THEORY AND LAW OF AIRPORT REVENUE DIVERSION

By Paul Stephen Dempsey, Tomlinson Professor of Law, McGill University[1]

I. INTRODUCTION

Harvard economist John Kenneth Galbraith observed, "In all countries the economic system depends on and develops from the State financing of highways, airports, postal services and urban infrastructure of the most diverse and essential sort."[2] Traditionally, many national governments have provided infrastructure services that were too complex and expensive for the local authorities to provide. Such services include airports and air navigation, meteorology, and communications systems. Federal oversight satisfied the need for a high degree of uniformity and standardization. The government also provided the services of health, immigration, customs, and the protection and security of civil aviation. But, relatively recently, several nations have embraced private enterprise and competition, rather than government oversight, to provide essential transport and have "corporatized" various portions of the infrastructure, such as airports and air traffic control services.[3]

Unlike the global paradigm of nationally owned and operated or corporatized or privatized airports, most airports in the United States are owned and operated by local (city, county, regional, and in some instances state) governments.[4] Despite local government ownership, the federal Airport Improvement Program (AIP) grants and Passenger Facility Charge (PFC) authorizations provide significant funding for many of these airports and oversee local airports directly, through Titles 14 and 49 of the Code of Federal Regulations, and indirectly, in the form of conditions imposed in grant agreements. The fiscal problems facing local governments more generally (including, for example, the needs of urban roads, water, sewage, parks, schools, hospitals, and other infrastructure, and fire and police protection) coupled with a declining tax base have forced many to search for new sources of revenue. Redirecting revenue from airports to fund nonairport municipal needs appears attractive to some local political leaders. Yet Congress has stepped in to promulgate laws to circumscribe the ability of federally funded airports to divert airport revenue "downtown." Conflicts over locally owned and operated airports and federal funding and regulation are by no means unique to revenue-diversion issues, but they manifest themselves here as well.

While, on the one hand, Congress has been concerned with assisting airports with their need to secure adequate funding, on the other, it has been concerned about the possibility that airports might use airport revenue for nonairport purposes. Where federal funds have been spent to build or improve local airport infrastructure, allowing airport revenue to be spent on nonaviation-related activities in effect results in an indirect transfer from the federal to the local treasury. Airlines and aircraft operators, as well as airport concessionaires, have objected to diversion on grounds that if airport revenue is spent on nonaviation uses, they will be forced to shoulder the economic burden thereby created. Airports account for between 4 percent and 6 percent of

[1] Tomlinson Professor of Law and Director, Institute of Air & Space Law, McGill University, Montreal, Quebec, Canada. From 1979–2002, Dr. Dempsey was Professor of Law & Director of the Transportation Law Program, University of Denver College of Law. A.B.J. (1972), J.D. (1975), University of Georgia; LL.M. (1978), George Washington University; D.C.L. (1986), McGill University. Admitted to the practice of law in Colorado, Georgia, and the District of Columbia.

[2] Bev Desjarlais, *Doug Young's Defection Shows His True Colors*, HILL TIMES, June 5, 2001, at 16.

[3] *See*, *e.g*., Soon-Kil Hong & Kwang Eui Yoo, *A Study on Airport Privatization in Korea: Policy and Legal Aspects of Corporatization and Localization Over Airport Management*, 66 J. AIR L. & COM. 3 (2000); PAUL DEMPSEY ET AL., THE MCGILL REPORT ON GOVERNANCE OF COMMERCIALIZED AIR NAVIGATION SERVICES (2006), reproduced at http://www.mcgill.ca/files/iasl/ANS_Report_final.pdf (Last visited Jan. 23, 2008).

[4] For many years, the Washington, D.C., airports (Reagan National and Washington Dulles) were federally owned and operated, but these too have been transferred to local governmental institutions. In 1987, the U.S. government transferred the operation of Ronald Reagan Washington National and Dulles International Airports to the newly created Metropolitan Washington Airports Authority under a 50-year lease.

Most airports in the U.S. were created as departments of cities or counties; most remain owned and operated by a governmental institution. As of 2003, city-owned airports were the most common form of ownership in the United States (38 percent), followed by regional/airport authority (25 percent), single county (17 percent), and multiple-jurisdictions (9 percent). For example, the cities of Atlanta, Chicago, Denver, Detroit, Miami, and Philadelphia own their airports. State ownership accounts for 5 percent of the total, including Baltimore Washington International Airport, Anchorage International (and most other airports in Alaska), and the Hawaiian airports. Airports at Boston, Dallas/Ft. Worth, Minneapolis/St. Paul, New York/New Jersey, Seattle/Tacoma, and Washington are operated by independent authorities (several by multi-purpose Port Authorities, which account for 3 percent of the total). Airports Council International–North America, Who Governs the Airport and Does It Matter?, http://www.aci-na.org/docs/70-Airport%20Governance.doc (Last visited Jan. 23, 2008).

airline industry costs, and a diversion of revenue could, according to the airlines, only worsen the airlines' financial condition, which, since deregulation, has fallen to historic lows.[5]

As a consequence, Congress has imposed constraints on the use of airport funds for off-airport municipal activities, at least for most airports receiving federal financial support. This study examines the issue of airport revenue diversion, the theoretical rationale for its prohibition, and the array of federal statutes and Federal Aviation Administration (FAA) policies that regulate it.

II. AIRPORT FINANCE

A. General Principles of Airport Finance

Understanding revenue diversion requires a basic understanding of general principles of airport cost and revenue and their subcomponents—capital and operating expenditures and the various sources of revenue.[6] The laws and policies restricting revenue diversion are concerned with both revenue and expenditures. Thus, we evaluate financial issues at two levels.

First, an airport seeking to expand its facilities or a governmental entity seeking to build a new airport must raise sufficient capital to finance such infrastructure development from public or private sources or a combination of both. *Capital costs* consist of the component costs (e.g., labor, materials, and equipment) of construction of the airport and its component parts. Funds come from a variety of public (including federal) and private (including municipal general obligation (GO) bonds and general airport revenue bonds (GARBs)) sources.[7] Sources of capital for airport development include governmental or international organization loans and grants; commercial loans from financial institutions; equity or debt (typically bonds) from commercial capital markets, including private investors, banks investment houses, or fund pools; and the extension of credit from contractors and suppliers. Commercial loans typically incur the highest interest rates, though such rates may be reduced by governmental loan guarantees. Existing airports also may have retained earnings in a capital development account.

Second, once built, an airport must earn sufficient revenue to pay its operating expenses and retire its debt. Revenue comes from a number of sources, including rents, aeronautical fees, concessions, and parking.[8] *Operating costs* include expense items such as interest and depreciation or amortization on debt, taxes, and maintenance and administrative costs, including salaries, power, and repairs.

B. Funding for Airport Infrastructure

This section examines how airport infrastructure is financed and the role federal funding has in infrastructure development. The reader is introduced to cash flow revenue streams, private bonding sources, the AIP, PFCs, and state and local financing.[9]

1. Cash Flow

In order to understand airport finance, one must comprehend not only where the revenue goes, but where it originates. Airside revenue streams include landing fees, fuel taxes, and maintenance and cargo facility leases. Landside revenue streams include terminal rents and gate leases, concessions, and parking fees. PFCs are another significant source of revenue that cannot be readily classified as air side or land side. All revenue generated by a public airport, as well as local fuel taxes, must be used for legitimate airport purposes—the capital or operating costs that directly and substantially relate to air transport. PFCs are subject to additional limitations and requirements as discussed below.

In addition to government grants and subsidies, the airport turns to its tenants—the airlines, concessionaires, parking providers—and the passengers they serve to finance its maintenance and operating costs and debt service. Airports derive revenue streams from rents, charges, and fees imposed upon airlines; various concessionaires (such as car rental companies, restaurants, news stands, taxi and van services, catering and baggage services); fuel providers; and parking. Except for many small airports, most U.S. commercial airports are self-sustaining, with revenue collected from businesses (concessionaires), passengers, and airlines covering most airport operating expenses. In fact, about half of the smaller commercial airports (nonhub primary and nonprimary commercial service airports) in the United States do not break even. Likewise, most general aviation airports are subsidized by their owners.

Airport concessionaires (such as restaurants, news stands, auto rental companies) typically pay rent for the space they occupy, while some pay a gross-receipts fee. These revenues, in turn, finance operating and mainte-

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[5] See Daniel P. Rollman, *Flying Low: Chapter 11's Contribution to the Self-Destructive Nature of Airline Industry Economics*, 21 EMORY BANK. DEV. J. 381 (2004); PAUL DEMPSEY & ANDREW GOETZ, AIRLINE DEREGULATION & LAISSEZ FAIRE MYTHOLOGY (1993).

[6] See generally Christopher R. Rowley, *Comment: Financing Airport Capital Development: The Aviation Industry's Greatest Challenge*, 63 J. AIR L. & COM. 605 (1998); John Sabel, *Airline–Airport Facilities Agreements: An Overview*, 69 J. AIR L. & COM. 769 (2004); PAUL DEMPSEY, ANDREW GOETZ & JOSEPH SZYLIOWICZ, DENVER INTERNATIONAL AIRPORT: LESSONS LEARNED 183-228 (1997); PAUL DEMPSEY, AIRPORT PLANNING & DEVELOPMENT: A GLOBAL SURVEY 178–80 (2000); and ALEXANDER WELLS, AIRPORT PLANNING & MANAGEMENT 159–69 (3d ed. 1996).

[7] See Sabel, *supra* note 6; PAUL DEMPSEY, ROBERT HARDAWAY & WILLIAM THOMS, AVIATION LAW & REGULATION § 7.06 (1992).

[8] REGIS DOGANIS, THE AIRPORT BUSINESS 57 (Routledge 1992).

[9] See generally Rowley, *supra* note 6, and Dempsey, *supra* note 6, at 174–77.

nance expenses, principal and interest debt service, and various "pay as you go" infrastructure, such as terminal or runway expansions or improvements.[10]

Airlines pay rental charges for the space they occupy at ticket counters, gates, and baggage handling, maintenance, and catering facilities, and also pay takeoff and landing fees, parking fees, and fuel fees.[11] Two methodologies dominate computation of airline fees and charges under airport use agreements: the residual method and the compensatory method.[12] Many airports use a combination of residual and compensatory ratemaking.

In a *residual agreement*, the signatory airlines accept the financial risk, and guarantee to provide the airport with sufficient revenue to cover its operating and debt-service costs. Under this approach, the airport deducts an agreed amount of nonairline (concession) revenue from its expenses, leaving the airlines responsible for the remaining (residual) amount.[13] Airline rates then are set accordingly. Airlines bear the risk that their fees will be increased should concession revenue fall short. Airports using residual methodology typically give airlines majority-in-interest power to veto new major capital expenditures.[14]

Compensatory agreements, whereby the airport undertakes the risk of meeting its costs, usually exist at mature airports that have achieved successful revenue generation. Under the compensatory method, an airport is divided into various cost centers (such as airfield, terminals, and parking areas), and airlines pay a share of those costs based on the amount of space they occupy (at, for example, ticket counters, gates, and baggage sorting and catering facilities); volume of landing and departing aircraft; and other measures of airline use.[15] The airport retains concession revenue for discretionary capital improvement projects.

These so-called "captive customers" (i.e., airlines and concessionaires) have become highly interested in whether airports might charge them fees exceeding the cost of operating the airport in order to cross-subsidize the local governmental institution that owns the airport. Politically, they have encouraged the Congress to promulgate prohibitions on certain forms of revenue diversion.

2. Commercial Debt (Bonds)

Historically, in the United States, funding for airport capital infrastructure, such as runways, taxiways, and terminals, has come from two primary sources: (1) federal ticket taxes (or AIP funds) from the Airport Trust Fund collected on every airline ticket purchased in the United States; and (2) tax-free GARBs issued by municipalities. In the late 1990s, approximately 80 percent of the capital for the airport project came from AIP grants, while the remaining 20 percent was raised by municipalities in GARBs.[16] In the half century between 1946 and 1996, the U.S. government granted more than $24 billion in grants to airports.[17] In 1990, Congress

[10] National Civil Aviation Review Commission, Airport Development Needs and Financing Options (June 4, 1997), reproduced at: http://www.faa.gov/ncarc/whitepaper/airports/#cfs (Last visited Jan. 23, 2008).

[11] Air Transport Association of America, Airline Handbook, ch. 7 (available at http://members.airlines.org/about/d.aspx?nid=7951 (visited Jan. 23, 2008).

[12] One source notes:

> At most commercial service airports, the financial and operational relationship between an airport and the airlines it serves is defined in legally binding agreements that specify how the risks and responsibilities of airport operations are to be shared between the two parties. Commonly referred to as "airport use agreements," these contracts generally specify the methods for calculating the rates airlines must pay for use of airport facilities and services, as well as identify the airlines' rights and privileges, which in some cases include the right to approve or disapprove any major proposed airport capital development projects (which the airlines are required to finance).

National Civil Aviation Review Commission, Airport Development Needs and Financing Options (June 4, 1997), reproduced at http://www.faa.gov/ncarc/whitepaper/airports/#cfs (visited Jan. 23, 2008).

[13] Airlines typically stand behind the revenue bonds with "use and lease agreements," pledging to make up the difference in revenue shortfalls by paying higher landing fees. The quid-pro-quo for the residual funding agreement historically has been a long-lease term for gates and a "majority-in-interest clause" (MII) giving airlines a say (often an effective veto) over airport expansion and a return of excess revenue collected, often in the form of lower landing fees. ALEXANDER WELLS, AIRPORT PLANNING AND MANAGEMENT 181 (1992). As of 1990, majority-in-interest clauses were in effect at 36 of the 66 largest U.S. airports. Kenneth Mead, Airline Competition (testimony on passenger facility charges before the House Subcomm. on Aviation, June 19, 1990). As of 1999, the U.S. DOT reported that most of the large and medium hub airports had MII clauses in their use and lease agreements. U.S. DEP'T OF TRANSP., AIRPORT BUSINESS PRACTICES AND THEIR IMPACT ON AIRLINE COMPETITION ix (1999), available at http://ostpxweb.dot.gov/aviation/Data/airportsbuspract.pdf (Last visited Jan. 23, 2008) (identified 30 out of 45 large airports with MII clauses based on an ACI-NA survey). However, these data may be somewhat overstated, as many airports have either moved away from majority-in-interest clauses or substantially weakened them in recent lease negotiations.

[14] Nancy Kessler, Airport-Airline Fee Disputes and Privatization of Airports (address before the 117th Summer Meeting of the Virginia Bar Association (July 21, 2007)).

[15] Air Transport Association of America, *supra* note 11.

[16] HENRY HYDE & JESSE JACKSON, JR., THE PARTNERSHIP FOR METROPOLITAN CHICAGO'S AIRPORT FUTURE 30 (1997). The GAO recently published a report with more up-to-date figures on the use of bonds versus AIP. U.S. GOV'T ACCOUNTABILITY OFFICE, AIRPORT FINANCE, OBSERVATIONS ON PLANNED AIRPORT DEVELOPMENT COSTS AND FUNDING LEVELS AND THE ADMINISTRATION'S PROPOSED CHANGES TO THE AIRPORT IMPROVEMENT PROGRAM, GAO-07-885 (June 2007), http://www.gao.gov/new.items/d07885.pdf (Last visited Jan. 23, 2008).

