UNITED STATES DEPARTMENT OF TRANSPORTATION
FEDERAL AVIATION ADMINISTRATION
WASHINGTON, DC

United Airlines, Inc., **Complainant,** **v.** **The Port Authority of New York and New Jersey,** **Respondent.**	**FAA Docket 16-14-13**

ORDER AFFIRMING IN PART AND REMANDING IN PART

I. INTRODUCTION

This matter is before the Federal Aviation Administration (FAA) Associate Administrator for Airports on an appeal filed by the Port Authority of New York and New Jersey (PANYNJ or Port Authority) of the Director's Determination (Determination) issued on November 19, 2018. The Director of the FAA Office of Airport Compliance and Management Analysis (Director) found PANYNJ in violation of Grant Assurance 22, *Economic Nondiscrimination* and Grant Assurance 25, *Airport Revenues.*[1]

PANYNJ argues on appeal that the Director's findings and conclusions "contain errors of fact and law which require it to be overturned." [FAA Exhibit 2, Item 6B, p. 5]. PANYNJ argues that the Director erred in finding that it 1) engages in deficient accounting practices and recordkeeping, 2) lacks transparency in setting airport rates and charges, 3) engages in improper and inconsistent airport revenue grandfathering methodologies and reporting, and 4) improperly uses airport revenues for non-airport purposes. PANYNJ faults the Director's reliance on reports prepared by a FAA consultant which evaluated PANYNJ's grandfather revenue reporting, financial records, accounting processes, and EWR cost allocations. PANYNJ argues the reports "are inaccurate" and the Director's Determination "is equally flawed." [FAA Exhibit 2, Item 6B, pp. 1-5].

Upon the appeal of a Part 16 Director's Determination, the Associate Administrator will consider the issues accepted in the Director's Determination using the following analysis:

[1] Pursuant to the *Rules of Practice for Federally Assisted Airport Enforcement Proceedings* found in 14 CFR part 16 (Part 16),

(1) Are the findings of fact each supported by a preponderance of reliable, probative, and substantial evidence contained in the record?
(2) Are conclusions made in accordance with law, precedent and policy?
(3) Are the questions on appeal substantial?
(4) Have any prejudicial errors occurred?

14 CFR § 16.33(e).

The Associate Administrator examined the record in detail, including the Determination, the administrative record supporting the Determination, and the Appeal pleadings and confirms the following:

- The Director did not err in finding that PANYNJ expended airport revenues on non-owned facilities or projects, in violation of Grant Assurance 25, *Airport Revenues,* and FAA's *Policy and Procedures Concerning Use of Airport Revenue* (Revenue Use Policy) and contrary to its 49 U.S.C. §§ 47107 and 47133 grandfathering authority.

- The Director did not err in finding that PANYNJ is not using an acceptable methodology to calculate the amount of grandfathered airport revenues and has not complied with the grandfathering exception provided by 49 U.S.C. § 47107(b)(2) and § 47133, Grant Assurance 25, *Airport Revenues*, and FAA's Revenue Use Policy.

- The Director did not err in finding that PANYNJ lacked transparency in setting its rates and charges in violation of Grant Assurance 22, *Economic Nondiscrimination* and contrary to the FAA's *Policy Regarding Airport Rates and Charges* (Rates and Charges Policy), and engaged in deficient accounting practices and record-keeping in violation of Grant Assurance 22, *Economic Nondiscrimination*.

II. THE PARTIES

A. Newark Liberty International Airport (EWR)

Newark Liberty International Airport (EWR) is a public-use commercial service airport located in the southeastern portion of the City of Newark and the northeastern section of the City of Elizabeth, New Jersey. EWR serves as a hub for United. Since 1982, EWR has been the recipient of 139 Airport Improvement Program (AIP) grants totaling $332 million from the FAA. [FAA Exhibit 2, Item 1, pp. 1-2].

B. The Port Authority of New York and New Jersey

PANYNJ, headquartered in New York City, is a bi-state corporate instrumentality and political subdivision of New York and New Jersey. PANYNJ was created by an interstate compact made by New York and New Jersey in 1921 and consented to by Congress. The two states established PANYNJ to provide transportation, terminal, and other facilities of commerce within the Port District,

which includes the cities of New York and Newark, and other municipalities in the two states. [FAA Exhibit 2, Item 1, p. 2].

C. United Airlines, Inc.

United Airlines Inc. (United) is a corporation organized under the laws of the State of Delaware having a principal place of business in Chicago, Illinois. Continental Airlines and United Airlines, Inc., merged on October 1, 2010, resulting in the newly-formed United Continental Holdings, Inc. United has the largest carrier presence at EWR and operates approximately 135,000 departures from there annually. [FAA Exhibit 2, Item 1, p. 2].

III. SUMMARY OF THE DIRECTOR'S DETERMINATION

On December 10, 2014, United filed a Complaint alleging that PANYNJ (1) charges unreasonable rates using a fee methodology that is not cost-based and lacks transparency in violation of 49 U.S.C. § 47107(a), Grant Assurance 22, *Economic Nondiscrimination*, and the FAA's Rates and Charges Policy; (2) generates excessive surplus revenues in order to subsidize non-aeronautical functions, and improperly diverts airport revenue in violation of 49 U.S.C. § 47107(b)(2), and Grant Assurance 25, *Airport Revenues*, and FAA's Revenue Use Policy; and (3) acts contrary to the Anti-Head Tax (49 U.S.C. § 40116) and the *Airline Deregulation Act* (49 U.S.C. § 41713, et seq.). PANYNJ rejected United's allegations and argued that its actions are consistent with its federal obligations. [FAA Exhibit 2, Item 1]. In response the Director made a number of findings.

First, the Director found that the allegations of deficient accounting practices, poor record-keeping, and lack of transparency in setting its rates and charges to be adequately substantiated by the record and therefore found a violation of Grant Assurance 22, *Economic Nondiscrimination*. These findings were based on the administrative record including but not limited to reports prepared by an independent consultant retained by the Director, voluminous PANYNJ financial documents, correspondence between the parties, and PANYNJ's failure to evaluate the basis of its 38% markup for flight fees at EWR since about 1973.

Second, the Director also found that PANYNJ expended airport revenues on non-PANYNJ owned projects contrary to the grandfather provisions contained within 49 U.S.C. §§ 47107 and 47133 and in violation of Grant Assurance 25, *Airport Revenues*. The Director's findings on airport revenue were based upon a separate report prepared by the consultant, certain reports submitted to the FAA by PANYNJ, and certain PANYNJ financial statements.

Finally, the Director rejected United's claims that PANYNJ's actions were contrary to the *Anti-Head Tax Act* (49 U.S.C. § 40116) and the *Airline Deregulation Act* (49 U.S.C. § 41713, et seq.). [FAA Exhibit 2, Item 1]

IV. PROCEDURAL HISTORY

After a 60-day extension to file, PANYNJ filed *its Appeal of the Director's Determination* and related *Memorandum In Support of the Port Authority of New York and New Jersey's Appeal of the*

Director's Determination, dated February 19, 2019. The Appeal included several declarations and analyses by PANYNJ's internal and external accounting subject matter experts with supporting exhibits. [FAA Exhibit 2, Items 6A-11].

After a 60-day extension to file, Complainant United filed its *Reply of United Airlines, Inc. to Respondent's Appeal of the Director's Determination*, dated May 10, 2019. United's Reply included declarations and analyses by external accounting subject matter experts with supporting exhibits. [FAA Exhibit 2, Items 12-19].

A comprehensive listing of additional motions, petitions, and orders related to the procedural history of this appeal are identified in the Index to the Administrative Proceeding of this Order, pages 34-46.

V. FACTUAL BACKGROUND

In its Complaint, United raised a number of claims about PANYNJ's financial management of EWR. United asserted that PANYNJ's flight fees at EWR were not reasonable and not transparent and that PANYNJ generated excessive surpluses and improperly diverted substantial amounts of airport revenue to surface transportation projects and other non-airport projects that it does not own. United claimed that "since 2004, [PANYNJ] has diverted more than $2 billion from the New York area airports to non-airport uses" and adds that "United and other airlines at EWR, and ultimately the traveling public, pay the price to the tune of hundreds of millions of dollars each year." [FAA Exhibit 1, Item 1, pp. 6-7]. United asked the FAA "to investigate (i) the entire ratemaking structure at EWR; (ii) the reasonableness of the resulting aeronautical fees; and (iii) the extent to which the Port Authority diverts aeronautical revenues at EWR to non-aeronautical functions." [FAA Exhibit 1, Item 1, p. 8].

In response, PANYNJ denied United's allegations and stated that its actions were consistent with all of its federal obligations. PANYNJ stated it makes EWR "available as an airport for public use on reasonable terms and without unjust discrimination to all types, kinds, and classes of aeronautical activities, including commercial aeronautical activities offering services to the public at the airport." [FAA Exhibit 1, Item 3, pp. 1-2].

Pursuant to 14 CFR § 16.29 the Director conducted an investigation to determine whether:

- PANYNJ charges aeronautical users, including United, unreasonable rates, fails to make EWR available on reasonable terms, and uses a fee methodology that is not cost-based and lacks transparency in violation of 49 U.S.C. §47107(a), FAA *Policy Regarding Airport Rates and Charges*, and FAA Grant Assurance 22, *Economic Nondiscrimination*.

- PANYNJ generates excessive surplus revenues in order to subsidize non-aeronautical functions and improperly diverts airport revenue in violation of 49 U.S.C. § 47107(b)(2) and 49 U.S.C. § 47133, and Grant Assurance 25, *Airport Revenues*, and FAA's *Policy and Procedures Concerning the Use of Airport Revenue*.

- PANYNJ acts contrary to the *Anti-Head Tax Act* (49 U.S.C. § 40116) and the *Airline Deregulation Act* (49 U.S.C. § 41713, et seq.);

To support the Director's investigation, the FAA contracted with an independent accounting firm and an airport financial consulting firm to provide support services. The contractor support included site visits to PANYNJ offices, data collection and reconciliation, and communication/coordination efforts, which culminated in three final reports.[2] The reports form part of the administrative record.

VI. APPEALING THE DIRECTOR'S DETERMINATION

A party adversely affected by the Director's Determination may file an appeal with the Associate Administrator within 30 days after the date of service of the initial determination [14 CFR § 16.33(c)]. Review is limited to an examination of the Director's Determination and the administrative record upon which such determination was based. The Associate Administrator does not consider new allegations or issues on appeal unless finding good cause to do so.

VII. PRELIMINARY ISSUES

A. Petition to Submit Additional Evidence Under 14 CFR § 16.33(f).

Throughout its appeal, PANYNJ takes issue with reports prepared by Kearney & Company, the independent consultant retained by the Director to assist in evaluating the Complaint. Kearney prepared reports on PANYNJ's rates and charges, accounting and financial practices at EWR, and grandfathered airport revenue. The Director's Determination relied, in part, upon the Kearney reports.

