

UNITED STATES DEPARTMENT OF
TRANSPORTATION FEDERAL
AVIATION ADMINISTRATION
WASHINGTON, DC

FAA Docket No. 16-14-13

United Airlines,
Complainant,
v.
Port Authority of New York and New Jersey,
Respondent.



DIRECTOR'S DETERMINATION

I. INTRODUCTION

United Airlines (United) brings this complaint pursuant to 14 CFR Part 16 against the Port Authority of New York and New Jersey (PANYNJ/Port Authority), sponsor of Newark-Liberty International Airport (EWR), in New Jersey. [FAA Exhibit 1, Item 1].

On December 10, 2014, United filed this complaint alleging that PANYNJ (1) charges unreasonable rates using a fee methodology that is not cost-based and lacks transparency, in violation of 49 USC § 47107(a), Grant Assurance 22, *Economic Nondiscrimination*, and *Policy Regarding Airport Rates and Charges*; (2) generates excessive surplus revenues in order to subsidize non-aeronautical functions, and improperly diverts airport revenue in violation of 49 USC § 47107(b)(2), and Grant Assurance 25, *Airport Revenues*, and FAA's *Policy and Procedures Concerning the Use of Airport Revenue*; and (3) PANYNJ's actions are contrary to the *Anti-Head Tax Act* (49 USC § 40116) and the *Airline Deregulation Act* (49 USC § 41713, et seq.). [FAA Exhibit 1, Item 1, Pages 2-3].

In response, PANYNJ denies all United's allegations and asserts the flight fees are not unreasonable or unjustly discriminatory. PANYNJ claims as a grandfathered airport there is no unlawful diversion of revenue because it can use airport revenue for non-aeronautical purposes. PANYNJ raises as an affirmative defense that United is challenging the reasonableness of fees that were established by agreements to which United is a party. [FAA Exhibit 1, Item 3, Pages 1-34; Item 7, Page 3 and Item 2B, Pages 21-22, 33-36].

Based on the evidence of record in this proceeding, the Director finds that PANYNJ is in violation of Grant Assurance 22, *Economic Nondiscrimination* and Grant Assurance 25, *Airport Revenues*.

II. PARTIES

A. 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. [FAA

Exhibit 1, Item 2B, Exhibit 1, Page 9]. EWR serves as a hub for United. From 1982 on, EWR has been the recipient of 139 Airport Improvement Program (AIP) grants totaling \$332 million from the FAA. [FAA Exhibit 1, Item 21].

B. PANYNJ Overview

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 and between the two states 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 1, Item 29, Page 3].

John F. Kennedy International Airport (JFK) is the region's main international airport, EWR serves both national and international markets, and LaGuardia (LGA) is a short-haul facility. Stewart (SWF) is a developing air carrier airport owned by the State of New York while Teterboro (TEB) operates as a reliever/general aviation facility for PANYNJ. JFK, EWR, LGA, SWF are operated under leases. It also operates the Downtown Manhattan Heliport for the city of New York. PANYNJ's governance of EWR, and its other airports, is based on several laws and requirements including the General Reserve Fund statutes (Chapter 48 of the Laws of New York of 1931), Chapter 5 of the Laws of New Jersey of 1931, and the 1952 *Port Authority Consolidated Bond Resolution*. [FAA Exhibit 1, Item 18].

C. United Airlines, Inc.

United Airlines Inc., is a corporation organized under the laws of the State of Delaware having a principal place of business in Chicago, Illinois. [FAA Exhibit 1, Item 2B, Page 8]. Continental and United Airlines, Inc., merged on October 1, 2010, resulting in the newly-formed United Continental Holdings, Inc. The current framework for United's operations at EWR was established in 1969 under Lease AN-535. [FAA Exhibit 1, Item 2B, Page 9]. At EWR, United operates in accordance with several leases, including Lease ANA-170 (Master Lease). [FAA Exhibit 1, Item 2B, Page 3].

Those lease agreements were assumed by United when the merger was completed in 2013. [FAA Exhibit 1, Item 2B, Exhibit E]. United's investment in EWR (including Continental's) includes \$730 million in Terminal C-3 and \$150 million for Terminals C-1 & C-2. [FAA Exhibit 1, Item 3, Pages 3, 7, 10, and Exhibit H]. United has the largest carrier presence at EWR and operates approximately 135, 000 departures from there annually. [FAA Exhibit 1, Item 1, Page 11].

III. PROCEDURAL HISTORY

On December 10, 2014, United filed a 14 CFR Part 16 Complaint against PANYNJ. [FAA Exhibit 1, Item 1, Pages 1-2]. On December 18, 2014, PANYNJ wrote to FAA opposing United's filing. [FAA Exhibit 1, Item 1A]. On December 19, 2014, the FAA docketed the Complaint. [FAA Exhibit 1, Item 2].

On February 10, 2015, PANYNJ filed a Motion for Summary Judgment Dismissing the Complaint. [FAA Exhibit 1, Item 2B]. On March 27, 2015, United filed an Answer to PANYNJ's Motion for Summary Judgment. [FAA Exhibit 1, Item 2H].

On April 27, 2015, the FAA denied PANYNJ's Motion for Summary Judgment Dismissing the Complaint. [FAA Exhibit 1, Item 4A].

On May 15, 2015, PANYNJ filed its Answer to the Complaint. [FAA Exhibit 1, Item 3]. On June 4, 2015, United filed its Reply and on June 15, 2015, PANYNJ filed its Rebuttal. [FAA Exhibit 1, Item 6, and Item 7].

On June 19, 2015, PANYNJ filed a Motion for Leave to Include Supplementary Material in the Record of this Proceeding. [FAA Exhibit 1, Item 8]. On July 2, 2015, United filed its Answer to PANYNJ's June 19, 2015 request. [FAA Exhibit 1, Item 10].

On May 22, 2017, United filed a Motion for Release of Audit Report requesting the FAA to release the results from the audit (financial review) that the FAA had authorized in 2015 as part of the investigation. [FAA Exhibit 1, Item 30].

On June 1, 2017, PANYNJ filed an Answer in Opposition to the Motion for Release of Audit Report. [FAA Exhibit 1, Item 31]. On June 12, 2017, United filed a Reply to PANYNJ's Answer to United's Motion for Release of Audit Report, reiterating its justification for the request. [FAA Exhibit 1, Item 32].

On June 14, 2017, PANYNJ filed a Sur-Reply in Opposition to Motion of United Airlines, Inc. for Release of Audit Report. [FAA Exhibit 1, Item 33].

IV. BACKGROUND

In January 1995, PANYNJ and Continental executed a revision to Master Lease ANA-170 providing for (1) an extension for Terminal C to 2013 with adjustments in rentals and fees, (2) payment of AirTrain fees, and (3) payment of Phase IA charges for roadway work. [FAA Exhibit 1, Item 2B, Exhibit N]. In 1995, United entered into Supplement 24 to AN-535 extending the flight fee formula to December 31, 2018, and agreeing to add a Phase IA Charge Factor to the flight fees to recover certain airport roadway costs and add a fee to recover costs for the EWR Air Train. [FAA Exhibit 1, Item 2B, Pages 11 and 15].

PANYNJ instituted the fee to recover capital and operating costs that it incurred in constructing, maintaining, and operating the AirTrain system. [FAA Exhibit 1, Item 2B, Exhibit 1, Page 10]. In November 1998, Continental secured \$730 million in Special Facility Revenue Bonds for its EWR projects. [FAA Exhibit 1, Item 2B, Exhibit G, Pages 31-31, Item 2B, Exhibit 2, Exhibit U]. In September 1999, Continental agreed to extend the flight fee provisions set forth in Schedule C to December 31, 2018. [FAA Exhibit 1, Item 2B, Page 11].

In 2003, negotiations were underway for new operating agreements at JFK and LGA between New York and PANYNJ. The so-called "Dewey Leases," which had been in effect since 1953, were due to expire at the end of 2003. A committee representing the airlines operating at JFK and LGA met with PANYNJ to negotiate what became known as the "Freedom Agreement." Among other things, the agreement established a new methodology for the flight fees at JFK and LGA. [FAA Exhibit 1, Item 2H, Page 7].

In January 2006, Continental requested PANYNJ to provide information on EWR's rates and charges. Continental stated that PANYNJ "continues to rely on the existence of a written lease agreement between Continental and [PANYNJ] as somehow providing a

limitation on Continental's rights to information, as well as a limitation on any inquiry into the reasonableness of rates and charges" at EWR. The letter noted that "in refusing to provide any information regarding revenues generated at EWR," PANYNJ ignores "that the existence of a net surplus of revenue over expenses could indicate unreasonably high rates and charges." [FAA Exhibit 1, Item 2H, Exhibit WW].