[17] U.S. GENERAL ACCOUNTING OFFICE, AIRPORT PRIVATIZATION 8 (Feb. 29, 1996). Annual Reports of AIP accomplishments can be used to provide approximate figures of

also passed the Aviation Safety and Capacity Expansion Act, creating a federally authorized but locally collected program of airport PFCs to supplement public airport capital needs.[18] Between 2001 and 2005, airports received an average of approximately $13 billion a year for capital development, most of which comprised bonds ($6.5 billion), federal grants ($3.6 billion), and PFCs ($2.2 billion). The nation's 67 largest airports, which account for approximately 90 percent of passenger traffic, rely more heavily on bond financing, while the remaining 3,300 smaller airports in the national system rely more heavily on grants.[19]

Early airport construction was financed by GO bonds backed by the "full faith and credit" of a governmental unit and secured by taxes collected by it.[20] The industry was in its infancy, and airports were not capable of generating sufficient revenue to finance infrastructure costs. Since World War II, GARBs have replaced GO bonds as the preferred means of financing new airport construction, expansion, or improvement. In fact, since 1982, more than 95 percent of airport debt, exceeding some $50 billion, has been in the form of GARBs.[21] GARBs are paid off by revenue generated by the facility they finance.[22] Although GARBs have been the primary source of debt financing, special facility bonds secured by revenue from the indebted facility (e.g., hangar or maintenance facility) are sometimes issued.[23] Both GARBs and GO bonds historically have been tax exempt (as industrial revenue bonds), allowing states, municipalities, and airport authorities to lower the long-term costs of capital financing.[24] The cost of capital (i.e., interest rates) paid by airports on GARBs is lower than commercial rates because of the tax benefits. GARBs typically run for a 25–30 year term and usually pay lower interest than taxable corporate bonds of comparable risk.[25]

3. Federal Funding: The Airport and Airway Trust Fund and the Airport Improvement Program

Prior to 1970, federal funding of the airport and airway system was from the general fund. That year, the Airport and Airway Trust Fund (AATF) and the Airport Development Aid Program were established. Revenue to fund the trust fund was derived from passenger ticket and other excise taxes.[26]

The Airport and Airway Improvement Act of 1982[27] (AAIA) established the current framework for federal financing of U.S. airport development and improvement projects. The AATF is the depository for airport infrastructure revenue under the AIP. Such revenue is derived from airline ticket taxes, fuel taxes, airway bill taxes, and other taxes and fees.[28]

Before 1997, the aviation taxes deposited in the AATF included a 10 percent ticket tax, a 6.25 percent

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grants for the period 1997 thru 2007. These reports can be obtained from the FAA Web site at the following URL: http://www.faa.gov/airports_airtraffic/airports/aip/grant_histories (Last visited Jan. 23, 2008).

[18] 49 U.S.C. § 40177. See Village of Bensenville v. FAA, 363 U.S. App. D.C. 78, 376 F.3d 1114 (D.C. Cir. 2004).

[19] U.S. GOVERNMENT ACCOUNTABILITY OFFICE, AIRPORT FINANCE: OBSERVATIONS ON THE ADMINISTRATION'S PROPOSED CHANGES IN THE AIRPORT IMPROVEMENT PROGRAM, GAO-07-885 (June 2007), available at http://www.gao.gov/new.items/d07885.pdf (Last visited Jan. 23, 2008).

[20] One source notes:

> In the 1950's and early 1960's, general obligation (GO) bonds were more widely used than revenue bonds for airport development. GO bonds were backed by the taxing authority of the issuer. Since the 1960's, airport revenue bonds have been the major financing mechanism for capital improvements at large, medium, and some small hub airports. These financial instruments pledge the airport's revenue streams to repay bond holders. The ability of an airport to utilize revenue bonds depends on a number of factors, including: debt structure; airport management, administration and scope of operations; revenue structure and financial operations, economic base; and plant.

National Civil Aviation Review Commission, Airport Development Needs and Financing Options (June 4, 1997), reproduced at http://www.faa.gov/ncarc/whitepaper/airports/#cfs (Last visited Jan. 23, 2008).

[21] Air Transport Association of America, *supra* note 11.

[22] Rowley, *supra* note 6; DEMPSEY, GOETZ & SZYLIOWICZ, *supra* note 6, at 186.

[23] U.S. GENERAL ACCOUNTING OFFICE, AIRPORT FINANCING: FUNDING SOURCES FOR AIRPORT DEVELOPMENT 38, GAO/RCED-98-71 (Mar. 1998), http://www.gao.gov/archive/1998/rc98071.pdf (Last visited Jan. 23, 2008).

[24] Michael Bell, AIRPORT FINANCING, IN AIRPORT REGULATION, LAW & PUBLIC POLICY 93-95 (R. Hardaway ed., 1991).

> The availability of tax-exempt bonds is estimated to save airports and airlines over $1 billion a year in interest costs. (Airports and airlines also make extensive use of Special Facility bonds which are revenue bonds that are usually secured by the guarantee of an airport tenant. Also, airports continue to make use of GO bonds that are secured by the taxing authority of the issuer, but there is heavy competition to use such bonds for other municipal purposes.)

National Civil Aviation Review Commission, Airport Development Needs and Financing Options (June 4, 1997), reproduced at http://www.faa.gov/ncarc/whitepaper/airports/#cfs (Last visited Jan. 23, 2008).

[25] The cost of private capital typically is higher than public capital, though interest rates can be ameliorated by governmental guarantees and insurance. The competitiveness of airport bonds in the market can be gauged by the bond ratings by the major investment houses, the interest rate, and the default ratio. Tax exemptions on the bond's purchase price or interest can also stimulate investor interest in airport bonds. INTERNATIONAL CIVIL AVIATION ORGANIZATION, AIRPORT ECONOMICS MANUAL 69 (1991).

[26] National Civil Aviation Review Commission, *supra* note 10.

[27] 97 Pub. L. No. 248, 96 Stat. 671. This Act replaced the Airport and Airway Development Act of 1970, 91 Pub. L. No. 258, 84 Stat. 219.

[28] The Airport and Airway Trust Fund also provides the financing for the FAA's capital and research and development budget and for most of the FAA's operating budget.

cargo waybill tax, a $6 international departure tax, a 15 cents per gallon general aviation gasoline tax, and a 17.5 cents per gallon general aviation fuel tax.[29] Legislation passed that year shifted much of AIP funding away from the traditional 10 percent tax imposed on each ticket sold.[30] Beginning in January 2000, aviation-related federal taxes generated to fund the AIP included a 7.5 percent domestic ticket tax and a $2.50 per person per flight segment fee for all flights, though certain rural airports were exempted from the latter. The federal grant programs also are funded by a $12.00 international arrival tax and a $12.00 international departure tax (adjusted for inflation from 1999), a 6.25 percent domestic air freight tax, a 4.3 cents per gallon domestic air fuel tax, and taxes on the fuel consumed by small aircraft and for noncommercial purposes.[31] Table 1 summarizes the tax structure that funds the trust fund.

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[29] For a complete list of the taxes charged, see PAUL STEPHEN DEMPSEY & LAURENCE GESELL, AIRLINE MANAGEMENT: STRATEGIES FOR THE 21ST CENTURY 402–13 (1997), and PAUL DEMPSEY, ROBERT HARDAWAY & WILLIAM THOMS, 1 AVIATION LAW & REGULATION § 2.26 (1993). See also Rowley, *supra* note 6.

[30] The new taxing structure was as follows:

Commercial

- Ticket tax of 9 percent in FY 1998; 8 percent in FY 1999; and 7.5 percent in FY 2000 through FY 2002;
- Segment charges per passenger of $1.00 in FY 1998, $2.00 in FY 1999, $2.25 in FY 2000, $2.75 in FY 2001, and $3.00 in FY 2002;
- International departure and arrival taxes of $12;
- Frequent flyer award tax;
- $0.043 commercial user fuel tax (formerly the deficit reduction tax); and
- 6.25 percent cargo waybill tax.

Noncommercial

- $0.193 aviation gasoline tax and
- $0.218 aviation jet fuel tax.

NATIONAL CIVIL AVIATION REVIEW COMMISSION, AVOIDING AVIATION GRIDLOCK & REDUCING THE ACCIDENT RATE II-26 (1997).

[31] Air Transport Association of America, *supra* note 11.

TABLE 1. CURRENT AVIATION EXCISE TAX STRUCTURE[32]
(Taxpayer Relief Act of 1997, P.L. 105-35)

Aviation Taxes	Comment	Tax Rate
PASSENGERS		
Domestic passenger ticket tax	Ad valorem tax	7.5% of ticket price (October 1, 1999, through November 30, 2007)
Domestic flight segment tax	Domestic segment = a flight leg consisting of one takeoff and one landing by a flight	Rate is indexed by the Consumer Price Index (CPI) starting January 1, 2002. Rate per passenger per segment in calendar years (CYs): 2003 – $3.00 2004 – $3.10 2005 – $3.20 2006 – $3.30 2007 – $3.40
Passenger ticket tax for rural airports	Assessed on tickets on flights that begin/end at a rural airport Rural airport: <100K enplanements during 2nd preceding CY, and either (1) not located within 75 miles of another airport with 100K+ enplanements, (2) is receiving essential air service subsidies, or (3) is not connected by paved roads to another airport	7.5% of ticket price (same as passenger ticket tax). Flight segment fee does not apply.
International arrival and departure tax	Head tax assessed on passengers arriving or departing for foreign destinations (and U.S. territories) that are not subject to passenger ticket tax	Rate is indexed by the CPI starting January 1, 1999. Rate per passenger in CYs: 2003 – $13.40 2004 – $13.70 2005 – $14.10 2006 – $14.50 2007 – $15.10
Flights between continental United States and Alaska or Hawaii		Rate is indexed by the CPI starting January 1, 1999. International facilities tax rate (+ applicable domestic tax rate) in CYs: 2003 – $6.70 2004 – $6.90 2005 – $7.00 2006 – $7.30 2007 – $7.50
Frequent flyer tax	Ad valorem tax assessed on mileage awards (e.g., credit cards)	7.5% of value of miles
FREIGHT / MAIL		
Domestic cargo/Mail		6.25% of amount paid for the transportation of property by air
AVIATION FUEL		
General aviation fuel tax Commercial fuel tax		Aviation gasoline: $0.193/gal Jet fuel: $0.218/gal $0.043/gal

[32] Source: http://www.faa.gov/about/office_org/headquarters_offices/aep/aatf/media/Simplified_Tax_Table.xls (Last visited Jan. 23, 2008).

The AIP provides funding for airport planning and development projects that enhance capacity, safety, and security and mitigate noise. Several thousand airports have been designated by the FAA as eligible for AIP funding. Most funds are allocated on the basis of a statutory entitlement formula based on passenger enplanements, with set-aside categories for designated types of airports and airport projects.[33] The largest U.S. airports receive only about 10 percent of their capital funding through AIP, while the smaller airports as a group acquire more than half of their capital funding from AIP.[34] During fiscal year 2006, AIP funds totaling $3.6 billion funded 2,059 new grants and 729 grant agreements.[35]

4. Federal Funding: Passenger Facility Charges

Recognizing the need to generate local discretionary sources of capital, Congress in 1990 created the PFC program, which allowed airports to impose a $1, $2, or $3 charge directly on each boarding passenger (up to a maximum of $12 per passenger) for FAA-approved projects. For the largest airports, Congress required the airport to surrender half of its AIP funding in exchange for the right to impose the PFC.[36] Priority was given to capital improvements to finance capacity, safety, security, and environmental projects and projects to enhance airline competition.

These limits have since been increased. Beginning in 2000, the maximum PFC rate was increased to $4.50 per segment, with a roundtrip cap of $18.00.[37] These taxes must be pledged to specific FAA-approved capital improvements that (1) preserve or enhance the safety, capacity, or security of the national air transportation system; (2) reduce noise; or (3) enhance air carrier competition. Once all the money needed for the approved projects has been raised, the airport may no longer collect the PFC approved therefor.[38]

By 1994, the FAA had approved applications by about 100 airports to generate $6.4 billion in PFC revenue.[39] By the late 1990s, PFCs were generating more than $1.1 billion annually for approved projects at more than 200 airports.[40] Today, more than 300 airports have been authorized to collect PFCs that total more than $62 billion. In recent years, PFCs have generated more than $2.5 billion per year.[41]

PFCs also differ from other forms of financing in their potential susceptibility to revenue diversion. PFCs may only be collected for specified, FAA-preapproved projects. Hence, it is less likely that such funds will be used for nonapproved purposes.

5. State and Local Financing

Most states also provide financial assistance to airports, usually in the form of matching funds for AIP grants. States fund their contribution through aviation fuel and aircraft sales taxes, highway taxes, bonds, and general fund appropriations. In 1996, the states provided $285 million to U.S. airports.[42] Between 2001 and 2005, states provided approximately $3.8 billion to the national system airports, 57 percent of which went to general aviation or reliever airports.[43] Even when states contribute matching funds, they normally do not contribute the full matching share, but expect the airport or municipality owning the airport also to contribute. Occasionally a local municipality or outside developer may provide financial assistance to an airport. Usually such assistance is in the form of operating subsidies for smaller airports.[44]

C. The Theory of Natural Monopoly and Monopolistic Abuse

It has been asserted that airports constitute a monopoly "…with the ability to charge fees and control aviation traffic. Diverting funds while charging fees and

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[33] U.S. GENERAL ACCOUNTING OFFICE, AIRPORT IMPROVEMENT PROGRAM: MILITARY AIRPORT PROGRAM AND RELIEVER SET-ASIDE UPDATE 2, GAO/T-RCED-96-94 (Mar. 13, 1996), http://ntl.bts.gov/lib/1000/1400/1450/rc96094t.pdf. (Last visited Jan. 23, 2008).

[34] U.S. GENERAL ACCOUNTING OFFICE, AIRPORT FINANCING: COMPARING FUNDING SOURCES WITH PLANNED DEVELOPMENT 1, GAO/T-RCED-98-129 (Mar. 19, 1998), http://www.gao.gov/archive/1998/rc98129t.pdf (Last visited Jan. 23, 2008).

[35] FEDERAL AVIATION ADMINISTRATION, AIRPORT IMPROVEMENT PROGRAM FISCAL YEAR 2006 (2007), available at http://www.faa.gov/airports_airtraffic/airports/aip/grant_histories/media/aip_annual_report_fy2006.pdf (Last visited Jan. 23, 2008).

[36] One source notes:

> Since it was recognized that principally large and medium hub airports would benefit from PFC revenues, such airports imposing PFCs were required to "turnback" 50 percent of their AIP entitlement funds. (75 percent of the forfeited entitlements funds were used to create the AIP Small Airport Fund, benefiting non-commercial service airports and non-hub commercial airports. The remaining 25 percent was added to the AIP discretionary fund. Of this 25 percent, half was to be provided to small hub airports and half was to be distributed between other discretionary accounts. The idea was that small airports would not raise PFCs directly, and this was a way for them to benefit indirectly from PFCs levied by the larger airports.)

National Civil Aviation Review Commission, *supra* note 10.

[37] The passenger entitlement turn-back percentage was raised from 50 percent to 75 percent for airports imposing a PFC of more than $3.

[38] Air Transport Association of America, *supra* note 11.

[39] U.S. House Comm. on Public Works & Transportation, Aviation Infrastructure Act of 1993, H.R. REP. NO. 103-240, at 27 (1993).

[40] National Civil Aviation Review Commission, *supra* note 30, at II-43.

[41] Federal Aviation Administration, Key Passenger Facility Charge Statistics (Nov. 1, 2007) available at http://www.faa.gov/airports_airtraffic/airports/pfc/monthly_reports/media/stats.pdf (Last visited Jan. 23, 2008). See also Air Transport Association of America, *supra* note 10.

[42] U.S. GENERAL ACCOUNTING OFFICE, *supra* note 23, at 43.

[43] U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 19, at 26–27.

[44] U.S. GENERAL ACCOUNTING OFFICE, *supra* note 23, at 43.

receiving funds through the AIP funds essentially is double-dipping and taxpayers pay the brunt of this practice. Air carriers and air travelers also pay a heavy price for airport revenue diversion."[45]

Monopolies generally have been disfavored in American law since promulgation of the Sherman Act of 1890. Antitrust legislation tends to reflect the normative conclusion that large firms or corporations that dominate particular industries as bastions of enormous concentrations of wealth and power are undesirable.[46] By the late 19th century, Richard Ely had identified a number of industries as natural monopolies, including railroad, express, telegraph, streetcar, gas, and water companies.[47] Other examples of natural monopolies include gas and oil pipelines, electricity transmission, and local distribution utilities such as telephone service, gas, water, electricity, and cable television.

