Case Comment

Northwest Airlines v. County of Kent, Michigan: More Than You Ever Wanted to Know About Airport Ratesetting, Part One (Pricing in the Courts)

Rise J. Peters*

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* Rise J. Peters holds a J.D. from the Harvard Law School and a Master of Public Policy degree from the Kennedy School of Government of Harvard University. She is an associate in the Transportation Practice Group at Spiegel & McDiarmid, Washington, D.C., and wishes to express all appropriate demonstrations of gratitude to all the proper people, primarily including Jack Corbett of Spiegel & McDiarmid.

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Transportation Law Journal, Vol. 22 [1994], Iss. 2, Art. 6

I. Introduction

The recent Supreme Court case, in *Northwest Airlines v. County of Kent, Michigan*,[1] (*Grand Rapids*) represents a shift in bargaining power between public airport proprietors and the airlines which are their primary commercial users. Moreover, the airlines' attempt to secure a legislative reversal of that decision have effectively backfired, resulting in legislation that provides additional procedural protection to airports and that sets the stage for a transition to a federally-regulated system of airport ratesetting.

In *Grand Rapids*, airlines serving the Kent County International Airport challenged the airport proprietor's right to impose rates designed to recover from airlines the full cost of their use of airfield facilities and terminal space, rather than offsetting those costs by sharing the profits from nonairline revenue sources. The airlines claimed that those rates were statutorily and constitutionally impermissible. The lower courts and the Supreme Court disagreed and upheld virtually every aspect of the airport's rates, and suggested that the courts are not an appropriate forum for initial review of airport ratemaking.

This Comment, Part One examines the Supreme Court decision as one movement in the evolving counterpoint of federal law on airport pricing. It briefly discusses the legislative response to that decision, and sets the stage for Part Two, which will analyze U.S. Department of Transportation/Federal Aviation Administration's (DOT/FAA) final policy on airport rates and charges and consider the likely results of a fully-developed system of airport rate regulation. Part Two will be published in the next volume of the *Transportation Law Journal*. In section II of Part One, the development of the federal law of airport pricing is explored. Section III discusses the history and decision in *Grand Rapids*. The Court's rationale for its decision is analyzed in section IV. Section V briefly sets out the legislative response to the decision, and the framework in which DOT/FAA's regulatory policy will take shape.

II. Development of the Federal Law of Airport Pricing

The *Grand Rapids* decision foreclosed the possibility that federal courts would act as rate regulators overseeing airport pricing. Further, while the Supreme Court did not go so far as to direct the DOT/FAA to issue regulations on the subject, no one reading the decision could come away with any misunderstanding as to the Court's clear preference. This decision and the subsequent responsive legislation put an end to a period

1. 62 U.S.L.W. 4103 (1994).

of confusion in which airports and their users were uncertain, not only of the standards governing airport ratesetting, but also of the proper forum in which rate challenges should be brought.

A. Evansville and the Federal Anti-Head Tax Act

Before 1972, airports' charges to airlines and their passengers were limited on the federal level, primarily by the constitutional prohibition against unreasonable burdens on interstate commerce, Art. I, § 8 of the U. S. Constitution.[2] Change was precipitated when the Evansville-Vanderburgh Airport Authority District, a political subdivision of the State of Indiana, implemented a "use and service charge" of $1 on enplaning passengers at Dress Memorial Airport in Evansville, Indiana. The revenue from this so-called "head tax" was to be used for improvement and maintenance of the airport. A similar charge was imposed by the State of New Hampshire for passengers enplaning in the state, with fifty percent of the funds allocated to the State's aeronautical fund, and the remainder going to the airport proprietor as unrestricted general funds.