The letter claims that "Continental is entitled to know the source and extent of any surplus revenues generated at EWR." Continental added that it is entitled to know how the revenues are spent, and that PANYNJ's refusal to provide the information makes it impossible to determine whether the rates and charges are being affected, and whether the requirements of federal law regarding revenue diversion were being met. [FAA Exhibit 1, Item 2H, Exhibit WW]. PANYNJ referred Continental's correspondence to the Port's Freedom of Information Administrator for processing under the PANYNJ's Freedom of Information Policy. [FAA Exhibit 1, Item 2H, Exhibit XX].

In June 2006, a meeting was held between representatives of Continental and PANYNJ. At that meeting, Continental again asked for details about the calculation of the EWR Flight Fees and the amount and sources of airfield and airport revenue surpluses. In response, PANYNJ reiterated its position that the terms of a written lease agreement [superseded] federal requirements and that Continental was not entitled to the requested information. [FAA Exhibit 1, Item 2H, Exhibit B, Page 3].

On April 26, 2008, an article was published that stated the PANYNJ hired a consultant to evaluate its staffing practices and make suggestions. The article noted (1) that overtime had jumped 12% to \$42.9 million, (2) there were no caps on overtime, (3) difficulties existed reassigning staff, (4) archaic record keeping existing and, (5) lenient sick time policies prevailed. [FAA Exhibit 1, Item 3, Page 15].

A March 2011 PANYNJ legal memorandum, concerning PANYNJ's ability to fund the Pulaski Skyway, Wittpenn Bridge and New Road projects, stated the projects were outside the realm of the typical PANYNJ undertaking, and noted that PANYNJ "does not generally participate in large-scale projects that do not involve an existing [PANYNJ] asset, or the acquisition of a [PANYNJ] asset." It also stated that PANYNJ "has no authority...to construct, own, maintain, or operate any of the approaches to the Holland Tunnel," it "would not own any of the assets comprising the Projects," and that PANYNJ "would be the only party funding the Projects." The memorandum concluded that PANYNJ would be the sole party funding the Projects notwithstanding the fact that NJDOT would retain title to all of the assets. [FAA Exhibit 1, Item 1, Page 17, Footnote 12 and Exhibit I].

On August 18, 2011, the Governors of New York and New Jersey charged PANYNJ's Board of Commissioners to undertake a comprehensive review and audit of the entire agency, covering its finances, operations, and ten-year Capital Plan, and that a Special Committee of the Board was organized to oversee that directive. [FAA Exhibit 1, Item 3, Pages 11-12].

Two reports (Navigant Reports) were issued, finding that (1) PANYNJ had expanded beyond its transportation mission and had become a major real estate developer; (2) aviation was the only positive free cash flow contributor with the largest capital expenditures; (3) PANYNJ needed to align its capital strategy with its mission, (4) PANYNJ's salaries were high and overtime reduction is needed; and (5) PANYNJ must

focus on efficiencies, transparency, and accountability. [FAA Exhibit 1, Item 3, Pages 11-12, Item 2H, Pages 11-12]. During that same month, the New York State Comptroller issued a report critical of PANYNJ's management and control of overtime. [FAA Exhibit 1, Item 3, Pages 15-17].

On January 5, 2012, PANYNJ notified FAA it had met with the airlines to discuss FAA's Grandfathered Payments Report, revenue diversion, PANYNJ's Operating and Financial Summary Form 127, and the 2010 Income Statement. PANYNJ presented how the grandfathering calculations were made, causes for overruns, and future payment estimates. [FAA Exhibit 1, Item 27].

On April 20, 2012, the FAA wrote a letter to PANYNJ concerning the grandfathered payments and a proposed schedule for PANYNJ to recover the net overage for a six-year period and that PANYNJ would be required to recover \$291 million. This required PANYNJ to stay below the grandfathered cap, contingent upon PANYNJ providing quarterly financial updates on grandfathered payments, completing high priority capacity projects, and maintaining operational and safety standards at its airports. [FAA Exhibit 1, Item 3, Exhibit 1, Exhibit B, FAA Letter dated April 20, 2012].

On April 8, 2013, following an FAA 14 CFR Part 139 airport certification investigation, a settlement between FAA and PANYNJ was executed requiring that PANYNJ pay \$3.5 million in civil penalties, take remediation actions, and create a stand-alone ARFF (Aircraft Rescue and Fire Fighting) cadre. [FAA Exhibit 1, Item 1, Page 41 and Exhibit FF].

On July 19, 2013, after PANYNJ announced an increase in ARFF fees for EWR, JFK, and LGA, United and other airlines wrote to PANYNJ to express concern at the 284% fee increase and disappointment that PANYNJ's did not provide detailed back-up information. Two months later, United again protested the ARFF fee increase and requested information upon which to base a determination whether or not the increase was reasonable. [FAA Exhibit 1, Item 2H, Exhibit A, Page 16]. United continued to convey its concerns to PANYNJ over the cost increases in the ARFF fees. [FAA Exhibit 1, Item 1, Pages 49- 51].

In March 2014, a Rudin Center for Transportation Policy & Management Report noted that PANYNJ's financial resources are to be used solely for core mission facilities, services, and projects. [FAA Exhibit 1, Item 1, Pages 25-26].

On September 15, 2014, United wrote PANYNJ raising concerns with PANYNJ's rates and charges and requesting a meeting. United noted that "if the dispute could not be resolved," it would "seek relief from the FAA." [FAA Exhibit 1, Item 1, Pages 50-51].

In October and November 2014, United and PANYNJ met, but the parties were not able to resolve their differences. [FAA Exhibit 1, Item 1, Page 51]. On December 10, 2014, United filed a 14 CFR Part 16 Complaint against PANYNJ. [FAA Exhibit 1, Item 1].

On June 7, 2016, the FAA notified PANYNJ it had reviewed the 2015 grandfathered data and found that PANYNJ exceeded the adjusted base-year amount by \$564 million. [FAA Exhibit 1, Item 28].

On November 17, 2016, Airlines for America (A4A) wrote to FAA stating that "as was the case in 2010, the PANYNJ has once again reported revenue diversion at levels far

exceeding their annual limit...or \$564.2 million,” including payments to facilities it does not own. A4A added that FAA should require PANYNJ to recover the diverted revenue. [FAA Exhibit 1, Item 25 and Item 25A].¹

On January 10, 2017, the Securities and Exchange Commission (SEC) issued an *Order, In the Matter of the Port Authority of New York and New Jersey* (SEC Order). The SEC Order references that in response to requests by the State of New Jersey for funding of certain roadway projects, including the Pulaski Skyway, and Wittpenn Bridge, PANYNJ approved \$1.8 billion and initially allocated bond proceeds towards funding the projects, without disclosing known risks surrounding the potential lack of legal authority to fund them.

The SEC noted that PANYNJ counsel cautioned that “projects that fall outside the scope of the Port Authority’s mandate would be *ultra vires*” and could not be undertaken or funded by PANYNJ. The SEC found that PANYNJ’s “lax governance” allowed the projects to be approved. PANYNJ agreed to pay a civil money penalty of \$400,000 to the SEC. [FAA Exhibit 1, Item 29, Pages 1-2, and 10-13].

V. ISSUES

Upon review of the facts summarized above, the Director has determined that the following issues require analysis to provide a complete review of the PANYNJ’s compliance with its Federal obligations:

Issue 1 - Whether PANYNJ’s Flight Fees and charges are unreasonable or unjustly discriminatory in violation of 49 USC § 47107(a), Grant Assurance 22, Economic Nondiscrimination, and Policy Regarding Airport Rates and Charges;

Issue 2 - Whether PANYNJ improperly diverts airport revenue in violation of 49 USC § 47107(b)(2), 49 USC § 47133, and Grant Assurance 25, Airport Revenues, and FAA’s Policy and Procedures Concerning the Use of Airport Revenue; and

VI. APPLICABLE FEDERAL LAW AND POLICY

A. The Airport Improvement Program

Airport sponsors receiving federal grants under the Airport Improvement Program (AIP) are subject to a number of statutory conditions, one of which restricts the use of airport revenue. 49 USC § 47101, *et seq.*, provides for federal financial assistance for the development of public-use airports under the AIP. 49 USC § 47107, *et seq.*, sets forth certain assurances to which an airport sponsor must agree to as a condition of receiving federal financial assistance. These assurances become a binding contractual obligation between the airport sponsor and the FAA.

