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Recent Developments in U.S. Aviation Law, Regulation, and Policy

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Grading Congress and the Administration on the topic of "Recent Developments in U.S. Aviation Law, Regulation and Policy," both would get an "F," but for opposite reasons. Congress flunks for failing for yet another year to pass the multi-year FAA Reauthorization Act, - namely NEXTGEN, which is so necessary to move along air traffic control modernization. The current Administration flunks for re-regulating airline sales and marketing practices and proposing to impose a $100 departure tax on all flights; double the passenger security tax to $5 per one-way trip in 2012, and triple the tax to $7.50 by 2017. This is on top of the fact that airlines already are taxed more heavily than alcohol and tobacco—taxes the government uses to discourage Americans from buying products.

The situation for aviation in Washington has become so bad a few months ago the Air Transport Association, after 75 years, changed its name to Airlines For America. A4A's new CEO, Nick Calio, is hoping the new name will remind government and the public that the airline industry generates more than 10 million U.S. jobs, more than $1 trillion a year in economic activity, and 5 percent of U.S. GDP. The impact of aviation on economic growth is geometric.

So what is current aviation policy? Well it appears to be to make things as difficult as possible for airlines to earn the profits they need to buy new, more fuel-efficient aircraft, which also would emit less carbon, while enhancing their ability to compete globally. The lack of Congressional guidance and expansive assertion of agency authority over the industry has led to a significant number of court challenges to FAA and DOT decisions, including our own for re-regulating the industry.

This morning I will give a brief overview of what Congress has not accomplished, highlight how the Department of Transportation and the FAA have stepped up their assault on the industry, and the industry's combative reaction.

LEGISLATIVE ACTIONS/INACTION

The primary legislative goal last year was to pass a full multi-year FAA Reauthorization bill. The last FAA Reauthorization Act expired in 2007. Since then Congress has passed 22 short-term extensions for funding FAA programs. Delay in passing a new Reauthorization is holding up implementation of the NEXTGEN air traffic control system, the lack of steady funding makes it impossible to plan for other long-term infrastructure improvements.

Reauthorization got off to a promising start. By April, both the House and Senate had passed FAA Reauthorization bills. However, differences between the bills have held them up for the past 9 months. Four sticking points between the House and Senate are preventing final legislation: (1) Funding levels—the Senate version provides $34.5 billion in funding for two years while the House version provides $59.7 billion for four years; (2) Essential Air Service for small communities—the Senate version increases funding for this, while the House would phase out the program by 2013; (3) Long-haul flights allowed to and from Reagan National Airport; and (4) the National Mediation Board rule regarding how unions are created—the House version reverses a recent NMB rule that changed how votes for and against unionization are counted.

This past summer, John Mica, Chairman of the House Transportation Committee, in frustration attempted to make an end run around conference negotiations by slashing Essential Air Service funding in one of the FAA short-term extensions passed by the House. As many of

you will remember, when the Senate rejected the bill, the result was a partial shutdown of the FAA for two weeks which led to over $350 million in lost tax revenue.

With respect to the NMB rule, Delta and ATA challenged the rule in federal court as an arbitrary reversal of policy. Their argument was that the new rule is unbalanced because it makes unionization easier while keeping de-unionization difficult. Just before the Congressional recess, the D.C., U.S. Court of Appeals upheld the rule as a reasonable interpretation of the Mediation Board's governing statute. The effect of this decision on Congressional action is yet to be seen. Democrats have interpreted it as a validation of the rule that gives support to their contention that the FAA Reauthorization Bill is not the forum for overturning the Board's decision. Rep. Mica has introduced a stand-alone bill that would simply reset the balance of the prior rule by making de-unionization as easy as unionization. Congressional Republicans may drop the provision from the FAA reauthorization in support of this stand-alone bill instead.