In both cases, affected airlines challenged the constitutionality of head taxes. The state courts split, with the Indiana Supreme Court finding the Evansville head tax an unreasonable burden on interstate commerce, while the New Hampshire Supreme Court sustained the constitutionality of that state's charge.[3] In *Evansville-Vanderburgh Air-*

2. In addition, the early 1970s saw enactment of the Airport and Airway Development Act of 1970 (the "AADA," which is a predecessor to a series of airport funding statutes, all of which are commonly referred to as the Airport and Airway Improvement Act of 1982, as amended (the "AAIA")), then at 49 U.S.C. app. § 1701 *et seq.*, which provided for airport development grants from the Aviation Trust Fund (in recent years, these grants have been issued under the Airport Improvement Program ("AIP")). A provision of the AADA (and, later, the AAIA) imposed conditions on approval of AIP grants, requiring the Secretary of Transportation to determine, *inter alia*, that fees charged by the airport operator will "make the airport as self-sustaining as possible under the circumstances existing at that particular airport," then 49 U.S.C. app. § 2210(9) (1990), and will make the airport "available for public use on fair and reasonable terms," then 49 U.S.C. app. § 2210(a)(1)(1990). As discussed below, DOT/FAA fulfilled this statutory mandate by requiring airports receiving grants to enter into contracts containing "grant assurances" in which the airport assured DOT/FAA of its compliance with the statutory requirements. *See* FAA Order 5100.38A, Airport Improvement Program (AIP) Handbook (October 24, 1989), Appendix 1. Those grant assurances became another source of limits on airport rates, first as airlines and other users attempted to enforce them through the court system, and later as a basis for administrative action. *See, e.g.*, Interface Group v. Massachusetts Port Authority, 816 F.2d 9, 15 (1st Cir. 1987); Northwest Airlines v. County of Kent, 955 F.2d 1054, 1058 (6th Cir. 1992).

3. In Evansville *infra*, the Supreme Court noted, 405 U.S. at 711, n. 3 (1972), that state courts in Montana and New Jersey had invalidated similar airport fees, while legislative proposals for such fees elsewhere had been abandoned based on opinions from state or local officials arguing their invalidity.

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port Authority District v. Delta Airlines,[4] (the *Evansville* decision), the Supreme Court held that the head taxes imposed in those cases were constitutionally permissible.[5]

The *Evansville* Court reasoned that a "facility provided at public expense aids rather than hinders the right to travel. A permissible charge to help defray the cost of the facility is therefore not a burden in the constitutional sense."[6] In language that became central to development of case law in this area, the court held that where that charge is "based on some fair approximation of use or privilege for use . . . [and is] neither . . . discriminatory against interstate commerce nor excessive in comparison with the benefit conferred, it will pass constitutional muster, even though some other formula might reflect more exactly the relative use of the state facilities by individual users."[7] Both the Indiana and New Hampshire charges, the Court found, met those standards.

Congress responded to *Evansville*, and to the increased number of local head taxes passed in its wake, with enactment of the Anti-Head Tax Act ("AHTA"), since codified at 49 U.S.C. § 40116.[8] As codified, AHTA prohibits any state or its political subdivisions from imposing "a tax, fee, head charge, or other charge on an individual traveling in air commerce; the transportation of an individual traveling in air commerce; the sale of air transportation; or the gross receipts from that air commerce or transportation."[9] However, AHTA further provides that States and their subdivisions are not prohibited from imposing "taxes [except for certain

4. Evansville-Vanderburgh Airport Authority District v. Delta Airlines, 405 U.S. 707 (1972).

5. *Id.* at 711-22.

6. *Id.* at 714.

7. *Id.* at 714-15.

8. The legislative history of AHTA demonstrates that Congress, having recently imposed an eight percent federal ticket to fund airport development through AIP grants from the Aviation Trust Fund, was concerned that travelers not be taxed again on the state level for the same purpose. In addition, Congress was concerned about inconvenience to travelers and about diversion of head tax revenues into general municipal coffers. *See* S.Rep. No. 12, 93d Cong., 1st Sess. 1, *reprinted in* 1973 U.S.C.C.A.N. 1434, 1446; H.R.Rep. No. 157, 93d Cong., 1st Sess. 4 (1973). The legislative history of the AHTA and Congressional intent are discussed in Aloha Airlines v. Director of Taxation of Hawaii, 464 U.S. 7, 9-10 (1983).