¹ The issues raised by A4A relate to the issues raised by United and are discussed in this decision. On March 31, 2017, the FAA responded to A4A’s letter and stated that “the Port Authority of New York and New Jersey’s grandfathered revenue payment and the methodology by which the Port calculates its grandfather payment” are “at issue in an ongoing part 16 investigation and cannot be addressed outside of that proceeding.” The FAA added that the “letter will be submitted to the FAA part 16 Docket No. 16-14-13, and will be considered by the agency in its investigation of the complaint. Once the investigation is complete, the FAA’s determination will be publicly available.” [FAA Exhibit 1, Item 25A].

B. Airport Sponsor Grant Assurances

As a condition precedent to providing airport development assistance under the AIP the FAA must receive certain assurances from the airport sponsor.² 49 USC § 47107(a) sets forth certain sponsorship requirements to which an airport sponsor receiving federal financial assistance must agree. The FAA has a statutory mandate to ensure that airport owners comply with these sponsor assurances.

FAA Order 5190.6B, FAA Airport Compliance Manual (Order) provides the policies and procedures to be followed by the FAA in carrying out its compliance program. The grant assurances relevant to this Complaint are listed below as are other relevant policies.

1. Grant Assurances:

- Grant Assurance 22, *Economic Nondiscrimination*;
- Grant Assurance 24, *Fee and Rental Structure*; and
- Grant Assurance 25, *Airport Revenues*.

2. Related Policies:

- *FAA Policy and Procedures Concerning the Use of Airport Revenues (February 16, 1999)*.
- *Factors Affecting Award of Airport Improvement Program (AIP) Discretionary Funding (June 9, 1999)*.
- *DOT/FAA Policy Regarding Airport Rates and Charges (September 10, 2013) (Rates and Charges Policy)*.

3. 49 USC § 47107(b) (1) Use of Revenue

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 used for the capital or operating costs of (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.

4. 49 USC § 47133 Restriction on Use of Revenues

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.

² See https://www.faa.gov/airports/aip/grant_assurances/media/airport-sponsor-assurances-aip.pdf.

5. 49 USC §§ 47107(b)(2) and 47133(b) 'Grandfathering'

Certain airports may use airport revenue for otherwise impermissible expenditures when the airport qualifies as "grandfathered." An airport is "grandfathered" when provisions establishing certain financial arrangements exist that were in effect prior to the enactment of the AIA on September 3, 1982. (See 49 USC §§ 47107(b)(2) and 47133(b)). Specifically, for grandfathered airports, the revenue use restriction 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.

Grandfathered airports are grandfathered only as to what was in effect as of September 3, 1982. Under the "grandfather provision", an airport operator may use airport revenues for local purposes other than those proscribed in sections 47107 and 47133. This may include paying the sponsor for costs that are for purposes other than the airport's capital and operating costs. When a use would be diversion of revenue but is grandfathered, the use is considered lawful revenue diversion. [FAA Order 5190.6B, Page 15-7 and Appendix E].

As required by 49 USC § 47115(f), the FAA considers as a factor militating against the approval of an application for AIP discretionary funds the fact that a grandfathered airport has exercised its rights to use airport revenue for non-airport purposes when, in the airport's fiscal year preceding the date of application for discretionary funds, the FAA finds that the amount of airport revenues used for non-airport purposes exceeds the amount used for such purposes in the airport's first fiscal year ending after August 23, 1994, adjusted for changes in the Consumer Price Index. In making this determination, the FAA will evaluate the grandfathered payments for the fiscal year preceding the date of the application. [FAA Order 5190.6B, Page 15-7].

6. Airport Financial Reporting

In the FAA Authorization Act of 1994 (Public Law (P.L.) No. 103-305), Congress established the requirement for sponsors obligated under AIP Grant Assurances to submit to the Secretary and to make available to the public certain airport financial information. The Act also requires the Secretary to provide annual summaries of the financial reports to Congressional committees. Congress enacted additional provisions for monitoring and enforcing revenue use in the FAA Reauthorization Act of 1996.

Section 111(a) of the 1994 Authorization Act, codified as 49 USC § 47107(a)(19), requires airport owners or operators to submit to the Secretary and make available to the public (1) all amounts the airport paid to other government units, as well as the purposes for which each payment was made, and (2) all services and property the airport provided to other government units along with the compensation received for each service or property provided. Section 111(b) of the Act requires a report in a uniform simplified format for each fiscal year of each commercial service airport's sources and uses of funds, net surplus or loss and other information that the Secretary may require.

Section 805 of the 1996 Reauthorization Act added § 47107(l), Audit Certification, which relates to the annual audits required of local governments receiving federal assistance. 49

USC § 47107(l) requires that these annual audits (called Single Audits because one audit is conducted to cover financial assistance received from all federal programs) include a review and opinion on whether the use of airport funds is consistent with § 47107.

7. 49 USC § 40116 Anti-Head Tax Act

The Anti-Head Tax Act codified at 49 USC § 40116 provides that states and political subdivisions may collect a tax on a commercial aircraft flight only if the flight takes off or lands within the locality. Additionally, 49 USC § 40116(e)(2) states that a state or political subdivision may levy or collect "reasonable rental charges, landing fees, and other service charges from aircraft operators for using airport facilities of an airport owned or operated by that State or subdivision." The Act provides that state and local governmental entities (including a local airport authority) "may not levy or collect a tax, fee, head charge, or other charge on (1) an individual traveling in air commerce; (2) the transportation of an individual traveling in air commerce; (3) the sale of air transportation; or (4) the gross receipts from that air commerce or transportation."

C. The FAA Airport Compliance Program

The FAA discharges its responsibilities for ensuring airport owners' compliance with their federal obligations through its Airport Compliance Program. The program is designed to ensure the availability of a national system of safe and properly maintained public-use airports operated in a manner consistent with the airport owners' federal obligations and the public's investment in civil aviation. FAA Order 5190.6B sets forth policies and procedures for the Airport Compliance Program. In addressing allegations of noncompliance, the FAA will make a determination as to whether an airport sponsor is currently in compliance with the applicable federal obligations.

D. FAA Enforcement Responsibilities

The Federal Aviation Act of 1958, as amended, 49 USC § 40101, assigns the FAA Administrator broad responsibilities for the regulation of air commerce in the interests of safety, security, and development of civil aeronautics. Commitments assumed by airport owners or sponsors in property conveyance or grant agreements are important factors in maintaining a high degree of safety and efficiency in airport design, construction, operation and maintenance, as well as ensuring the public reasonable access to the airport. Pursuant to 49 USC § 47122, the FAA has a statutory mandate to ensure that airport owners comply with their federal grant assurances.

E. The Complaint and Investigative Process

Pursuant to 14 CFR § 16.23, a person directly and substantially affected by any alleged noncompliance may file a complaint with the FAA. The complainant shall provide a concise but complete statement of the facts relied upon to substantiate each allegation and describe how the complainant was directly and substantially affected by the things done or omitted by the respondents. If there is a reasonable basis for further investigation, the FAA will investigate. The regulations governing Part 16 proceedings provide that, if the parties' pleadings supply "a reasonable basis for further investigation," the FAA should investigate "the subject matter of the complaint." 14 CFR § 16.29(a).

In accordance with 14 CFR § 16.33(b) and (e), "a party adversely affected by the Director's determination may file an appeal with the Associate Administrator for Airports within 30

days after the date of service of the initial determination.” If no appeal is filed within the time period specified in paragraph (b) of this section, the Director's Determination becomes the final decision and order of the FAA without further action.

VII. ANALYSIS

Issue 1 - Whether PANYNJ's Flight Fees and charges are unreasonable or unjustly discriminatory in violation of 49 USC § 47107(a), Grant Assurance 22, *Economic Nondiscrimination*, and *Policy Regarding Airport Rates and Charges*.

United claims that PANYNJ's rate structure unlawfully discriminates against aeronautical users of EWR, and that PANYNJ charges higher flight fees for EWR than it does at the other major airports it operates in the New York metropolitan market. United argues that air carriers operating out of JFK and LGA, “on the one hand, are making similar use of the New York area airport system as those air carriers operating out of EWR,” but on the other hand PANYNJ “charges higher flight fees for EWR than it does for JFK and LGA.” United describes this as unjust economic discrimination, impacting United. [FAA Exhibit 1, Item 1, Pages 71-72].

