Report of the AVIATION COMMITTEE

2000 Spring Council Meeting

Chair: Frank J. Costello

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The theme of the Spring meeting is the evolution of infrastructure. Aviation, the most "evolved" of post-deregulation infrastructure industries, does not present any readily apparent templates in that regard. Some things are better, some things are worse, and most things are different. Change is the only constant.

As always, this Report reflects those changes and new developments. The focus of this report is on business aviation, itself the product of many changes.

Business Aviation

One of the most important components of our national air transportation system is business aviation. Business aviation generally is defined as general aviation aircraft (*i.e.*, aircraft not operated by airlines or by the government) used in the furtherance of a business. The business aviation industry is not as highly visible as the airline industry, but its scope is significant. In 1998, U.S. airlines operated approximately 5,300 jet-powered aircraft. That same year, there were over 7,300 jet-powered aircraft operated by U.S. companies in the furtherance of their businesses – and another 31,000 piston-powered aircraft operated by U.S. companies.

Profile of Business Aviation

Business aviation has been around since the post-WWI years. Lindbergh's transatlantic flight, in what would be considered a light general aviation aircraft today, proved the concept. By the 1930's, many companies were using aircraft to meet a variety of business requirements, from transporting executives to inspecting facilities. Many of the best pilots were employed by companies for their own flights (including General Jimmy Doolittle, who headed Shell Oil's flight department in the 1930's). By the end of the Depression, three manufacturers had emerged – Beech, Cessna and Piper – who would shape general aviation for the next fifty years.

Access to surplus military aircraft, and the uniquely American general aviation manufacturing industry, sustained the growth of business aviation through the late 1950's. Most of the piston-powered aircraft types still in use today were developed during that period. In 1958, the jet age began when a four–seat French-made MS 760 was delivered to a U.S. company. By the early 1960's, six manufacturers were offering business jets for the U.S. market. In 1964, Beech introduced the turboprop King Air, still the single most popular jet-powered business aircraft.

The boom continued until the early 1980's when general economic conditions began to take their toll. By 1992, although business aviation operations remained

healthy, the manufacturing sector has reached its nadir with sales approximately 40% below where they had been a decade earlier.

Today, all sectors of the business aviation industry are booming. A prosperous economy, airline service that is increasingly unfriendly to business and an 18-year statute of repose enacted in 1994 for smaller general aviation aircraft,[1] has led to a boom in sales. In 1998, U.S. manufacturers booked $5.9 billion in sales (compared to $1.8 billion in 1992). Jet-powered aircraft accounted for 94% of those sales. General aviation imports also reached a new high in 1998 -- $3.5 billion in sales, again almost entirely jet-powered aircraft. Most expect that 1999 will report even better results.

The National Business Aviation Association ("NBAA") is the trade association representing the business aviation user community. While NBAA's primary mission is to promote and sustain professionalism within that community, it conducts extensive surveys of its membership to determine their requirements. Those surveys consistently report three general reasons why companies choose to operate their own aircraft:

- To improve productivity. The success of airline deregulation has also greatly enhanced the need for, and success of, business aviation. Hub and spoke systems make economic sense for the airlines but do not always match the needs of business travelers. Company aircraft, on the other hand, offer point-to-point transportation with agreed-upon schedules. They also allow business to be accomplished enroute, something that is all but impossible on an airline.

- To maximize safety. Business aviation, and jet-powered business aviation in particular, has the best safety record in the aviation industry. While the safety regulatory scheme imposed on business aviation is in some respects less severe than that imposed on the airlines, it has permitted the development of a very sophisticated "owner on board" safety culture.

- To maximize security. Public transport of any type raises concerns about security and confidentiality that, for the most part, are not present in private transportation.

Business Aviation Issues

The major issues facing business aviation are airport access and regulation.

1. Airport access. Airport access problems are driven more by appearance than by reality. Business jets generally are quieter than their airline counterparts. But a corporate jet departing a Southern California airport at 10:00 p.m. is not viewed by the surrounding community in the same light as a large airline jet departing at the same time. The latter may be viewed as a nuisance but a necessary one, even if its destination is a resort. The corporate aircraft. on the other hand, often is viewed (and described in the press) as a "luxury jet" even though it may be departing on a business mission that is

[1] General Aviation Revitalization Act of 1994, P.L. 103-298, 49 U.S.C. § 40101 note.

important to the community. The Committee's Spring 1999 report took a detailed long at aviation "noise" issues. Those issues, and, in particular, the policies and procedures of the FAA under the Airport Noise and Capacity Act, 49 U.S.C. § § 47521 et seq., are likely to be tested in the next two years, and primarily with restrictions proposed for business aircraft operations.