Other than FAA Reauthorization there has been very little legislative activity concerning the aviation industry. Bills introduced in the House or Senate have focused on hot button issues of the day, including privacy issues related to body scanners, privatization of the TSA inspection force, and increasing penalties, including 5 years in prison, for aiming a laser pointer at an aircraft. Most of these bills are currently in committee, going nowhere fast. The House did pass one bill aimed at attacking the European Union's Emissions Trading Scheme – The EU ETS Prohibition Act of 2011. The Senate has a similar bill under consideration. ATA, now A4A, challenged application of Europe's emissions trading scheme to non-European air carriers in the European Court of Justice as a violation of international law. Last month, these challenges were denied. Accordingly, starting this month, the EU is requiring all international flights traveling to

and from the EU to participate in its emissions trading scheme, which requires purchasing emissions allowances to cover the carbon footprint of international flights.

The House and Senate bills would prohibit U.S. air carriers from participating in the scheme. But until the U.S. takes legislative action, U.S. airlines are preparing for the increased cost of European air travel. On January third, Delta was the first major U.S. airline to add a $3 surcharge to fares on flights between the U.S. and Europe. American Airlines, United and U.S. Airways quickly followed suit, all adding a $3 surcharge to European flights by the end of the first week of January.

Congress did pass appropriations legislation that included $12.5 billion in FAA funding. A string attached to that funding led to the end of a court challenge brought against the FAA by the National Business Aviation Association. The NBAA challenged the FAA's decision to end the Block Aircraft Registration Request, or BARR Program in the U.S. Court of Appeals for the D.C. Circuit. The BARR program blocked aircraft flight information from real time public availability upon request of the aircraft operator. The FAA elected to restrict participation in the program only to aircraft operators who could demonstrate a valid security concern. After the NBAA challenge, Congress resolved the issue by tying FAA funding to a reinstitution of the more liberal BARR program policy, which allowed any operator to block aircraft information, no questions asked.

Another proposed bill gaining momentum is the Pilot's Bill of Rights, introduced by Senator James Inhofe of Oklahoma last July. The bill is being reviewed by the Senate Commerce Committee and currently has 60 sponsors. It is designed to provide greater due process protection for pilots under investigation by the FAA.

Where Congress has failed to act the FAA and DOT have stepped in to fill the gap, taking up issues left dormant by Congress. For example, the FAA announced it would impose civil penalties of up to $11,000 on any person who aims a laser beam at an aircraft through enforcement of an FAA regulation that forbids interfering with the performance of a crew member's duties while operating an aircraft. Additionally, FAA created a website to facilitate reporting laser incidents. The FAA Reauthorization bills also include a number of consumer protection provisions, such as requiring airlines to better plan for tarmac delays. The DOT has incorporated tarmac delay regulations and other consumer protection provisions proposed by Congress in a series of consumer protection rulemakings.

REGULATORY ACTIONS

While Congress has been unable to pass even the FAA Reauthorization bill, DOT has been busy developing new and costly regulations for what was understood to be a deregulated airline industry.

DOT's major action for the year was adopting its second installment of consumer rules in the omnibus rulemaking entitled Enhancing Airline Passenger Protections. These rules will cost millions of dollars for the industry to implement, while doing little for passengers, except ensuring higher prices. At the end of November, the entire industry requested a one year postponement for a provision of the rule requiring that uniform baggage fees be charged on every leg of a code-share or interline flight because of the high cost and technological complexity of complying with the new rule. DOT denied this request, but agreed to enforce the regulation leniently for the first six months to give the airlines more time to comply with the rule.

The First Enhancing Airline Passenger Protections rulemaking was adopted in 2009 and imposed the tarmac delay rule to prevent lengthy tarmac delays and ensure passengers are supplied with food, water, and the opportunity to use the restroom while stuck on the runway. This rule means substantial fines for airlines found at fault for allowing a plane to sit on the tarmac for three hours or more. In November DOT imposed the first penalty by fining American Eagle $900,000 for allowing 608 passengers in 15 aircraft to sit on the tarmac for 15 to 45 minutes over the 3 hour threshold after a storm caused considerable delay and congestion at O'Hare International Airport.

DOT considers the tarmac delay rule to be a great success and in the second passenger protection rulemaking applied it to international flights and foreign airlines. However, the airlines and industry analysts at the American Aviation Institute have emphasized that, to avoid the risk of hefty fines, many airlines now preemptively cancel flights rather than risk the heavy fines that can accompany lengthy tarmac delays.