PANYNJ denies the allegations but admits that United's leases require the payment of flight fees. PANYNJ admits that the flight fee methodologies at the New York and New Jersey airports differ and vary in certain respects and, over the years, depending on the level and type of expenditures recovered. [FAA Exhibit 1, Item 3, Pages 3, 5 and 19.]

1. United's Position on the Flight Fees

United asserts that the airfield fees it pays must be related to recovering the costs of operating and maintaining the airfield and must be transparent and reasonable, but at EWR they are set through a hidden ‘cost-plus’ formula that creates a markup of 38% above actual costs. United states that this formula creates a perverse incentive for PANYNJ to increase the expenses included in the rate base, because the more costs PANYNJ passes on to the airlines, the more profit it earns. United challenges EWR's flight fee based on take-off weight rather than landing weight, and that it far exceeds landing fees at other major airports. United claims that neither United, nor its predecessor-in-interest, Continental, negotiated the EWR Master Lease, and PANYNJ did not disclose to United the hidden profit embedded in the methodology until 2013. United also claims it never agreed – in writing or otherwise – to the ARFF charges or the other unreasonable or excessive charges, and that a charge imposed unilaterally by an airport calculated under a formula that exists in a master lease, is not a charge imposed by written agreement. [FAA Exhibit 1, Item 1, Pages 5-6, 12, and 54-55].

United's states that the flight fee costs at EWR have increased 46% since 2012, and that EWR's flight fee is excessive compared to JFK and LGA. United claims this cannot be explained away because the New York area is expensive since EWR's fee is 75% higher than the flight fee at JFK and 27% higher than at LGA. Finally, United states that “the exorbitant flight fee at EWR is a primary driver of the huge revenue surpluses generated at [EWR] each year.” [FAA Exhibit 1, Item 1, Pages 12-14].

United relies on the Anti-Head Tax Act, 49 USC § 40116 in further support of its argument that PANYNJ's rates and charges are unreasonable at EWR. [FAA Exhibit 1, Item 1, Pages 2-3]. United quotes an FAA statement referencing that the purpose of the

revenue use requirements is to prevent a hidden tax on air transportation. [FAA Exhibit 1, Item 1, Page 4]. United in arguing that PANYNJ's rates and charges at EWR are unreasonable references the Airline Deregulation Act of 1978 (ADA). [FAA Exhibit 1, Item 1, Pages 23]. United asserts that neither United, nor its predecessor-in-interest, Continental, negotiated the EWR Master Lease. United claims that the flight fee formula in the EWR Master Lease was first implemented by PANYNJ in 1972, before the enactment of the ADA. [FAA Exhibit 1, Item 1, Page 54; Item 3, Pages 2, and 27].

In its complaint, United contends PANYNJ has monopoly power because there is "no effective market discipline" that could act as a check on rates at EWR. United claims its EWR service competes with airlines serving JFK and LGA. United also claims it depends on its EWR hub to serve the New York metropolitan market, and that PANYNJ's unreasonable charges put it at a competitive disadvantage. [FAA Exhibit 1, Item 1, Pages 6, 14, and 39-40]. United submitted an expert report that PANYNJ's control of the three major commercial airports serving the NYC metropolitan area provides it with what is effectively a monopoly in the provision of commercial airport services in the NYC metropolitan area. [FAA Exhibit 1, Item 1, Exhibit EE, Page 29].

United also contends that PANYNJ's ability to charge prices well in excess of its costs (thereby earning high profits, particularly at EWR) is a direct result of the fact that it enjoys a monopoly position for the provision of airport facilities in the New York City metropolitan area. [FAA Exhibit 1, Item 1, Pages 34, 36-37, and Exhibit EE, Pages 18 and 23].

2. PANYNJ's Position on the Flight Fees

PANYNJ denies the allegations, and notes that United operates out of Terminals A, B and C pursuant to lease agreements and that each lease includes a description of the two components of the flight fee and a schedule C that sets forth the methodology for calculating the flight fee charged to United. [FAA Exhibit 1, Item 2B, Exhibit 1, Page 3].

PANYNJ claims that although the revenue produced by the flight fee exceeds certain costs, other reimbursable costs were simply left out of the formula including numerous overhead costs, including the executive salaries and other PANYNJ activities which support the public airfield as well as the rental payments PANYNJ pays to the City of Newark for the airport. [FAA Exhibit 1, Item 2B, Page 6]. PANYNJ denies United's allegations about lack of transparency, claiming that the agreed-to EWR flight fee is based solely on designated EWR costs. [FAA Exhibit 1, Item 2B, Pages 6-7].

PANYNJ contends the EWR flight fee is charged to United Airlines for use of the airport and is established by Schedule C of Leases ANA- 170, ANB-056 and AN-535, which is also in lease agreements with other airlines at EWR, including cargo airlines. The flight fee is a separate charge from the rental payment for the use of leased space and is separate from the EWR AirTrain Fee. The flight fee formula has two components:

- A Public Airport Facilities Charge Factor is based on the costs of all investment in the EWR Public Aircraft Facilities and all operating costs of the EWR Public Airport Facilities and includes public ramp, apron space, runways, aircraft parking and storage space, taxiways, and emergency services, including ARFF services. [FAA Exhibit 1, Item 2B, Page 12].

- An Airport Services Charge Factor is a portion of expenditures of PANYNJ performed for the benefit of EWR attributable to the Public Airport Facilities and include investment in non-revenue producing areas, costs of operation, maintenance, and administration of non-revenue producing areas, and PANYNJ police and contractors.

Both factors are combined and multiplied by an airline's total maximum take-off weight of aircraft for a year, in thousands of pounds, to determine that airline's flight fee for the year. [FAA Exhibit 1, Item 2B, Page 24 and Exhibit 1, Page 7].

An additional factor, known as the Phase 1A Charge Factor, was added to the flight fee calculation in 1995 pursuant to Lease ANA-170. The Phase 1A Charge Factor recovers costs associated with the construction of certain EWR roadways. Finally, the AirTrain Factor recoups annual amortized capital costs, annual operation, and maintenance costs of the EWR AirTrain. Airlines that pay flight fees are also given a credit for revenues received from the collection of aircraft parking fees. [See FAA Exhibit 1, Item 2B, Pages 24-25, and Exhibit 1 Page 13].

The flight fee has varied over time, increasing in some years and decreasing in other years. These fluctuations are the result of changes in the EWR costs, changes in EWR air traffic volume, and in the proportion of EWR occupied by the Public Airport Facilities, and the revenue received from airport parking fees. The flight fee calculations do not include on-airport or off-airport overhead costs incurred by PANYNJ in operating EWR such as rental payments made by PANYNJ to the City of Newark, on-airport police, maintenance and operation, administrative and clerical costs, and off-airport indirect overhead costs. [FAA Exhibit 1, Item 2B, Exhibit 1, Pages 16- 17].

These overhead costs have no effect on what the PANYNJ charges for flight fees because they are based on the formula agreed to between PANYNJ and the signatory airlines. They are solely based on EWR expenditures that are part of calculation of the flight fee components, the portion of the airport used as Public Aircraft Facilities, and the level of EWR flight activity for the year in which the flight fee is established. [FAA Exhibit 1, Item 2B, Exhibit 1, Pages 17-18]. Similarly, the EWR flight fee in any one year is the same irrespective of the amount of all PANYNJ off-airport expenditures, airport overhead costs, or for bridges, tunnels, Port Authority Trans-Hudson rapid transit, or any other off-airport expenditures.

PANYNJ also derives revenue at EWR from other sources such as concession fees and rentals, advertising fees, hotel and rental car fees, cargo handling permit fees, public vehicular parking, and aviation fuel fees. In 2013, flight fees from scheduled aircraft using EWR produced about \$216 million in revenue, compared to total EWR revenue of \$800 million. Thus, scheduled aircraft flight fee revenue constituted 27% of total EWR revenues. The estimated and final calculations of EWR flight fees are presented to the EWR airlines in writing four times a year. [FAA Exhibit 1, Item 2B, Exhibit 1, Pages 18-19].

PANYNJ counters the claim of its monopoly power by asserting that United has a dominant market share of EWR traffic and United exercises dominant market power at EWR. PANYNJ claims this is supported by Continental's decision to stake out a dominant market share at EWR and its decision to invest millions of dollars to support that decision. [FAA Exhibit 1, Item 2B, Page 28]. In further support of its position, PANYNJ submitted a study entitled *Airports Do Not Operate as Monopolies*. [FAA Exhibit 1, Item 2B, Exhibit 1, Pages 32, and Item 3, Exhibit 2, Exhibit B, Page 8].