9. 49 U.S.C.A. § 40116(b) (1994). Note that the decisions cited in this comment refer to various provisions of law in a pre-codified form; for example, citations in published decisions to the federal Anti-Head Tax Act are to 49 U.S.C. app. § 1513 (1990 & Supp. 1994), while citations to the grant assurance requirements of the Airport and Airway Improvement Act of 1982, as amended, are to 49 U.S.C. app. § 2210 (1990). Those provisions were recently codified in Pub. L. No. 103-272 (July 5, 1994). While the description of the codifying law states that the intent of that law was to "revise, codify, and enact without substantive change certain general and permanent laws, related to transportation . . .", in fact the codifiers worked substantial changes in at least some provisions under discussion in this Comment; for this reason, statutory language quoted by the courts in the decisions cited herein may no longer be consistent with the statute as codified.

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taxes imposed specifically against airlines and their property] including property taxes, net income taxes, franchise taxes, and sales or use taxes on the sale of goods or services; and *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."[10] Over time, AHTA grew to encompass all airport pricing to airlines, as courts assumed that all charges to airlines and their passengers, except those exempted in subsection (e), were barred by statute.[11]

B. Two Systems of Airport Ratesetting

Airport proprietors provide a wide range of services and facilities to many classes of users, each of whom may pay for their use of the airport under a different pricing system. For example, concessionaires (such as restaurants, gift shops, or rental car companies) commonly pay a market rate set by bid or negotiation.[12] General aviation operators (non-airline aircraft operations, including operations by private pilots and by corporate aircraft) generally pay a fuel flowage fee, which is a per-gallon charge on the fuel they buy at the airport. Airlines generally pay two kinds of rates: a landing or takeoff fee, which pays for their use of the airfield facilities (runways, taxiways, and aircraft parking areas), and terminal rents, which pay for their use, exclusively or in common with others, of offices, ticket counters, baggage handling facilities, passenger waiting rooms (holdrooms), and boarding areas (gates). These rates can be set by ordinance passed by the airport proprietor (ordinance rates,) or can be negotiated between the airlines and airport as one element of a written airport-airline lease and use agreement.

Calculation of rates may be done using either a "compensatory" or a "residual" system.[13] Under a compensatory system, an airline pays only the actual cost for the facilities and services it uses. The formulas are applied differently for airfield and terminal facilities, but as an example, an airline paying a compensatory terminal rent would pay a per square foot rate for the space it leases in the terminal. The cost for unleased areas, such as public circulation space or janitorial storage, would be paid for by the airport proprietor from nonairline revenues. Under a residual

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10. 49 U.S.C.A. § 40116(e) (1994) (emphasis added).

11. *See* J. Thomas' dissent in *Grand Rapids*, in which he criticizes the majority's view that § 40116(a) "prohibits virtually all airport user fees" while subsection (e) "'saves' those fees that are 'reasonable.'" *Grand Rapids*, J. Thomas dissenting, slip op. at 2.

12. Rates to concessionaires, whether arrived at by bid or negotiation, generally include some factor calculated as a percentage of receipts. Thus, payments from the concessionaire to the airport will vary depending on the success of the concession business.

13. The *Grand Rapids* district court decision includes a succinct discussion of the relevant distinctions between compensatory and residual ratesetting, 738 F. Supp. at 1114.

system, the airlines as a group pay rent equal to the costs of the entire terminal net of other operating revenues. Thus, each airline pays a proportional share of the net cost of the terminal.

In theory, the primary difference between these two methods should be a shifting of two types of risks: the risk of success or failure of the nonairline revenue sources and the risk of a mismatch between airport capacity and demand for that capacity.

With regard to the risks of nonairline revenue fluctuations, under the compensatory system, the airport bears the risk that concession revenues will fall short of the amount needed to pay the costs of the public area and other unleased terminal space. In the event of a shortfall, the airport must cover those costs from its reserves, from local tax revenue if it has taxing authority, or from other nonairline revenue sources. If concessionaires prosper, and concession revenues exceed the costs of the unleased space, the excess revenues are available to the airport proprietor to pay off airport debt, to fund capital projects or operating costs, or as a reserve against future contingencies.[14] In contrast, under a residual system the risks of concessionaire performance lie on the airlines, which pay as terminal rent the net (of nonairline revenues) costs of the terminal. Thus high concession revenue lowers the net costs to the airlines, while low concession revenue increases the airlines' costs. Because a residual system shifts risks to the airlines, it cannot be imposed by ordinance, but is only a product of a negotiated agreement.