This second consumer rulemaking adopted over 25 additions and modifications beyond the first rulemaking, including new rules that directly impose DOT preferences over airline marketing practices—decisions left to airline managers for decades. This expansive rulemaking brought court challenges to rules that mandate the content of Customer Service Plans, dictate how air fares are displayed, and freeze the price of all optional services after ticket purchase. Specifically, in June, our firm challenged these rules in the U.S. Court of Appeals for the D.C. Circuit on behalf of Spirit Airlines and Allegiant Air. Southwest has intervened in support and the Airlines for America, formerly the ATA, as well as the International Air Transportation Association (IATA) have filed as *amicus curiae* in support of our court challenge. Accordingly,

the entire global airline industry is with us and united in fighting this burdensome rulemaking. The Interactive Travel Services Association and American Society of Travel Agents (ITSA and ASTA) have joined on the side of the Government.

We argue the challenged rules are an attempt to re-regulate the airline industry, contrary to the intent of DOT's governing statute, the Airline Deregulation Act, under the guise of prohibiting deceptive practices. This is the first time since deregulation that a Court has been asked to interpret the scope of DOT's authority to prohibit deceptive practices in light of the pro-competitive mandates of the Deregulation Act. DOT has responded to our challenge of its authority with a very expansive interpretation of its power. Essentially the government asserts that its power to prohibit unfair and deceptive practices gives it the power to regulate any aspect of the airline industry that is not providing, in DOT's opinion, the optimal result for consumers. The D.C. Circuit should issue an opinion in late summer.

One of the challenged rules mandates that all airlines allow customers to hold reservations for at least 24 hours. In the first passenger protection rulemaking, DOT required domestic carriers to adopt customer service plans that inform consumers of airline policies on 11 specific topics, including tarmac delays, holding or cancelling reservations, and notification of flight status. The second rulemaking applied the customer service plan requirement to foreign carriers and established minimum standards, including a requirement that all carriers allow customers to either hold reservations or cancel a purchased ticket without penalty for at least 24 hours if more than a week before flight. This effectively prohibits the sale of non-refundable tickets. Non-refundable tickets have enabled low-cost airlines to offer very low priced tickets. The new requirement, if upheld, will clearly lead to higher fares.

One of the most controversial provisions of the rule reverses 25 years of airfare advertising policy. Prior to and since deregulation, including today, airlines, like all other industries, are allowed to advertise prices without including government taxes and fees in the price advertised. DOT allowed this practice so long as consumers were clearly and conspicuously notified of the type and amount of government taxes elsewhere in the advertisement. The new rule requires sellers of air transportation to include all government taxes and fees in all advertised prices. This essentially hides the very high tax burden placed on the industry by the government. During the rulemaking, and now in federal court, the airlines argue this reversal in policy treats airlines differently from all other industries without any evidence that current advertising is "unfair or deceptive" - the statutory standard. They also argue the new rule violates their political and commercial free speech rights. In response to First Amendment challenges, DOT reinterpreted the scope of the rule to allow airlines a greater ability to break out base fares and taxes and fees from the total price, however the rule still places significant limitations on any statements about price components.

The Court challenge to this rulemaking has caused DOT to reconsider the scope of some of its rules. One of the challenged rules prohibited increasing the price of air transportation for a customer after a ticket has been purchased. The DOT asserted this rule prohibited not only increasing the price of a ticket after purchase, but increasing the price of any optional products, including baggage, seat upgrades, or even food or drink sold on board the aircraft. Talk about government micro-management! As a direct result of our challenge, the DOT realized the absurdity of this rule and drastically scaled back its scope. Now, only the price of the first and second checked bag is frozen at the time of ticket purchase. DOT says it will consider expanding

the rule to other ancillary products in a third passenger protections rulemaking they're working to release later this year.

Unfortunately, DOT has many other regulations in the works that stand to increase the cost of air travel. DOT introduced a proposal to increase Ancillary Revenue reporting requirements. Currently, airlines report revenue from baggage and reservation change fees. DOT now proposes that airlines be required to report revenue from 25 separate categories of fees, including separate categories for onboard sales of food and alcohol, fees for transporting pets, and fees for unattended minors.