PANYNJ also states that PANYNJ and Continental amended Lease ANA-170 27 times during the past 20 years, and that ANA-170 describes the flight fee and its formula's calculation. [FAA Exhibit 1, Item 2B, Exhibit 1, Page 5]. PANYNJ states that although United's other leases (i.e. JFK) were negotiated between 2003 and 2004, the methodologies in the New York and New Jersey formulas differ in certain respects. And over the years, depending on the level and type of expenditures recovered both flight fees have varied. [FAA Exhibit 1, Item 3, Pages 4-5].

PANYNJ argues United is not being charged a flight fee that is different from the flight fee charged to any other carrier at EWR. [FAA Exhibit 1, Item 7, Page 4]. PANYNJ adds that the flight fee is set pursuant to agreements to which United is a party, and that under long-standing statutes and policy, FAA jurisdiction does not exist over an air carrier's challenge to the terms of an airport agreement to which the air carrier is a party. PANYNJ also states that current FAA policy is that FAA will not entertain a complaint about the reasonableness of a fee set by agreement filed by a party to the agreement setting the disputed fee. [FAA Exhibit 1, Item 2B, Page 2].

3. Discussion

The fact that a carrier or tenant at an airport has an existing agreement does not absolve a sponsor of its grant assurance obligations, or curtail an airline's right to file complaints or otherwise bar FAA's jurisdiction. In January 2006, Continental requested PANYNJ to provide information on EWR's rates and charges, but the information was not provided by PANYNJ, but rather Continental was advised to file a Freedom of Information Act request. PANYNJ is incorrect that "the terms of a written lease agreement superseded federal requirements and that Continental was not entitled to the requested information." [FAA Exhibit 1, Item 2H, Exhibit B, Page 3]. The availability and public access to an airport's rates and charges is a critical element for sponsor compliance with Grant Assurance 22, Economic Nondiscrimination and the Rates and Charges Policy for transparency to ensure that each air carrier using the airport shall be subject to nondiscriminatory and substantially comparable rates, fees, rentals, and charges.

Furthermore, the FAA has entertained numerous cases in which the airport sponsor and a Part 16 complainant have a formal agreement. FAA's role is not to enforce the lease terms of an agreement, but to enforce the federal obligations in the grant agreements between an airport sponsor and the federal government. Although negotiation and lease agreements are considered reasonable means by which to achieve reasonable access, they do not nullify FAA's ability to ascertain compliance with the federal obligations.

United describes how it is directly and substantially affected by PANYNJ actions, and alleges facts and makes legal arguments that fall under the FAA's 14 CFR Part 16 jurisdiction.

In furtherance of the investigation of the complaint, the Director sought external technical support for the review of airport financial records and transactions concerning PANYNJ's aviation activities, grandfathering, and records specifically related to EWR. [FAA Exhibit 1, Items 9 and 11]. The Director examined PANYNJ's use of revenue, reviewed terminal rates, and conducted an overview of PANYNJ's accounting and financial processes. Additionally, the investigation includes a review whether PANYNJ (1) applied reasonable, nondiscriminatory, and substantially comparable rates, fees, other charges with respect to

facilities directly and substantially related to the airport; and (2) uses transparent cost methodologies in calculating rates, fees, other charges and accumulated substantial surplus aeronautical revenues.

FAA made several data requests to PANYNJ as part of this effort. The data collected was organized into three separate FAA reports:

- FAA Report No. 1 *Revenue Compliance Analysis of PANYNJ - Grandfathering Analysis*;
- FAA Report No. 2 *Deliverable of the Final Report for Newark Liberty International Airport Analysis*; and
- FAA Report No. 3 *Flight Fee Review*.

FAA Report Nos. 2 and 3 are discussed here in Issue 1, and FAA Report No. 1 is discussed in Issue 2. [FAA Exhibit 1, Items 17, 18, and 19].

Basis for Rates and Fees

FAA Report No. 2 *Deliverable of the Final Report for Newark Liberty International Airport Analysis* discusses terminal rates and an overview of PANYNJ accounting and financial processes. FAA Report No.3 *Flight Fee Review* discusses and analyzes the rates and charges structure at EWR: rates and charges methodology, reasonableness of expenditures and charges compared to other airports. [FAA Exhibit 1, Item 9, Item 11, Item 17, Item 18, and Item 19].

The Director examined whether PANYNJ, in computing the flight fee, applied reasonable, nondiscriminatory, and substantially comparable methodologies. The data shows inconsistencies regarding EWR's terminal rates, certain costs, and related processes, which are unclear, and in some cases, deficient. Report No. 3 indicates that the flight fee, established in 1973, has never been evaluated to determine if the markups in price align with PANYNJ's actual costs. [FAA Exhibit 1, Item 19, Page i].

The Director could not verify that direct and indirect costs included in the fees charged for aeronautical use were based on reasonable and transparent cost allocation methodologies. There is no established consistent, clear, and fully justified method of establishing the rate base on a predictable schedule, as examined and discussed in more detail below.

EWR and JFK Flight Fee Comparison

FAA Report No. 3 compared the rates and charges at EWR with those at JFK and LGA. The Report compared various components of rates and charges at JFK with their equivalents at EWR. Significant differences were found in the structure of the flight fee. The JFK Flight Fee recovers indirect costs within the fee, and the EWR fee recovers them with a 38% markup to the fee. Differences in AirTrain cost and structure represent another significant contrast between the two fees. [FAA Exhibit 1, Item 19, Pages i-ii].

Report No. 3 notes that the determination of which flight fee is higher depends on the method of comparison and explained two scenarios for applying JFK's flight fee formula to EWR. One scenario resulted in a lower fee than EWR actually charged and the other resulted in a higher fee than EWR actually charged. The report finds that the flight fee at JFK is more easily understood than the fee at EWR because any markups are explicitly stated. The report discusses the way in which actual costs are charged, with certain types

of PANYNJ cost increases costing more at JFK, while others cost more at EWR. [FAA Exhibit 1, Item 19, Pages i-ii].

The different methodologies have different levels of transparency because the JFK formula is much more precise about which costs are included in the flight fee cost base. Any markups included in the JFK formula are explicitly stated in the flight fee formula and in the materials provided to the airlines for review. In contrast, the calculation of the markups of the EWR flight fee are not explicitly identified in the flight fee agreements or in the backup material that is provided to the airlines for review.

PANYNJ stated that it has not performed any analysis to assess whether the markups embedded in the EWR flight fee formula approximate the indirect costs at EWR. However, PANYNJ provided data which appeared to attempt to calculate the flight fees at EWR under the JFK flight fee formula. This appears to be similar to some of the evaluations described in Report No. 3, but based on 2014 budgeted costs rather than actual costs. Several of the costs and percentages differ from other source documents. However, as per PANYNJ's analysis, the EWR flight fees in 2014 (based on budgeted costs) would be approximately 18% lower under the JFK formula than under the EWR formula, with the majority of the difference resulting from the AirTrain component of the fees. [FAA Exhibit 1, Item 19, Page 57].

Report No. 3 shows that the flight fees at both airports handle indirect costs differently. The JFK flight fees recover indirect costs within the fee, and the EWR flight fees recover these costs with a markup to the fee. Although the flight fees at EWR are not clear from a methodology standpoint and certain costs variables are vague, the fees are not unreasonable, are comparable to other PANYNJ airports, and are generally uniformly applied to other EWR airlines. Consequently on its face, the 38% mark-up is not impermissible.

The Director finds that despite different methodologies used at EWR and JFK, the EWR flight fee is not dramatically different from JFK's flight fee formula when applied to the 2014 EWR costs. If the EWR's flight fees formula explicitly included the indirect costs that are included at JFK (in lieu of building markups into the EWR formula) the resulting flight fees (excluding AirTrain costs) would be comparable to the fees actually charged in 2014 (roughly 6% higher). The different treatment of AirTrain costs between the two airports could swing the total flight fee to be higher or lower.

The Director notes that while the Airline Deregulation Act prohibits states and local governments from directly regulating air traffic, the structure Congress created virtually ensures that fees will vary across airports. Thus resulting differences among airports is not unlawful. Federally-obligated airports, as independent entities, are designed to be all-inclusive controlling entities.

Report No. 3 demonstrates that PANYNJ flight fees at EWR are not unreasonable when compared to JFK or its other airports. PANYNJ has the discretion to recover costs in different ways between its airports. The application of a mark-up as a means to recover certain costs is not impermissible. However, PANYNJ has difficulty in explaining its justification for its rate setting process, and this denotes a lack of transparency and calls into question the reasonableness of the flight fees. As indicated in FAA Reports Nos. 2 and 3, there are inconsistencies with EWR's terminal rates, certain costs, and related processes. While the application of a markup as a means to recover certain costs is not impermissible, the markup must be explained and justified to be transparent.