Regarding shifting the risks of overbuilding, under the compensatory system, the airport proprietor, when it chooses to build additional capacity, bears the risk that capacity will go unused. For example, if an airport with a compensatory terminal rate builds additional gates, and those gates go unleased, the airport must pay the cost of those unleased gates out of nonairline revenues. In contrast, under the residual system, those risks fall on the airlines. If an airport with a residual terminal rate builds additional gates and those gates go unleased, the costs of the gates go into the total terminal cost without any offsetting additional revenues, thus increasing the net cost to the airlines.

The airport proprietor may impose compensatory rates, or may negotiate rates based on either a compensatory system, a residual system, or some hybrid of the two. Airlines, exercising their rights under the Airline Deregulation Act to freely enter and exit domestic markets, use their market power for leverage in negotiations with airports; they typically

14. Under current law and the terms of grant agreements between the federal government and airports accepting federal funds, airport revenues at federally-funded airports may be legally used for a limited range of airport-related purposes and may not be spent for non-airport related expenses. 49 U.S.C.A. § 47107 (1994); FAAAA §§ 110, 111, and 112. The intricacies of law and policy on airport revenue use are outside the scope of this Comment.

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seek to secure residual agreements where the risks look favorable to them, and also to limit their exposure to airport proprietors' capital development decisions by bargaining for the contractual right to control airport capital development.

C. Indianapolis

In 1984, airport proprietors suffered a significant loss when the Seventh Circuit Court of Appeals ruled on a challenge to ordinance rates at the Indianapolis International Airport.[15] Airlines that had served the airport under a fifteen-year residual contract sued, rather than pay compensatory rates imposed by ordinance after the residual agreement expired. The appellate court accepted the airlines' argument that the airport had a "locational monopoly" and that, absent rate regulation by the court, the airport would use that monopoly to extract unreasonable rates from airport users.[16] The court essentially accepted the airlines' argument that they were entitled to have rates set on a residual basis (actually, a risk-free residual basis, in that they would receive the benefit of concession surpluses without being responsible for any shortfall in overall airport revenues), and held that under the circumstances at Indianapolis, the AHTA entitled airlines to rates calculated to give them the benefits of concession revenues.

In reaching that decision, the court assumed that concessions are frequented "with rare exceptions" by airline passengers.[17] The court then apparently made an unstated and unsupported assumption that charges by concessionaires for the wares they sell are unavoidable by passengers — a factually incorrect belief that forms an unvoiced premise of the court's conclusion that "when the airport charges a rental fee to concessionaires it is as if it were charging a landing fee to the airlines or imposing a head tax on the passenger . . . [w]hat matters to [the passenger] is the total cost that he must incur to make the flight, rather than the form in which the cost is distributed among the various items that he must buy."[18] From the conclusion that concession rentals (as passed through in prices to consumers) are unavoidable costs of travel, the *Indianapolis* court proceeded further to conclude that the AHTA entitled the passenger (or the airline, as the passengers' proxy) to offset concession revenues against the operating costs of the airport as a whole, and that rates set without such offset were unreasonable.[19] Since the *Indianapolis* decision

15. Indianapolis Airport Authority v. American Airlines, 733 F.2d 1262 (1984)(the "Indianapolis" decision).

16. *Id.* at 1267.

17. *Id.*

18. *Id.* at 1267-68.

19. *Id.* at 1268.