PANYNJ filed a petition to submit additional evidence in support of its appeal to address issues with the Kearney reports. PANYNJ argues that it first saw the Kearney reports "over two years after the review was conducted in November 2018 when the FAA's Director's Determination was issued." [FAA Exhibit 2, Item 10, pp. 39-40]. PANYNJ claims that it "never had the opportunity to (i) understand how EWR operations were being assessed; (ii) contest the scope of work being performed; (iii) review the work product for accuracy and completeness; or (iv) present information to challenge its conclusions. [FAA Exhibit 2, Item 6A, p. 4]. PANYNJ contends that "this is not the way typical audits or independent reviews are conducted" and "if these events had occurred, the Port Authority would have been able to provide clarification or in certain cases corrections to certain issues raised" in the Kearney report. [FAA Exhibit 2, Item 10, p. 39]. PANYNJ states the additional evidence:[3]

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[2] *Revenue Compliance Analysis of PANYNJ - Grandfathering Analysis* discusses revenue surpluses and the grandfathering implications [FAA Exhibit 1, Item 18.]*; Deliverable of the Final Report for Newark Liberty International Airport Analysis* discusses terminal rates and an overview of Port Authority accounting and financial processes [FAA Exhibit 1, Item, 17]; and, *Flight Fee Review* discusses analyze the rates and charges structure at EWR, airport charges methodology, reasonableness of expenditures at EWR, and charges at EWR compared to other airports. [FAA Exhibit 1, Item 19].

[3] 14 CFR § 16.33(f) provides that "Any new issues or evidence presented in an appeal or reply will not be considered unless accompanied by a petition and good cause found as to why the new issue or evidence was not presented to the Director. Such a petition must: (1) Set forth the new matter; (2) Contain affidavits of prospective witnesses, authenticated documents, or both, or an explanation of why such substantiation is unavailable; and (3) Contain a statement explaining why such new issue or evidence could not have been discovered in the exercise of due diligence prior to the date on which the evidentiary record closed."

> could not have been discovered in the exercise of due diligence prior to the close of the record below because it responds to three private consultant reports relied on heavily in the Director's Determination that were not made available to the Port Authority prior to the November 19, 2018 issuance of the Director's Determination, despite the fact that the consultant reports were received by the FAA two years before issuance of the Director's Determination. [FAA Exhibit 2, Item 6C, p. 2].

The petition sought to:

> address serious due process and fairness concerns raised by uncritical reliance on factually inaccurate and procedurally flawed reports, which were never provided for review or rebuttal. [FAA Exhibit 2, Item 6C, p. 2].

United opposes PANYNJ's petition on several grounds. United argues PANYNJ previously opposed the release of the Kearney reports and that the "vast majority" of the additional evidence "already existed." [FAA Exhibit 2, Item 16]. In reply, PANYNJ asserts that its previous position was to "limit production of expansive, non-public materials demanded by United" and that its effort to shield "confidential information" is "qualitatively different" than responding to "clearly erroneous" positions taken by the Director. [FAA Exhibit 2, Item 6B, p. 24].

The Associate Administrator agrees with United that PANYNJ's petition contradicts its earlier position. During the Director's investigation, United requested access to materials provided by PANYNJ and any reports prepared by outside consultants assisting the investigation. PANYNJ strenuously objected.[4] 14 C.F.R Part 16 does not provide for the disclosure of evidence or analyses prior to the issuance of the Director's Determination. The Director did not rule on United's request or PANYNJ's opposition.

The Associate Administrator concludes that – despite PANYNJ's previous objection – good cause exists to grant PANYNJ's petition. The additional evidence could not have been produced prior to the issuance of the Determination and the Kearney reports. The additional evidence consists of after-the-fact defenses, declarations, and analyses of the Kearney reports and financial evaluations relied upon by the Director. The additional evidence also raises substantial questions regarding the reliability of the Kearney reports. (14 CFR §16.33(e)(3)) The additional evidence – which the Associate Administrator reviewed – is considered in the following analyses.

Complainant United also submitted a petition to submit additional evidence under 14 CFR § 16.33(f) "to respond fully to the Port Authority's claims." [FAA Exhibit 2, Item 18]. The Associate Administrator likewise grants United's petition and accepts and considers United's additional evidence.

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[4] Complainant United filed a *Motion for Release of Audit Report* (May 22, 2017) [FAA Exhibit 1, Item 30]; Respondent PANYNJ filed an *Answer in Opposition to the Motion for Release of Audit Report* (June 1, 2017)[FAA Exhibit 1, Item 31].

B. Cognizant Federal Agency

PANYNJ states that its "cognizant agency" under 2 CFR § 200.19 is the Federal Transit Administration (FTA) – not the FAA. According to PANYNJ, the cognizant agency is responsible for "reviewing, negotiating, and approving cost allocation plans or indirect cost proposals." PANYNJ claims that the "FAA's second-hand review" of PANYNJ's cost allocation plan "without any stated reason or justification" does not comport with the *Single Audit Act*, codified at 31 U.S.C. § 7501. [FAA Exhibit 2, Item 6B, p. 33].

2 CFR § 200.19, Appendix V, paragraph F.1 provides that for indirect cost allocation plans, the cognizant agency is the Federal agency with the largest dollar value of direct Federal awards with a governmental unit. The *Single Audit Act* establishes audit requirements for non-federal entities meeting a minimum threshold for the award of federal grants, including grants awarded under the FAA Airport Improvement Program (AIP). The FAA recognizes FTA as the "cognizant agency" for approving PANYNJ's cost allocation plans related to AIP project funding eligibility.

FTA approval of indirect costs does not, however, constitute a review of PANYNJ's compliance with its AIP grant obligations. FTA's approval also does not preclude the Director from undertaking a review of PANYNJ's compliance with airport revenue use requirements under Grant Assurance 25, *Airport Revenues* and 49 U.S.C. §§ 47107 and 47133. Allegations of noncompliance with AIP grant assurances fall well within the ambit of Part 16. (14 CFR § 16.1(a)(5)). PANYNJ's challenge to FAA jurisdiction is rejected.

C. Consensual Agreement and Reviewability under 14 CFR Part 16

PANYNJ argues that fee and contract disputes are state court matters not reviewable in a 14 CFR Part 16 proceeding. [FAA Exhibit 2, Item 6B, pp. 9-11]. PANYNJ relies upon *Roadhouse Aviation, LLC v. City of Tulsa,* FAA Docket 16-05-08, Final Decision and Order (June 26, 2007) (Roadhouse) and *Northwest Airlines, Inc. v. Indianapolis Airport Authority*, FAA Docket 16-07-04, Final Decision and Order (October 27, 2009)(Northwest), in arguing that the FAA has "repeatedly refused to unwind rates agreed to between commercial entities." [*Id.*].

United contends that the FAA "can and should" exercise jurisdiction over PANYNJ's grant assurance violations and explains that PANYNJ's reliance upon *Northwest* and *Roadhouse* is misplaced because United is not asking the FAA to adjudicate a contract dispute, but rather, to determine if the EWR Flight fee violates federal law.[5] [FAA Exhibit 2, Item 12, p. 25]. Also, relying on the First Circuit's ruling in *Penobscot*, United points out that the Director previously confirmed that the FAA has entertained numerous cases involving formal agreements, and that any action that is contrary to the sponsor's grant assurances is within the scope of FAA review. *See Penobscot Air Services, Ltd. v. FAA* 165 F.3d 713, 717 (1st Cir. 1999). [FAA Exhibit 2, Item 12, p. 26][FAA Exhibit 2, Item 6B, pp. 10-11].

[5] United also argues that PANYNJ's reliance on *Roadhouse Aviation, LLC v. City of Tulsa,* FAA Docket 16-05-08, Final Decision and Order (June 26, 2007) is flawed for the same reasons.

The Director previously rejected PANYNJ's Part 16 contract reviewability argument by Order of April 27, 2015,[6] holding that any action contrary to the sponsor's grant assurances is within the scope of FAA review.[7] [FAA Exhibit 2, Item 12, p. 26]. The Director's Determination likewise affirmed that an existing agreement with an airport sponsor does not absolve a sponsor of its grant assurance obligations, or curtail an air carrier's right to file a complaint, or otherwise bar FAA's jurisdiction. [FAA Exhibit 2, Item 1, p. 13].

The availability and public access to an airport's rates and charges are critical elements of sponsor compliance with Grant Assurance 22. The FAA's role is to determine whether the airport sponsor is in compliance with its grant obligations and statutory obligations relating to airport fees.[8] [78 Fed. Reg. 55332 (September 10, 2013)] United's Complaint alleged facts and legal arguments regarding EWR fees that fall under the FAA's 14 CFR Part 16 jurisdiction. United's contract with PANYNJ does not obviate the FAA's ability to evaluate those facts and arguments.

VIII. ISSUES ON APPEAL

The Associate Administrator identified the following three issues to be reviewed on Appeal:

1. Whether the Director erred in finding PANYNJ improperly expended airport revenue on projects that were not owned or operated by PANYNJ?
2. Whether the Director erred in finding PANYNJ performed its grandfathering calculations using an improper methodology?
3. Whether the Director erred in finding the EWR flight fees lacked transparency and PANYNJ engaged in deficient accounting practices and record-keeping?

ISSUE 1: Whether the Director erred in finding PANYNJ improperly expended airport revenues on non-owned projects in violation of Grant Assurance 25, *Airport Revenues* and 49 U.S.C. §§ 47107(a) and 47133(a)?

In the Director's Determination, the FAA acknowledged that Federal statutes provide for certain grandfather rights to divert revenue. However, the Director held that these rights fall "within certain limits." [FAA Exhibit 2, Item 1, p.19]. With regard to such limits, the Director held that it was impermissible to spend diverted revenue to support projects for facilities that are not owned by the airport sponsor. [*Id.* at 22.]

PANYNJ's Argument

PANYNJ raises three arguments as to why the Director's Determination holding on the use of grandfathered revenue should be overturned. First, PANYNJ argues the Director has misinterpreted the statute. Second, PANYNJ argues that the Director's Determination is inconsistent with the

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[6] FAA Exhibit 2, Item 1, p. 3

[7] See also *M. Daniel Carey and Cliff Davenport v. Afton-Lincoln County Municipal Airport Joint Powers Board*, FAA Docket No. 16-06-06, (January 19, 2007)(Director's Determination), Issue 7]

[8] The FAA's role is not to enforce the lease terms between the parties to an agreement, but to enforce the Federal obligations in the grant agreements between an airport sponsor and the Federal Government. [*See AmAv v. Maryland Aviation Administration*, FAA Docket No. 16-05-12, (March 20, 2006) (Director's Determination), p. 23]

FAA's long-standing practice of allowing airport proprietors to use grandfathered revenue to fund non-proprietor owned facilities and operations. Third, PANYNJ argues that the "law controlling financing" that gives rise to its grandfather rights allows PANYNJ to support its facilities and this is not limited to only those facilities that it owns. According to PANYNJ, "funding roadways that give access to Port Authority tunnels and bridges (although the roadways may not themselves be owned or operated by the Port Authority)" is a permissible use of grandfathered revenue. [FAA Exhibit 2, Item 6B, p.58].

PANYNJ's three arguments are addressed below.

I. The Director Misinterpreted the Statute

In its first argument PANYNJ maintains that the Director's interpretation of the statute is "plainly wrong." [*Id.* at 49.]

A. Relevant Statutory Provisions and Grant Assurances

Two statutory provisions and one grant assurance provide the grandfathering rule at issue in the case. These three authorities are presented below.

First, section 47133(a) provides in pertinent part:

> (a) Prohibition.—Local taxes on aviation fuel (except taxes in effect on December 30, 1987) or the revenues generated by an airport that is the subject of Federal assistance may not be expended for any purpose other than the capital or operating costs of—
> (1) the airport;
> (2) the local airport system; or
> (3) any other local facility that is owned or operated by the person or entity that owns or operates the airport that is directly and substantially related to the air transportation of passengers or property.