Commingling and Reporting

PANYNJ uses a single general ledger for all facilities including EWR. Thus, for accounting purposes, all revenues from its facility operations, airports, bridges, tunnels are deposited to one account. All facility operating expenses are deducted from the same account. Each year, the PANYNJ issues annual consolidated financial statements. Report No. 2 describes this process of commingling funds and despite the single general ledger, PANYNJ has a federal obligation to comply with financial reporting requirements.

The FAA performed an analysis of EWR financial reporting including revenue and expense transaction-level detail. PANYNJ was unable to provide source documentation for the original expense incurred and recorded in the accounting system for any of the selected sampled cost allocation transactions. The fact that PANYNJ commingles revenues does not excuse the Port Authority from its obligation to clearly and in a transparent manner, identify costs and revenues for each of its airports, including EWR.

The Director finds that PANYNJ did not maintain an adequate audit trail for the allocation of its expenses and engaged in deficient accounting practices and record keeping.

Excessive Fees

United asserts that several of PANYNJ's expenses at EWR are excessive. [FAA Exhibit 1, Item 1, Page 62]. Specifically, United asserts that the Aircraft Rescue and Fire Fighting (ARFF) service has increased United's costs at EWR by more than \$25 million annually and almost 510% more than in 2012. United characterizes PANYNJ's ARFF practices as far beyond the FAA's requirements and resulting in an "enormous fee increase...is unreasonable and grossly improper." In addition, United also argues that security costs included in the landing fee total more than \$37 million, and have risen 40% since 2010. United claims that EWR's rate base includes excessive and unreasonable administrative costs largely the result of unconstrained spending on overtime and other benefits. [FAA Exhibit 1, Item 1, Pages 7-8, and 42, and Exhibits GG and U]. PANYNJ denies the allegation and argues that general statements about PANYNJ salaries are irrelevant since only PANYNJ salaries included in costs covered by the flight fee formula are relevant. [FAA Exhibit 1, Item 7, Page 12].

In examining reasonableness of fees, the Director strives to balance PANYNJ's discretion to manage its costs (including ARFF, police, and administrative), and the requirement that the resulting fees and rates imposed on airlines, are reasonable. The Rates and Charges Policy does not explicitly discuss the amount that an airport may charge or a method for determining cost of labor. Nor does it address overtime or benefits pay, which are issues raised by United here. The FAA policy does not mandate a single approach to airport rate-setting, but it requires consistent application to similarly situated aeronautical users, i.e., airlines at EWR.

Grant Assurance 24, *Fee and Rental Structure* requires an airport sponsor to maintain a fee and rental structure for the facilities and services at the airport that will make the airport as self-sustaining as possible under the circumstances existing at the particular airport, taking into account such factors as the volume of traffic and economy of collection.

FAA's policy regarding rates and charges provides that revenues from fees imposed for use of the airfield may not exceed the costs to the airport proprietor of providing airfield

services and airfield assets currently in aeronautical use unless agreed to by the affected aeronautical users. The policy identifies the "rate base" as the total of all costs of providing airfield facilities and services to aeronautical users that may be recovered from aeronautical users through fees charged for providing airfield aeronautical services and facilities. The policy requires that 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. Moreover, the policy states that an airport proprietor should provide adequate information to permit aeronautical users to evaluate the airport proprietor's justification for the change and to assess the reasonableness of the proposal. [See Rates and Charges Policy, 78 Fed. Reg. 55330, 55332-3].

Both Grant Assurance 24, Fee and Rental Structure (self sustainability) and the Rates and Charges Policy provide a significant level of discretion to airport sponsors. Accordingly, sponsors have latitude about the amount that they can charge for a particular service, *i.e.*, ARFF. FAA does not dictate how much airports can pay their employees. The sponsor has flexibility on how it chooses to comply with federal obligations while balancing its fiscal responsibility and discretion.

PANYNJ has discretion to staff ARFF, police, or other positions with qualified personnel. The same is true for the compensation methodologies or justifications it selects. FAA does not dictate or approve levels of compensation for ARFF personnel or any other airport-related function. It is not a violation of the applicable federal obligations for PANYNJ to compensate its police officers with "better packages" than the New York Police Department offers its personnel. As the airport sponsor, PANYNJ has discretion on financial actions, which may incentivize high quality applicants to apply and remain at EWR. This is not a violation of the federal obligations. United has not demonstrated that the costs are unreasonable.

The Director finds United's reliance on the Anti-Head Tax Act in further support of its claim of unreasonable rates is misplaced. Additionally, as to United's claim of PANYNJ's monopoly position, FAA's policy regarding rates and charges touches on the issue of monopoly power. The Department of Transportation noted that the claim of airport proprietors exercising monopoly power in pricing essential aeronautical facilities was not supported by the Department's experience. The Department noted that many U.S. carriers benefited from airports' competition with each other to be the location of aeronautical facilities, including facilities for passenger and cargo hubs. [DOT/FAA Policy on Rates and Charges Policy, 61 Fed. Reg. 31994, 32007].

The Director, however, is concerned about the lack of transparency in PANYNJ's rates and charges as detailed above. It is questionable whether PANYNJ provided adequate information to United to permit the airline to evaluate and assess the charges imposed under their lease.

4. Conclusion Issue 1

The costs included in the fees charged to United are not based on a reasonable and transparent cost allocation methodology in accordance with 49 USC § 47107(a), Grant Assurance 22, and DOT/FAA Policy Regarding Airport Rates and Charges. The Director finds that PANYNJ did not maintain an adequate audit trail for the allocation of its expenses, and engaged in deficient accounting practices and record keeping. Corrective Action is needed to ensure PANYNJ's common costs are allocated according to a

reasonable, transparent, and not unjustly discriminatory cost allocation methodology that is applied consistently, and with improved accounting practices and record keeping.

Issue 2 - Whether PANYNJ improperly diverts airport revenue in violation of 49 USC § 47107(b)(2), 49 USC § 47133, and Grant Assurance 25, *Airport Revenues*, and FAA's *Policy and Procedures Concerning the Use of Airport Revenue*.

1. Overview of United's Position on Revenue Diversion

United argues that PANYNJ is in violation of the federal revenue use obligations because it diverts airport revenues to fund its non-airport, money-losing operations, and uses airport revenues to fund projects that exceed the limits of the "grandfather" exception. [FAA Exhibit 1, Item 1, Page 73]. United references a PANYNJ press release to claim that PANYNJ has allocated \$1.8 billion for the 2011-2021 period for the rehabilitation of the Pulaski Skyway, the Wittpenn Bridge and the Routes 1 and 9 truck route, and that none of these facilities are owned or operated by PANYNJ. [FAA Exhibit 1, Item 1, Page 16-17]. United also states that PANYNJ uses airport revenues to pay for highways, bridges, parks, hospitals, and other facilities that it does not own or operate. It claims that in 2014 alone, PANYNJ spent \$181 million to repair the Pulaski Skyway and \$60 million on the Wittpenn Bridge, structures owned and operated by the State of New Jersey. [FAA Exhibit 1, Item 1, Page 4]. United argues that PANYNJ operates EWR for its own benefit and imposing excessive, unreasonable, and discriminatory charges to generate huge surpluses that are used for non-aeronautical operations. [FAA Exhibit 1, Item 1, Pages 1-2].

2. PANYNJ's Position on Revenue Diversion

PANYNJ denies that there has been or that there is unlawful revenue diversion at EWR and states that United misunderstands the applicable statutory language and mischaracterizes the expenditures it challenges. PANYNJ states that pursuant to the Airport and Airway Improvement Act the Port Authority is a 'grandfathered' airport allowing it to use airport revenue for non-aeronautical purposes. [FAA Exhibit 1, Item 3, Page 8, and Item 2B, Pages 30-35].

PANYNJ asserts that language in the statutes plainly anticipates that expenditures of grandfathered airports include facilities used to support other PANYNJ's facilities. PANYNJ claims that the expenditures United cites are related to or in support of PANYNJ facilities and/or operations. [FAA Exhibit 1, Item 2B, Pages 34-35]. PANYNJ asserts that pursuant to 49 USC § 47107(b)(2), the Port Authority's use of airport revenue for non-aeronautical purposes does not disqualify the Port Authority from receiving federal airport grants under 49 USC § 47107(b)(1). [FAA Exhibit 1, Item 3, Exhibit 1, Page 1].