2. Regulation. The vast majority of business aviation aircraft and operations are regulated by the FAA as general aviation under 14 C.F.R. part 91. While part 91 sets a high standard for safety, it generally involves a lower level of FAA surveillance than that in place for the airlines. The safety record of business aviation and, in particular, of jet-powered business aviation aircraft, is outstanding.

This is a regulatory scheme that does not require any economic operating authority. For almost three decades, Subpart F to part 91 has permitted business aviation to operate in a variety of formats intended to spread capital costs and improve aircraft utilization, including joint ownership, time-sharing, interchange agreements and limited cost-sharing, provided that "the carriage is within the scope of, and incidental to, the business of the company." 14 C.F.R. part 91.501(b)(5). Airlines and other "for hire" aircraft operations, however, are subjected to both economic regulation and a higher degree of safety surveillance under 14 C.F.R. parts 121 and/or 135.

In 1986, a variation on these formats was introduced with the first fractional aircraft ownership program. In a fractional ownership program, the purchase of an interest in an aircraft also entitles the owners to a pro rata use of other aircraft in the program manager's pool of aircraft. This typically is the entry level for business aviation, *i.e.*, if a company does not require more than a few hundred hours of aircraft time per year, fractional ownership, although very expensive on an hourly basis, certainly is more cost-effective than purchasing an entire aircraft. Fractional programs are growing rapidly. As of January 2000, it is estimated that there were 450 fractionally owned aircraft and over 1,800 fractional owners.

Although the FAA tacitly approved the development of fractional ownership programs under part 91, it never explicitly confronted the underlying legal and policy issues. Namely, should these programs be regulated under parts 121 and 135 as common carriage and/or because of their size (several programs operate more aircraft than are operated by most airlines). The issue was raised by many on-demand charter operators who viewed fractional programs as less-regulated competition.

The FAA took a unique approach to resolving these issues through the creation of an advisory rulemaking committee pursuant to 49 U.S.C. § 106(p)(5). This statutory authority gives the FAA the ability to set up industry panels without the constraints of the Federal Advisory Committee Act. The Fractional Ownership Aviation Rulemaking Committee (FOARC) was composed of representatives from interested parties on all sides of the issues.

The FOARC issued its recommendations to the Administrator of the FAA on February 22, 2000 in the form of a draft Notice of Proposed Rulemaking. The key factual finding was that fractional ownership programs had the best safety record in aviation. Starting from that point, the gist of the recommendations was that fractional ownership programs should be kept under part 91 but with certain enhanced safety-related requirements that reflect best practices in the industry. These requirements would be set forth in a new part 91 subpart K. At the same time, certain restrictions applicable to on-demand charter operators, primarily related to airport access, would be modified to mirror the part 91 requirements, provided that the on-demand charter operators met certain flight-crew related requirements of the new subpart K.

The FAA has taken the FOARC's recommendation under advisement but has committed to beginning a rulemaking proceeding this year. If successfully implemented, the FOARC's recommendation will resolve one of the more contentious issues in the aviation industry. Equally important, the process used to reach that result may serve as a model for the resolution of other regulatory disputes.

Competition Issues

As the Justice Department's section 2 "predation" case against American proceeds through discovery, the core competition issues raised in that case continue to reappear elsewhere.

1. TACA International Airways, S.A. v. Continental Airlines, Inc., DOT Docket OST-99-6418. On October 28, 1999, TACA, a consortium of five Central American airlines, filed a complaint against Continental alleging predatory pricing in certain U.S.-Central American markets. The complaint invokes the authority of the DOT to prohibit "unfair methods of competition" in the airline industry, 49 U.S.C. § 41712, authority identical to that in section 5 of the Federal Trade Commission Act. The gist of the complaint is that Continental has flooded markets where it competes with TACA with low fares. The docket remains in the pleading stage, but it should be noted that the DOT only rarely has used its section 41712 authority for any purpose and never to reach airline-pricing activities.

2. Virgin Atlantic Airways Limited v. British Airways PLC, 69 F.Supp. 571 (S.D. NY 1999). The litigation between Virgin and British Airways could fill several books. This chapter involves a section 2 action by Virgin alleging that British Airways used incentive agreements with travel agents and corporate customers to leverage its monopoly power in an effort to monopolize five U.S. - Heathrow city-pair markets. The district court granted British Airways' motion for summary judgment. The result was, perhaps, inevitable, but the immediate circumstances underlying that result are instructive.