49 U.S.C. § 47133(a). An exception to this rule is provided by subsection (b), which provides:

> Subsection (a) shall not apply if a provision enacted not later than September 2, 1982, in a law controlling financing by the airport owner or operator, or a covenant or assurance in a debt obligation issued not later than September 2, 1982, by the owner or operator, provides that the revenues, including local taxes on aviation fuel at public airports, from any of the facilities of the owner or operator, including the airport, be used to support not only the airport but also the general debt obligations or other facilities of the owner or operator.

This provision applies to any sponsor that has been the "subject of Federal assistance" regardless of whether its grants have otherwise expired, as long as the sponsor was subject to revenue use requirements on or after October 1, 1996, the effective date of the statute. Revenue Use Policy, 64 Fed. Reg. 7696, 7698 (Feb. 16, 1999). This provision is applicable to PANYNJ.

Second, another applicable provision is in §47107. Section 47107(b), *Written Assurances on Use of Revenue*, provides, in part:

> (1) The Secretary of Transportation may approve a project grant application under this subchapter for an airport development project only if the Secretary receives written assurances, satisfactory to the Secretary, that local taxes on aviation fuel (except taxes in effect on December 30, 1987) and the revenues generated by a public airport will be expended for the capital or operating costs of—
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> (A) the airport;
> (B) the local airport system; or
> (C) other local facilities owned or operated by the airport owner or operator and directly and substantially related to the air transportation of passengers or property.
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> (2) Paragraph (1) of this subsection does not apply if a provision enacted not later than September 2, 1982, in a law controlling financing by the airport owner or operator, or a covenant or assurance in a debt obligation issued not later than September 2, 1982, by the owner or operator, provides that the revenues, including local taxes on aviation fuel at public airports, from any of the facilities of the owner or operator, including the airport, be used to support not only the airport but also the general debt obligations or other facilities of the owner or operator.

49 U.S.C. § 47107(b). In this section, the revenue use provisions are presented as a condition to which the sponsor must agree before the FAA may approve a grant.

Finally, to comply with § 47107, the Secretary, through the FAA, has imposed grant assurance number 25, *Airport Revenues,* on all sponsors. As a condition of obtaining its grants, PANYNJ has agreed to this assurance, and it binds PANYNJ. The assurance provides:

> a. All 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 which are directly and substantially related to the actual air transportation of passengers or property; or for noise mitigation purposes on or off the airport. The following exceptions apply to this paragraph:
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> 1) 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.

FAA Sponsor Assurances #25.

B. Argument of the Parties

With regard to its statutory interpretation argument, PANYNJ begins with § 47107(b) and states that

> if an airport proprietor satisfies the requirements of paragraph (2), then the proprietor is not subject to the revenue use restriction of paragraph (1). Consequently, § 47107(b) places *no limits* on the uses to which the Port Authority may properly put grandfathered airport revenues.

[FAA Exhibit 2, Item 6B, p. 51 (emphasis added).] Based on this reading PANYNJ concludes it is free to use airport revenue on any projects, such as the Pulaski Skyway and Wittpenn Bridge, or any other purpose related to PANYNJ facilities. [*Id.* at 51-53.]

In response, United argues that the PANYNJ's interpretation is unsupported, wrong, and against public policy. According to United:

> the Port Authority's argument can be summarized as follows: '47107(b)(2) says that the limitations on airport revenue use do not apply if there was a pre-1982 law requiring the airport to spend on 'A' (general debt obligations) or 'B' (other facilities of the sponsor). The Port Authority had a pre-1982 law requiring it to spend airport revenue on A and B. Therefore, there are no limits and we can spend on not only on A and B but also C and D and E and all the way to Z.' That reading of the statute makes no sense, and no one -- not FAA, not DOT, not any court -- has ever read the statute that way.

[FAA Exhibit 2, Item 12, p. 38.]

C. Associate Administrator's Analysis

1. The Grandfather Rights Are Limited By The Terms of the Exception.

Under PANYNJ's view of the grandfather provision, if it has the requisite "debt obligation" or the requisite "law controlling financing," then it is grandfathered.[9] According to PANYNJ, these conditions determine if it is grandfathered in the first instance, but in no way restrict how grandfathered revenue may be used once that status is conferred. The Associate Administrator disagrees and finds that the proper reading of the statute is that these two statutory attributes both give rise to grandfathered status, as PANYNJ argues, but also define the allowable scope of the exception.

PANYNJ asserts that its grandfather right arises from a "law controlling financing." [FAA Exhibit 2, Item 6B, p. 53]. Under § 47107 it is not *any* law controlling financing that is sufficient to give rise to grandfathered status. Rather, to qualify, there must be a "law controlling financing" that has two specifically prescribed statutory attributes. Those attributes are that the law must "provide" that

[9] For purposes of this analysis, the Associate Administrator assume without deciding that the Port is grandfathered. However, as noted later in this Order, the Associate Administrator remands this matter to the Director to analyze and confirm, if so found, that the Port currently retains grandfather rights.

airport revenue "be used" for 1) general debt service or 2) other facilities of the owner or operator. The Associate Administrator's interprets the statute so that these attributes define the extent to which revenue may be diverted, i.e., the extent to which the primary obligation "shall not apply." FAA disagrees with an interpretation that divorces the grandfather right from the provisions that give rise to it.

As noted by both parties, the interpretation urged by PANYNJ results in a regime where there are "no limits" on grandfathered expenditures. The Associate Administrator sees nothing in the statutory text that compels such an unreasonable result. Reasonable statutory interpretation must account for "the broader context of the statute as a whole." *Util. Air Regulatory Grp. v. E.P.A.,* 573 U.S. 302, 321 (2014). Here, Congress has passed an overarching restriction on the use of airport revenue and has provided an exception only where a sponsor satisfies specific requirements. These requirements give rise to the grandfather right and are reasonably interpreted to define its scope. In fact, PANYNJ itself, in its briefing below recognized "limits" to the grandfather rights and never made the arguments it makes now, notwithstanding its current characterization of the statute as "unambiguous." [*Compare* FAA Exhibit 1, Item 2B, p. 35 *with* FAA Exhibit 2, Item 6B, p. 50.]

The Associate Administrator's position is supported by the statute and the legislative history. When Congress amended the revenue use limitations in the Airport and Airway Safety Act of 1987, the House Report specifically indicated that the grandfather provisions were to address local legislation that made it "difficult or impossible" for the sponsor to comply with the underlying prohibition on diversion. [H. Rep. 100-123(II), p.14.] Nowhere in this statutory scheme does Congress evince an intent to throw the gates wide open, and rules of statutory construction prevent us from inferring such. *Commissioner v. Clark,* 489 U.S. 726, 739 (1989) (where "a general statement of policy is qualified by an exception, we usually read the exception narrowly in order to preserve the primary operation of the provision"). Both the statute and legislative history shows the extent to which Congress is wary of revenue diversion. Congress directed the FAA to assure "prompt and effective enforcement" of the revenue diversion rules. 49 U.S.C. § 47107(k)(1). The legislative history demonstrates Congress' concern that diversion unduly burdens airport users with "hidden taxation for unrelated municipal services." [House and Senate Conference Reports, Public Law 97-248, *Airport and Airway Improvement Act of 1982* (AIAA) Section 511, *Project Sponsorship.*]

Finally, the decision the Associate Administrator reaches is consistent with FAA's written and longstanding positions on grandfathering. FAA and DOT have clearly and repeatedly expressed that an airport sponsor may divert revenue under § 47107(b)(2) only "if the 'grandfather' provisions of 49 U.S.C. § 47107(b)(2) are applicable to the sponsor *and the particular use."* Policy and Procedures Concerning the Use of Airport Revenue, 64 Fed. Reg. 7696, 7719 (Feb. 16, 1999) (emphasis added); *see also* Policy and Procedures Concerning the Use of Airport Revenue, 61 Fed. Reg. 66,735, 66,740 (Dec. 18, 1999) (considering use of airport revenue proper "if the 'grandfather' provisions of 49 U.S.C.47107(b)(2) are applicable to the sponsor *and the particular use")* (emphasis added); ("OIG Report") Office of the Inspector Gen., U.S. Dep't of Justice, Report on Revenue Diversions at San Francisco International Airport, at 2 (2004) ("[n]on-airport use of revenue is limited to the terms and duration specified in the grandfathered agreements"). In conclusion, based on statutory construction, Congressional intent, and precedent, FAA declines to interpret the statute as PANYNJ suggests.

2. *Grandfathered Diverted Revenue May Only Be Used to Support Facilities that PANYNJ Owns or Operates.*

Having held that the requirements of the statute give rise to grandfathered status and define the scope of the grandfather right, the Associate Administrator now addresses the holding of the Director that the grandfather rights do not include the right to divert revenue to facilities not owned and operated by PANYNJ. The Director based his decision on the language that qualifies the "law controlling financing" as one that provides that airport revenue "be used" to support "not only the airport" but the "other facilities *of the owner or operator*." The Director interpreted that the phrase "other facilities of the owner or operator" means facilities that PANYNJ owns. [FAA Exhibit 2, Item 1, p. 22].

The Associate Administrator upholds this finding. One of the definitions for the preposition "of" is a "word to indicate belonging or a possessive relationship." *Merriam Webster Online Dictionary* (2020). Thus, the plain language indicates that the facilities in question are those that the owner or operator actually owns. And, as discussed further below, after analyzing the statute in its entirety, the Associate Administrator is further convinced that the Director's finding – i.e., that ownership is required – is correct.

It is a "fundamental canon of statutory construction that the words of a statute must be read in their context and with a view to their place in the overall statutory scheme." *Davis v. Michigan Dept. of Treasury,* 489 U.S. 803, 809 (1989). A court must therefore interpret the statute as a symmetrical and coherent regulatory scheme and fit, if possible, all parts into an harmonious whole. *Food & Drug Admin. v. Brown & Williamson Tobacco Corp.,* 529 U.S. 120, 133 (2000) (internal quotes and cites omitted). Reading the statute as a whole the Associate Administrator finds that the exception to the revenue diversion rule must be read consistently with the rule itself. *See Pott v. Arthur,* 104 U.S. 735 (1881).

The statute provides that, apart from the airport, a sponsor may use airport revenue on "any other local facility that *is owned or operated*" that is directly and substantially related to the air transportation of passengers or property. 49 U.S.C. § 4133(a) (emphasis added). Thus, when the exception provides for spending grandfathered diverted revenue on non-aeronautical "facilities of the owner or operator," it is consistent to interpret this repetition of the term "facilities" -- here in the formulation of "facilities *of the owner or operator*" -- as applying to "facilities *owned or operated by* the airport sponsor." Such holding is also in accord with the principle that grandfather rights should be interpreted narrowly "to preserve the primary operation of the provision." *Commissioner v. Clark,* 489 U.S. 726, 739 (1989)**.** Accordingly, the Associate Administrator upholds the Director's finding the grandfathered diversion of airport revenue is limited to support facilities that PANYNJ owns or operates.

3. *Remand on Grandfathered Status*

Although the Director found that grandfather rights allow diversion to occur "within certain limits," the Determination appears to assume PANYNJ is grandfathered without analyzing this issue. PANYNJ notes that it is has grandfather status based on a pre-1982 law controlling financing. [FAA Exhibit 2, Item 6B, p.53.] Presumably, this suggests that any pre-September 2, 1982 debt

obligations, which could also give rise to grandfathered status, have been retired. Assuming that to be the case, the Director did not analyze the extent to which PANYNJ's enabling act qualifies it for grandfathered status. In order to definitively resolve the questions of compliance, such an essential condition must be established and not merely assumed. For this reason, I remand this case, in part, to the Director, to determine the basis for PANYNJ's grandfather rights, if any. And, if such rights are based solely on the PANYNJ's enabling act, whether the enabling act is sufficient to create grandfathered status and, if so, its scope.