PANYNJ admits that the \$1.8 billion Lincoln Tunnel Access Program, being done by and in coordination with the New Jersey Department of Transportation, consists of three distinct projects, designed to improve the mobility of goods and services in the region. PANYNJ admits that it spent \$121 million on the Lincoln Tunnel Access Program, and that its 2014 budget called for another \$181 million for the Pulaski Skyway and \$60 million for the Wittpenn Bridge. PANYNJ claims that the other expenditures identified in United's Complaint were part of the Regional Economic Development Program undertaken in support of PANYNJ facilities or operations at the request of the respective governors consistent with existing legislation. [FAA Exhibit 1, Item 3, Pages 8-9 and Item 2B, Page 36].

PANYNJ emphasizes that the expenditures in question were used for facilities that support PANYNJ facilities and are permissible under its grandfathered authority. PANYNJ explains that facilities that generate net income such as the airports help pay for those that have been operating at a loss." [FAA Exhibit 1, Item 3, Page 8].

3. Discussion

Revenue Surpluses and Grandfathering Reporting

The revenue-use requirements under 49 USC §§ 47107(b)(1) and 47133, do 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 exception permitting the use of airport revenues for non-airport purposes allows for lawful revenue diversion, within certain limits. 49 USC § 47115(f) requires the FAA to consider as a factor militating against the distribution of AIP discretionary funds when the FAA finds that the amount of revenues used by the airport for purposes other than capital or operating costs in the airport's fiscal year preceding the date of the application for discretionary funds exceeds the amount of such revenues in the airport's first fiscal year ending after August 23, 1994, adjusted for changes in the Consumer Price Index.

PANYNJ claims that the Port Authority and the FAA have agreed to a methodology to determine the amount of revenue generated by the Port Authority airports that would be used to fund the Port Authority's non-aviation activities. [FAA Exhibit 1, Item 3, Exhibit 1, Page 2]. Under that methodology, the reduction in Port Authority's financial reserves caused by expenses and capital costs net of revenues of Port Authority non-aviation facilities in any one year is compared to the reduction in Port Authority reserves caused by expenses and capital costs net of revenues of Port Authority non-aviation facilities for the first fiscal year ending after August 23, 1994, adjusted for changes in the Consumer Price Index of All Urban Consumers published by the Bureau of Labor Statistics of the Department of Labor. See, 49 USC § 47115(f)(2). [FAA Exhibit 1, Item 3, Exhibit 1, Page 2].

As stated above, the Director sought external technical support for the review of certain airport financial records and transactions concerning PANYNJ's aviation activities, including records specifically related to the PANYNJ use of its grandfathering authority. FAA Report No.1 - Revenue Compliance Analysis of PANYNJ - Grandfathering Analysis examined: (1) PANYNJ's "grandfathered" expenditures; (2) the extent of PANYNJ's "grandfathered" status and methodology; and (3) PANYNJ's revenue use. [FAA Exhibit 1, Item 18].

FAA Report No. 1 discusses compliance with the laws governing the use of airport revenue and the grandfathering provisions. The analysis included grandfathered projects and payments, exemption revenues, aviation and non-aviation surplus revenue, and transfer of excessive amounts. The report analyzed grandfathering legislation that PANYNJ uses as the basis for pooling surplus revenue from all of its operations. It considered the Interstate Compact, the General Reserve Fund statutes, Chapter 5 of the Laws of New Jersey, and

the Consolidated Bond Resolution. [FAA Exhibit 1, Item 18, Pages 9-10].

FAA Report No. 1 findings are as follows:

1. In 2009-2014, PANYNJ generated approximately \$2.7 billion in surplus revenue from aviation facilities to include EWR, JFK, and LGA. Figure 1 below shows the percent of surplus revenue by aviation facility using total gross revenues, operating expenses, and non-operating income and expenses:

Facility	Gross Revenue	Operating Expenses	Non-Operating Income & Expenses	Surplus Revenue	% of Surplus Revenue
EWR	\$4,724,731	\$2,589,595	(\$780,826)	\$1,354,310	28.66%
JFK	\$6,465,251	\$4,169,507	(\$1,055,435)	\$1,240,309	19.18%
LaGuardia	\$2,005,682	\$1,491,694	(\$366,912)	\$147,076	7.33%
Teterboro	\$220,914	\$139,761	(\$64,538)	\$16,615	7.52%
Stewart	\$49,189	\$107,009	(\$43,103)	(\$100,923)	(205.17)%
Heliport	(\$139)	\$495	\$32	(\$602)	(433.09)%
Total	\$13,465,628	\$8,498,061	(\$2,310,782)	\$2,656,785	19.73%

Figure 1 - Surplus revenues by aviation facility (2009-2014). Source: FAA Exhibit 1, Item 18, Page 2.³

2. Operating expenses reported in 2014 on PANYNJ's financial statements were approximately \$1.2 million less than what the PANYNJ reported to the FAA.
3. PANYNJ recorded \$4.4 billion (as of 12/31/2014) in reserve funds from all of its facilities (both aviation and non-aviation) into its two reserve accounts (1) General Reserve Fund and (2) Consolidated Bond Reserve Fund.
4. In 2009-2014, PANYNJ contributed \$2.7 billion from aviation facilities to its reserves, and in time, these reserves may benefit the airports, but PANYNJ could not identify the amounts that contributed directly to the airports due to the PANYNJ's revenue pooling methodology and multiple reserves.
5. The review computed the grandfather base using the financial statements schedules for 1995 and 2009 and compared it to what was reported to the FAA as verification. However, this calculation did not agree with FAA reports and PANYNJ could not justify the difference. This showed that the 1995 methodology differs from the one used in 2009-14.
6. There were inconsistencies in PANYNJ's base year used to calculate its grandfathering payments. PANYNJ reported its grandfather base as of 1994, but used 1995 data instead. Moreover, there were inconsistencies in grandfathered payment amounts reported to the FAA for 1995-98 and 2004-06.
7. Using consistent methodologies for 1995 and 2009-14 and using aviation and non-aviation financial balances, the review calculated grandfathered payment overages totaling \$1.2 billion (using surplus aviation revenue) or \$811.8 million (using non-aviation revenue and outlays). In both cases, overages exceeded the \$605.8 million reported by PANYNJ to the FAA. Additional inconsistencies in grandfathered payment amounts reported to the FAA were found for 1995, 1996, 1997, 1998, 2004, 2005, and 2006, totaling \$11.6 million in differences.
8. PANYNJ exceeded the adjusted base amount in every year (except 2014), and exceeded the base in 2009-2010.
9. The amount of surplus revenue from the Port Authority aviation and non-aviation business segments varied between 2009 and 2014. Aviation was the only business segment that consistently generated surplus revenue each year. The Interstate Transportation Network generated surplus revenue in 2009 and from 2011 to 2014. The remaining three business segments collectively reduced the Port Authority's reserves. The aviation business segment reported substantially higher surpluses than

³ Sixth Column % of Surplus Revenue represents excess revenue as a % of gross revenue.

non-aviation business segments, while most non-aviation business segments reported losses.

10. Because of PANYNJ's consolidated operations and multiple reserves, the review could not determine the amount of diverted airport revenue that was later claimed as expended to improve airport operations.
11. PANYNJ made assumptions that all diverted aviation revenue is reinvested at the airports, but this could not be validated because PANYNJ could not trace the source of the funds after recording them in the reserve accounts.
12. EWR generated the most revenue surplus for aviation operations, with JFK as second (2009-2014). EWR contributed 50% of PANYNJ's aviation surplus revenue, and when combined with JFK, account for 97.6% of the total aviation surplus revenue for PANYNJ. Other aviation facilities generated a net loss of approximately \$700 million.
13. In 2009-2014, EWR generated the most surplus revenue with \$1.4 billion and \$4.7 billion in gross revenue. JFK generated gross revenue of \$6.4 billion, with surplus revenue of \$1.2 billion. Higher operating and non-operating expenses at JFK, in comparison to EWR explains the differences in surplus revenue generated by each airport (*i.e.*, higher operating revenue at JFK, but lower non-operating costs at EWR).
14. PANYNJ contributed \$2.1 billion in direct investment in its facilities from 2009-14, with \$655 million for EWR.
15. The review could not determine if grandfathered payments had a negative impact on capital expenditures at EWR. [FAA Exhibit 1, Item 18, Pages 2-12].