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was published, it has not found favor among other courts considering airport ratesetting issues, and has been cited favorably only by Judge Richard Posner, its author, and only in non-airport contexts involving traditionally regulated utilities. Still, it served the airlines well as a negotiating tool for a decade before being put to rest, first by the refusal of a district court to follow it,[20] and finally by the decisions of the lower courts and Supreme Court in *Grand Rapids.*

III. *Northwest Airlines v. County of Kent (Grand Rapids)*

The *Grand Rapids* case began with a success story: the Kent County International Airport ("KCIA") in Grand Rapids, Michigan, succeeded in finding sources of nonairline revenue sufficient to allow it to amass contingency reserves of approximately $9 million, following a strict compensatory methodology (the "Buckley method," named after airport cost accounting pioneer James Buckley).[21] This "Buckley method," used at KCIA since 1968, resulted in rates that formed the basis of negotiated agreements with the airlines until issuance of the challenged rate study in 1986.[22] The new rates (to take effect January 1, 1987), as compared to those established in 1984, raised the landing fee by $.20/thousand pounds, decreased the overnight aircraft parking fee by $.08/thousand pounds, and increased the terminal space rental rates.[23] The airlines refused to

20. City and County of Denver v. Continental Air Lines and United Air Lines, 712 F.Supp. 834, 837-38 (D. Colo. 1989). The City and County of Denver sought a declaratory judgment that its financing plan for the New Denver Airport, which relied in part on charges to concessionaires and airlines using Stapleton Airport, did not violate the AHTA. The federal district court, ruling on cross-motions for summary judgment, upheld Denver's right to use Stapleton concession revenues for costs of the replacement airport. The airlines challenged the use of concession revenues based on a claim that all costs and revenues from Stapleton must be considered together (sometimes called "cross-crediting") in setting "reasonable" airline rates and charges.

Read literally, the court stated, the AHTA "has no application to concession revenues at Stapleton." That conclusion was reinforced by the legislative history of the Act, where the court found no sign Congress intended to regulate concession rates or to preclude airport operators generating surplus concession revenues to fund airport expansion and development. "On the contrary," the court stated, "Congress recognized concession revenues as an important source of airport capital funding since federal government grant money does not finance 100% of any 'airport development project.'"

The court declined to find that concession charges exploit passengers, stating that "no person traveling to, from or through Stapleton . . . is required to park in the parking lot, rent a car, eat at a restaurant or buy a magazine. These are all individual decisions driven by individual perceptions of need and economic values. That is not the case with respect to the use of the airport's runways, taxiways, and airline portions of the terminal building. . . . Denver's decision to operate concessions at a profit is not an exploitation of airline passengers who have the freedom of choice to use the amenities Denver has provided." The Denver court declined to follow Indianapolis, stating that it disagreed with the public utility analogy underlying that decision.

21. Northwest Airlines v. County of Kent, 738 F. Supp. 1112, 1114 (E.D. Mich. 1990).

22. *Id.*

23. *Id.* at 1115.

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agree to the new rates, arguing that the surplus revenue generated by the airport demonstrated that the rates were unreasonable under the rationale of *Indianapolis*. The airport responded by passing ordinance rates.

The airlines brought suit in federal court, claiming that the Buckley method violated the AHTA because of: the unreasonable level of rates resulting from the method; the resulting "exorbitant profits" (claimed to far exceed the costs the airlines impose on the Airport) extracted from the airlines, and indirectly from passengers; the failure of the Buckley method to cross-credit surplus nonairline concession revenues to the airlines in establishing rates and charges; and discrimination against airlines and in favor of general aviation.[24] The district court, evaluating the airlines' argument, stated that the "overriding theme to plaintiffs' argument is that the rates and fees are inherently unreasonable since they generate a surplus in excess of $2,000,000 per year and have resulted in a cash surplus on hand in 1989 of over $9,000,000."[25]

In the initial district court decision, the court held that landing fees and terminal rentals charged the airlines did not violate the AHTA, except that charges for overnight parking of aircraft overrecovered the costs of apron space reserved for aircraft parking.[26] The district court assumed, based on a line of cases starting with *Evansville*, that plaintiff airlines had the burden of proving that the rates and fees are unreasonable in the light of the benefit conferred on the airlines, and found that the airlines had failed to meet that burden.