4. Required Spending

Before leaving the issue of whether PANYNJ was permitted to use airport revenue to support facilities that it does not own, such as the Wittpenn Bridge, the Associate Administrator will address another argument set forth by United. United has argued that only expenditures that PANYNJ is "required" to make can be considered grandfathered.[10] [FAA Exhibit 2, Item 12, pp. 38, 44.] As set forth below, the Associate Administrator agrees with this position. This position provides an independent reason to not allow the diversion of revenue to support facilities not owned by PANYNJ.

PANYNJ argues that the intent of the grandfather provisions is

> to permit airport proprietors operating under certain pre-1982 laws to continue to engage in long-standing, well-known pre-1982 revenue practices ……

[FAA Exhibit 2, Item 6B, p. 54]. According to PANYNJ, if it qualifies for grandfathered status, then there are "no limits" and there is essentially blanket authority to divert revenue. [*Id.* at 51.] PANYNJ also notes that irrespective of whether it uses airport revenue, its authorizing statute allows it to support related but non-owned facilities. [*Id.* at 62.]

United asserts, however, that a grandfathered airport may divert airport revenue only where its requisite "law controlling financing" "*required* such spending." [FAA Exhibit 2, Item 12, pp. 38, 44 (emphasis provided)]. Upon first glance, the statutory source for United's argument is unclear. The statute provides a grandfather right where the "law controlling financing" "provides" that airport revenue "be used" for "debt service or other facilities of the owner or operator." 49 U.S.C. §§ 47107(b), 47133. The word "required" does not appear.

But, the Associate Administrator notes ambiguity with the statute in that it contains neither a permissive or mandatory modifier. For instance, if the statute provided that the law controlling financing "provides" that airport revenue "*may* be used" for debt service or other facilities, we would have a permissive regime. Thus, if on September 2, 1982, the airport had the *option* of using airport revenue for non-airport purposes, then it would be grandfathered. However, if the statute provided that the airport revenue "*shall* be used" for debt service or other facilities, then only if the airport had a legal obligation to divert, would grandfather rights arise. *See Anderson v. Yungkau*, 329 U.S. 482, 485 (1947).

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[10] Here again the Associate Administrator assumes without deciding that the Port is grandfathered. However, as noted above, this issue is subject to remand.

As noted above, Congress did not provide any such mandatory or permissive modifier or signals. However, based on cannons of statutory construction and legislative intent, United's argument is persuasive. As a matter of interpretation, where Congress has enacted a general rule that bars revenue diversion, "we should not eviscerate that legislative judgment through an expansive reading of a somewhat ambiguous exception." *Comm'r v. Clark,* 489 U.S. 726, 739 (1989). This directs us to a narrow reading that only payments required to be made by a pre-1982 enabling act give rise to grandfathered status.

This holding is further supported by the fact that if the enabling act merely gave PANYNJ the option to divert revenue, then there is no need for a grandfather right to exist in the first place. That is because the PANYNJ would have no conflict under its reading of the statute. The payments that constitute diversion would be permissible under the enabling act but not mandatory. The PANYNJ could abstain from making such payments and not violate either its enabling act or its Federal statutory duty to spend airport revenue on its airports. The narrow reading also has support from the legislative history. The House and Senate Conference Reports describe the grandfather rights in section 511(a)(12) as follows[11]:

> Airports that are part of a unified ports authority are exempt from …[the revenue diversion] requirement if covenants or assurances in previously issued debt obligations or controlling statutes *require that these funds are available for use at other port facilities*. However, airport users should not be burdened with 'hidden taxation' for unrelated municipal services.

[House and Senate Conference Reports, Public Law 97-248, *Airport and Airway Improvement Act of 1982* (AIAA) Section 11, *Project Sponsorship* (emphasis added).]

Accordingly, the Associate Administrator holds that under the grandfather exception, the baseline prohibition on revenue diversion "shall not apply" only when the particular diversion at issue is one required by the pre-1982 law controlling financing. Absent a showing that PANYNJ's enabling statute requires it to divert revenue to facilities that it does not own, the Associate Administrator holds that the permissive nature of the diversion provides an independent basis to disallow it, i.e., to disallow the expenditure of airport revenue to support facilities that PANYNJ does not own.

II. <u>The Director Ignored FAA Precedent and Practice.</u>

In its second argument, PANYNJ maintains that the Director's Determination is inconsistent with "long-standing, well known pre-1982 revenue practices" and undermines the very purpose of the grandfather exception. [FAA Exhibit 2, Item 6B, pp. 54, 58.]

PANYNJ cites its "longstanding partnership with the U.S. Government" as proof that the FAA has not interpreted § 47107(b)(2) to disallow funding non-PANYNJ projects. PANYNJ points to Congressional authority and its 1921 state enabling legislation to justify participating financially in a 1999 contract with the Department of the Army to dredge the Kill Van Kull Channel.

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[11] House and Senate Conference Reports, Public Law 97-248, *Airport and Airway Improvement Act of 1982* (AIAA) Section 511, *Project Sponsorship*

PANYNJ contends the FAA has never objected to PANYNJ using grandfathered airport revenues to fund the project. [FAA Exhibit 2, Item 6B, p. 57].

PANYNJ argues that the project was the result of "multiple acts of Congress" who "appropriated some of the funds" for the project but relied on a non-federal share from PANYNJ in accordance with statutory cost-sharing requirements.[12] [FAA Exhibit 2, Item 6B, p. 57; FAA Exhibit 2, Item 8]. PANYNJ's funding of the non-federal share notwithstanding, the cited Congressional acts did not mandate reliance on, or even reference, airport revenues for the funding. Similarly, PANYNJ's 1921 enabling legislation provides only that PANYNJ "urge upon the federal authorities improvement of channels." [FAA Exhibit 2, Item 6B, p. 57]. The legislation does not mandate PANYNJ to commit airport revenues to the project. PANYNJ fails to demonstrate that participation in the project precludes compliance with airport revenue use requirements in 49 U.S.C. § 47107 and § 47133.

Additionally, PANYNJ argues that "airport proprietors around the country" operate with the understanding 49 U.S.C. § 47107(b) places no limits on the use of grandfathered revenue, citing the San Francisco Airport Authority and MassPort as examples. [FAA Exhibit 2, Item 6B, pp. 54-56]. The San Francisco example involves the sponsor's annual payment to the City which is characterized as the return on the City's prior investments in the airport. As United points out, the FAA allows a sponsor to repay funds contributed or loaned to the airport, provided certain conditions are met. [*See Airport Compliance Manual*, Order 5190.6B, §15-5]. Consequently, the use of grandfathered airport revenue to repay certain prior investments or loans to the sponsor is limited and authorized- not unlimited, as PANYNJ suggests.

PANYNJ's other example involves MassPort's annual payments in lieu of taxes to the City of Boston and the Town of Winthrop. According to United, those payments are required by MassPort's enabling act and a 1978 agreement. As such, the payments fit squarely within the previously existing financial arrangements that the 49 U.S.C. § 47107(b) exception was intended to allow. Further, a sponsor's payments in lieu of taxes based upon an acceptable and transparent cost allocation formula constitutes a proper use of airport revenue, in any event. [*See Airport Compliance Manual*, Order 5190.6B, §15-10].

III. PANYNJ Has Statutory Authority to Support Facilities that it Does Not Own.

In its third argument, PANYNJ maintains that the Director's Determination is incorrect because its enabling acts allow it to support facilities that it does not own such as the Pulaski and Wittpenn projects.

Many of the PANYNJ's arguments in this section are already addressed above. The Associate Administrator has held that grandfathered airport revenue may not be diverted to facilities that the PANYNJ does not own. Whether this activity is characterized as "support" or not, would not change the decision already reached. This Order holds that the phrase "other facilities of the owner or operator" limits a grandfathered sponsor from diverting revenue to only those facilities that it owns or operates. The term "support" does not broaden that limitation.

[12] Public Law 99-662, Water Resources Development Act of 1986, Section 101, *Harbors*

PANYNJ points us to the holding in the case of *AAA Northeast v. PANYNJ*. 221 F.Supp.3d 374 (S.D.N.Y. 2016). But, the holding in that case does not address the scope of PANYNJ's grandfather rights and does not discuss at all the statutory prohibition on diverting airport revenue. In *AAA*, the court examined a distinct issue as to what costs could be added to the rate base of the PANYNJ's Interstate Transportation Network so as to not violate the Dormant Commerce Clause. 221 F.Supp.3d at 389, 392. PANYNJ fails to explain how an analysis of its commerce clause constraints applies to its FAA grant assurances. Moreover, the Associate Administrator notes from that court's discussion of PANYNJ's Capital Infrastructure Fund, that PANYNJ is very capable of segregating funds to individual "line departments." *Id.* at 376, 390. Finally, the Associate Administrator does not see the link between the word "support" in the revenue diversion statute and the concepts contained in the "functional relationship" test that the court has used to examine the legality of tolls under the Dormant Commerce Clause. *Id.* at 389.

PANYNJ argues it is authorized under state laws to fund the Pulaski Skyway and Wittpenn Bridge projects. PANYNJ fails to address or explain, however, the questions raised about its legal authority to fund those projects in the January 10, 2017, SEC Cease and Desist order entered against it. The Order specifically questioned PANYNJ's state law based authority to spend any revenue on those projects. [FAA Exhibit 1, Item 29, pp. 6-7]. And, according to the Order, PANYNJ counsel opined that "the Port Authority has no authority in such unification statutes to construct, own, maintain or operate any of the approaches to the Holland Tunnel." [*Id*.]. Nevertheless, even if PANYNJ could demonstrate legality, our holdings above would preclude such diversion.

Finally, this Order need not address PANYNJ's other arguments regarding the legality of its support for facilities it does not own, because the Associate Administrator has found that these expenditures – whether proper or not under its enabling law or the Dormant Commerce Clause – run afoul of the limitation found within 49 U.S.C. §§ 47107(b)(2), 47133(b)(1) and grant assurance 25, that grandfathered airport revenue may only be diverted to facilities owned or operated by PANYNJ. Nothing in this Order would prevent PANYNJ from using non-airport revenue to support facilities that it does not own.

ISSUE 2: Whether the Director erred in finding PANYNJ Utilized an Improper Methodology to Calculate the Amount of Grandfathered Airport Revenues?

PANYNJ challenges the Director's finding that PANYNJ used an improper methodology to calculate the amount of grandfathered airport revenue. [FAA Exhibit 1, Item 1, p. 23]. PANYNJ advances several arguments on appeal. PANYNJ contends its grandfathering methodology was agreed to by the FAA on several occasions. PANYNJ also asserts it uses a reasonable method of measuring grandfathered airport revenue and that a report relied upon by the Director is riddled with errors and unreliable.