Virgin had responded to the British Airways motion with an affidavit from an economist setting forth a "predatory foreclosure" theory. Under this theory, if an airline prices "on the margin" and additional flights must be added to handle the additional

traffic, those additional flights are operated below marginal costs and meet the average variable cost threshold for actionable predatory pricing. This essentially is the theory advanced by the Justice Department in its complaint against American. The district court held that whatever one might think about this theory, there was no factual basis for the assumption that additional flights were added by British Airways to carry the incentivized traffic.

International

1. Chicago Convention Redux, or "Just Say No to the GATT". In 1944, under the auspices of the newly created United Nations, the Allied civil aviation authorities met in Chicago to decide the post-war rules that would apply to international civil aviation. The result was the Convention on International Civil Aviation, better known as the Chicago Convention, an instrument that provided for certain basic rights and established minimum standards, but that left traffic rights to be negotiated by the individual nations. Nations have done so for more than fifty years, mostly on a bilateral basis.

In December 1999, the U.S. DOT convened a meeting of world aviation ministers in Chicago to "reassess" the Chicago Convention. Since much of international civil aviation now is conducted under relatively liberal "open skies" agreements, almost all entered into on a bilateral basis, the real issue was one of structure rather than goals. Specifically, all agreed (albeit some reluctantly) that enhanced competition was the goal, *i.e.*, "liberalization beyond open skies," and that this should be accomplished through consideration of regional, multilateral and plurilateral systems. The unstated agreement was that it should not be accomplished by adding aviation services to the GATT.

The Fall 1999 Committee report noted that the World Trade Organization had the addition of aviation services as an agenda item in the GATTS 2000 negotiations. There is resistance to this among aviation regulators both here and abroad. Not coincidentally, the U.S. has invited the member states of the Caribbean Community (CARICOM) to discuss a regional aviation agreement with the U.S. Outside the U.S., the European Commission has invited the U.S. to join in discussions looking toward a Transatlantic Common Aviation Area (TCAA), and a number of African nations are circulating a proposal for a multilateral agreement. While a regional agreement with CARICOM is much more likely than the prospects of the U.S. entering into the TCAA - which effectively would make the U.S. a member of the European Union for aviation purposes -- each of these initiatives is, at least in part, a response to the GATT alternative.

2. U.S.-U.K. Aviation Relations. At recent Congressional hearings, several influential House members threatened renunciation of the U.S.-U.K. aviation agreement (Bermuda 2), denial of U.S. operating rights to U.K. airlines and other forms of retaliation unless the U.K. agreed to "liberalize" Bermuda 2. The controversy even reached the Clinton-Blair level. The dispute has been going on so long, and has seen so many iterations, that it is useful to review the bidding.

The U.S.-U.K. market is both highly restricted and highly competitive. The restrictions that remain are largely on the margin and primarily focus on access to London's Heathrow Airport. Transatlantic service to/from Heathrow presently is limited by the terms of Bermuda 2 and slot constraints to American, British Airways, United and Virgin. All other passenger service is to/from London's Gatwick Airport. Other U.S. airlines, notably Continental and Delta, want limited access to Heathrow. US Airways also wants to operate nonstop between Pittsburgh and Gatwick. Although American and British Airways withdrew their long-pending request for antitrust immunity last July, the DOT has refused to approve their code-share agreement; and a similar request by United and British Midland is sitting on the DOT's back burner. Finally, Federal Express wants greater rights to serve points beyond the U.K.

Various "mini-deals" short of an open sky agreement have been proposed by both parties, but nothing has resulted to date. The Congressional hearings gave voice to that frustration, although actual retaliation remains both unwise and unlikely.

Retail Distribution

Times continue to be difficult for travel agencies. The average domestic point-to-point commission, a figure near the 10% level not that many years ago and at 6.7% in January 1999, was at 4.5% in January 2000. The comparable figure for international tickets was 10.9%, compared to 12.7% one year ago. This past January, U.S. travel agency revenues from airline commissions declined by $94 million versus January 1999. At the end of January, there were approximately 29,000 travel agency locations, the lowest number since 1986.[2]

The decline in commission levels is only part of the bad news for travel agencies. Airlines continue to find ways to reach consumers directly. Airline web sites presently account for approximately 5% of sales for most airlines, but the numbers are increasing quickly. Southwest Airlines, always less agent-dependent than its competitors, reported that 27% of its sales in January were over its web site and that it forecasts the first one billion-dollar internet sales year in airline history.