PANYNJ developed its methodologies based on applicable non-federal legislation [*i.e.*, Compact, General Reserve Fund statutes]. PANYNJ posits this 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 [PANYNJ's] facilities regardless of the source of the revenue." [FAA Exhibit 1, Item 18, Page 10]. PANYNJ claims that the methodology currently used that accounts for non-aviation revenues and expenditures was verbally approved by the FAA around 1998, and that the methodology has been in place since the mid-1990s (estimated 1994). [FAA Exhibit 1, Item 18, Pages 8-9].

However, no formal or written documentation exists of FAA approval of PANYNJ's grandfathering methodology, and the parties to this agreement are unknown. PANYNJ has not submitted any written documentation to validate its claim that the FAA agreed to the grandfathering methodology that purportedly has been in place since the mid-1990s (estimated 1994). [FAA Exhibit 1, Item 18, Pages 8-9]. More importantly, the data and analysis indicates that PANYNJ has not applied a consistent methodology in calculating grandfathered revenue use. The record reflects that PANYNJ has used inconsistent grandfather bases for grandfathering computations, potentially resulting in under reporting.⁴

Accordingly, the grandfathered amounts provided to date, are not reliable, and could result in PANYNJ underestimating grandfathered overages in excess of the base amount adjusted by CPI. Corrective action is needed to properly establish an acceptable grandfathering methodology to be used consistently to account for PANYNJ's use of revenue under its grandfather authority.

⁴ The FAA was not aware at the time the agency issued its April 20, 2012 letter that PANYNJ was not using consistent bases for its grandfathering computations. Therefore, the 2012 letter was based on inaccurate and incomplete information and can in no case be used to indicate that FAA approved PANYNJ's grandfathering methodology. [FAA Exhibit 1, Item 3, Exhibit 1, Exhibit B, FAA Letter April 20, 2012].

Use of Revenues for Non-PANYNJ Projects

As United asserts, PANYNJ's 2014 Budget allocated \$181 million for improvements to the Pulaski Skyway and \$60 million for repairs to the Wittpenn Bridge, but neither are owned or operated by PANYNJ. In addition, neither was listed as PANYNJ facilities in the 2014 Budget. [FAA Exhibit 1, Item 1, Page 74, and Exhibit A]. In an order issued by the U.S. Securities Commission (SEC) on January 10, 2017, PANYNJ admitted wrongfully offering and selling bonds despite questions about whether projects, including the Pulaski Skyway, were outside its mandate. Specifically, the January 10, 2017 SEC order raises concerns about PANYNJ's legal authority to spend airport revenue for the above-mentioned expenditures. If PANYNJ cannot lawfully fund these projects, its grandfathered authority under 49 USC §§ 47107 and 47133 does not extend to these projects.

PANYNJ's is mistaken that certain expenditures, including those for Pulaski Skyway and the Wittpenn Bridge, are allowable if in support of its facilities or operations within the context of 49 USC § 47107(b)) The statutory grandfather provision states:

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.

A plain reading of this language confirms that revenue can be used for the airport, general debt obligations of PANYNJ, and facilities owned by PANYNJ. As explained in House Conference Report 97-760, at 1474, (1982 Conf. Rep.), airports that are part of a unified port authority are exempt from the airport revenue use 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. The intent of the grandfathering provision was to permit entities like the PANYNJ to continue to use funds for debt obligations or at other port-owned facilities. In no case does this authority extend to facilities not owned or operated by the PANYNJ, or to facilities that merely support PANYNJ owned facilities or operations.

It is probably true that not every dollar used on these projects was from revenue generated at the airport. However, because PANYNJ funds are commingled, it is reasonable to conclude that airport revenues were used for impermissible purposes. This is especially true since FAA Report No. 1 identified that PANYNJ's aviation business segment was the only one that consistently generated surplus revenue each year. In addition, funding spent on projects or at facilities not owned or operated by PANYNJ involved considerable levels of PANYNJ airport funding, and thus have an impact on PANYNJ's finances, including at EWR. Language in the Conference Report 97-760 makes it clear that Congress did not want airports users burdened with "hidden taxation" for unrelated municipal services. (See H. R. Rep. No. 97-760, at 1474 (1982 Conf. Rep.). Use of airport revenue on facilities not owned by PANYNJ clearly burdens airport users, including United.

4. Conclusion on Issue 2

PANYNJ has not clearly articulated the methodology it used to calculate the amount of grandfathered revenues. PANYNJ has a history of large fluctuations in grandfathered

payments. The record also shows that PANYNJ has expended considerable amounts of airport revenue on non-aviation facilities it does not own. PANYNJ has used excess profits generated by aviation fees to fund non-airport related projects. EWR users are improperly subsidizing a portion of PANYNJ's non-airport related projects. The Director finds that PANYNJ cannot demonstrate that the PANYNJ has complied with the grandfathering exception permitted by 49 USC § 47107(b)(2) and § 47133, Grant Assurance 25, Airport Revenues, and FAA's Policy and Procedures Concerning the Use of Airport Revenue.

Corrective action is needed to ensure PANYNJ establishes a proper grandfathering methodology, and to ensure airport revenue is only used permissibly under PANYNJ's lawful grandfather authority. This includes (a) identifying the total amounts of diverted airport revenue (2012-2018), (b) crediting the accounts for each of PANYNJ airports, (c) adjusting PANYNJ rates and charges at EWR to reflect this change in costs, and (d) identifying measures that will be taken to prevent future occurrences.

VIII. CONCLUSION AND FINDINGS

Based on the evidence of record in this proceeding, the Director finds that:

- A. PANYNJ's actions are in violation of Grant Assurance 22, Economic Nondiscrimination based on PANYNJ's deficient accounting practices, poor record keeping, associated procedures and its' lack of transparency in setting its rates and charges, which are not consistent with the DOT/FAA Policy Regarding Airport Rates and Charges; and
- B. PANYNJ's actions are in violation of Grant Assurance 25, Airport Revenues by expending airport revenues on non-airport projects contrary to its 49 USC §§ 47107 and 47133 grandfathering authority, and are not compliant with FAA's Policy and Procedures Concerning the Use of Airport Revenue;
- C. All other motions not specifically granted herein are denied.

ORDER

The Director, in accordance with 14 CFR § 16.109(c), directs PANYNJ to submit within 30 days a corrective action plan describing in detail the following:

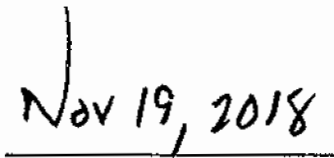
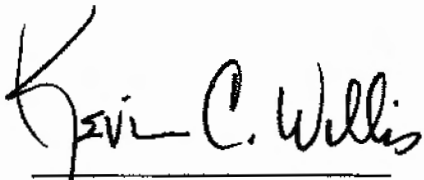
- 1. How PANYNJ's common costs are allocated according to a reasonable, transparent, and not unjustly discriminatory cost allocation methodology that is applied consistently at EWR;
- 2. How PANYNJ intends to modify its accounting practices and associated procedures in order to eliminate the identified deficiencies concerning the financial management of operations at EWR;
- 3. How PANYNJ intends to establish and present to FAA an acceptable and proper grandfathering methodology to be used consistently effective fiscal year 2019, and going forward to account for PANYNJ's use of revenue under its grandfather authority; and
- 4. How PANYNJ intends to (a) identify the total amounts of diverted airport revenue (2012-2018), including for past economic development expenditures, (b) credit the

accounts for each of PANYNJ airports accordingly, (c) adjust PANYNJ rates and charges at EWR to reflect this change in costs, and (d) identify measures to be taken to prevent future occurrences.

In the event that PANYNJ fails to submit a Corrective Action Plan acceptable to the FAA within the time provided, unless extended by the FAA for good cause, and/or if PANYNJ fails to implement and/or complete the Corrective Action Plan as specified herein, the Director may initiate action to revoke and/or deny applications for Airport Improvement Program grants under 49 USC §§ 47114 and 47115. Such circumstances could also impact the FAA's ability to approve an application from the PANYNJ to impose a Passenger Facility Charge per 14 CFR Part 158.

RIGHT TO APPEAL

This Director's Determination under FAA Docket No. 16-14-13 is an initial agency determination and does not constitute a final agency decision and order subject to judicial review. 14 CFR § 16.247(b)(2). A party to this proceeding adversely affected by the Director's Determination may appeal the initial determination pursuant to 14 CFR § 16.33(c) within 30 days after service of the Director's Determination.



Kevin C. Willis
Director, Airport Compliance and Management Analysis
Federal Aviation Administration

Date