After discussing the genesis of the AHTA in the *Evansville* decision, the court, citing *City and County of Denver v. Continental Air Lines, Inc.*, agreed with the *Denver* court that the AHTA on its face does not apply to nonairline concession revenues and does not require the Airport to cross credit non-airline concession revenues to airlines when setting rates and fees.[27]

Like the *Denver* court, the court declined to follow *Indianapolis*. It distinguished that case as involving an airport with a regional monopoly on air travel, and found that the airport in Grand Rapids was not a monopoly.[28] Further, the court agreed with the *Indianapolis* concurring judge and the *Denver* court that "the AHTA is inapplicable to fees charged to nonairline users of the Airport." Airline passengers are not a

24. The airlines' complaint included a claim that the challenged rates violated the AAIA, but the district court ruled, on cross motions for summary judgment, that there was no cause of action under the Commerce Clause and no private right of action under the AAIA. The case then went forward on the AHTA claims.

25. *Id.* at 1116.

26. *Supra* note 21 at 1119-20.

27. *Grand Rapids*, 733 F.2d 1262 at 1118-19.

28. *Id.* at 1118.

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"captive audience" for concessionaires, so that high concession prices are an inescapable add-on to the cost of travel; rather, the court stated, the high percentage of origin and destination traffic at the airport meant that most passengers wishing to avoid high concession prices could easily do so.[29]

The court then considered whether the rates and fees charged the airlines were reasonable, and decided that "except for the aircraft parking fee, the plaintiffs were charged the break-even costs for the areas they use . . . the Airport is charging plaintiffs only for their share of the operating expenses and is not generating any of its surplus revenues from rates and fees charged plaintiffs."[30] The court concluded that the charges were therefore reasonable as compared to the benefits conferred. The parking fee, which overrecovered the cost of providing the parking area, was found unreasonable.[31]

Considering the claimed cross-subsidy between the airlines and general aviation users, the court found that the shortfall from general aviation was covered by charges to concessionaires and other nonairline users, instead of being made up by higher rates for airlines.[32]

In conclusion, the court stated:

> [T]he AHTA does not require defendants to cross credit nonairline revenues when establishing rates to be charged airlines. Although the Court is troubled by such large surpluses generated by the Airport, it must acknowledge the prudent management which allows the Airport to run efficiently and with foresight thereby avoiding the necessity of seeking extra tax or bond revenues from the citizens of Kent County for expansion or improvement.[33]

The case went up on appeal to the Sixth Circuit. In its brief to the appellate court, the airport focused on its compensatory ratesetting method, arguing that use of that method was a local governmental ratemaking decision entitled to "substantial deference" by the courts. The airport pointed out that the increases complained of were clearly related to increased CFR costs and airport improvements attributable to airline activity at the airport; that the cost per passenger for landing fees had gone down, even with the increases; and that airport management, including fee setting, has been prudent and had kept the airport from becoming a charge on local taxpayers. The airport has a legal right to

29. *Id.*
30. *Id.*
31. *Id.* at 1119-20.
32. *Id.* at 1120.
33. *Id.*

choose its own rate-setting method, it argued, and for the court to give the airlines the relief they seek would force the airport to adopt residual rate-setting.

The Airline's appellate reply brief focused on the degree to which the airport's total income exceeded the cost of its operations, stating that airport fees are so much in excess of revenue needed to make the airport self-sustaining that they are plainly unreasonable. The airlines argued that the Buckley methodology, which charges most of the airport's costs of the air operations area and the terminal to the airlines, and little to the concessions, is plainly unreasonable as well, because "concessions, like the Airlines, benefit substantially from and are dependent on the air operations and common areas of the terminal." The airlines argued that they are not seeking "cross-crediting".

> The Airlines do not seek a "share" of concession "revenues." Indeed, our contention has nothing to do with assigning concession revenues to the Airlines; it has to do with fairly allocating Airport costs to the concessions . . . the real issue is the Airport's refusal to acknowledge in its cost-allocation methodology that the concessions as well as the Airlines receive substantial benefit from the air and passenger-terminal operations, and that, therefore, some fair share of the Airport's costs of those operations should be allocated to the concessions.