A. PANYNJ's Arguments on the Grandfathering Methodology

PANYNJ claims it has used a reasonable and proper methodology to compute grandfather payments for many years. PANYNJ's methodology deems the annual amount of grandfathered airport revenue "to be the calculated net change in the reserve fund balances attributable to PANYNJ's non-aviation business segments." [FAA Exhibit 2, Item 6B, p. 37]. PANYNJ notes non-

federal legislation "permits it to pool revenue from all facilities (both before and after 1982), including aviation facilities, to pledge as collateral for its bonds and use any excess revenue (less operating expenses) to cover expenses at any of the Port Authority's facilities regardless of the source of the revenue." The methodology "provides the ability to finance capital investments for all business segments through bond issuance, bank loans, and/or the use of reserve funds." [FAA Exhibit 1, Item 18, p. 7]. PANYNJ claims that the "FAA has not historically been very clear on how grandfather revenue should be calculated,"[13] and that in the "absence of contrary direction, the Port Authority has determined a reasonable basis for reporting." [FAA Exhibit 2, Item 6B, p. 44]

PANYNJ also contends that its methodology was approved by the FAA on several occasions and the FAA has never challenged its use. [FAA Exhibit 2, Item 6B, p. 38]. PANYNJ cites two examples from 2004 and 2012 where its calculations were subjected to FAA review and settlements were entered into using its existing methodology as part of the corrective action calculations. [FAA Exhibit 2, Item 6B, pp. 38-41]

PANYNJ argues that the Director erred in relying upon the Kearney grandfathering report. PANYNJ contends the report contains calculation errors, is unsupported by the data, is not bound by standard audit practices, and is so unreliable that the findings based on the report must be "vacated." [FAA Exhibit 2, Item 6B, p. 2]. PANYNJ argues Kearney used the wrong grandfather base year, used the wrong financial schedules for reconciliations, and ignored bond resolutions governing pooled revenues. [FAA Exhibit 2, Item 6B, pp. 36-40].

B. United's Reply

United contends that PANYNJ's "methodology is simply an accounting trick" that has "no relation to the actual use of airport funds" and that "PANYNJ vastly understates the amount it diverts." United points out that in 2014, PANYNJ generated $201M in surplus airport revenue but reported "a negative grandfather payment of $416.3 million," which it says implies that "the airports were the recipients of funds from other operations, not vice versa." [FAA Exhibit 2, Item 12, p. 52]. United contends the FAA contractor "logically decided to measure airport surplus revenue rather than non-airport revenue," and its calculations show PANYNJ's "methodology understated the actual transfer of airport revenues to off-airport uses" by more than $2B. [FAA Exhibit 2, Item 12, p. 53]. United argues the Determination should be upheld.

C. Associate Administrator's Analysis

The Associate Administrator first addresses PANYNJ's contention that the FAA approved its grandfathering methodology. This is followed by an analysis of PANYNJ's claim the Kearney's report is unreliable, together with a review of the adequacy of PANYNJ's grandfather methodology.

FAA Approval of PANYNJ's Methodology

As an initial matter, the Associate Administrator rejects PANYNJ's contention that United's Complaint is barred by the FAA's explicit or implicit approval of PANYNJ's grandfather

[13] Citing to DOT OIG Report No. AV2018041 *FAA Needs to More Accurately Account for Airport Sponsors' Grandfathered Payments,* April 17, 2018.

methodology. The Director found "no formal or written documentation exists of FAA approval of PANYNJ's grandfathering methodology." [FAA Exhibit 2, Item 1, p. 21]. The Associate Administrator likewise found no evidence in the administrative record or FAA files indicating PANYNJ's grandfathering methodology was reviewed or approved by the FAA.

Further, assuming an agreement existed in 2004 or 2012, United is not precluded from bringing a Part 16 complaint questioning PANYNJ's compliance with its revenue use obligations. *See Bombardier Aerospace Corp. v. City of Santa Monica*, no. 16-03-11, Director's Determination, at 8 (January 4, 2005). And nothing precludes the FAA from evaluating whether an airport sponsor complies with its obligations under the applicable statutes or grant assurances. *See Skydive Sacramento v. City of Lincoln, CA*., FAA Docket No. 16-16-09, Director's Determination, (May 4, 2011)(insurance requirement in skydiving operator's lease found to violate grant assurances); *Nishio v Saipan International Airport (Commonwealth Ports Authority), FAA Docket No. 16-13-03*, Director's Determination, (insurance requirement in flight school lease violated grant assurances).

PANYNJ's Grandfather Calculation Methodology Improperly Measures Grandfathered Revenue.

As explained above in Issue 1, 49 U.S.C. § 47107(b)(1) and § 47133 restrict the use of airport revenue. Section 47133 prohibits "revenues generated by the airport" from being "expended for any purposes other than the capital or operating costs of (1) the airport; (2) the local airport system or (3) any other local facility that is owned or operated owned or operated by the person or entity that owns or operates the airport that is directly and substantially related to the actual air transportation of passengers or property." Section 47133 requires an airport sponsor to have a revenue use accounting system that can show it limits the use of airport revenue as required by the statute and grant assurances. *See* FAA's Revenue Use Policy, [64 Fed. Reg. 7696; 7720 (February 16, 1999)] and Rates and Charges Policy [78 Fed. Reg. 53330 (Sept. 10, 2013)].

The grandfather exception provided in 49 U.S.C. § 47115(f)(2) also requires a grandfathered airport sponsor to track "the amount of revenues used by the airport for purposes other than capital or operating costs . . . ." That amount is then compared to the analogous amount diverted in the first fiscal year ending after August 23, 1994 as adjusted by a certain index published by the Department of Labor. Section 47115(f) thus requires a methodology that accurately tracks the amount of airport revenue used "for purposes *other than* capital or operating costs of the airport or the local airports 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." 49 U.S.C. § 47115(f)(1) (emphasis added).

PANYNJ, under its challenged methodology, measures the annual amount of grandfathered airport revenue "to be the calculated net change in the reserve fund balances attributable to PANYNJ's non-aviation business segments." [FAA Exhibit 2, Item 6B, p. 37]. PANYNJ initially argues this methodology is a reasonable way to calculate grandfathered revenue because the FAA has not adopted standards to evaluate or approve grandfather methodologies. [FAA Exhibit 2, Item 6B, p. 43]. PANYNJ's argument misses the mark. The issue presented is whether PANYNJ grandfather methodology complies with the requirements of 49 U.S.C. § 47107(b)(2), § 47133, and 49 U.S.C. § 47115(f).

Kearney, the Director's consultant, was retained to help determine whether PANYNJ's methodology satisfied the statutory requirements. Kearney evaluated PANYNJ's grandfather methodology by using aviation and non-aviation source revenues, as reported in PANYNJ's audited financial statements. Kearney concluded that PANYNJ used inconsistent grandfather computations, and also determined that potential grandfather payment overages of $811M and $1.2B (depending on the source of revenue) resulted when a consistent methodology was used. [FAA Exhibit 2, Item 1, p. 20]. Both figures substantially exceed the $605.8M reported by PANYNJ to the FAA. On appeal, PANYNJ challenges the accuracy of Kearney's calculations, primarily related to the 1995 base year and specific financial schedules used to reconcile the calculations with amounts reported to the FAA. [FAA Exhibit 2, Item 6B, p. 38].

The Associate Administrator agrees that PANYNJ has cast sufficient doubt on the reliability of Kearney's grandfathering report concerning its use of the 1995 base year, wrong financial schedule, and wrong business segment, and accordingly disregards those findings. However, even if those calculations are disregarded for being erroneous or misattributed, other undisputed material facts directly derived from PANYNJ's annual reports provided to the FAA and in PANYNJ's annual financial statements support and provide substantial evidence to affirm the Director's Determination.

PANYNJ does not dispute that the combined aviation revenues from its five airports contributed $2.7B to its reserves and aviation was the only business segment that consistently generated surplus revenue from 2009-2014. [FAA Exhibit 2, Item 1, p. 20]. PANYNJ does not dispute that the amount of grandfather payments reported to the FAA totaled only $604M over the same period, leaving a large discrepancy of about $2.1B. [FAA Exhibit 1, Item 18, p. 8]. PANYNJ explains this discrepancy by claiming the diverted aviation revenues were reinvested in its airports. However, this assertion could not be validated because PANYNJ admittedly cannot trace the source of funds once recorded in its reserve accounts. [FAA Exhibit 2, Item 1, p. 21]. And most of PANYNJ's non-aviation business segments reported a loss at that time, so an unknown amount of airport revenue was spent on those non-aviation segments. [FAA Exhibit 1, Item 18, p. 5].

PANYNJ does not dispute that it "has expended considerable amounts of airport revenue on non-aviation facilities it does not own." [FAA Exhibit 2, Item 1, p. 23]. And PANYNJ admits that it "knows the amount of net aviation revenue flowing into the reserve funds in a given year" but claims it is "not possible to directly track" whether those aviation revenues are "used to service debt…remains in the reserve funds…or is expended on the Port Authority's operations and facilities." [FAA Exhibit 2, Item 6B, p. 39]. These undisputed findings and admissions provide substantial evidence supporting the Director's conclusion that "PANYNJ cannot demonstrate that PANYNJ has complied with" 49 U.S.C. § 47107(b)(2), § 47133, § 47115(f), Grant Assurance 25, *Airport Revenues*, or the Revenue Use Policy. [FAA Exhibit 2, Item 1, p. 23].

PANYNJ's admitted inability to track the use of approximately $2.7B in airport revenues – regardless of the existence of bond resolutions and reserve funds – sufficiently demonstrates the impropriety of its methodology. Under PANYNJ's methodology, ascertaining the actual use of airport revenue deposited in the reserve account is virtually impossible. This precludes PANYNJ (or the FAA) from assuring compliance with the revenue use limitations provided in 49 U.S.C. §§ 47107(b) and 47133. And measuring PANYNJ's non-aviation expenditures as a means to determine

whether grandfather revenues exceed the inflation-adjusted amount does not comport with 49 U.S.C. § 47115(f). Under that statute, the FAA must consider the amount of airport revenue diverted above a sponsor's revenue use cap in the year preceding a grant application as a factor militating against the sponsor's grant funding. In sum, the Associate Administrator finds that measuring the amount of non-aviation net revenue (or expense) is an improper means of calculating the amount or actual use of airport revenue. The methodology fails to satisfy the revenue use requirements provided in § 47107(b), § 47133, and § 47115(f).

As United points out, PANYNJ admits spending substantial amounts of airport revenue on facilities not owned or operated by PANYNJ, including non-revenue producing facilities at the Wittpenn Bridge and the Pulaski Skyway. [FAA Exhibit 2, Item 12, p. 54]. As we have held above, this spending violates the revenue use limitations and applicable statutes. The type of spending must cease, be accounted for, and reimbursed to the airports. It also constitutes another reason PANYNJ's methodology is flawed. It is impossible to determine the source and amount of revenues spent on the non-owned facilities, including whether the revenue was airport revenue, and if so, the amount. [FAA Exhibit 2, Item 12, p. 54]. PANYNJ's indirect method lacks accountability and transparency and improperly allows the amount of grandfathered airport revenue to be fixed by non-aviation enterprises or facilities of others, and at the expense of airport revenue available to its airports.

D. Conclusion – *Grandfathering Methodology.*

PANYNJ's challenge to the accuracy of Kearney's grandfather report does not address the fundamental underlying issue raised by United about the legality of PANYNJ's grandfather methodology. The Associate Administrator concludes that the amount of grandfathered airport revenue cannot be measured by the non-aviation method employed by PANYNJ. The Associate Administrator concludes that the findings in the Determination are supported by the great weight of reliable, probative, and substantial evidence and upholds the Director's finding that PANYNJ has not complied with the grandfathering exception provided by 49 U.S.C. § 47107(b)(2) and § 47133, and Grant Assurance 25, *Airport Revenues*.