In most cities, airports are natural monopoly bottlenecks[48] (with declining costs over a long range of output).[49] Costs tend to decline until airside or landside demand exceeds capacity, for airport infrastructure expansion can be politically difficult and financially challenging. Many airports are hemmed in by surrounding development and opposed by residents fed up with noise and congestion. Some residents may embrace a "NIMBY" (not in my back yard) attitude toward new airport development or existing airport expansion. Congestion imposes the need for landside and airside expansion, yet land constraints and local political opposition to the construction of new airports or expansion of existing ones impose severe financial and political barriers to economical expansion. Some argue that airports do not share the characteristics of most other natural monopolies in terms of declining costs over a long range of output. One source put it this way:

> Compared with the more traditional "natural" monopoly examples, supply in the airport industry is probably characterised [sic] by increasing, rather than decreasing, long-run costs at quite moderate levels of output. That is to say, if we double the potential output of a sizable airport by doubling the capacity available for use, total costs will more than double…. The source of the airport monopoly, therefore, is not the usual economies of scale in the long-run production function, but the fixity of "locational" inputs (i.e. good sites) and economies of scope associated with established air service networks.[50]

In the United States, the large commercial airports are owned predominantly by local governments. In several countries where airports have been privatized, economic regulation or price caps have been imposed to prohibit monopolistic exploitation of tenants, for airports hold monopoly power over airlines, and private ownership encourages wealth maximization.[51]

Because of concerns about the potential for airports to exhibit the characteristics of natural monopolies, airlines have a strong interest in ensuring that airports do not charge fees beyond those necessary to provide adequate and safe infrastructure. To airlines and air-

[45] Airport Revenue Diversion, Hearings before the U.S. Sen. Subcomm. on Aviation of the Commerce Comm. (May 1, 1996), at 34, reproduced at: http://books.google.com/books?id=nQEDkwETmdkC&dq=%22aiport+revenue+diversion%22&printsec=frontcover&source=web&ots=f7QKBCZe8&sig=ZsilCY2rHH1ZSYysVMapyMALmMM#PPA30,M1 (Jan. 23, 2008).

[46] Thomas W. Hazlett, *The Curious Evolution of Natural Monopoly Theory*, IN UNNATURAL MONOPOLIES 3 (R. Poole, Jr. ed., 1985).

[47] Richard Ely, *The Future of Corporations*, HARPERS 260 (July 1887).

[48] A "bottleneck" is a term used generally by some economists to describe a situation where all the traffic must pass through a single portal. For a discussion of the concept of a "monopoly bottleneck," see also United States v. W. Elec. Co., 269 U.S. App. D.C. 436, 846 F.2d 1422 (D.C. Cir. 1988). In some cities with only a single commercial airport, and without intercity rail service, an airport can be such a "bottleneck" for intercity passenger service. The concept of an airport "bottleneck" and its competitive implications is discussed in Spirit Airlines v. Northwest Airlines, 431 F.3d 917, 927 (6th Cir. 2005), and Reza Dibadj, *Saving Antitrust*, 75 U. COLO. L. REV. 745 (2004).

[49] See International Air Transport Association, Airport Privatization, in http://www.iata.org/NR/rdonlyres/473F5695-12A6-4071-8C64-2141913373B6/0/airport_privatisation.pdf (Last visited Jan. 23, 2008).

[50] David Starkie, A New Deal for Airports (Institute of Economic Affairs, Nov. 1, 1999), at http://www.iea.org.uk/record.jsp?type=book&ID=373 (Last visited Jan. 23, 2008).

[51] In 1994, the Canadian government announced its intention to privatize (or "corporatize") Canada's airports and air traffic control system (NavCan). Peter Holle, *Privatized Air Control a Canadian Success Story*, GUELPH MERCURY, Sept. 24, 2002, at A7. Toronto's Lester Pearson Airport was privatized in 1996. Canada's major airports were transferred to local nonprofit companies that would continue to pay the federal government rent of the Crown land on which the airports sat. Critics pointed out that Canada's eight largest airports pay $250 million a year to the federal government in rent, which, of course, is passed through to airlines and their passengers as a hidden tax. Walter Robinson, *Let Air Canada Heal Self-Inflicted Wounds*, HAMILTON SPECTATOR, Apr. 2, 2003, at A11; Stephanie Rubec, *Bungled Air Deals Millions Lost in Airport Privatization*, CALGARY SUN, Oct. 18, 2000, at 2. After Canada's airports were privatized, airlines experienced a significant increase in airport landing and terminal fees and rents. *Air Canada Welcomes Transport Canada Airport Policy Initiatives*, CANADA NEWSWIRE, June 13, 2001. The International Air Transport Association (IATA) complained that airport fees at Toronto Pearson Airport would have to increase by at least 150 percent to pay for the debt incurred in terminal expansion, making it the world's fifth most expensive airport in which to operate. It was projected that increased fees for Air Canada alone would exceed $100 million annually. CANADIAN PRESS NEWSWIRE, Dec. 31, 2003; *Weaker Dollar and High Costs Hurt Canada's Airlines*, AIRLINE FINANCIAL NEWS, May 17, 1999. Denouncing Pearson Airport as a "true monopolist," IATA Director General Giovanni Bisignani declared, "Clearly the future of Pearson as Canada's largest international gateway is in jeopardy of sinking under the weight of the airport's $6-billion debt." *Start-Up for Pittsburgh,* AIRLINE BUS., Nov. 1, 2003, at 14. *World Airline Group Takes Shots at New Pearson "Tollway for Extravagance,"* CANADIAN PRESS NEWSWIRE, Apr. 5, 2004.

port concessionaires, airport revenue diversion constitutes a hidden municipal tax upon them. Moreover, growing airport costs have been of increasing concern to airlines. According to the Air Transport Association of America (ATA):

> While the fees airlines pay to airports represent a small portion of overall airline operating costs (approximately 5 percent), they have been one of the industry's fastest-rising costs. Between 1992 and 1999, airport costs exclusive of PFCs, rose 35 percent. Including PFCs, they rose 70 percent. In contrast, the producer price index over that same period of time increased less than eight percent and airline prices rose less than four percent.[52]

The airlines are concerned that spending airport revenue on nonairport services results in increased rents, fees, and charges to airlines exceeding the cost of airport capital and operating expenses. ATA observes, "Of increasing concern to airlines (and many airport operators) has been local political interest in siphoning money away from airports for other nonaviation purposes."[53] According to ATA, "revenue diversion is a burden on interstate commerce—an unfair tax on airline passengers and shippers, not unlike forced 'tribute' charged in ancient times for safe passage through foreign lands."[54] The funding of airports has been on a closed-loop financial basis, supported by fees paid by airlines, their passengers, and other users and not through local taxes: "Local tax revenues did not and do not support our national system of airports." Moreover, "because airports are local monopolies, federal law also places significant restrictions on airports' ability to take advantage of their monopoly status."[55]

Similarly, the Aircraft Owners and Pilots Association (AOPA) opposes airport revenue diversion. AOPA Senior Vice President of Government and Technical Affairs Andy Cebula insists,

> When an airport doesn't get the revenue it's due, its expenses still have to be paid. They often result in higher rates and fees charged to individual pilots and aircraft owners, which is one of the reasons AOPA fights to make sure airports get all the money that's coming to them.[56]

The AOPA argues that revenue diversion impacts aviation in many ways: "Airport tenants may be asked to pay higher rates and charges as a result of diverted revenue. The lack of funds could also impact much needed safety enhancements and capital improvement projects at the airport."[57] Commercial airlines and general aviation aircraft operators have been successful in lobbying Congress to protect them from diversion, though several grandfather provisions have been carved out.

However, the airport trade association, Airports Council International–North America (ACI-NA), has a different view. Airports, ACI-NA contends, are not predatory monopolies at all, but instead are governmental institutions that provide essential infrastructure. ACI-NA argues that U.S. airports are self-sustaining and nonprofit enterprises, subject to intensive, if not excessive, government regulation. ACI-NA insists that airports are competitive with other airports and have little incentive to abuse their market power.[58] In addition, a number of airports have concentrated on lowering, not increasing, costs charged to airlines and other aeronautical users. Examples include debt refinancings by Minneapolis/St. Paul and Denver. These transactions were primarily undertaken in order to reduce the costs to airlines using the respective airports. Airports in different cities or within the same metropolitan area compete in many ways. For example, they compete for international traffic and cargo and vie for the status of becoming airline hubs. Thus, ACI-NA is generally opposed to federal regulation of airport rates and charges.

Nevertheless, ACI-NA also opposes revenue diversion, insisting, "airport operators have been—and continue to be—staunchly opposed to diversion of airport revenues….[A]irport operators reaffirm their commitment to the dedication of user charges and fees, and other revenue derived from airport activities, to be used only for airport purposes."[59] One can understand the aversion an airport operator might have to seeing its revenue siphoned off for use by the local government for nonairport purposes.

III. FEDERAL LEGISLATION

A. The Federal Relationship with Airports

In the United States, the overwhelming number of public commercial airports have been owned and operated by local governments with federal financial support and federal regulatory oversight.[60] Congressional enactments governing aviation began with the Kelly Act (Contract Air Mail Act of 1925), which gave the Postmaster General authority to award contracts for

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[52] Air Transport Association of America, *supra* note 11.

[53] Air Transport Association of America, *supra* note 11.

[54] Airport Revenue Diversion, Hearings Before the U.S. Sen. Subcomm. on Aviation of the Commerce Comm., May 1, 1996, at 49 (testimony of Edmund Merlis), reproduced at: http://books.google.com/books?id=nQEDkwETmdkC&dq=%22airport+revenue+diversion%22&printsec=frontcover&source=web&ots=f7QKBCZe8&sig=ZsilCY2rHH1ZSYysVMapyMALmMM#PPA30,M1.

[55] *Id.* at 48–49.

[56] http://www.aopa.org/whatsnew/newsitems/2004/04-2-096x.html (Last visited Jan. 23, 2008).

[57] http://www.aopa.org/whatsnew/region/revenue.html (Last visited Jan. 23, 2008).

[58] David Plavin, The Top 10 Myths about Airports—The North American Experience (Apr. 15, 2004), http://www.aci-na.org/dexa/docs/70_Myths%20about%20Airports.ppt#256,1 (Last visited Jan. 23, 2008).

[59] Airport Revenue Diversion, *supra* note 54, at 87–88.

[60] At one time, the federal government owned and operated Washington National and Washington Dulles International Airports, but divested itself of them in the 1980s.

the carriage of mail to private carriers—essentially, a subsidy system for the nascent airline industry. The first federal legislation addressing airport finance, the Air Commerce Act of 1926, provided initial federal funding for airport infrastructure. It authorized the Secretary of Commerce to regulate the design of aircraft and materials used in their construction, as well as the safety and maintenance of airways, airports and air navigation facilities.[61] That statute was replaced by the Civil Aeronautics Act of 1938, creating the Civil Aeronautics Authority (whose name was changed to the Civil Aeronautics Board 2 years later) and vesting in it safety and economic (pricing, entry, and antitrust) regulatory jurisdiction.[62] That legislation was subsumed by the Federal Aviation Act of 1958, which gave safety jurisdiction to the FAA.[63] The FAA was housed in the U.S. Department of Transportation (DOT) with the U.S. DOT's creation in 1966. The federal government provides financial support to airports through the AIP program, authorizes the collection of additional revenue from local passengers through the PFC program, and provides regulatory oversight over certain airport practices, including issues surrounding both revenue and expenditures.

B. Airport Revenue Statutes

Several federal statutes govern the use of airport revenue, including principally:

- The Anti-Head Tax Act of 1973
- The AAIA
- The Airport and Airway Safety and Capacity Expansion Act of 1987
- The Aviation Safety and Capacity Expansion Act of 1990
- The Federal Aviation Administration Authorization Act of 1994 (FAAA Act)
- The Airport Revenue Protection Act of 1996.

In *Evansville–Vanderburgh Airport Authority v. Delta Air Lines,*[64] the U.S. Supreme Court rejected a "Commerce Clause" challenge to a $1.00 airport tax imposed upon airline passengers to fund local airport construction and maintenance. The Court held that "a charge designed only to make the user of state-provided facilities pay a reasonable fee to help defray the costs of their construction and maintenance may constitutionally be imposed on interstate and domestic users alike."[65] Congress responded by promulgating the Anti-Head Tax Act of 1973*,* prohibiting head taxes (taxes on passengers traveling in air commerce), taxes on the transportation of an individual, taxes on the sale of air transportation, or air commerce or transportation gross receipts taxes.[66] However, the statute does authorize airports to collect property, income, franchise, and sales and use taxes, as well as reasonable and nondiscriminatory rental charges, landing fees, and other service charges.[67]

The AIAA[68] established the current framework for federal financing of U.S. airport development and improvement projects.[69] As originally enacted, AAIA required that the airport owner and operator "use all revenues generated by the airport…for the capital or operating costs of the airport, the local airport system, or other local facilities which are owned or operated by the owner or operator of the airport and directly related to the actual transportation of passengers or property."[70] The AAIA also provides that, as a condition precedent for receiving federal funds, airports must agree that their facilities "will be available for public use on fair and reasonable terms and without unjust discrimination."[71] Certain prior uses of airport revenue for nonairport purposes were grandfathered.[72]

The AAIA[73] prescribes assurances to which an airport sponsor receiving federal funds must agree as a condition precedent to receipt of federal financial assistance.[74] These grant assurances are the quid pro quo for AIP funding. Upon acceptance of an AIP grant by an airport sponsor, the assurances contained in the AIP grant agreement become a binding obligation between the airport sponsor and the federal government. Such sponsorship assurances must be included in every AIP grant agreement.[75] The airport operator must give writ-

[61] 69 Pub. L. No. 254, 44 Stat. 568 (May 20, 1926).

[62] 75 Pub. L. No. 706, 52 Stat. 973 (June 23, 1938).

[63] 85 Pub. L. No. 726, 72 Stat. 731 (Aug. 23, 1958).

[64] 405 U.S. 707 (1972), 92 S. Ct. 1349, 31 L. Ed. 2d 62.

[65] *Id*. at 714.

[66] 49 U.S.C. § 40116(b).

[67] 93 Pub. L. No. 44, 87 Stat. 88; 49 U.S.C. § 40116(e)(2) (1995). See Airway Arms, Inc. v. Moon Area Sch. Dist., 498 Pa. 286, 446 A.2d 234 (Pa. 1982); Burbank-Glendale-Pasadena Airport Auth. v. City of Burbank, 64 Cal. App. 4th 1217, 76 Cal. Rptr. 2d 297 (Cal. App. 1998).

[68] Title V of the Tax Equity and Fiscal Responsibility Act, 97 Pub. L. No. 287, 96 Stat 1225 (now codified at 49 U.S.C §§ 47107(b), 47133).

[69] Roy Goldberg, *Airline Challenges to Airport Abuses of Economic Power*, 72 J. AIR L. & COM. 351 (2007); PAUL DEMPSEY, AIRPORT PLANNING & DEVELOPMENT: A GLOBAL SURVEY 174 (2000).

[70] 49 U.S.C. § 47107(b).

[71] 49 U.S.C. § 2210(a)(1). See James F. Gesualdi, *Gonna Fly Now: All the Noise about the Airport Access Problem*, 16 HOFSTRA L. REV. 213, 232–33 (1987).

[72] FAA, Policy and Procedures Concerning the Use of Airport Revenue, 64 Fed. Reg. 7696 (Feb. 16, 1999).

[73] 49 U.S.C. § 47107(a).

[74] *Id.*

[75] Section 511(b) of the AAIA, 49 U.S.C. § 47107(g)(1) and (i) as amended by Pub. L. No. 103-305 (Aug. 23, 1994) authorizes the DOT Secretary to prescribe project sponsorship requirements to ensure compliance with §§ 511(a), 49 U.S.C. § 47107(a)(1)(2)(3)(5)(6). See FAA Order 5100.38A, Airport Improvement Program Handbook, ch. 15, Sponsor Assurances and Certification, § 1, Assurances-Airport Sponsors (Oct. 24, 1989). Current assurances are set forth at

ten assurances that airport revenue will be used for the capital and operating costs of the airport, the local airport system, or other facilities directly and substantially related to air transportation.[76] Therefore, airports must provide an annual report specifying all sums paid by the airport to other governmental entities, the purposes thereof, and all services provided to other governmental entities and the amount of compensation received.

The Airport and Airway Safety and Capacity Expansion Act of 1987[77] circumscribed the use of airport revenues to facilities "substantially" and directly related to air transportation. It also required local aviation fuel taxes enacted after December 30, 1987, to be spent on the airport or, in the case of state fuel taxes, state aviation programs or noise mitigation.[78]

The Aviation Safety and Capacity Expansion Act of 1990 established the PFC program as a means of allowing airports to collect revenue locally for approved infrastructure improvements. This program is discussed in Section II.B.4.