The question on which the court should focus, the Airlines said, is not whether the airport could operate without concessions, but whether the concessions could operate without the airport. On this point, they argued that without the substantial expenditures made by the airport on the air operations area and terminal, there would be no concessions and no concession revenues; thus, concessionaires should bear a portion of the costs that made the concession revenues possible.

In response to the airlines' argument that the charges were inherently unreasonable because they produced substantial reserves, the Sixth Circuit found that concession fees are not covered by AHTA,[34] which limits only fees to commercial airlines and travellers.[35] The court distinguished the *Indianapolis* case, as involving an airport where travellers could not easily drive to another facility. The Sixth Circuit also agreed with the *Denver* court that operating concessions at a profit does not exploit airline passengers, who are free to avoid those charges by not consuming the goods or services in question.

34. The Sixth Circuit Court upheld the district court decision that the airlines had a private right of action under the AHTA, but no right of action under the AAIA or the Commerce Clause.

35. Northwest Airlines, Inc. v. County of Kent, 955 F.2d 1054 (6th Cir. 1992).

The Sixth Circuit also held against the airlines on their claim that they were being discriminated against in favor of general aviation, in that the airport recovers from airlines 100% of their costs, while the fuel flowage fees imposed on general aviation recover only 20% of the costs attributed to those users. Because the shortfall was made up out of concession revenues, not additional airline charges, the court found it had no authority to require the airport to change its fee system. AHTA applies only to travellers in "air commerce"; thus the court is limited to oversight of charges to commercial airlines, not to general aviation or concessions.

In response to a certiorari petition filed by the airlines, the Supreme Court sought a brief from the U.S. Solicitor General stating the federal government's position in the case. The Solicitor General responded, on behalf of the government, that Supreme Court review was unnecessary and that DOT, rather than the federal courts, should determine the reasonableness of airport rates and charges. The Solicitor General also said that the charges imposed by Kent County appear reasonable under federal aviation law. Despite the Solicitor General's urging, the Court granted certiorari, and on January 24, 1994, the Court issued a 7-1 decision in favor of the airport proprietor, holding that the rates charged by the airport were reasonable under the AHTA.[36]

IV. Analysis of *Grand Rapids* Decision

In Supreme Court oral argument, the airlines argued that the airport's fees were unreasonable primarily because concessionaires pay no share of the airfield costs, even though they benefit from the traffic flow created by operation of the airfield; all airfield costs are allocated to airlines and general aviation. The airlines also complained that the combination of break-even fees to airlines and market-based fees to concessionaires generates unreasonable surplus revenue for the airport.

To determine the reasonableness of the charges, the Court applied the three-part test set out in the *Evansville* decision, considering whether the charge is: based on some fair approximation of use of the facilities, not excessive in relation to the benefits conferred, and does not discrimi-

36. Justice Thomas did not join the majority, instead dissenting on the fundamental issue of whether the AHTA prohibition on head taxes encompasses all airport user fees. In his view, the prohibition in 49 U.S.C.A. § 40116(a) (1994) defines the bases on which taxes or charges may not be calculated, while the permissive language of subsection (e), with its reference to "reasonable" charges, "does not impose a requirement that all airport user fees be 'reasonable.' Instead, it simply makes clear that state and local governments remain free to impose charges other than those proscribed by [subsection (a)]." *Grand Rapids*, J. Thomas, dissenting, slip op. at 5. Thus, in Justice Thomas' view, airport user fees not calculated on an impermissible basis are limited simply by the dormant Commerce Clause, and the case should have been remanded to give the lower court the opportunity to consider the airlines' dormant Commerce Clause challenge.

nate against interstate commerce. The Court held that because airlines and general aviation are the only actual users of the airside facilities, while concessionaires actually use only terminal facilities, the airport's fees "reflect a fair, if imperfect, approximation of the use of facilities for whose benefit they are imposed."[37] As for surpluses resulting from concession fees, the Court found that such surpluses are not regulated by AHTA.[38]

Finally, the airlines challenged the airport's rates as violating the constitutional prohibition on discrimination against interstate commerce, arguing that airlines should not be charged full cost-recovery rates, while general aviation users paid only twenty percent of the costs allocated to them. However, that argument depended on the claim that general aviation is typically intrastate, and the Court held that the airlines had not established that claim on the record.[39]