ISSUE 3: Whether the Director erred in finding the EWR Flight Fees Lacked Transparency and PANYNJ engaged in Deficient Accounting Practices and Record-keeping?

PANYNJ challenges the Director's decisions that the flight fees at EWR lacked transparency, and PANYNJ engaged in deficient accounting practices, poor record-keeping, and associated procedures in setting rates and charges at EWR. Each challenge is discussed separately below.

A. PANYNJ's Arguments on the Flight Fees

In its Complaint, United claimed PANYNJ's flight fees at EWR were unreasonable and lacked transparency based upon a "hidden" 38% markup over PANYNJ's actual costs. The 38% markup was used to calculate the amount of flight fees necessary to recover EWR airfield costs. The Director' found that PANYNJ engaged in a lack of transparency in setting its rates and charges, including flight fees charged to United at EWR. [FAA Exhibit 1, Item 1, p. 22]. The Director relied,

in part, upon a report on flight fees prepared by GRA, Incorporated (GRA), PANYNJ's financial records, and correspondence between the parties.

PANYNJ challenges the Director's Determination on several grounds. PANYNJ argues the EWR flight fee calculation is based on a "typical cost-of-recovery" methodology for recouping expenses incurred for operating EWR and that its use of a "multiplier" to recover certain indirect costs was long-ago accepted by United and its predecessors. [FAA Exhibit 2, Item 6B, pp. 5-6]. PANYNJ asserts the "fees charged to United were consensual and are based on a fair, reasonable, and transparent cost methodology in accordance with 49 U.S.C. § 47107(a)." [FAA Exhibit 2, Item 6B, p. 5].

PANYNJ next contends that GRA's comparison of the flight fee methodology at EWR and JFK shows PANYNJ's flight fees at EWR are reasonable. Based upon the comparison, PANYNJ points out that the Director found the "fees are not unreasonable [and] are comparable to other PANYNJ airports" and that "United cannot even begin to show that the fees are unconscionable." [FAA Exhibit 2, Item 6B, p. 16]. PANYNJ notes the Director "found that the [EWR methodology] and the [JFK methodology] would generate virtually identical recoveries for Fiscal Year 2014." [FAA Exhibit 2, Item 6B, p. 16].

PANYNJ argues that United's claims about "inheriting" the EWR flight fee do not apply to the EWR AirTrain Fee, which was "directly agreed to by United when the EWR AirTrain was conceived and constructed." PANYNJ points out the Determination noted the EWR flight fee is "separate" from the AirTrain Fee and must be evaluated separately. [FAA Exhibit 2, Item 6B, pp. 21-22].

PANYNJ also argues that it "has already acceded to United's request" by its January 1, 2019 implementation of the "New Liberty Fee Agreements" (Liberty Agreements) at EWR. The fees in the new Liberty Agreements were "calculated using the same principles as the JFK Freedom Flight Fee methodology" and whose "cost assessment methodology was noted by the FAA's flight fee consultant, and was expressly adopted by the Director's Determination." [FAA Exhibit 2, Item 6B, p. 7]. PANYNJ appeal shows that the Liberty Agreements were "adopted by the Port Authority Board in November 2018, prior to the release of the Director's Determination." [FAA Exhibit 2, Item 7, Exhibit A].

B. United's Reply

United argues that it did not "agree" to the EWR flight fee, made multiple requests for detailed information on fee methodologies, and "sought unsuccessfully" to change the flight fee formula in the 2003/2004, 2005/2006[14], and 2013/2014 timeframes. United argues that PANYNJ refused to clarify flight fee formulas, refused to negotiate a new fee, and "reiterated its position that the terms of the written lease agreement trumped federal requirements." [FAA Exhibit 2, Item 12, pp. 14-19]. United rejects PANYNJ's claim that "the parties have willingly retained" the flight fee. [FAA Exhibit 2, Item 12, p. 20].

[14] 2003-2006 communications were between United's pre-merger predecessor Continental Airlines, Inc. and PANYNJ

United argues PANYNJ's use of a "multiplier" developed in 1969 was improper and that PANYNJ cannot "offer any support" that a 50-year old cost allocation designed for an "enterprise one-sixth the size" of EWR is valid today. [FAA Exhibit 2, Item 12, pp. 27-28]. United points out EWR has evolved over time and that "cost allocation methods must be periodically assessed" to ensure it captures costs and produces an accurate result as facts change. [FAA Exhibit 2, Item 19, p. 12]. PANYNJ's admission that it cannot validate the EWR flight fee "should end the inquiry." [FAA Exhibit 2, Item 12, pp. 27-28].

Lastly, United claims that "comparison with the JFK fee demonstrates nothing about the reasonableness of the EWR flight fee," which it says can only be ascertained by looking at EWR costs and revenues. United posits that it is "entirely inappropriate to judge the reasonableness of a clearly non-transparent and arbitrary fee at one airport by comparing it to the hypothetical, after-the-fact result of the application of a formula from a different airport." United refutes PANYNJ's (and the Director's) comparison of EWR flight fees to JFK fees and requests clarifications from the Associate Administrator. [FAA Exhibit 2, Item 12, pp. 30-31].

C. Associate Administrator's Analysis of the Flight Fee

The New Liberty Agreements

As a preliminary matter, the Director found that PANYNJ lacked transparency in setting EWR flight fees based on the EWR rates and charges methodology used when United filed its Complaint in 2016. The new Liberty Agreement flight fee methodology – developed in the 2017-2018 timeframe – sets forth a new methodology after and unrelated to United's original challenge to EWR flight fees. As such, the formulation of the Liberty Agreement flight fee methodology does not resolve the challenge. Evidently, the new Liberty Agreements are intended to replace the previous agreements between PANYNJ and EWR airlines (such as United). [FAA Exhibit 2, Item 7, Exhibit A]. The validity of the new agreements was not before the Director in this proceeding and do not raise substantial questions regarding the Director's findings. [14 CFR §16.33(e)(3 and 4); §16.33 (f)(1)]. The agreements do not moot United's challenge or alter the Director's findings. Consistent with §16.33(e) and (f), the Associate Administrator declines to consider the Liberty Agreements in this appeal.[15]

Transparency and Reasonableness of the EWR Flight Fee

49 U.S.C. § 47107(a) (1) and Grant Assurance 22, *Economic Nondiscrimination*, require an airport sponsor to make the airport available to all types, kinds, and classes of aeronautical activity on fair and reasonable terms and without unjust discrimination. The FAA's Rates and Charges Policy provides the methodology that a sponsor should follow in setting the fees, rates, and charges on aeronautical users in order to comply with the requirements of Grant Assurance 22. [78 Fed. Reg. 53330 (Sept. 10, 2013)]. Paragraph 2 of the Policy provides that "rates, fees, rentals, landing fees…imposed on aeronautical users for aeronautical use of the airport must be fair and reasonable." [78 Fed. Reg. 55333]. *See R/T 182, LLC. v. F.A.A*., 519 F.3d 307 (6th Cir. 2008).

[15] United has expressed discontent with the new Liberty Agreements regarding a lack of fee negotiation and PANYNJ's treatment of AirTrain costs at EWR. [FAA Exhibit 2, Item 12, p. 30]. In the event of an unresolved fee dispute involving the new Liberty Agreements, United may file a Part 16 in accordance with the regulatory requirements.

Under paragraph 3.1, "airport proprietor must apply a consistent methodology in establishing fees for comparable aeronautical users of the airport." [*Id*.] With respect to cost-based rates, paragraph 2.3 provides "airport proprietors must employ a reasonable, consistent, and transparent (i.e., clear and fully justified) method of establishing the rate base and adjusting the rate base on a timely and predictable schedule." [78 Fed. Reg. 55333]. Paragraphs 2.4.5 and 2.7.1 provide that shared costs and indirect costs included in aeronautical fees should be based upon "reasonable and transparent" methodologies or formulas.

The Director first considered whether the EWR flight fee was reasonable and transparent based upon United's claim that a "hidden" 38% markup over actual costs was used in the formula to recover EWR airfield costs. [FAA Exhibit 2, Item 1, p. 10]. The Director determined that markups as a means of recovering costs are not impermissible if they are adequately explained and justified. The Director concluded, however, the makeup of what costs are included in the 38% markups of the EWR flight fee is not clear or transparent, and the formula has not been evaluated since 1973 to determine if the markups align with EWR's actual costs.

On appeal, PANYNJ fails to explain the basis of the 38% markups or accounting principles used to justify the markups. PANYNJ admits that it has not recently assessed the validity of the flight fee. [FAA Exhibit 2, Item 1, p. 15]. PANYNJ further explains that it "no longer has information available" to show what costs the EWR flight fee was "designed to capture or whether precision was the goal at the time." [FAA Exhibit 2, Item 7, p.7]. PANYNJ's admission illustrates the lack of transparency underpinning the flight fee.

United also claims that PANYNJ resisted and failed to cooperate with United's multiple attempts (going back to at least 2003) to ascertain the components of the EWR flight fee and to renegotiate its EWR lease. United points to multiple letters and correspondence from PANYNJ to United stating that United was not entitled to know airfield cost information, airport revenue expenses, or whether the flight fee was justified by costs. [FAA Exhibit 2, Item 12, pp. 14-19]. PANYNJ does not dispute United's claims.

PANYNJ argues that United entered successive lease agreements with PANYNJ and thereby agreed to the rates. This does not necessarily defeat United's Complaint. The successive leases do not constitute irrefutable proof of transparent airport rates and charges, nor do they legitimize arbitrary cost recovery methods. As United argues, a historical cost multiplier should not be used without a process to analyze, true-up, or actualize the multiplier for current cost considerations. Airports evolve over time and certainly do so over a period of almost fifty years. Therefore, in this case, the cost allocation method should have been assessed to determine if it still maintained an appropriate relation to actual costs. [FAA Exhibit 2, Item 19, p. 14]. Under paragraph 2.3 of the Rates and Charges Policy and the facts as presented herein, PANYNJ had an ongoing responsibility to periodically analyze and true-up its EWR flight fee methodology relative to its actual costs. [78 Fed. Reg. at 55333]. PANYNJ has failed to do so at EWR since ~1973.

The Associate Administrator concludes that PANYNJ's failure to cooperate with legitimate inquiries from United, and its failure to periodically analyze and true-up markups to actual costs coupled with its admitted inability to validate cost recovery markups of the EWR flight fee, constitute substantial evidence supporting the Director's finding of an insufficiently transparent

rate-setting methodology. The Associate Administrator affirms the Director's finding of a lack of transparency.

Reasonableness of the EWR Flight Fee Methodology Compared to the JFK Method.

The Director engaged consultant GRA, Inc. to evaluate and compare rates and charges at EWR with JFK and LGA to evaluate United's claim that PANYNJ's flight fees at EWR were unreasonable. GRA prepared a flight fee report on its findings. Based on the report, the Director found that explicitly including indirect costs in the EWR formula in lieu of markups (and excluding AirTrain costs) resulted in comparable flight fees. [FAA Exhibit 2, Item 1, p. 15]. The Director found, and United has not demonstrated on appeal, that any specific costs at EWR are unreasonable. [FAA Exhibit 2, Item 1, p. 17].