Responding to the financial crisis in the airline industry in 1993, President Bill Clinton appointed a committee—the National Commission to Ensure a Strong Competitive Airline Industry—to study "whether the nation's beleaguered air carriers could benefit from a healthy dose of government authority." Its report to the President and Congress made several recommendations, including "rigorous enforcement of existing Airport Improvement Program grant assurance language barring diversion of airport revenues to non-airport purposes…[and] continued close scrutiny of airport proposals to collect [PFCs]."[79]

Also in 1993, the U.S. House of Representatives Surveys and Investigations Staff reported that airport revenue was being diverted at 17 of the 30 airports investigated, though most diversions were lawful. Out of approximately $900 million diverted, $641 was diverted lawfully under the grandfather provisions, and $141 million was diverted where the airport sponsors proclaimed eligibility for grandfather diversion. But $112 million was diverted under circumstances where the sponsor did not appear to meet the statutory exemption requirements.[80] In 1994, the U.S. DOT Office of Inspector General (IG) reported that FAA monitoring of airport revenue was not adequate to ensure that fee and rental structures were maintained at the level necessary to ensure that airports were as self-sustaining as possible or that unlawful revenue diversion was not occurring.[81]

The FAAA[82] reaffirmed that airports must be as self-sustaining as possible[83] and that airport charges, fees, or taxes must be reasonable and used for airport or aeronautical purposes.[84] Airports should not attempt to create revenue surpluses exceeding the amount needed for the airport system, including reasonable reserves and funds needed to facilitate financing or cover contingencies.[85] The U.S. DOT Secretary was instructed to enforce the revenue-use requirement promptly and effectively. The FAAA Act requires the U.S. DOT Secretary to establish policies and procedures to assure enforcement of the airport's self-sustaining and revenue-use grant assurances. These policies and procedures must prohibit airport revenue diversion for various uses, including direct or indirect payments other than those reflecting the value of services and facilities provided, as well as payments in lieu of taxes or other assessments that exceed the value of services provided.[86] Impermissible uses of revenue may include:

- Direct or indirect payments, other than payments reflecting the value of services provided to the airport;
- The use of airport revenue for general economic development, marketing, or promotional purposes unrelated to the airport;
- Payments in lieu of taxes that exceed the value of services provided; and
- Payments to compensate nonsponsoring governmental bodies for lost tax revenue in excess of stated tax rates.[87]

The Secretary may withhold approval of a grant application seeking to impose a PFC for violating the revenue-diversion requirements and may impose civil penalties up to $50,000 upon airport sponsors for violations.[88] The FAAA Act prohibits a state or political subdivision thereof from imposing a new tax, fee, or charge exclusively upon a business located at a public airport, other than a tax, fee, or charge whose revenue is used for airport or aeronautical purposes.[89] The FAAA Act also authorizes the Secretary of Transportation to determine the reasonableness of airport fees, though the Secretary is not to set the level of the fee.[90] The legislation explicitly affirms that different rate methodologies may be employed.

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http://www.faa.gov/airports_airtraffic/airports/aip/grant_assurances/media/airport_sponsor_assurances.pdf (Last visited Jan. 23, 2008).

[76] 49 U.S.C. § 47107(b).

[77] 100 Pub. L. No. 223, 101 Stat. 1486 (Dec. 30, 1987).

[78] FAA, Policy and Procedures Concerning the Use of Airport Revenue, 64 Fed. Reg. 7696 (Feb. 16, 1999).

[79] Suzanne Imes, *Comment: Airline Passenger Facility Charges: What Do They Mean for An Ailing Industry?*, 60 J. AIR L. & COM. 1039, 1051–52 (1995) [citations omitted].

[80] 61 Fed. Reg. 7134.

[81] *Id.*

[82] 103 Pub. L. No. 305, 108 Stat. 1569 (Aug. 23, 1994).

[83] 49 U.S.C. § 47101(a)(13).

[84] 49 U.S.C. § 47129.

[85] 49 U.S.C. § 47101.

[86] 49 U.S.C. § 47107.

[87] 49 U.S.C. § 47107(b)(2).

[88] 49 U.S.C. § 47111.

[89] 49 U.S.C. § 40116(d)(2)(A).

[90] 49 U.S.C. § 47129.

In 1996, congressional hearings focused on airport revenue diversion, and in particular, the diversion by the City of Los Angeles from Los Angeles International Airport (LAX). The U.S. DOT's IG testified that FAA enforcement in this area was lax and that penalties for revenue diversion (then $50,000) were weak. The airline trade association testified that the FAA had failed to promulgate rules mandated in earlier legislation.[91] As a result, new legislation was introduced and passed strengthening the revenue diversion prohibition and the sanctions to be imposed.

The Airport Revenue Protection Act of 1996[92] expanded the revenue restriction requirement to any airport receiving federal financial assistance, public or private, after October 1, 1996.[93] It codified the existing grant assurance revenue-use requirements.[94] It also reaffirmed the power of the Secretary of Transportation (acting through the FAA Administrator) to withhold funds from a violator of the revenue-use requirements, to institute a civil action, and to impose civil penalties in an amount three times that of the unlawfully diverted revenue.[95] This legislation enacted a 6-year statute of limitations for reimbursement for sponsor capital contributions or operating expenses, running from the date of the contribution or expense.

IV. FEDERAL AVIATION ADMINISTRATION POLICIES AND PROCEDURES

A. Evolution of Policy

The statutes described in the preceding section are elucidated in a series of FAA policy statements and procedures addressing what are or are not appropriate expenditures for federally-assisted airports. This section addresses the evolution of federal policy principally as described in the FAA's attempts to apply legislative requirements to federal funding in a number of policy statements and regulations.

In 1986, the FAA announced that it would consider an airport sponsor's funds in support of nonaviation facilities as an element militating against a grant of discretionary AIP funds.[96]

The U.S. DOT issued a "Policy Regarding Airport Rates and Charges" in February 1995.[97] It provided that airports were not to charge more than aeronautic costs on a break-even basis. The rate base was to be valued according to historic cost, rather than fair market value (FMV).

In 1996, the FAA issued a comprehensive policy statement on airport rates and charges that superseded the 1995 policy statement.[98] It required that:

- Fees for the use of airfield and public-use roadways should be based on cost, as valued by their historic cost to the original airport proprietor;
- Rates, fees, and charges to aeronautical users must be fair and reasonable;
- Unjustly discriminatory rates and charges are prohibited; and
- The fee and rental structure for the airport must make it as self-sustaining as possible.[99]

The policy statement also required that the rate base be established by reasonable, consistent, and transparent methods. Fees may be set by the compensatory method, by the residual method, by a combination of the two, or by any other reasonable methodology so long as it is applied consistently to similarly situated aeronautical users and is just and reasonable. Capital and operating costs must be allocated to various cost centers on the basis of cost causation. New fees must not be imposed to create revenue surpluses, although reasonable reserves may be maintained to facilitate financing and cover contingencies.[100] The policy statement stressed the use of airport–airline consultation and negotiation as the preferred means of establishing fees.[101]

Also in 1996, the FAA issued its rules addressing practices in federally assisted airport proceedings, including rules for filing and adjudicating complaints.[102] Among other things, it declared that persons alleging revenue diversion that do business with, or pay fees or rents to, a federally assisted airport are deemed directly

[91] Airport Revenue Diversion, *supra* note 54.

[92] Title VIII of the Federal Administration Reauthorization Act of 1996, 104 Pub. L. No. 264 § 704, 110 Stat. 3213 (Oct. 9, 1996).

[93] 49 U.S.C. § 47133.

[94] *Id*.

[95] 49 U.S.C. § 46301(n)(5). The Department of Transportation and Related Agencies Appropriation Act of 1998, 105 Pub. L. No. 66, 111 Stat. 1425 (1998), included a provision relieving the State of Hawaii from reimbursing the airport for diverted airport revenue as compensation for ceded native land, but prospectively prohibiting further revenue diversion. Brian Duus, *Reconciliation Between the United States and Native Hawaiians: The Duty of the United States to Recognize a Native Hawaiian Nation and Settle the Ceded Lands Dispute*, 4 ASIAN-PACIFIC L. & POL'Y J. 393 (2003). See Office of Hawaiian Affairs v. Hawaii, 110 Haw. 338, 133 P.3d 767 (Hawaii 2006).

[96] FAA, Policy on Use of Airport Improvement Discretionary Funds, 51 Fed. Reg. 20728 (June 6, 1986).

[97] 60 Fed. Reg. 6906 (Feb. 3, 1995). *See also* FAA, Proposed Policy Regarding Airport Rates and Charges – Part VIII (supplemental notice of proposed policy), 59 Fed. Reg. 51836 (Oct. 12, 1994), and FAA, Policy Regarding Airport Rates and Charges—Part IV (request for comments), 60 Fed. Reg. 6906 (Feb. 3, 1995).

[98] FAA, Policy Regarding Airport Rates and Charges (policy statement), 61 Fed. Reg. 31994 (June 21, 1996).

[99] 61 Fed. Reg. 31994 (June 21, 1996).

[100] See Alaska Airlines v. Los Angeles World Airports, Doc. No. OST-2007-27331-184 (recommended decision of A.L.J. Richard Goodwin, May 15, 2007).

[101] 61 Fed. Reg. 31994, 32018.

[102] FAA, Rules of Practice for Federally-Assisted Airport Proceedings (final rule), 61 Fed. Reg. 53998 (Oct. 16, 1996).

and substantially affected for purposes of having standing to file a revenue diversion complaint.[103] The FAA takes the position that if the sale of airport property for nonairport purposes causes an increase in airport fees, carriers serving the airport may file a complaint under 49 U.S.C. § 47129 to challenge the increase. The fees or rents they pay are considered airport revenue. An association will be allowed to file a complaint by its members who are directly and substantially affected by potential revenue diversion. Nonaeronautical users may also be deemed directly and substantially affected for purposes of standing. However, an airport employee does not have standing.[104] The FAA expected that before formal complaints were filed, complainants would first make good faith efforts to resolve the disputes informally.[105]

In 1999, the FAA concluded that the impact on AIP discretionary funding of revenue diversion, delinquent submission of financial reports, unsatisfactory progress on outstanding grant agreements, and the use of AIP funds on low-priority development was a priority in the FAA's National Priority System development plan.[106] Where the FAA concludes that an airport is not in compliance with the revenue-diversion prohibition, the FAA may, after opportunity for notice and hearing, and upon failure of the sponsor to take corrective action, withhold: (1) future AIP entitlement and discretionary grants;[107] (2) approval for the modification of existing grant agreements that seek an increase in the amount of AIP funds available;[108] and/or (3) payments under existing grants.[109]

Also in 1999, the FAA issued comprehensive policies and procedures on the use of airport revenue.[110] A person directly and substantially aggrieved by any alleged noncompliance may file a complaint with the FAA.[111] The complainant must provide a concise and complete statement of the facts relied upon to substantiate each allegation and describe how he or she was directly and substantially affected by the purported noncompliance.[112] If a prima facie case is established, the FAA will investigate.[113] In rendering its initial determination, the FAA may render a decision based on informal procedures (without a formal, on-the-record hearing) consisting of evidence adduced from the complaint and the responsive pleadings and documents provided by each party.[114]

A party adversely affected by the decision of the Director of the FAA Office of Airport Safety and Standards may file an appeal with the FAA Associate Administrator within 30 days of the date of service of the initial determination. The airport sponsor may request an evidentiary hearing if the Director's determination found a violation and entitlements are to be withheld. On appeal, the Associate Administrator assesses whether (1) the findings of fact made by the Director are supported by a preponderance of reliable, probative, and substantial evidence, and (2) the conclusions of law are consistent with applicable law, precedent, and public policy.[115] In making his or her determination, the Associate Administrator issues a final decision without a hearing.[116] If no appeal is filed within the prescribed period, the Director's determination becomes final and is not judicially reviewable.[117]

The FAA may impose sanctions against an airport operator if it concludes unlawful revenue diversion has occurred: "The FAA seeks current compliance by airport sponsors and generally does not take punitive action for past behavior except in very limited circumstances (such as in the case of unlawful diversion of airport revenue)."[118] The FAA may not withhold new grants and payments or withhold approval of an application for entitlement funds for more than 180 days unless the airport sponsor is provided with an opportunity for a hearing and a final decision of noncompliance is made.[119]

B. Less Formal Policies

In addition to formal policies published in the *Federal Register,* FAA policies also are expressed in FAA Chief Counsel and U.S. DOT General Counsel Opinions and in Guidance Letters issued by Airport Division Staff, as well as in Airport Grant Agreements. Several of these are discussed below.

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[103] 49 U.S.C. § 47107(b); 14 C.F.R. § 16.23(a).

[104] Clarke v. City of Alamogordo, 2006 FAA Lexis 629 (2006).

[105] 14 C.F.R. pt. 16. *See also* FAA, Policy and Procedures Concerning the Use of Airport Revenues (supplemental notice of proposed policy), 61 Fed. Reg. 66735 (Dec. 18, 1996); and FAA, Policy and Procedures Concerning the Use of Airport Revenue (notice of proposed policy), 61 Fed. Reg. 7134 (Feb. 26, 1996).

[106] FAA, Factors Affecting Award of Airport Improvement Program (AIP) Discretionary Funding, 64 Fed. Reg. 31031 (June 9, 1999).

[107] 49 U.S.C. §§ 47106(d), 47111(e).

[108] 49 U.S.C. § 47111(e).

[109] 49 U.S.C. § 47111(d).

[110] FAA, Policy and Procedures Concerning the Use of Airport Revenue–Part II (final policy), 64 Fed. Reg. 7696 (Feb. 16, 1999). *See also* FAA, Policy Regarding Airport Rates and Charges (advance notice of proposed policy), 63 Fed. Reg. 43228 (Aug. 12, 1998).

[111] 14 C.F.R. § 16.23.

[112] 14 C.F.R. § 16.23(b)(3),(4).

[113] *But see* Continental Micronesia, Inc. v. Commonwealth of the Northern Mariana Islands and Commonwealth Ports Auth., DOT Order 95-4-14 (1995) (where the DOT concluded it had no jurisdiction over an airport revenue diversion complaint).

[114] 14 C.F.R. § 16.29.

[115] See Ricks v. Millington Municipal Airport, FAA Docket No. 16-98-19, at 21 (Dec. 30, 1999), and 14 C.F.R., § 16.227.

[116] 14 C.F.R. § 16.33.

[117] *Id.*

[118] Jim Martyn v. Port of Anacortes, Washington, 2003 FAA Lexis 162 (Apr. 14, 2003).

[119] 49 U.S.C. § 47111(d).

C. Contractual Obligations of Airport Operators: Grant Assurances

As noted above, 49 U.S.C. § 47107, originating in the AAIA, requires that the U.S. DOT may approve a project grant application for airport development only if the airport provides certain written assurances, including assurances on the use of airport revenue.[120] The grant assurance on use of airport revenue provides:

> [A]ll revenues generated by the airport and any local taxes on aviation fuel established after December 30, 1987, will be expended by it for the capital or operating costs of the airport; the local airport system; or other local facilities which are owned or operated by the owner or operator of the airport and directly and substantially related to the actual air transportation of passengers or property; or for noise mitigation purposes on or off the airport. Provided, however, that if covenants or assurances in debt obligations issued before September 3, 1982, by the owner or operator of the airport, or provisions enacted before September 3, 1982, in governing statutes controlling the owner or operator's financing, provide for the use of the revenues from any of the airport owner or operator's facilities, including the airport, to support not only the airport but also the airport owner or operator's general debt obligations or other facilities, then this limitation on the use of all revenues generated by the airport (and, in the case of a public airport, local taxes on aviation fuel) shall not apply.[121]

Thus, before a new grant is conferred, the FAA may insist that such funds be used only for specified purposes. Moreover, prospectively, theses grant assurances may hold the airport operator to certain commitments beyond those explicitly enumerated in the applicable statutes and regulations. The FAA has noted:

> The federal role in civil aviation has been augmented by various legislative actions that authorize programs for providing federal funds and other assistance to local communities for the development of airport facilities. In each such program, the airport sponsor assumes certain obligations, either by contract or restrictive covenants in property deeds and conveyance instruments, to maintain and operate its airport facilities safely, efficiently and in accordance with specified conditions. Commitments assumed by airport sponsors in property conveyance or grant agreements are important factors in maintaining a high degree of safety and efficiency in airport design, construction, operation, and maintenance, as well as ensuring the public has fair and reasonable access to the airport.[122]

[120] 49 U.S.C. § 47107(b).