This increased interest in ancillary revenue was spurred by a GAO report that found there is not enough information available on sources and amount of ancillary revenue to assess the impact on the Airport and Airway Trust Fund. The fund is maintained through taxes on airfare, whereas ancillary fees are not taxed and do not contribute to the fund. As airlines unbundle the cost of air transportation, revenue that used to be taxed as part of the ticket price, such as the cost of transporting baggage, is going untaxed, concerning lawmakers. Other industry analysts have concluded that the drop in trust fund revenues is related more to passengers traveling less due to the recession than to the rise in ancillary revenue.

In the coming year we expect more action from the government. As mentioned before, DOT plans to introduce a third Enhancing Airline Passenger Protections rulemaking this spring. In this third rulemaking, DOT is expected to focus regulations on code-share partners, including requiring airlines to assist codeshare partners when they experience lengthy tarmac delays. DOT may also require airlines to give information on ancillary fees, at no charge, to competing booking services run by the Global Distribution Systems (GDSs), and require ticket agents to

adopt customer service plans and disclose any special relationship they may have with an airline, such as incentive payment programs.

On the FAA side, a Final Rule on Flight Crewmember Duty and Rest Requirements was released the end of December. Spurred by the 2009 Colgan Air crash that killed 50 and which many believe was caused by pilot fatigue, the rule increases the minimum amount of pilot rest from 8 to 10 hours and mandates that pilots have the opportunity for 8 hours of uninterrupted sleep during that period. This means that pilots with round-trip commutes longer than 2 hours will need rest periods over the 10 hour minimum. The rule also requires airlines and pilots to jointly ensure that pilots are fit for duty. As part of this requirement, pilots must affirmatively state that they are fit for duty before beginning work.

The FAA has received backlash on the expense of this rule and for not including cargo pilots in the new rest requirements. The Independent Pilot Association, which is the UPS pilot union, is challenging the decision to exclude cargo pilots from the rule in federal court. FAA justified its decision by explaining that "covering cargo carriers under the new rule would be too costly compared to the benefits generated in that portion of the industry."

The FAA has a number of other significant rulemakings underway that will increase safety and training requirements for airlines and airports. In 2009, FAA proposed a rulemaking that would require all types of FAA certificate holders, product manufacturers, applicants, and employers to institute Safety Management Systems that would obligate the aviation industry to manage safety with the same priority as other core business processes. This year the FAA withdrew this broad rulemaking to focus on such SMS rulemakings for Part 121 certificate holders and airports. Final Rules are expected to be released by this summer.

The comment period has closed on the Qualifications, Service and Use of Crewmembers and Aircraft Dispatchers Rulemaking – a Rulemaking which proposes to increase training requirements for pilots and crew, including increased use of flight simulation training devices for all flight crew members.

If adopted as proposed, the combination of increased training and rest requirements is predicted to lead to extreme pilot shortages in the coming years. Increased rest requirements means more pilots will be needed to fly the same routes, and increased training requirements will decrease the inflow of new pilots to a trickle, leaving smaller regional airlines vulnerable to having their pilots hired away by larger carriers.

CONCLUSION

As the recent bankruptcy filing by American Airlines highlights, the U.S. airline industry remains fraught with problems caused by rising fuel prices, the slow economy, and difficult labor negotiations. One year ago, the Future of Aviation Commission created by Secretary LaHood produced a report with 23 recommendations. Unfortunately, policy-makers seem to have ignored most of these recommendations, as was the case with recommendations of several prior commissions.

As a result FAA Reauthorization remains bogged down on collateral issues, new taxes are being proposed, and DOT pushes forward with rules that provide little benefit to the public but harm the innovation and competition envisioned by Deregulation intended to provide consumers with greater choices for travel. The cumulative effect of all this regulation is significant increases in airline operating costs and ultimately, air transportation costs for consumers. A recent report by the American Aviation Institute estimates that the total industry

cost for the DOT passenger protection regulations alone will be $1.7 billion annually. In order to re-coup these costs, airlines will have to increase ticket prices and/or decrease capacity on less profitable routes, putting small and medium sized cities at risk of being left out of the air transportation system. Again, we maintain this was not the intent of Congress in deregulating the airline industry.