requirements for the sale, airports must: (1) receive fair market value for the land; (2) retain an interest in the land sufficient to ensure that it will be used compatibly with the airport; and (3) return the federal government's share of the acquisition cost or reinvest the proceeds in another noise compatibility project.²³

In September 2005, the Department of Transportation Office of the Inspector General (OIG) released an audit report on 11 airports' compliance with these requirements.²⁴ The OIG found that several of these airports had retained property that was no longer needed for noise compatibility, and/or transferred property without returning proceeds to the Federal Government or using proceeds for another approved noise compatibility project. In March 2006, the FAA released a policy directive to its staff outlining the steps that must be taken by the FAA and airports to address the deficiencies identified by the OIG.²⁵ In particular, the FAA called for a comprehensive inventory of noise compatibility lands to be completed immediately by each of the 11 audited airports and within approximately three years for all other airports. These are ambitious deadlines for airports to meet unless they have careful and complete records on prior land transactions. Importantly, the FAA did not indicate whether and how it would recover the federal share of land previously transferred by the 11 airports and any other airports.

Revenue diversion

In April 2006, the Supreme Court of Hawaii issued the latest, although probably not the last, decision in a long-running

controversy over whether the State of Hawaii is authorised to contribute revenue generated by the State at the Honolulu Airport to the Office of Hawaiian Affairs (OHA).²⁶ Although the State was obliged under Hawaiian law to pay the funds, the Department of Transportation OIG and FAA found that the payment constituted 'revenue diversion' in violation of the State's grant assurances because it did not reflect an operating or capital cost of the airport. Congress subsequently mandated in the so-called Forgiveness Act that, although the State and OHA did not have to return funds previously paid to OHA, the State could not make future payments.

OHA alleged in state court that the State breached its trust obligations by failing to challenge the OIG and FAA decisions that resulted in the Forgiveness Act and in the corresponding invalidation of the state law. OHA further alleged that the State had made an agreement to make payments to OHA regardless of the Forgiveness Act. The Supreme Court of Hawaii held that the state law did not constitute an enforceable agreement or contract and thus could be invalidated by the federal legislation, and that OHA had failed to timely and properly file its claims for breach of trust. The court nevertheless advised that the State may yet be required to pay OHA for revenue generated by the State at the airport, even if airport revenue could not be used to make the payment. Although the case has limited precedential value because of its unique facts, this controversy is reflective of the potential conflict between an airport's obligations under the grant assurances and its obligations under state and local law.

Proprietary exclusive rights

Federal law prohibits airport proprietors from granting monopolies, referred to as

'exclusive rights', to aeronautical service providers.²⁷ For decades, FAA policy statements have provided that the statute applies only to the *grant* of exclusive rights, but also have provided that airports can reserve for themselves the *exercise* of an exclusive right to provide aeronautical services.²⁸ Acting in reliance on this guidance, many airports provide one or more aeronautical services, such as the provision of fuel, on an exclusive basis and derive substantial revenue from their efforts. In 2004, a fixed base operator (FBO) challenged the FAA's interpretation of the statute, arguing that the federal aviation statutes prohibit monopolies, whether by private parties or an airport proprietor. The FAA issued its final decision in July 2005, reaffirming the right of airport proprietors to exercise exclusive rights in providing aeronautical services.²⁹ The FBO appealed the FAA's decision to the United States Court of Appeals for the District of Columbia, but, in February 2006, the court dismissed the appeal for lack of standing.³⁰

Antitrust

The FAA has long maintained that the proprietary exclusive right described immediately above is independent of the federal antitrust statutes. Two recent cases confirm that, in most instances, an airport will be immune from antitrust liability in addition to the protection it enjoys from the prohibition on exclusive rights. In *Pennsylvania v Susquehanna Regional Airport Authority*,³¹ the State challenged the Airport Authority's attempt to condemn private property to take over a private parking lot. The United States District Court for the Middle District of Pennsylvania held that the airport was entitled to 'state action immunity', because it was foreseeable that the power

to condemn property conferred by the Airport Authority's enabling legislation would have anticompetitive effects. The other recent case, *Jet 1 Center, Inc. v City of Naples Airport Authority*, involved the Airport Authority's decision to conduct retail fuel sales on an exclusive basis.³² The court in that case similarly held that the airport was immune from antitrust liability, because it was foreseeable that the powers conferred by the enabling legislation would have anticompetitive effects.

ENVIRONMENTAL REVIEW

With the return of pre-September 11 traffic levels, there is renewed attention on the need for capital improvement projects to expand airport infrastructure. One of the greatest challenges in such projects is determining whether, and if so to what extent, environmental review under the National Environmental Policy Act (NEPA) is required. Three FAA regulatory documents control this area. The first document, Order 1050.1E (Environmental Impacts: Policies and Procedures), was released in June 2004. Order 1050.1E contains guidance on NEPA's application to FAA activities and, in particular, includes an updated list of projects that are categorically excluded from environmental review under NEPA.

In April 2006, the FAA released Order 5050.4B (NEPA Implementing Instructions for Airport Actions). Although the two orders overlap considerably, Order 5050.4B provides detailed guidance on the application of NEPA to airport projects. While it will take some time before the provisions of Order 5050.4B can be applied to individual projects, the Order does not appear to contain any dramatic changes or departures from pre-existing FAA policy. Order 5050.4B does provide important

guidance on the content of Environmental Assessments, Environmental Impact Statements and procedural requirements for public participation and agency review. The Order also allows greater airport proprietor involvement in the preparation of environmental documents than the prior FAA order, reflecting changes in the law in the 20 years since the agency last revised its regulations.

The third document, yet to be released, is 'An Environmental Desk Reference for Airport Actions'. The Desk Reference will be a compendium of background documents, including laws and regulations that must be addressed during the course of environmental review, such as the requirements of the Clean Water Act, Clean Air Act and the National Historic Preservation Act. The FAA has not yet indicated when the Desk Reference will be available, although it is aiming for a late 2006 release date.

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