[121] Assurance 25(a), "Airport Revenues," implementing the requirements of 49 U.S.C. §§ 47107(b) and 47133, reproduced at http://www.faa.gov/airports_airtraffic/airports/aip/grant_assurances/media/airport_sponsor_assurances.pdf (Last visited Jan. 23, 2008). *See also* In the Matter of Revenue Diversion by the City of Los Angeles at Los Angeles Int'l, Ontario, Van Nuys and Palmdale Airports, 1997 FAA Lexis 1535 (Mar. 17, 1997).

[122] Boca Aviation v. Boca Raton Airport Auth., 2003 FAA Lexis 143 (Mar. 20, 2003).

D. The Airport Compliance Program

The FAA ensures that airport sponsors adhere to their federal obligations through its Airport Compliance Program.[123] The FAA seeks to achieve voluntary compliance with such obligations. Sponsor obligations are imposed by statute and regulation, as well as through grant agreements, when the sponsor receives federal funds, or when accepting the transfer of federal property for airport purposes. Obligations incorporated into grant agreements and instruments of conveyance become contractually binding upon airport sponsors. Through the Airport Compliance Program, the FAA seeks to ensure compliance by airport owners with their contractual obligations as specified in their grant agreements and instruments of conveyance.[124]

One way an airport operator avoids conflicts over issues of revenue diversion with the FAA is to seek prior approval of land transfers. For example, certain airports have sought and obtained prior FAA approval for the exchange of airport land with private developers for privately owned land of greater potential for airport use.[125] Similarly, the sale of airport property at FMV has received FAA approval.[126] The FAA has authority to

[123] FAA Compliance Handbook, FAA Order 5190.6A (Oct. 2, 1989), contains guidance on the policies and procedures for FAA personnel to carry out in implementing the FAA Airport Compliance Program and interpreting and administering the commitments airport operators make as a condition of receiving federal grants or property.

[124] Airport compliance enforcement procedures are set forth in FAA Rules of Practice for Federally-Assisted Airport Proceedings, 14 C.F.R. pt. 16. See the current requirements at http://www.faa.gov/airports_airtraffic/airports/aip/grant_assurances/media/airport_sponsor_assurances.pdf (Last visited Jan. 23, 2008).

[125] Notice of Intent To Rule on Request To Release Airport Property at the Deer Park Municipal Airport, Deer Park, WA, 69 Fed. Reg. 63,191 (Oct. 29, 2004):

> The Deer Park Municipal Airport requests the release of non-aeronautical airport property consisting of approximately 5 acres on the east side of the airport to a private developer. The purpose of this release is to trade unimproved airport land to a private developer for use as a residential emergency egress, for 8.88 acres of improved light industrial property adjacent to the west side of the airport. The airport property proposed for release has not been used for aviation purposes and no aeronautical use of the property is planned or anticipated. The City of Deer Park has determined that the property requested is not within critical areas affecting safety of flight and that the proposed use of the property as a residential emergency egress would not interfere with airport operations. The property to be acquired by the Airport in trade would benefit the airport for future revenue producing development. The airport would realize a net gain of property.

[126] Notice of Intent To Rule on Transfer of Airport and Requests To Release Airport Property at the North Bend Municipal Airport, North Bend, OR, 69 Fed. Reg. 44,707 (July 27, 2004):

> The City of North Bend Oregon plans to transfer all assets and liabilities associated with the North Bend Municipal Airport, including surplus government land and AIP Grant obligations, to the Coos County Airport District. After the transfer, the Coos County Airport District will sell 6.92 acres of airport land

provide guidance, and airports seek that guidance on whether a particular expenditure would violate the statutory requirements for the use of airport revenue.

The airport sponsor must submit an annual auditing report and other financial reports that the U.S. DOT may reasonably request.[127] The local government must support its capital and operating expenses charged to the airport with documented evidence.[128] The FAA takes the position that although a city may transfer airport revenue into its general fund, it must expend those funds for airport purposes.[129]

V. SYNTHESIS: FEDERAL LAW AND POLICY ON REVENUE DIVERSION[130]

A. Which Airports Are Subject to, or Immune from, the Revenue-Diversion Prohibition?

1. Airports That Receive "Federal Assistance"

The revenue-use requirements apply to every airport that receives "federal assistance."[131] "Federal financial assistance" is defined by FAA policy as: (1) airport development and noise mitigation grants; (2) planning grants related to a specific airport; (3) transfers of federal property under the Surplus Property Act;[132] and (4) deeds of conveyance issued under specified federal statutes.[133] However, the FAA's installation and operation of navigational aids or the FAA's operation of air traffic control towers is not considered federal financial assistance. Nor are reasonable fees paid by the federal government to the operator of an airport for use of facilities, land, or services provided.[134]

2. Private Airports

All airports that receive federal financial assistance are subject to the revenue-diversion prohibition. This now includes privately owned, public-use airports that received AIP grants after October 1, 1996.[135] Moreover, once an airport is deemed to fall under these rules, the revenue-use requirement remains in effect so long as the airport functions as an airport, even should it decline AIP grants in any subsequent year.[136]

3. Privatized Airports

Privatized airports, or the sale of airport land, would also fall under the revenue-diversion prohibition. Although the FAA will treat the proceeds from the sale or lease of an airport as revenue subject to the diversion prohibition, the FAA promises to remain "open and flexible in specifying conditions on the use of revenue…without unnecessarily interfering with the appropriate privatization of airport infrastructure."[137] The FAA cannot waive the revenue-use requirement, but it promises to "exercise its authority to interpret the requirement in a flexible way to account for the unique circumstances presented by a change of ownership."[138] The FAA also would attach to its approval of the sale of any airport a condition that the proceeds of the sale would be used consistently with the revenue-use requirements.[139]

The United Kingdom sold many of its major airports to private investors in 1987. A number of other nations have since followed suit and privatized their airports. In 1992, President George W. Bush issued Executive Order 12803, which removed a general requirement that state and local governments that sell or lease federally aided infrastructure assets must repay fully the federal money invested therein. However, as an Executive Order, this action was not sufficient to overcome statutory requirements for repayment, such as those included in the statute governing AIP. As part of the Federal Aviation Reauthorization Act of 1996, the U.S. Congress created the Airport Privatization Pilot Program,[140] a demonstration program authorizing the FAA to exempt five airports from certain statutory and regulatory requirements governing the use of airport revenue, including the airport's obligation to repay federal grants, to return property acquired under federal assistance, and to use the proceeds exclusively for airport purposes.[141]

The first two airports to apply to participate in the pilot privatization program were Brown Field near San Diego, California, and Stewart International Airport in

to the City of North Bend. The City's sewage treatment plant is currently located on this parcel. The land is non-aeronautical property and will be sold at fair market value with proceeds used for airport capital improvement projects.

[127] 64 Fed. Reg. 7696, 7722. 49 U.S.C. §§ 47107(a)(15), (18), and (19).

[128] Letter from FAA Office of Airport Safety and Standards Director David Bennett to Weschester County Commissioner Joseph Petrocelli (Feb. 14, 1997).

[129] 14 C.F.R. pt. 16.

[130] Many of the letters and memoranda cited in this report were obtained by the researcher through his submission of a Freedom of Information Act Request to determine the outcome of cases and other information available.

[131] 49 U.S.C. § 47133.

[132] 49 U.S.C. § 47151.

[133] The statutes are Federal Airport Act of 1946 § 16, the Airport and Airway Improvement Act of 1970 § 23, and the Airport and Airway Improvement Act of 1982 § 516.

[134] 64 Fed. Reg. 7696.

[135] 64 Fed. Reg. 7696.

[136] 49 U.S.C. § 47133.

[137] 61 Fed. Reg. 7134, 7140.

[138] 64 Fed. Reg. 7696.

[139] 49 U.S.C. §§ 47107(b), 47133. 64 Fed. Reg. 7696, 7717.

[140] See Rowley, *supra* note 6, at 605, 628–29; Dan Kramer, *How Airport Noise and Airport Privatization Effect Economic Development in Communities Surrounding U.S. Airports*, 31 TRANSP. L.J. 213, 222 (2004); Paul R. Verkuil, *Public Law Limitations on Privatization of Government Functions*, 84 N.C.L. Rev. 397 (2006); and DEMPSEY, *supra* note 6, at 189–94.

[141] 49 U.S.C. § 47134.

New York State.[142] At this writing, Stewart is the only airport to have been privatized under this program, and it is abandoning privatization in favor of a purchase by the Port Authority of New York and New Jersey.[143]

4. Grandfathered Airports

Certain grandfathered airport operators may use airport revenue for local purposes that are forbidden under the revenue-diversion prohibition. If, on or before September 2, 1982, a statute or ordinance controlling the airport operator's financing was enacted, or a covenant or assurance in an airport operator's debt obligation was issued, then airport revenue may be applied to general debt obligations or other facilities of the airport operator. Moreover, local taxes on aviation fuel in effect on December 30, 1987, may be used for any local purpose.[144] The U.S. DOT has observed:

> The general purpose of [the revenue diversion prohibition] is simply to prevent an airport owner or operator who receives federal assistance from using airport revenues for expenditures unrelated to the airport. Congress recognized, however, that not all sponsors were legally capable of so dedicating their revenue, due to legislation or covenants in their debt obligations. To avoid the inequity of omitting them from the federal aid grant program, Congress did not impose the strict revenue retention requirement on them.[145]

Nonetheless, as directed by statute, the FAA considers the use of airport revenue for local purposes under the grandfather provision as a factor militating against the award of discretionary AIP funding if the airport revenue so used in the fiscal year preceding the application for discretionary funds exceeded the amount of revenue used in the airport's first fiscal year ending after August 23, 1994, adjusted for inflation.[146] Moreover, should an airport fail to provide information necessary to determine whether these requirements were satisfied, that would also preclude the FAA from considering an application for discretionary funds.[147]

The jurisprudence on grandfather clauses generally suggests they are to be strictly construed.[148] However, U.S. DOT has taken the position that "grandfather clauses are generally calculated to prevent hardship by saving accrued rights and interests from the operation of a new rule. They are generally construed favorably to their benign purposes."[149]

The U.S. DOT concluded that the use of airport revenue by Boston Logan Airport over a 2-year period to pay more than $13 million in lieu of taxes to surrounding cities and make community charitable contributions of nearly $300,000 for scholarship, athletics, culture, recreation, and art was grandfathered in under Massport's 1956 Enabling Act and was consistent within the airport's right, as a corporation, to make charitable contributions.[150]

The U.S. DOT found that St. Louis Lambert International Airport's payments of 5 percent gross receipts to the city were grandfathered by virtue of the longstanding bond ordinances for these payments since 1962, even though several ordinances were issued after September 3, 1982.[151] However, responding to an attempt by the State of Maryland to amend a preexisting statutory scheme governing its transportation trust fund so as to transfer $22 million to the state's general fund to meet a budget shortfall, the U.S. DOT concluded: "A sponsor may not rely on the fact that its pre-AAIA statutory arrangements are grandfathered to enact additional direct or indirect diversion of airport revenue."[152] A 1988 City Council resolution seeking to transfer 1 percent of the historic value of property, plant, and equipment from the Palm Springs Airport (later increased to 2 percent) as an in lieu property fee was deemed not grandfathered since it was not in effect on September 3, 1982.[153]

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[142] U.S. GENERAL ACCOUNTING OFFICE, AIRPORT FINANCING: FUNDING SOURCES FOR AIRPORT DEVELOPMENT, GAO/RCED-98-71 (Mar. 1998). In 2000, the State of New York transferred the operation of Stewart International Airport, in Newburgh, New York, to National Express Group, a private company, under a 99-year lease. New York's Albany County airport sought FAA approval to be purchased by a private company. The FAA formed a taskforce to evaluate the application, but it deadlocked over the legal and financial feasibilities of the proposed sale, and ultimately denied the request. Kramer, *supra* note 140, at 213, 223.

[143] Joe Mysak, *Airport Privatization*, PITTSBURGH TRIBUNE-REVIEW, Feb. 4, 2007.

[144] 49 U.S.C. §§ 47107(b), 47133(b).

[145] Memorandum from Assistant DOT General Counsel Roberta Gabel to IG Regional Manager James Brucia (Apr. 12, 1994).

[146] 49 U.S.C. § 47115(f).

[147] Factors Affecting Award of Airport Improvement Program (AIP) Discretionary Funding, 64 Fed. Reg. 31031 (June 9, 1999).

[148] *See* Spokane Inland RR v. United States, 241 U.S. 344, 350, 36 S. Ct. 668, 671, 60 L. Ed. 1037, 1041 (1915); United States v. Allan Drug Corp., 357 F.2d 713 (10th Cir. 1966). No reported court cases address grandfather provisions in the context of airport revenue diversion. However, different grandfather clauses have been applied to airports in the environmental context in Khodara Envtl. Inc. v. Blakey, 376 F.3d 187 (3d Cir. 2004), and Clay Lacey Aviation v. City of Los Angeles, 2001 U.S. Dist. Lexis 24492 (C.D. Cal. June 18, 2001); and in the aircraft operations context in San Francisco v. Federal Aviation Admin., 942 F.2d 1391 (9th Cir. 1991).

[149] Memorandum from DOT Assistant General Counsel Roberta Gabel to IG Regional Manager James Brucia (Dec. 7, 1992).

[150] *Id.*

[151] Memorandum from DOT Assistant General Counsel Roberta Gabel to IG Regional Manager James Brucia (Dec. 8, 1992).

[152] Memorandum from Assistant General Counsel Roberta Gabel to IG Regional Manager James Brucia (Apr. 12, 1994).

[153] Memorandum from Assistant General Counsel Roberta Gabel to IG Regional Manager James Brucia (Nov. 18, 1992).

B. What Constitutes "Airport Revenue"?

Airport revenue subject to the diversion prohibition consists of all fees, rents, charges, or other payments received by the airport sponsor,[154] including proceeds from the sale, lease, or disposal of airport property.[155] It includes revenue received from "air carriers, tenants, lessees, purchasers of airport properties, airport permittees making use of airport property and services, and other parties."[156] Airport revenue also includes sponsor activities at the airport such as revenue received from any activity conducted on airport property acquired with federal assistance, any aeronautical activity directly connected to the sponsor's ownership of the airport, and any noncommercial activity on airport property not acquired with federal assistance to the extent of the fair rental (or fair market) value of the property.[157]

Also included within the concept of airport revenue are state and local aviation fuel taxes in effect after December 30, 1987.[158] For most public, and some private airports, such revenue is subject to the revenue-diversion prohibition. If the property was acquired with federal funds or donated by the federal government, even more restrictive rules apply. However, a city's general sales tax, though collected by an airport from private tenants, is not considered airport revenue.[159]

PFCs are not considered "airport revenue" for purposes of the diversion prohibition. But they are subject to more stringent rules whereby charges collected may be used to fund only the allowable costs of preapproved projects. Moreover, a violation of the revenue-diversion policies may warrant denial of new authority to impose a PFC until corrective action is taken.[160]

In 1985, the Burlington Airport Authority sought an opinion as to whether the use of car rental revenue equal to the revenue from rentals not associated with the use of airport purposes could be used for nonairport purposes. The legislative history provided that the revenue diversion prohibition applied to "such facilities as terminal concessions…serving the terminal or other air transportation purposes."[161] From this, the FAA found that revenue derived from airport concessions constitutes airport revenue. The FAA concluded that the

> segregation of revenues received from Airport concessions in the manner proposed by you is not permitted. The fundamental principle [of the statute] is that all activities which generate revenue at an airport do so because of the airport. Therefore, these revenues must be applied to the airport which made them possible.[162]

In contrast, that same year the Erie Municipal Airport Authority sought an opinion as to whether royalties paid upon the discovery of natural gas on airport property constituted airport revenue. The airport sought to transfer the mineral rights to the City of Erie. The FAA observed that the statutory phrase "revenues generated by the airport" was broad enough to encompass gas royalties. However, the legislative history of the AAIA provided that:

> This provision is not intended to apply to revenue generated by facilities which are located on airport property but are unrelated to air operations or services which support or facilitate air transportation. It accordingly would not apply to revenue generated by such facilities as a water reservoir or a convention center which happen to be located on airport property but which serve neither the airport nor any air transportation service.[163]

Since natural gas production serves neither the airport nor air transportation services, the royalties received therefrom were deemed not to constitute airport revenue. However, the FAA made it clear that it preferred that the proceeds from such production be used "only for airport-related purposes," and that diverting them to nonairport uses could be viewed negatively in the future in considering the issuance of discretionary federal airport grants.[164]

In 1995, the Portland International Jetport sought an opinion as to whether a proposed waiver of landing fees for 90 days to any carrier providing new and improved service constituted revenue diversion. The FAA replied

[154] 49 U.S.C. 47107(b).