The Director found, and the Associate Administrator agrees, there is insufficient evidence the 38% markup at EWR was unreasonable. The Director compared the components of rates and charges at JFK with their equivalents at EWR. The Director stated that a markup may be used as a method to recover costs, and PANYNJ has the discretion to recover costs in different ways between its airports. [FAA Exhibit 2, Item 1, p. 15]. The reasonableness of the 38% EWR markup – measured in terms of indirect costs recovered and fees generated – was not found to be in contravention of Grant Assurance 22 and thus warrants no additional consideration by the Associate Administrator.

However, the Associate Administrator does note that the comparison of rates and charges at JFK to those at EWR, while providing some point of comparison, is ultimately of limited value. There is no evidence that PANYNJ operates the two airports using consistent and transparent cost bases or methodologies, so the apparent equivalency may be coincidental. In any event, United did not meet its burden to show the fee was unreasonable. PANYNJ must adopt a transparent flight fee methodology that enables all users, and the FAA, to evaluate the reasonableness of the flight fees.

For its part, United correctly states that airport rates and charges must be based on airfield specific costs and revenues. The Determination affirms that requirement in finding that PANYNJ's flight fees are insufficiently transparent in identifying how EWR costs are calculated and recovered. As to United's argument that EWR fees should not be compared to JFK, United itself raised this issue in its Complaint by alleging higher flight fees at EWR resulted in unfair cost benefits to competitor airlines operating out of JFK and LGA. [FAA Exhibit 2, Item 1, pp. 10-11].

D. Conclusion –Flight Fees

The Associate Administrator affirms the Director's holding that the methodology used to establish the EWR flight fee is insufficiently transparent to comply with Grant Assurance 22, even if United could not show that the markup itself was unreasonable. Consequently, PANYNJ must true-up and actualize the EWR markup to reflect actual costs to be sufficiently transparent and comply with Assurance 22. The Associate Administrator affirms the Director's holding there is insufficient evidence that PANYNJ's flight fees at EWR are unreasonable.

Issue 3: Deficient Accounting Practices and Record-keeping

PANYNJ challenges the Director's finding that PANYNJ engaged in deficient accounting practices and procedures, poor record-keeping, and a lack of transparency in setting its rates and charges at EWR. [FAA Exhibit 1, Item 1, p. 22]. PANYNJ raises several grounds supporting its challenge.

A. PANYNJ's arguments

The Director relied, in part, upon an accounting report prepared by Kearney which analyzed PANYNJ's terminal rates and accounting and financial processes for Newark. First, PANYNJ contends Kearney's "work product is unstructured by common audit standards" and is "procedurally defective." [FAA Exhibit 2, Item 6B, pp. 22-26]. PANYNJ claims that AICPA consulting services standards are "more lenient" and "differ fundamentally" from auditing standards. [FAA Exhibit 2, Item 6B, p. 24]. PANYNJ argues that the conclusions are not "supported by a preponderance of reliable, probative, and substantial evidence" in accordance with 14 CFR § 16.33(e)(1) and "must be reversed." [FAA Exhibit 2, Item 6B, p. 28].

Second, PANYNJ challenges the accuracy and reliability of the Kearney accounting report, claiming it is "substantively wrong," reached "a number of incorrect conclusions," and the "errors render [the Report] utterly unreliable." PANYNJ detailed multiple alleged errors in the accounting report regarding the terminal rate analysis, reconciliation of FAA Forms 5100-126 and 5100-127, primary and secondary expense allocations, expense source documentation, and internal orders. [FAA Exhibit 2, Item 11, pp. 14-17] [FAA Exhibit 2, Item 10, pp. 24-31].

Finally, PANYNJ argues it employs acceptable accounting practices and maintains an adequate audit trail that are independently audited annually in accordance with Generally Accepted Government Auditing Standards. Those standards require "in-depth transaction level testing" of PANYNJ's revenue and expense accounts and tests its "internal controls…and compliance with applicable laws." PANYNJ asserts the audits found "no material weaknesses." [FAA Exhibit 2, Item 6B, p. 23].

B. United's Reply

United points out that PANYNJ "devoted 15 pages to quarreling" with Kearney's financial reconciliations and findings. United declined to respond to PANYNJ's challenge to the accuracy of the report on the belief that the arguments are "irrelevant" and because United was not afforded an opportunity to dispute accounting documents provided by PANYNJ to support the Director's investigation. [FAA Exhibit 2, Item 12, p. 36].

United does argue that PANYNJ mischaracterizes the facts by its belief the investigation would involve a "traditional audit of its books and records." United argues that the Director's use of Kearney's support "was not, and never was intended to be" an audit. [FAA Exhibit 2, Item 12, pp. 31-32]. United points out that the FAA indicated it would be seeking "support services" for "certain airport records and financial transactions," and that the accounting report itself notes performance in accordance with "AICPA Consulting Standards." [FAA Exhibit 2, Item 12, p. 32; FAA Exhibit 1, Item 17].

C. Associate Administrator's Analysis of PANYNJ's Deficient Accounting Practices and Record-keeping

The Associate Administrator first addresses PANYNJ's contentions regarding the applicable audit standards and then considers the PANYNJ's arguments concerning its accounting practices and record-keeping.

Applicability of Audit Standards

The Associate Administrator dismisses PANYNJ's contention that Kearney's accounting report should be disregarded because it was not prepared in accordance with generally accepted audit standards. United is correct that FAA communications with PANYNJ do not reference an audit to be performed or an audit standard to be used. The statement of work for Kearney is likewise silent on the issue. On the other hand, cost allocation audit guidelines (e.g. 2 CFR § 200) were referenced in the Kearney accounting report, and the report cover letter referred to the analysis as an "audit," lending certain merit to PANYNJ's claim of unclear review standards.[FAA Exhibit 1, Item 17, p. 5] [FAA Exhibit 2, Item 2].

In any event, the argument is irrelevant. Kearney's statement of work prescribes that relevant evaluation criteria be drawn from 1) 49 U.S.C. § 47107 and § 47133, 2) 2 CFR § 200 (OMB Super Circular), 3) FAA Order 5190.6B, *Airport Compliance Manual*, and 4) *FAA Policies and Procedures Concerning the Use of Airport Revenue*. [FAA Exhibit 2, Item 2, p. 6] [FAA Exhibit 1, Item 17, p. 8]. The statutes, regulations, and policies provide the standards; therefore, it does not follow that a "work product unstructured by common audit standards" is "procedurally defective," as PANYNJ claims. [FAA Exhibit 2, Item 6B, p. 25]. Likewise, the absence of a formal audit does not itself invalidate the Director's findings, and PANYNJ fails to demonstrate how AICPA review standards prevent the Director from factually determining PANYNJ's compliance with its federal obligations.

PANYNJ's Deficient Accounting Practices and Audit Trail

The Director found PANYNJ was required to take corrective action to ensure its common costs are allocated according to a reasonable, transparent, and not unjustly discriminatory manner. The Director's decision was based upon PANYNJ's inability to produce documents which substantiated certain costs incurred at EWR. The Director found that PANYNJ was unable to provide source documentation to validate expenses and costs incurred and recorded in its accounting systems. [FAA Exhibit 2, Item 1 p. 16; p. 18].

The FAA is authorized to require an airport sponsor to produce records and special financial reports under 49 U.S.C. § 47107(a)(15), which is implemented by Grant Assurance 26, *Reports and Inspections*. This authority includes requiring an airport sponsor to provide evidence to support airport financial transactions.[16] Such reports must be made available and may, as requested, include

[16] 49 U.S.C. § 47107(a)(15) provides that *"the airport owner or operator will submit any annual or special airport financial and operations reports to the Secretary that the Secretary reasonably requests and make such reports available to the public;"*

underlying accounting data (e.g. general and specialized journals, ledgers, manuals, and supporting worksheets) as well as corroborating evidence (e.g. invoices, vouchers, indirect cost allocation plans, leases, and other instruments) to support airport costs and expenses.

Kearney evaluated the documents produced by PANYNJ and, in its accounting report, identified numerous deficiencies in PANYNJ's cost allocation source documentation records, including records for:

- Mutual aid agreements;
- Allocated general, administrative, interest, and operating expenses (e.g. contracts, agreements, purchase orders, invoices, disbursement documents, receiving reports, etc.);
- Certain payroll expenses;
- Journal entries and adjustments;
- Leases and permits
- Operating and capital expenditures;
- Costs allocated to EWR between 2009 -2014.

[FAA Exhibit 1, Item 17, p. 5; pp. 7-12]

The Kearney report states that PANYNJ could only provide "SAP screenshots" for certain expenses which did not support the original operating or capital expenditure incurred and recorded. The report also tested PANYNJ's "automated audit trail," which was judged to "not support the costs allocated to EWR and other Port Authority facilities between 2009 and 2014." [FAA Exhibit 1, Item 17, p. 5]. Source documentation discrepancies were also noted for leases, permits, revenue transactions, operating expenditures, capital expenditures, etc. [FAA Exhibit 1, Item 17, pp. 9-12].

On appeal, PANYNJ argues that it "was not requested to provide supporting documentation for the "original expenses" for common cost centers and general ledgers. PANYNJ provided voluminous accounting software documents referred to as an "SAP audit trail report." PANYNJ claims the SAP report shows it can substantiate expenses and allocable costs. That may be true in the context of PANYNJ's internal accounting processes. However, PANYNJ still provided no evidence on appeal that any of the contracts, agreements, purchase orders, invoices, receiving reports, or other hardcopy sources judged to be deficient were maintained as required and available for review and reconciliation. [FAA Exhibit 2, Item 10, pp. 28-29][FAA Exhibit 1, Item 17, p. 5].

PANYNJ's expert consultant also tested the audit trail by applying PANYNJ's internal "Standard Practice Instructions"[17] to replicate EWR cost allocations. The consultant identified a difference of $2.9M between his calculations and PANYNJ's actual SAP cost allocations to EWR from 2009-2014. [FAA Exhibit 2, Item 11, pp. 19-20]. This $2.9M discrepancy – which the consultant described as "minimal" – provides additional evidence of PANYNJ's deficient accounting practices, particularly if PANYNJ's accounting instructions were used, as claimed.[18]

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[17] PANYNJ's "Standard Practice Instructions" identified as SPI-C08 and C-10, which were not provided to the record.
[18] PANYNJ's consultant claims to use PANYNJ's internal methodology on one hand, and on the other hand attributes the $2.9M discrepancy to his "use of an annual blended rate for direct labor ratios" versus PANYNJ's "monthly direct labor ratios." [FAA Exhibit 2, Item 11, p. 20].

PANYNJ's consultant also claims to have "mapped" and "validated" certain general ledger transactions, as well as "requested and reviewed supporting documentation (e.g., payroll reports, invoices)" for certain transactions deemed deficient by Kearney. The consultant "confirmed" that the amounts "substantially agreed" with the general ledger. [FAA Exhibit 2, Item 11, pp. 21-22]. However, PANYNJ provided no evidence to support the consultant's validation of the deficient source documentation for any of the transactions tested by Kearney.