These converging trends have led travel agencies, led by the American Society of Travel Agents (ASTA), to become more aggressive in seeking regulatory intervention. Two recent examples illustrate this.

1. American Society of Travel Agents v. United Airlines et al., DOT Docket OST-99-6410. On October 26, 1999, ASTA filed a complaint with the DOT against most major U.S. airlines and several non-U.S. airlines alleging, *inter alia*, that the commission reductions constituted an "unfair method of competition" under section 41172. ASTA argued that travel agents are essential to a competitive airline industry and that efforts to reduce the role of agents are necessarily anti-competitive. Answers have been filed, and the next step for the DOT is to decide whether or not to institute a formal investigation.

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[2] As reported by the Airlines Reporting Corporation.

2. ASTA Complaint to the Justice Department. On November 9, 1999, Continental, Delta, Northwest and United announced the formation of a partnership to create a joint internet Web-site. Since that date, a total of twenty-seven airlines have agreed to participate. On February 16, 2000, in a letter to Assistant Attorney General Klein, ASTA requested that Justice issue Civil Investigative Demands to all of the partners to determine whether the partnership is consistent with the draft Antitrust Guidelines for Collaborations Among Competitors. ASTA's contention is that "the U.S. airline industry has begun to operate as a single enterprise, of which the joint Web-site is just the most recent manifestation."

3. DOT Inspector General Investigation. On January 11, 2000, the DOT Office of the Inspector General announced that it was going to investigate airline overbooking practices as well as the low airfare information that airlines provide consumers. As part of this investigation, specifically authorized in DOT's FY 2000 appropriation, the OIG has created a Web-site where consumers can fill out questionnaires concerning their experiences. (www.oig.dot.gov).

Miscellaneous

1. Love Field and Legend Airlines. The history of the Dallas Love Field debate was recounted in the Spring 1999 Report. When we last left the parties, the DOT had issued Order 98-12-27 holding that Dallas was preempted from restricting service to/from Love Field and that service could be provided between Love Field and any other point with aircraft configured or reconfigured to carry no more than 56 passengers. This recently was upheld by the Fifth Circuit in a decision that analyzes the history and purpose of section 41713(b)(1) preemption. American Airlines, Inc., v. Department of Transportation, 2000 U.S. App. LEXIS 1276 (5th Cir. February 1, 2000).

Legend Airlines, which began this battle in 1996, is expected to initiate service between Love Field and Los Angeles, Washington Dulles and Las Vegas in early March. Legend will operate DC-9 aircraft configured with 56-seats.

2. Criminalization of Regulatory Violations. A violation of safety-related aviation regulations can have serious administrative consequences ranging from substantial penalties to the loss of ability to do business, either individually or as a corporation. But in the post-Valujet environment, violators also face the possibility of criminal action.

The most visible example of this was the conviction, on December 6, 1999, of an aircraft maintenance company for recklessly allowing the transportation of hazardous materials on the ill-fated Valujet flight in 1996. Two employees were also tried but acquitted. The company, which has long since filed for bankruptcy protection, also faces state charges for murder and manslaughter. But this is only the tip of the criminal iceberg. Included among criminal actions in the past twelve months were the following:[3]

[3] These are only some of the criminal actions. The DOT OIG reports that in the last half of FY99, its investigations resulted in 134 indictments, 93 convictions, 66 years of "hard" time and over $3.1 million in

- On December 16, 1999, American pled guilty to charges of illegally storing hazardous waste at Miami International Airport in violation of the Resources Conservation and Recovery Act. American will pay a $6 million fine, $2 million in "community services restitution" to the Miami-Dade County Fire department for use in its hazardous materials division and undertake a court-supervised compliance program at every airport in the world where it accepts cargo.

- Also on December 16, 1999, a Florida-based shipping firm and its president pled guilty to violating DOT hazardous material regulations by shipping flammable printer toner fluid on an aircraft. Sentencing is scheduled for early March.

- Again on December 16, 1999, a Miami security firm pled guilty to making false statements to the FAA in regard to background checks for screening personnel. The company was fined $110,000. The former general manager of the company earlier had pled guilty to 22 counts of making false statements. He received a prison sentence of 5 years and three months.

- On July 7, 1999, a Florida maker and distributor of aircraft hoses and its vice president pled guilty to making false statements to the FAA about the qualifications of their mechanics. The company was fined $200,000. The company's vice president was sentenced to 2 ½ years in prison.

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fines. This includes all transportation modes as well as internal DOT investigations (but does not include items after September 30, 1999). Nonetheless, it is an indication of the scope of the DOT's prosecutorial activities.