[155] Taxes levied by municipalities against parking patrons and not parking lot owners do not constitute airport revenue, and therefore do not violate 49 U.S.C. § 47133. Susquehanna Area Reg'l Airport Auth. v. Middletown Area Sch. Dist., No. 2005 CV 2052, 2006 Pa. Dist & Cnty. Dec. Lexis 95 (June 13, 2006).

[156] 64 Fed. Reg. 7696, 7716. It includes revenue received for:

> i. For the right to conduct an activity on the airport or to use or occupy airport property;
>
> ii. For the sale, transfer, or disposition of airport real property (as specified in the applicability section of this policy statement) not acquired with Federal assistance or personal airport property not acquired with Federal assistance, or any interest in that property, including transfer through a condemnation proceeding;
>
> iii. For the sale of (or sale or lease of rights in) sponsor-owned mineral, natural, or agricultural products or water to be taken from the airport; or
>
> iv. For the right to conduct an activity on, or for the use or disposition of, real or personal property or any interest therein owned or controlled by the sponsor and used for an airport-related purpose but not located on the airport (e.g., a downtown duty-free shop).

Id.

[157] 64 Fed. Reg. 7696.

[158] However, these taxes may be used to finance State aviation programs or noise mitigation programs off the airport property.

[159] Memorandum from DOT Assistant General Counsel Roberta Gabel to IG Regional Manager James Brucia (Dec. 8, 1992).

[160] 64 Fed. Reg. 7696, 7718.

[161] S. REP. NO. 97-494, at 712 (1982).

[162] Letter from FAA Chief Counsel J.E. Murdock III to Burlington Mayor Bernard Sanders (Jan. 8, 1985).

[163] 2 H.R. REP. NO. 97-760, at 712 (1982).

[164] Letter from FAA General Counsel Jim Marquez to William Sesler (May 21, 1985).

that it did not consider such a waiver a use of airport revenue, though it did express concerns that such a waiver might jeopardize its statutory obligation to make the airport as self-sustaining as possible.[165]

In the early 1990s, when Trans World Airlines (TWA) was in financial extremis and had entered one of its three bankruptcies, the City of St. Louis Airport Authority agreed to purchase certain property and equipment of TWA at and near Lambert International Airport. In Phase I of the transaction, the city would acquire property and equipment (such as gates, holdroom seating, and ramp equipment) used in TWA's day-to-day operations for $30 million, consisting of $24.7 million in cash, and $5.3 million in forgiveness of prepetition debt; TWA would repay the $24.7 million cash through rental payments over the remaining useful life of the acquired property and equipment. The FAA found that TWA's lease payments constituted airport revenue. Because the FAA also concluded that the property and equipment acquired constituted airport capital assets, it found the use of airport revenue in their acquisition was consistent with the city's federal obligations.

In Phase II of the transaction, the city would acquire some on-airport assets (i.e., a hanger and office building); property adjacent to the airport (i.e., a flight training center); and off-airport assets (i.e., a reservations center), to be funded by airport revenue bonds.

The FAA concluded,

> Unlike accumulated airport capital surpluses that are derived from airport revenues, bond proceeds themselves are not airport revenue. Rather, they are a fresh infusion of capital. As such, nothing prohibits an airport operator from issuing bonds to acquire assets that are not "airport capital"…so long as airport revenues…are not used to repay the bonds.[166]

The FAA found that to the extent that certain assets to be acquired were airport capital assets, the pro rata share of TWA's lease payments for those facilities would constitute airport revenue, but for the purchase of assets not qualifying as airport capital assets, the pro rata share of TWA's lease payments for those facilities would constitute something other than airport revenue.[167] With respect to the three properties to be acquired, the FAA concluded that the on-airport facilities were airport capital assets; because the city planned to incorporate the adjacent training center into the airport, it too would become an airport capital asset; and because the value of the leasehold interest in the off-airport training center was *de minimus,* its acquisition also did not appear to violate federal obligations.[168]

[165] 49 U.S.C. § 47107(a)(13). Letter from FAA Airports Law Branch Manager Barry Molar to Portland Int'l Jetport Manager Jeffrey Schultes (Oct. 21, 1995).

[166] Letter from FAA Ass't Chief Counsel David Bennett to Joseph Niemann (Dec. 2, 1993).

[167] *Id*.

[168] *Id*.

C. What Constitutes Unlawful Revenue Diversion?

The FAAA Act of 1994 gives the Transportation Secretary the authority to issue policies defining lawful vis-à-vis unlawful revenue diversion. The Act provides that revenue diversion shall consist, at minimum, of

> (A) direct payments or indirect payments, other than payments reflecting the value of services and facilities provided to the airport;
>
> (B) use of airport revenues for general economic development, marketing, and promotional activities unrelated to airports or airport systems;
>
> (C) payments in lieu of taxes or other assessments that exceed the value of services provided; or
>
> (D) payments to compensate nonsponsoring governmental bodies for lost tax revenues exceeding stated tax rates.[169]

Unlawful revenue diversion consists of the use of airport revenue for purposes other than the capital or operating costs of the airport, the local airport system, or other local facilities owned or operated by the airport owner or operator, and directly and substantially related to the air transportation of passengers, baggage, freight, or mail.

An exception exists for uses which are grandfathered, uses also known as "lawful revenue diversion." The grandfather exception permits revenue diversion if done pursuant to a law regulating airport financing enacted prior to September 2, 1982, or a covenant in a debt obligation entered into before that date.[170]

Under the FAA's policy statement, examples of unlawful revenue diversion include:

- Payments that exceed the fair value of services and facilities provided to the airport;[171]
- Payments based on a cost allocation formula inconsistent with FAA guidelines or not calculated consistently for the airport or other units or cost centers of government;
- Payments for general economic development;
- Marketing or promotional activities unrelated to the airport or airport systems;[172]
- Payments in lieu of taxes or assessments exceeding the value or services provided or not based on a cost allocation formula consistent with comparable governmental units or cost centers;

[169] 49 U.S.C. § 47107(l)(2).

[170] FAA, Policy and Procedures Concerning the Use of Airport Revenue, 64 Fed. Reg. 7696 (Feb. 16, 1999). The grandfathering provision is 49 U.S.C. § 47107(b)(2).

[171] The FAA "considers the cost of providing the services or facilities to the airport as a reliable indicator of value." Policy and Procedures Concerning the Use of Airport Revenue–Part II, 64 Fed. Reg. 7696 (Feb. 16, 1999) [hereinafter 1999 Policies].

[172] Examples include "participation in [a] program to provide hospitality training to taxi drivers and funding an airport operator's float containing no reference to the airport, in a New Years Day parade." 1999 Policies, *supra*.

• Payments to other governmental units for lost tax revenue exceeding the stated tax rates applicable to the airport;
• Loans or investment of funds in a governmental unit at less than prevailing interest rates;
• Land rented or used for nonaeronautical purposes at less than FMV;[173]
• Impact fees paid to a governmental unit exceeding the value of facilities or services provided;[174]
• Fees paid for certain community activities or events;[175] and
• Direct subsidies of airline operations, except waivers of fees or discounted landing or other fees for a promotional period.[176]

The FAA also has taken the position that proceeds from the sale or rental of surplus airport land should be used for airport operation maintenance or development. According to the FAA,

> each conveyance of revenue-producing property obligates the transferees to use the revenues derived from nonairport use of the property for operation, maintenance, or development of the airport. If the land has been identified and agreed upon by the FAA as revenue-producing property…then the revenue must be used on the airport or put into the airport fund.[177]

The FAA prohibits renting surplus property at a discount to support community nonprofit organizations or subsidize nonairport objectives. Specifically, the FAA insists that

> any lease or other rental arrangement covering the use of surplus property at an airport must assure that the fair rental value of the property will accrue to the airport and be available to meet airport expenses. Such property may not be rented at a discount to support community nonprofit organizations or to subsidize nonairport objectives.[178]

Airport real estate may not be released for sale without approval from the FAA. The FAA will not authorize the sale or disposal of airport real estate unless its FMV is sustained by an independent appraisal.[179]

D. What Are Lawful Uses of Airport Revenue?

Grandfathered airports, or private airports not receiving federal funds after October 1, 1996, are eligible to spend revenue in ways that other airports are not. Such expenditures by grandfathered airports are considered "lawful revenue diversion," while expenditures by private airports not receiving federal funds are not subject to the revenue-diversion prohibitions. The FAA also has identified other types of expenditures that, if reasonably related to the airport's financial situation, are considered legitimate:

• Capital or operating costs of the airport, the local airport system or other local facilities directly and substantially related to air transportation;[180]
• Promotional expenditures for the airport designed to increase air travel at the airport;[181]
• Expenditures to stimulate new air service and competition at the airport;
• Airport marketing expenses;

[173] An exception exists "to the extent permitted by Section-VII.D of this policy." The DOT has taken the position that an airport proprietor need not charge fair market value for aeronautical uses of airport land. Instead, the proprietor has discretion "to weigh the volume of traffic, economy of collection, and other circumstances at the airport, with the use made of the airport's facilities and services, to arrive at a schedule of charges that will make the airport as self-sustaining as possible." Memorandum from DOT Acting General Counsel Rosalind Knapp to FAA Assistant Secretary Melissa Spillenkothen (Oct. 11, 1995).

[174]

> However, airport revenue may be used where airport development requires a sponsoring agency to take an action, such as undertaking environmental mitigation measures contained in an FAA record of decision approving funding for an airport development project, or constructing a ground access facility that would otherwise be eligible for the use of airport revenue. Payments of impact fees must meet the general requirement that airport revenue be expended only for actual documented costs of items eligible for use of airport revenue under this Policy Statement. In determining appropriate corrective action for an impact fee payment that is not consistent with this policy, the FAA will consider whether the impact fee was imposed by a nonsponsoring governmental entity and the sponsor's ability under local law to avoid paying the fee.

64 Fed. Reg. 7696.

[175] Such fees are prohibited, "except to the extent permitted by this policy. See Section V, Uses of Airport Revenue. Examples of prohibited expenditures in this category include expenditure of $50,000 to sponsor a local film society's annual film festival; and contribution of $6,000 to a community cultural heritage festival." 64 Fed. Reg. 7696.

[176]

> Direct subsidies are considered to be payments of airport funds to carriers for air service. Prohibited direct subsidies do not include waivers of fees or discounted landing or other fees during a promotional period. Any fee waiver or discount must be offered to all users of the airport, and provided to all users that are willing to provide the same type and level of new services consistent with the promotional offering. Likewise prohibited direct subsidies do not include support for airline advertising or marketing of new services to the extent permitted by Section V of this Policy Statement.

64 Fed. Reg. 7696.

[177] FAA Order 5190.6A, Airport Compliance Requirements (Oct. 2, 1989).

[178] *Id.* at 4-18(f). Memorandum from DOT General Counsel Stephen Kaplan to Particia Parrish (Sept. 26, 1994). However, the FAA has taken the position that the use of airport land for community purposes, such as parks and recreational areas, or the rent or lease of land at below fair market value rates, can maintain positive community relations and be a legitimate use of airport revenue. But the greater the gap between the lease or rental rate, on the one hand, and its fair market value, on the other, the greater the burden of demonstrating an airport-related benefit upon the airport proprietor. 61 Fed. Reg. 66735 (Dec. 18, 1996).

[179] FAA Order 5190.6A, Airport Compliance Requirements, Oct. 2, 1989 § 7-8(d).

[180] 64 Fed. Reg. 7696, 7718.

[181] *Id.*

• Cooperative airline–airport marketing expenses promoting air service at the airport;[182]
• Reimbursements of certain sponsors of capital or operating costs;[183]
• Support of community activities or organizations so long as the expenditures are directly and substantially related to airport operations;[184]
• Certain mass transit airport access projects located entirely on airport property and designed and intended exclusively for use by airport passengers;[185]
• Costs incurred by government officials for services to the airport; and
• Lobbying and attorney fees used to support any activity or project consistent with these policies.[186]

E. What Payments May Be Made for Taxes?

Federal law prohibits states and subdivisions thereof from taxing airline passengers, as such taxes have been deemed an unreasonable burden on interstate commerce.[187] Specifically, they may not impose a tax upon: "(1) an individual traveling in air commerce; (2) the transportation of an individual traveling in air commerce; (3) the sale of air transportation; or (4) the gross receipts from that air commerce or transportation."[188]

They may, however, impose a tax on a flight taking off or landing within the state, although the application of this provision is generating some controversy.[189] But some local governments have sought to tax "around the edges" of the prohibition.

In *Susquehanna Area Regional Airport Authority v. Middletown Area School District*,[190] a regional airport authority challenged a tax imposed by a school board upon airport parking patrons. The airport alleged that the tax violated various federal statutes and the "Commerce Clause." Federal law prohibits a state or political subdivision thereof from imposing "a tax, fee, or charge, first taking effect after August 23, 1994, exclusively upon any business located at a commercial service airport or operating as a permittee of such an airport other than a tax, fee, or charge wholly utilized for airport or aeronautical purposes."[191] A lower Pennsylvania court concluded,

> Since we find that the Tax is levied against parking patrons and not parking lot owners, this money is not airport revenue. At no point does the money from this tax ever become the property of the Airport, and therefore it is not a violation [the Federal revenue-diversion prohibition] of § 47133 to use the money for the benefit of the School District.[192]

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[182] However, such expenses must be consistent with applicable grant assurances prohibiting unjust discrimination between carriers. Moreover,

> the direct payment of subsidies to airline involves the expenditure of airport funds and hence raises questions under the revenue-use requirements. The FAA continues to believe that the costs of operating aircraft, or payments to air carriers to operate certain flights, are not reasonably considered an operating cost of an airport. In addition, payment of subsidy for air service can be viewed as general regional economic development and promotion, rather than airport promotion. Use of airport revenue for these purposes is expressly prohibited under the terms of the 1994 FAA Authorization Act. The Final Policy does not preclude a sponsor from using funds other than airport revenue to pay airline subsidies for new service, and it does not preclude other community organizations—such as chambers of commerce or regional economic development agencies—from funding a program to support new air service. Therefore, the Final Policy maintains the distinction between direct subsidy of air carriers and the waiving of fees, and prohibits the former.

64 Fed. Reg. 7696, 7709-10.

[183] The claim must be made after Oct. 1, 1996, and within 6 years of the contribution or expenditure. Moreover, the direct and indirect reimbursements of airport capital and operating expenses must be supported by adequate documentary evidence.

> Adequate documentation consists of underlying accounting records and corroborating evidence, such as invoices, vouchers and cost allocation plans, to support all payments of airport revenues to other government entities. If this underlying accounting data is not available, the Final Policy allows reimbursement to a government entity based on audited financial statements, if such statements clearly identify the expenses as having been incurred for airport purposes consistent with the Final Policy statement. In addition, the Final Policy provides that budget estimates are not a sufficient basis for reimbursement of government entities.

64 Fed. Reg. 7696.

[184] An example would be an expenditure that enhances the airport's acceptance in local communities impacted by the airport. 64 Fed. Reg. 7696.

[185] 64 Fed. Reg. 7696, 7718-19. In its decision approving the use of airport revenue for the extension of the Bay Area Rapid Transit (BART) line to San Francisco International Airport,

> the FAA approved the use of airport revenues to pay for the actual costs incurred for structures and equipment associated with an airport terminal building station and a connector between the airport station and the BART line. The structures and equipment were located entirely on airport property, and were designed and intended exclusively for use of airport passengers. The BART extension was intended for the exclusive use of people traveling to or from the airport and included design features to discourage use by through passengers. Based on these considerations, the FAA determined that the possibility of incidental use by non-airport passengers did not preclude airport revenues from being used to finance 100 percent of the otherwise eligible cost items. For purposes of this analysis, the FAA considered "airport passengers" to include airport visitors and employees working at the airport.