PANYNJ's contention that its books and records are subjected to a formal independent annual audit does not address the specific deficiencies identified by Kearney. Instead, the deficiencies found by Kearney call into question the adequacy PANYNJ's formal financial audits – which show "no material weaknesses." – and may be good cause for the Director to compel an FAA-directed formal audit under 14 C.F.R §16.29(b)(3).[19]

The FAA's Revenue Use Policy requires a sponsor to maintain adequate documentary records (e.g. journals, ledgers, invoices, vouchers) supporting the use of airport revenue paid for an airport's direct and indirect costs. [64 FR 7719, (February 16, 1999)]. The principles of transparency and traceability are essential to establish that revenues are actually used according to Federal statutes, regulations, and the terms and conditions of a Federal grant. A sponsor's ability to tie transactions back to supporting documentation is a critical element in validating the reasonableness of the costs allocated to airfield users. Airfield cost records should be maintained to a level of precision and transparency such that the nature of the cost can be specifically identified. [*Id.*] PANYNJ did not demonstrate before the Director, or on appeal here, that expense and cost allocation source documentation is properly maintained and available for review and reconciliation upon request. For these reasons, reliable and substantial evidence supports the Director's findings, notwithstanding PANYNJ's objections to the factual reliability of certain findings contained in Kearney's accounting report.

D. Conclusion –Deficient Accounting Practices and Record-keeping

The Associate Administrator upholds the Director's finding that PANYNJ engaged in deficient accounting practices, poor record-keeping, and associated procedures in violation of Grant Assurance 22, *Economic Nondiscrimination,* and contrary to the FAA's *Policy and Procedures Concerning the Use of Airport Revenue*. The Director's prescribed corrective actions are likewise upheld.

IX. CONCLUSION

The Associate Administrator's role is to determine whether the Director erred in findings of fact or conclusions of law in issuing the Director's Determination. In arriving at a final decision in this Appeal, the Associate Administrator has reexamined the record in detail, including the Director's Determination, the administrative record supporting the Director's Determination, the Appeal, and Reply, and applicable law and policy. Based on this reexamination, the Associate Administrator concludes that the Director's Determination is supported by a preponderance of reliable, probative, and substantial evidence and is consistent with applicable law, precedent, and FAA policy. The

[19] 14 C.F.R §16.29(b)(3) *"Conducting or requiring that a sponsor conduct an audit of airport financial records and transactions as provided in 49 U.S.C. 47107 and 47121."*

Appeal does not contain persuasive arguments or evidence sufficient to reverse any portion of the Director's Determination.

The Director's Determination is affirmed. The Director's prescribed corrective actions are modified as ordered below and the case remanded, in part, to the Director to determine the basis for the PANYNJ's grandfather rights, if any, and a civil penalty, if any.

ORDER

ACCORDINGLY, it is hereby ORDERED that:

PANYNJ is afforded 90 days to submit a detailed Corrective Action Plan consistent with this Order and acceptable to the FAA, including at a minimum:

A. Resolution of Rates and Charges

PANYNJ shall disclose all financial data or information relevant to the use and accounting of Airport Revenue, such as cost and revenue data and adequate supporting documentation, in response to requests from the FAA or from other interested parties, including the airlines that serve the airports operated by PANYNJ. All such revenue, expenses, and costs must be verifiable. Any financial information required to be provided by this section, including but not limited to revenues generated and expenses paid using Airport Revenue, shall be reported on an airport-by-airport basis. Such disclosures shall be made within 60 days of the date of request and supported by readily available documentary evidence.

B. Limitations on the Use of Airport Revenue

1. Permitted Expenditures. Following the date of this Order, except as provided in paragraph 2 below, the PANYNJ shall only use Airport Revenue for the capital or operating costs of (1) the airport where the revenue was generated; (2) the local airport system; or (3) any other local facility or project that is (i) owned or operated by PANYNJ and (ii) directly and substantially related to the air transportation of passengers or property, in accordance with 49 U.S.C. §§ 47107(b)(1), 47133(a), and FAA's Policy and Procedures for the Use of Airport Revenue, 64 Fed. Reg. 7696 (Feb. 16, 1999).

2. Exceptional Use. PANYNJ may use Airport Revenue to make payments for purposes other than Permitted Expenditures as provided in paragraph 1 only if PANYNJ demonstrates to the satisfaction of the FAA that such payments qualify as Excepted Payments[20] in accordance with 49 U.S.C. §§ 47107(b)(2) and 47133(b)(1) and are used only for the support of a facility or project owned or operated by PANYNJ. Any Airport Revenue transferred by PANYNJ into a general fund intended to pay debt service on PANYNJ's outstanding bonds or general debt obligations must be accounted for as provided below in paragraph (G) and may be used to pay debt service attributable to the financing of non-aviation-related facilities or projects only if PANYNJ demonstrates to

[20] *Excepted Payments* means payments from Airport Revenue, other than for Permitted Expenditures, which are or were made to support non-aviation-related facilities or projects owned or operated by PANYNJ in accordance with a law or debt obligation meeting the requirements of 49 U.S.C. §§ 47107(b)(2) and 47133(b)(1).

the satisfaction of the FAA that such payments qualify as Excepted Payments in accordance with 49 U.S.C. §§ 47107(b)(2) and 47133(b)(1) and are attributable only to the financing of facilities or projects owned or operated by PANYNJ.

C. Separate Accounting of Airport Revenue

PANYNJ shall promptly establish, enhance, implement, and maintain a separate accounting and reporting methodology that fully discloses all expenditures made using Airport Revenue at each of its airports. The methodology must be operated and maintained in accordance with Generally Accepted Accounting Principles (GAAP) and shall include separate funds and general ledger account numbers to present distinct accounting records and reports for each airport. The enhanced accounting and reporting methodology may be phased in over 36 months commencing on the date of this Order; provided however, the methodology for EWR shall be implemented first and within 12 months of the date of this Order.

D. Separate Accounts

PANYNJ shall maintain separate accounts for Airport Revenue for each of its airports and shall provide evidence of such within 90 days of the date of this Order.

E. Accounting of Excepted Payments

For each year following this Order, PANYNJ shall report the amount of Excepted Payments to the FAA and shall disclose such payments in its annual audited financial statements in a way that clearly distinguishes them from payments made from general PANYNJ funds. For such reporting, the PANYNJ shall use form templates to be approved by the FAA.

For each year following this Order, the Port Authority shall annually report to the FAA how any Excepted Payments made during the previous year were used. For such reporting, PANYNJ shall use form templates to be approved by the FAA.

For each year following this Order, PANYNJ shall calculate and report to the FAA (1) the amount of Airport Revenue used by PANYNJ during the previous year for purposes other than Permitted Expenditures, and (2) the amount of Airport Revenue that was used by PANYNJ for purposes other than Permitted Expenditures during the PANYNJ's first fiscal year ending after August 23, 1994, adjusted for inflation using the Consumer Price Index of All Urban Consumers published by the Bureau of Labor Statistics of the Department of Labor or, if such Consumer Price Index is no longer promulgated, using a similar inflation index identified by the FAA.

F. Recoupment of Other Payments as Loans

To the extent PANYNJ made Other Payments[21] using Airport Revenue from January 1, 2012 until the date of this Order, PANYNJ shall, within 90 days following the date of this Order, quantify and report all such amounts, including the date each payment was made, to

[21] *Other Payments* means any payments from Airport Revenue made by PANYNJ from January 1, 2012 until the date of this Order for the support of any facility or project that was not owned or operated by the Port Authority.

the FAA in a manner and using an accounting methodology approved in writing by the FAA.

Thereafter, PANYNJ shall treat the disclosed amount of each Other Payment as a loan from its Airport Revenue accounts. PANYNJ shall repay each such loan back into its Airport Revenue accounts at an interest rate equal to the average investment interest rate for tax and loan accounts of the Department of the Treasury, rounded to the nearest whole percentage point, applied to each such loan beginning with the calendar year in which the corresponding Other Payment was made.

The term of each such loan shall be subject to prior FAA approval. The term shall be consistent with standard accounting methods and GAAP requirements and shall be in accordance with the Internal Revenue Service list of standard useful lifespan for calculating the useful life of the asset or facility to which the corresponding Other Payment relates. An amortization schedule will be prepared for each such loan, detailing the amount owed to PANYNJ's Airport Revenue accounts, the applicable interest rate, and other terms to determine the annual payment amounts for each such loan during the term of the loan, which shall be the generally accepted useful life of such asset or facility, but which shall not, in any event, exceed 30 years from the date the corresponding Other Payment was made.

G. Debt Service Payments

If PANYNJ intends to use Airport Revenue to pay debt service on its outstanding bonds or general debt obligations after the date of this Order, all such debt service payments using Airport Revenue must satisfy the requirements of paragraph B. above. The Port Authority shall separately account for and report to the FAA, using a methodology to be approved in writing by the FAA, the amounts of such debt service payments to be made using Airport Revenue that, 1) are attributable to the financing of PANYNJ's aviation-related facilities and projects and satisfy the requirements of subparagraph (B.1.) above for Permitted Expenditures and, 2) are attributable to the financing of non-aviation-related facilities or projects owned or operated by the Port Authority and satisfy the requirements of subparagraph (B.2.) above for Excepted Payments. For each year following the date of this Order, all debt service payments made using Airport Revenue that constitute Excepted Payments under this paragraph shall be included in the reporting of Excepted Payments required by paragraph E. above.

To the extent PANYNJ used Airport Revenue at any time between January 1, 2012 and the date of this Order to make debt service payments that were attributable to the financing of any facilities or projects that were not owned or operated by PANYNJ, such debt service payments shall constitute Other Payments within the meaning of this Agreement. PANYNJ shall identify all such past debt service payments which constitute Other Payments by date and amount using a methodology to be approved in writing by the FAA, and all such debt service payments shall be included in the loan amounts described in paragraph F. and shall be repaid into PANYNJ's Airport Revenue accounts with interest as provided for in paragraph F.

After the date of this Order, PANYNJ shall make no further use of Airport Revenue to make debt service payments attributable to the financing of facilities or projects that are not owned or operated by PANYNJ.

H. Sworn Declaration

For each year following this Order, PANYNJ shall annually submit to the FAA a sworn declaration signed under penalty of perjury by the Chairman of PANYNJ's Board of Commissioners and the Comptroller certifying the accuracy of all accounting and reports required to be prepared during the preceding year under the terms of this Corrective Action Plan.

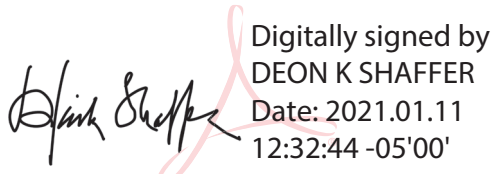
For the first such sworn declaration, PANYNJ shall include year-by-year calculations and supporting documentation, data, and inputs beginning in 1994 and continuing to the date of this Order demonstrating that the inflation-adjusted amounts described in paragraph (F) for each past year were accurately calculated and reported to the FAA or reconciling any discrepancies discovered. The FAA shall at all times remain entitled to challenge the calculations, data, and inputs used to prepare the reports required under this Corrective Action Plan. PANYNJ shall provide all calculations, data, and inputs within 30 days of a written request from the FAA.

I. Partial Remand

This matter is remanded to the Director to determine if PANYNJ has grandfather rights based on a pre-September 2, 1982 law controlling financing as provided for in 49 U.S.C. §§ 47107 & 47133 and grant assurance 25. This decision affirms the Director's decision that to the extent grandfather rights exist, they do not allow for the expenditure of airport revenue to support facilities that PANYNJ does not own or operate.

This matter is further remanded to the Director for a determination as to whether to issue a civil penalty consistent with the instances of non-compliance affirmed herein, and if so, the amount.

ACCORDINGLY, it is hereby ORDERED that (1) the Director's Determination is affirmed, as so modified, and (2) this matter is remanded, in part, to the Director, to determine the basis for the PANYNJ's grandfather rights, if any, and as to whether to issue a civil penalty.



D. Kirk Shaffer
Associate Administrator for Airports

Date