64 Fed. Reg. 7696, 7704.

The project must be either considered an airport capital project, or part of a facility owned and operated by the airport, and directly and substantially related to air transportation. 49 U.S.C. § 47107(b). 64 Fed. Reg. 7696.

[186] 64 Fed. Reg. 7696, 7718.

[187] 49 U.S.C. § 40116.

[188] 49 U.S.C. § 40116(b). The DOT has taken the position that both interstate and intrastate transportation are subject to this prohibition. Letter from DOT General Counsel Jim Marquez to Karen Haley (Dec. 18, 1985).

[189] 49 U.S.C. § 40116(c).

[190] No. 2005 CV 2052, 2006 Pa. Dist & Cnty. Dec. Lexis 95 (June 13, 2006).

[191] 49 U.S.C. § 40116(d)(2)(A)(iv).

[192] *Id*. at 46. Said the court, "the tax is paid by the patrons and never becomes airport revenue." *Id*. at 76.

Presumably then, had the tax been imposed upon parking lot companies holding an airport concession, rather than individuals, it would have been prohibited.

In *City of Syracuse v. Comerford*,[193] a lower New York court addressed a challenge brought by the City of Syracuse against the Town of Dewitt. For many years, Syracuse property in Dewitt had been exempt from taxation. Dewitt later imposed property tax assessments upon the Syracuse airport totaling more than $200 million. Syracuse argued that "the payment of such tax would represent impermissible diversion of airport revenue by payment of funds to the Town in excess of the value of services received from it; because it is alleged that no services are received from the Town, their value is claimed to be zero."[194] The court concluded that 49 U.S.C. § 47107 did not prohibit the imposition of real estate taxes, express authorization therefore being found in § 40116(e).[195]

The payment to a local municipality of lost taxes because of an airport's acquisition of land has also been an issue. The Burbank–Glendale–Pasadena Airport Authority sought an FAA opinion letter as to whether its payment to the City of Burbank of an amount equal to the lost tax revenue as a result of the airport's acquisition of land would constitute revenue diversion. The city was neither the airport owner nor the operator. The FAA identified three limitations on such payments: (1) they must be made to a nonsponsoring entity; (2) they must constitute compensation for lost tax revenue based on a preexisting tax rate; and (3) they must relate to property transfers occurring after promulgation of the FAAA Act or, more precisely, after August 23, 1994. The FAA found that the proposed payment in lieu of lost taxes by the airport authority was a proper use of airport revenue.[196]

Sales and use taxes of ancillary goods and services purchased by airlines, such as taxes on prepackaged meals purchased by airlines and served to passengers, or on aviation fuel, have been upheld.[197] The determination on sales taxes on fuel led to the 1987 amendments including fuel taxes within the scope of requirements on the use of revenue. However, taxes sought to be imposed upon air taxi, charter or scheduled interstate operations, or airline tickets have been deemed unlawful.[198]

[193] 2003 NY Slip. Op. 51356U, 2003 N.Y. Misc. Lexis 1336 (Sup. Ct. N.Y., Oct. 16, 2003).

[194] *Id*. at 11.

[195] *Id*. at 12.

[196] Letter from FAA Chief Counsel David Leitch to Richard Simon (July 9, 2001).

[197] 49 U.S.C. § 40116(e).

[198] Letter from DOT Deputy General Counsel Rosalind Knapp to Elizabeth Cuandra (Oct. 3, 1986).

F. How May Revenue Generated from Fuel Taxes Be Spent?

The Airport and Airway Safety and Capacity Expansion Act of 1987[199] required that local taxes on aviation fuel enacted after December 30, 1987, be spent on the airport, but allowed state taxes on aviation fuel to be spent on state aviation programs or noise mitigation at or near the airport.[200] Local aviation fuel taxes collected after December 30, 1987, may be spent only on the capital or operating costs of the airport, the local airport system, or other local facilities owned and operated by the airport owner and operator if the costs are directly and substantially related to the transport of persons or property.[201]

In 1989, the FAA was asked whether the imposition of an aviation fuel tax by a state or locality, the proceeds of which were to be used for nonaviation purposes such as human services, would be consistent with federal airport revenue requirements. The FAA noted that in 1987 Congress amended the law to make it clear that local fuel taxes were subject to airport revenue-use requirements. Congress also expanded the uses to which revenue generated from aviation fuel taxes could be spent to include aviation programs and noise mitigation efforts on or off the airport. The FAA concluded that "Congress, having expressly permitted two specific uses of aviation fuel tax monies, necessarily excluded other non-airport-related purposes."[202] Hence, the use of such proceeds for nonairport related human services would violate the statutory revenue use requirements.

In 1992, the State of Missouri enacted a new use tax on aviation fuel, the revenue of which was to be distributed to local governments under a local use tax fund, with no limitations on how the funds were to be spent. The FAA responded that "unless the tax revenue collected at the airport were used to fund the airport and airport related activities of the airport sponsor, a State aviation program, or a noise mitigation project, this tax plan could jeopardize the grant compliance status of federally-funded airports in the State of Missouri." The FAA urged the state to consider directing the tax proceeds away from the local use tax fund and restricting the use of such funds to those permitted under federal law.[203]

In 2000, the legislature of the State of Tennessee contemplated changing to general purposes its 4.5 percent state transportation fuel tax, the aviation portion of which was theretofore used to fund aviation programs within the State. The FAA took the position that even if the fuel tax were grandfathered in as promulgated prior to December 30, 1987, the Airway Safety and Capacity

[199] 100 Pub. L. No. 223, 101 Stat. 1486 (Dec. 30, 1987).

[200] 64 Fed. Reg. 7696-97.

[201] 49 U.S.C. § 47133. 64 Fed. Reg. at 7717.

[202] Letter from FAA Chief Counsel Gregory Walden to U.S. Senator Slade Gorton (Jan. 11, 1990).

[203] Letter from FAA Chief Counsel Kenneth Quinn to U.S. Senator Christopher Bond (Mar. 17, 1992).

Expansion Act made it clear that all revenue generated by a public airport and any local taxes on airport fuel must be expended for airport purposes.[204] The FAA concluded that

> the State of Tennessee may not rely on the fact that its 1986 State aviation fuel tax may be grandfathered to enact new measures to divert, directly or indirectly, airport revenue. In other words, if a tax on aviation fuel was in effect prior to December 30, 1987, but proceeds were on that date limited to purposes permitted by 47107(b), the FAA will not treat that tax as grandfathered. Passage of the legislation to permit general use of the proceeds from the aviation fuel tax may jeopardize continued Federal funding of the airport and noise abatement projects at Federally-assisted airports throughout the State of Tennessee.[205]

Hence, a state acts at its peril if it amends a grandfathered tax to redirect its use for nonairport purposes.

G. Which Expenditures for Intermodal Transportation Infrastructure Are Authorized?

Among the aviation statutes is a declaration of national policy "to develop a national intermodal transportation system that transports passengers and property in an efficient manner."[206] The Wendell H. Ford Aviation Investment and Reform Act for the 21st Century of 2000 amended this provision to provide for the encouragement and development "of intermodal connections on airport property between aeronautical and other transportation modes to serve air transportation passengers and cargo efficiently and effectively and promote economic development."[207] The FAA has implemented this policy in a series of decisions involving AIP grants, PFC authorizations, and local revenue expenditures.

As explained above, various federal statutes and regulations require that public airports accepting AIP funding agree that all revenue generated by the airport be used exclusively for the capital or operating costs of the airport, the local airport system, or facilities owned or operated by the airport directly and substantially related to the air transportation of persons or property.[208] One question that has arisen is whether airport funds spent on building or operating transit or rail lines or stations are to be owned or operated by the airport and directly and substantially related to the air transportation of passengers.[209]

Rail lines at Atlanta, Chicago, Cleveland, and Washington, D.C., airports have been financed by transit systems rather than airports. The Intermodal Surface Transportation Efficiency Act of 1991 (ISTEA) included a special appropriation for extension of a Bay Area Rapid Transit (BART) line to San Francisco International Airport (SFO). The Federal Transit Administration committed $750 million, or about 64 percent of the $1.2 billion project. The remaining $417 came from state and local funding sources.[210] But airport revenue funds were used to finance only the connector. The FAA approved airport funding for construction of a BART station at SFO, including the structures and equipment in the airport terminal building and a connector between that station and the BART line.[211] The FAA considered "airport passengers" to include the incidental use of the line by airport visitors and employees.[212] The 8.7-mile extension was the largest since BART was built in the early 1970s. About 68,000 riders a day were expected to use the line.[213]

Public transit terminals and rights of way may be made available at less than FMV rental so long as the facilities are directly related to air transportation, including the use by airport visitors and employees.[214] The FAA has taken the position that it believes "the use of airport property for a public transit terminal, transit right-of-way, or related facilities at less than fair rental value to be consistent with the self-sustaining assurance."[215] The transit system must be publicly owned and directly related to the transportation of passengers and airport visitors and employees to and from the airport.[216]

H. What Are the Requirements for a Self-Sustaining Airport Rate Structure?

To reduce the burden on federal and local tax resources, airports are required to adopt an airport fee and rental structure that is as self-sustaining as possible. Generally, airport sponsors must impose FMV commercial charges for nonaeronautical uses of airport property.[217] Aeronautical user charges are subject to the standard of reasonableness and nondiscrimination, but may be less than FMV.[218] An aeronautical charge is

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[204] 49 U.S.C. §§ 47107(b)(1), 47133(a).

[205] Letter from FAA Airports Division Manager Stephen Brill to Tenn. Ass't Att'y Gen. Winston Sitton (May 24, 2000).

[206] 49 U.S.C. § 47101(b)(1).

[207] 106 Pub. L. No. 181; 114 Stat. 61 (Apr. 5, 2000).

[208] 49 U.S.C. § 47107(b).

[209] 49 U.S.C. § 47107(b). 14 C.F.R. pt. 158. FAA Order 5100.3A ¶ 553(a), AIP Handbook (Oct. 24, 1989). U.S. DEP'T OF TRANSP., INTERMODAL GROUND ACCESS TO AIRPORTS: A PLANNING GUIDE 16, 202 (Dec. 1996). More recent interpretations by the FAA have liberalized this rather constricted view of the types of landside projects which are appropriate for federal airport funding. Federal funding of an airport with the surrounding highway, rail, or transit networks can come from the FAA, FHWA, or FTA.

[210] U.S. GENERAL ACCOUNTING OFFICE, SURFACE INFRASTRUCTURE: COSTS, FINANCING AND SCHEDULES FOR LARGE-DOLLAR TRANSPORTATION PROJECTS 18 (Feb. 1998).

[211] Letter from FAA Associate Administrator Susan Kurland to SFO Airport Director John Martin (Oct. 18, 1996).

[212] 64 Fed. Reg. 7696.

[213] Benjamin Pimentel, *BART's 4-Year Trip to SFO Starts Today,* SAN FRANCISCO EXAMINER, Nov. 3, 1997, at 1.

[214] 64 Fed. Reg. 7696, 7721.

[215] 61 Fed. Reg. 66735 (Dec. 18, 1996).

[216] *Id.*

[217] 64 Fed. Reg. 7696, 7721.

[218] *Id*. at 7720-21.

defined by the FAA as "any activity which involves, makes possible, or is required for the operation of aircraft, or which contributes to or is required for the safety of such operations."[219]

Certain use of property for community services, such as parks, recreational facilities, or bike and jogging paths are acceptable. However, the purchase or operation of road maintenance equipment and services or police and fire services not directly in support of the airport are deemed impermissible.[220] Certain uses of property for nonprofit aviation organizations at reduced rental rates, such as aviation museums, educational programs, or Civil Air Patrol operations, are acceptable. Moreover, nominal lease rates may be imposed upon military units.[221]

VI. CONFLICT BETWEEN FEDERAL AND LOCAL GOVERNMENTS OVER REVENUE DIVERSION

A. Agency Application of Revenue-Diversion Policy

This section succinctly introduces the policies described above in specific factual contexts, relying on U.S. DOT IG reports,[222] GAO reports, and FAA and U.S. DOT orders.[223] Tracing the outcome of all allegations and investigations of revenue diversion is beyond the scope of this project. This discussion, however, provides examples of how and why the question of revenue diversion has been raised or asserted in particular cases.

B. Revenue Diversion Found

Probably the most notorious case of revenue diversion involved Los Angeles International Airport. In the wake of the Los Angeles riots, city officials began to seek financial resources to rebuild the city and enhance police and fire services. In 1988, the City of Los Angeles hired a consultant to assist it in identifying ways of lawfully diverting airport revenue to the city. The George H.W. Bush Administration favored selling LAX, a sale that could have generated more than $1 billion. But an outright sale was deemed politically problematic. Rather than sell the airport, the city proposed instead to amend the city charter to allow airport revenue to be placed in the city treasury. The airport's cash surplus was $25 million in 1991, money that would enable the city to hire 800 police officers, 108 paramedics, and 60 firefighters; airport surpluses were projected to grow to $70 million annually. The charter amendment (Amendment K) passed in 1992.[224] One source noted:

> The airline industry led the opposition to the diversion of revenue from the airport to the city treasury. Opponents argued that passage of Proposition K would drive up prices at the airport on everything from airline tickets to airport food concessions and would diminish airport maintenance and improvements. Roger Cohen, Vice President for Government Affairs of the Air Transportation Association, said "the airport is the one thing in the city that works…. It has been run like a business and at no taxpayer expense. Proposition K represents the final blow in politicization of the airport." Cohen feared that, under Proposition K, city officials would use their power to review Airport Commission decisions to increase terminal rents, concession fees, and airline landing charges in order to bolster the funds in the city treasury. These costs would, of course, have to be passed on to consumers, thereby possibly decreasing the number of airline patrons.[225]

In 1994, the U.S. Supreme Court handed down its decision in *Northwest Airlines v. County of Kent*, upholding a change in airport fee methodology from residual to compensatory. It held that an airport charge is reasonable "if it (1) is based on some fair approximation of the use of the facilities, (2) is not excessive in relation to the benefits conferred, and (3) does not discriminate against interstate commerce."[226] Under this approach, airports were "given wide latitude in selecting a particular rate methodology and fee structure."[227]

Shortly after this decision, the City of Los Angeles changed its landing fee methodology from residual to compensatory. It imposed a FMV requirement in airfield valuation, based on the value of the land at the time it was ceded to the airport in 1928, adjusted for inflation. This resulted in a tripling of aircraft landing fees, from 51 cents per thousand pounds, first to $1.51, then to $2.06.[228] The airlines filed suit, but the courts held the applicable federal statutes (particularly the Anti-Head Tax Act) accorded no private right of ac-

[219] *Id*. at 7710. *See also* DOT Policy Statement on Airport Rates and Charges, 61 Fed. Reg. 31994, 32017 (June 21, 1996).

[220] 64 Fed. Reg. 7696, 7721.

[221] *Id*. at 7721.

[222] The role of the Department of Transportation Office of the Inspector General is to audit and investigate as necessary to promote effectiveness in departmental programs. See http://www.oig.dot.gov/about.jsp (Last visited Jan. 28, 2008).

[223] Many of the letters and memoranda cited were obtained by the researcher through his submission of a Freedom of Information Request to determine the outcome of cases and other information available.

[224] In 1992, the city passed Referendum K, which removed a prohibition in the city charter against taking airport revenue off the airport. Imes, *supra* note 79, at 1039, 1070–71 (1995).

[225] Imes, *supra* note 79, at 1039, 1071–72 [citations omitted].

[226] 510 U.S. 355, 368, 114 S. Ct. 855, 864, 127 L. Ed. 2d 183, 196 (1994).

[227] *Id*. For a comprehensive review of this decision, see Rise J. Peters, *Case Comment: Northwest Airlines v. County of Kent, Michigan: More Than You Ever Wanted to Know About Airport Ratesetting, Part One* (*Pricing in the Courts*), 22 TRANSP. L.J. 291 (1994).

[228] Airport Revenue Diversion, Hearings before the U.S. Sen. Subcomm. on Aviation of the Commerce Comm. (May 1, 1996), at 5-6 (statement of Sen. Wendell Ford), reproduced at http://books.google.com/books?id=nQEDkwETmdkC&dq=%22airport+revenue+diversion%22&printsec=frontcover&source=web&ots=f7QKBCZe8&sig=ZsilCY2rHH1ZSYysVMapyMALmMM#PPA46,M1 (Last visited Jan. 23, 2008).

tion.[229] The U.S. DOT Secretary mediated a standstill agreement.

Congress responded with the FAAA Act, directing the U.S. DOT to promulgate policies and procedures within 90 days providing for the "prompt and effective enforcement" of the revenue-diversion prohibition and giving the U.S. DOT authority to determine fee reasonableness. (In fact, the FAA failed to promulgate the final policy until 1996.) Further, the 1994 legislation prohibited airport payment for city services unrelated to airport operations, imposed new reporting requirements on airports, and authorized civil penalties up to $50,000.[230]

Nevertheless, in February 1995, the City of Los Angeles transferred $52 million to its general fund from the airport, claiming this amount consisted of principal and interest on land condemned for the Century Freeway in 1988. In February 1995, the FAA issued an informal opinion letter reviewing the legality of the transfer and concluded that it would not block the transfer.[231] The following month, the airline industry trade association filed a formal challenge.[232] Subsequently, Los Angeles announced it intended to use airport revenue to cover various municipal operating expenses, including police protection for the city at large.[233] In response, in 1997, the FAA froze $60 million in federal grants for capital improvements at Los Angeles's four airports, including LAX, and insisted upon repayment to the Los Angeles Airport Department of $30 million that the city had transferred into the city's general fund.[234] Ultimately, the city agreed to repay $30 million to the Airport Department.[235]

Allegations of the use of airport revenue for nonairport purposes are abundant. Of the 47 airports it inspected between 1991 and 1995, the U.S. DOT IG estimated revenue diversion on the order of $55 million annually.[236] The IG alleged that Westchester County, New York, spent nearly $24 million on nonairport projects in the early 1990s,[237] while in Hawaii, $64 million was spent on a dog track next to the airport. In Denver, Colorado, $4.7 million in indirect costs were charged to the airport in 1992–1993 for such things as nonairport-related lobbying, costs of the mayor and city council, and defense of a lawsuit from a concrete contractor who had never done any airport work.[238] The only category of airports in which the IG alleged no revenue reversion

[229] Air Transport Ass'n of America v. City of Los Angeles, 844 F. Supp. 550 (C.D. Cal. 1994).

[230] 49 U.S.C. § 47129.

[231] Letter from Cynthia Rich, Associate Administrator for Airports, to Theodore O. Stein, President, Board of Airport Commissioners (Feb. 28, 1995), cited in Air Transport Ass'n of America v. City of Los Angeles, 1995 DOT Av. Lexis 193 (Apr. 3, 1995). By 2004, the Air Transport Association noted, "we understand that the FAA is nearing conclusion of its investigation into the transfer of certain funds (eminent domain proceeds) from LAX to the City related to the acquisition of property and property rights used to construct the Century Freeway." Statement of James C. May, President and CEO, Air Transport Association of America, Inc., Before the Committee on House Transportation and Infrastructure Subcommittee on Aviation (Apr. 1, 2004).

[232] More than a year later, the FAA had failed to take formal action on the complaint. Airport Revenue Diversion, Hearings before the U.S. Sen. Subcomm. on Aviation of the Commerce Comm. (May 1, 1996), at 46–47 (statement of Edmund Merlis), reproduced at http://books.google.com/books?id=nQEDkwETmdkC&dq=%22airport+revenue+diversion%22&printsec=frontcover&source=web&ots=f7QKBCZe8&sig=ZsilCY2rHH1ZSYysVMapyMALmMM#PPA46,M1 (Last visited Jan. 23, 2008).

[233] The LAX conflict is discussed in Imes, *supra* note 79, at 1039, and Peters, *supra* note 227, at 22, and PAUL DEMPSEY & LAURENCE GESELL, AIR COMMERCE & THE LAW 474–75 (2004). The DOT Inspector General Report on Los Angeles' revenue diversion is available at http://www.oig.dot.gov/StreamFile?file=/data/pdfdocs/r9fa7005.pdf (Last visited Jan. 23, 2008).

[234] The city had transferred a total of over $31 million based on its contention that this sum represented the total with interest of prior unreimbursed general fund contributions to LAX by the city. The FAA found, "Of the $31,114,463 transferred from the Airport, the City provided documentation sufficient only to establish that the City provided contributions and services to the Airports Department in the amount of $1,159,674." The FAA concluded:

> The Determination finds that the City must return $30,287,835, with interest, to the Airport Revenue Fund in order to remain in compliance with its grant obligations, based on the finding that the City has not provided a legal basis or sufficient documentation to justify that amount. Until such time as this amount is returned, the FAA is suspending for 180 days, or until further notice, all payments of funds on FAA grants for projects at Los Angeles International (LAX), Ontario, Palmdale, and Van Nuys Airports, and considers the City and its airports ineligible to apply for new FAA grants.

In the Matter of Revenue Diversion by the City of Los Angeles at Los Angeles Int'l, Ontario, Van Nuys and Palmdale Airports, 1997 FAA Lexis 1535 (Mar. 17, 1997).

[235] *Rectrix Lawsuit Charges Barnstable Airport Commissioners Illegally Diverted Airport Funds in Violation of FAA Regulations; Suit Says Commissioners Conducted Illegal Racketeering Scheme to Monopolize Jet Fuel Sales*, PR NEWSWIRE (July 21, 2006).

[236] Airport Revenue Diversion, Hearings Before the U.S. Sen. Subcomm. on Aviation of the Commerce Comm. (May 1, 1996), at 49 (testimony of Edmund Merlis), reproduced at: http://books.google.com/books?id=nQEDkwETmdkC&dq=%22airport+revenue+diversion%22&printsec=frontcover&source=web&ots=f7QKBCZe8&sig=ZsilCY2rHH1ZSYysVMapyMALmMM#PPA30,M1 (Jan. 31, 2008).

[237] In 1997, the FAA concluded that the city owed the airport nearly $7 million in improperly diverted revenue. Letter from FAA Office of Airport Safety and Standards Director David Bennett to Weschester County Commissioner Joseph Petrocelli (Feb. 14, 1997).

[238] Airport Revenue Diversion, Hearings Before the U.S. Sen. Subcomm. on Aviation of the Commerce Comm. (May 1, 1996), at 50 (statement of Edmund Merlis), reproduced at: http://books.google.com/books?id=nQEDkwETmdkC&dq=%22airport+revenue+diversion%22&printsec=frontcover&source=web&ots=f7QKBCZe8&sig=ZsilCY2rHH1ZSYysVMapyMALmMM#PPA30,M1 (Jan. 31, 2008).

was that of independent port authorities, not subjected to rule by mayors and city councils.[239]

In the mid-1990s, the IG asserted the existence of revenue diversion or failure to obtain fair rental value for airport property, or both, in 38 cases. In its audit of Los Angeles, the IG determined the donation of airport funds to nonprofit and community groups to constitute revenue diversion. In 2003, U.S. DOT IG Kenneth Mead testified before Congress that:

> ….Airports that receive Federal grants are required to put any revenue generated at the airport back into the airport operating or capital funds in order to minimize Federal assistance. Any other use of the revenue is considered a diversion. Examples of common revenue diversions include airport sponsors or local governments (1) charging the airport for property or services that were not provided, or (2) renting airport property at less than fair market value.
>
> At a time when airports are continuing to look for new ways to fund their operations, we continue to find cases of airport revenue diversion. For example, at a sample of five airport sponsors reviewed, we found approximately $40.9 million in potential revenue diversions that were not detected by FAA's primary oversight methods…[240]

The FAA does not agree with the IG's interpretation that renting at less than FMV is diversion, unless the sponsor is renting to itself for nonaeronautical purposes.

The IG initially determined that between 1998 and 2002, approximately $12.5 million of airport revenue was diverted from SFO to city and county uses.[241] The FAA and IG ultimately concluded that the City and County of San Francisco were required to repay SFO approximately $4.5 million dollars. The U.S. DOT also concluded that SFO's transfer of 15 percent of its concession revenue (about $20 million) to the City each year is authorized under the grandfather provisions of the statute.[242]

The U.S. DOT IG asserted the existence of a $4.3 million revenue diversion from Dade County, Florida, between 1989 and 1996.[243] A smaller amount was diverted at Imperial County, California,[244] and Augusta–Richmond, Georgia.[245]

The FAA has ordered refunds of fees paid by airports deemed to be excessive.[246] In 2007, U.S. DOT IG Calvin Scovel testified:

> Since the early 1990s, we have identified hundreds of millions of dollars in airport revenue diversions, revenues that should have been used for the capital or operating cost of an airport but were instead used for non-airport purposes. In the last 4 years, we reported on revenue diversions of more than $50 million at seven large airports, including one airport whose sponsor…diverted about $40 million to other projects not related to the airport.[247]

The U.S. DOT IG's Web site[248] contains a number of airport investigations and findings on revenue diversion. However, its web site does not provide a complete picture of the issue because it does not describe the FAA's resolution of the particular issues raised in the IG's reports. In many cases, following additional investigation, the FAA concluded that no unlawful revenue diversion occurred or that the amount of unlawfully diverted revenue was less than the IG found, and the IG concurred.

Several airport operators also have sought informal opinion letters from the FAA before making questionable expenditures. As an example, the Susquehanna Regional Airport Authority sought an opinion as to whether it could use airport revenue to make an annual payment in lieu of taxes to the local school district. The FAA concluded that the payment would exceed the value of services rendered to the airport, and therefore would constitute unlawful revenue diversion.[249]

C. Revenue Diversion Not Found

In the early 1990s, Albany County, New York, the owner of Albany Airport, proposed to lease its airport to a private joint venture. The county proposed an initial lease payment of $30 million to cover the capital and operating costs it incurred over the preceding three decades. The FAA took the position that the airport

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[239] MARY SCHIAVO, FLYING BLIND, FLYING SAFE 125–27 (1997).

[240] Statement of The Honorable Kenneth M. Mead, Inspector General, U.S. Department of Transportation, House Committee on Budget (July 9, 2003), http://www.oig.dot.gov/StreamFile?file=/data/pdfdocs/cc2003132.pdf (Last visited Jan. 28, 2008).

[241] http://www.oig.dot.gov/item.jsp?id=1283 (Jan. 23, 2008).

[242] Nisid Hajari, *A Walk in the Clouds*, TIME, June 22, 1998; George Raine, *What's Up at SFO?*, SAN FRANCISCO EXAMINER, Feb. 17, 1998, at A-1. Memorandum from Assistant DOT General Counsel Robert Gabel to James Brucia (Nov. 23, 1993).

[243] http://www.oig.dot.gov/StreamFile?file=/data/pdfdocs/r4fa7035.pdf (Last visited Jan. 28, 2008).

[244] http://www.oig.dot.gov/StreamFile?file=/data/pdfdocs/av1998196.pdf (Last visited Jan. 28, 2008).

[245] http://www.oig.dot.gov/StreamFile?file=/data/pdfdocs/av1998093.pdf (Last visited Jan. 28, 2008).

[246] *See, e.g.*, Second Los Angeles International Airport Rates Proceeding, DOT Order 96-1-18 (1996); Los Angeles International Airport Rates Proceeding; Second Los Angeles International Airport Rates Proceeding, Order 97-12-31 (1997).

[247] Testimony by Calvin L. Scovel III, DOT Inspector General, on Fiscal 2008 Appropriations: Federal Aviation Administration, Before the Subcomm. on Transportation, Housing And Urban Development, and Related Agencies of the U.S. Senate Appropriations Committee (May 10, 2007), available at http://www.oig.dot.gov/StreamFile?file=/data/pdfdocs/Final_Budget_Statement_w-508.pdf (Last visited Jan. 31, 2008).

[248] http://www.oig.dot.gov/Room?subject=26 (Jan. 28, 2008).

[249] Letter from FAA Airport Compliance Division Manager Charles Erhard to Timothy Edwards (Mar. 20, 2007).

operator could not recoup its capital and operating costs long after it had made such investments. The U.S. DOT General Counsel put the question to the Justice Department, which took the opposite position, concluding that the use of airport revenue to reimburse prior capital or operating expenditures may fairly be characterized as a legitimate capital or operating expense within the meaning of the AAIA, irrespective of when such expenses were incurred.[250] Following issuance of this opinion, Congress in 1994 enacted the 6-year statute of limitations on use of airport revenue to reimburse sponsor for previous contributions to the airport.

When Hurricane Katrina hit New Orleans and the surrounding region, several airports sought to reimburse emergency costs incurred by sister airports in the region. Airports Council International sought an opinion as to whether such expenditures were consistent with the airport revenue-use requirements of 49 U.S.C. §§ 47107(b) and 47133. In an informal opinion letter, the FAA concluded that such relief was analogous to mutual aid agreements entered into by public airports with local governmental safety providers, and the expenditures were therefore lawful. However, the FAA took the position that this conclusion applied only to airport revenue and not to federal grants or PFC receipts.[251]

Many of the FAA revenue determinations are highly factually based and depend upon specific language in the grant agreements and action taken by FAA personnel in authorizing various transactions, including the disposal of airport land, for example. In many such cases, the FAA found no unlawful revenue diversion.[252]

VII. CONCLUSION

It is understandable that financially strapped local governments look to airports as "cash cows." Indirect taxes can be levied upon airlines and passengers who may have no vote in the local jurisdiction; hence there will be no political price for the local politician to pay for imposing unjust fees upon them for services they do not receive. Indeed, the local politician can be viewed as a hero among his constituents, who enjoy enhanced governmental services with no corresponding local financial burden.

Congress, however, has found this form of indirect taxation to constitute an impermissible burden on interstate commerce. Federal statutory prohibitions against revenue diversion are long-standing; they go back to 1982, with the promulgation of the AAIA that year, and have been reaffirmed and strengthened by Congress in successive legislation passed in 1987, 1994, and 1996. The FAA also has promulgated regulations and policy statements furthering the Congressional policies embraced in that legislation and has inserted language in federal grant agreements imposing contractual duties upon airport operators not to divert revenue.

Like most rules addressing complex issues, the revenue-diversion rules themselves are complex. There are areas of clarity and areas of ambiguity in the law and policy of airport revenue diversion. The basic principles are clear. Though there are exceptions, there can be no doubt of the general rule—local governments may not siphon off airport revenue for nonairport purposes. Airport revenue is to be spent on the capital and operating expenses of the airport. The devil, of course, lies in the details.

What an airport spends influences what it collects. Congress has decreed that funds derived from the federal government, as well as revenue derived from airlines and other users, are to be spent on the airport and related activities and are not to be diverted elsewhere. A review of FAA and U.S. DOT orders and opinion letters reveals that many determinations of whether individual expenditures fall on the lawful or unlawful side of revenue diversion are intensely factually based.

[250] DOJ Memorandum from Ass't Att'y Gen. Michael Luttig to Acting DOT General Counsel C. Dean McGrath, Jr., (Feb. 12, 1991).

[251] Letter from FAA Chief Counsel Andrew Steinberg to ACI General Counsel Patricia Hahn (Sept. 23, 2005).

[252] *See, e.g.*, Rudy J. Clarke v. City of Alamogordo, NM, 2006 FAA Lexis 629 (Sept. 20, 2006); Boca Airport, Inc., d/b/a Boca Aviation v. Boca Raton Airport Auth., 2003 FAA Lexis 143 (Mar. 20, 2003); Wilson Air Center v. Memphis and Shelby County Airport Auth., FAA Docket No. 16-99-10, Final Agency Decision (Aug. 30, 2001), and Director's Determination (Aug. 2, 2000); Steere v. County of San Diego, FAA Docket No. 16-99-15, Final Agency Decision (Dec. 7, 2004) and Director's Determination (July 21, 2004).

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DAPHNE A. FULLER provides liaison with the Federal Aviation Administration, BARRY MOLAR provides liaison with the Federal Aviation Administration, PATRICIA A. HAHN provides liaison with the Airports Council International-North America, and GWEN CHISHOLM SMITH represents the ACRP staff.

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