For procedural reasons, the Court did not decide whether the airlines can challenge airport rates directly in federal court, rather than first seeking review by DOT/FAA. Specifically, the Court held against the airport concerning allocation of costs for crash/fire/rescue service, and the airport did not cross-petition on that issue. As a result, the Court declined to decide whether a private right of action exists under the AHTA (instead assuming that one does for the purposes of this case), because to find no private right of action under the AHTA would effectively reach and reverse the Sixth Circuit's unchallenged decision on the CFR allocation issue.[40]

However, the Court telegraphed its preference that such complaints be brought first before the agency, stating that "[c]ourts . . . are scarcely equipped to oversee, without the initial superintendence of a regulatory agency, rate structures and practices."[41] The Court stated that DOT/FAA is better equipped to regulate than the court because the agency has an overall view of the field of airport charges, has established procedures, under 14 C.F.R. Part 13, for adjudicating such complaints, and has previously entertained such a challenge, (i.e, to the Massachusetts Port Authority's charges under its Program for Airport Capacity Efficiency (PACE)).[42] The Court rejected the approach taken by the Seventh Circuit in the *Indianapolis* case, which would have had the courts act as pub-

37. *Grand Rapids*, slip op. at 8-12.

38. Such surpluses arguably may be capped under the AAIA, but the airlines did not appeal the finding of the Sixth Circuit, 955 F.2d at 1058, that there is no private right of action under the pertinent provisions of that statute.

39. Grand Rapids, slip op. at 16.

40. *Id.* at 7-8.

41. *Id.* at 9.

42. *Id.* at 9-11 and n. 11.

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lic utility style regulatory bodies overseeing airport rates. According to the Court, the Seventh Circuit, in deciding to take on the role of public utility regulator, "overlooked a key factor" when it "reasoned explicitly from the incorrect premise that 'no agency has regulatory authority over the rate practices of the Indianapolis Airport Authority,'" and that the duty of regulation fell to the courts.[43] The key factor overlooked by the Seventh Circuit, said the Court, is the fact that DOT/FAA regulates airport rates.[44]

The decision in *Grand Rapids* is significant on several levels. First, for those airports facing renegotiation of their agreements with airlines, or contemplating enacting ordinance rates, it buries the *Indianapolis* decision, lifting the cloud created by the possibility that a court could undo an airport's efforts to set full cost-recovery rates. Second, the *Grand Rapids* decision, by telegraphing the Court's preference that challenges to airport rates be heard first before DOT/FAA, set the stage for the district court ruling to that effect in *Air Transport Association v. City of Los Angeles*,[45] and thus for a movement replacing court oversight of airport rates with administrative review. Finally and most importantly, however, it provided the impetus for legislative lobbying by the airlines, in an effort to secure a Congressional "reversal" of *Grand Rapids*, that resulted in enactment of legislation that will govern DOT/FAA's future administrative decisions on airport rates, but with an effect arguably quite different from that intended by the airlines.

V. The *LAX* Decision and the Legislative Response to *Grand Rapids*

On February 15, 1994, a mere three weeks after the Supreme Court decision in *Grand Rapids*, a federal district court in California dismissed a challenge brought by the Air Transport Association (the trade association of U.S. airlines) and numerous airlines to landing fee increases at the Los Angeles International Airport (LAX). The airlines had filed the suit when Los Angeles moved to impose full cost-recovery rates at LAX. Previously, rates were set under a fifteen-year-old residual methodology which used concession revenues to lower airlines' landing fees. The air-

43. *Id.* at 15.
44. *Id.*
45. Air Transport Association v. City of Los Angeles, No. CV 93-4539 AWT (C.D. Cal. Feb. 15, 1994) (the "*LAX*" decision).

lines argued that proposed new rates were unreasonable under the AHTA and raised state barriers to interstate commerce in violation of the Commerce Clause.[46]

The airlines initially refused to pay the increased fees, and the City responded with threats of a "lock-out," denying them operating privileges at LAX. Rather than lose operating privileges, the airlines signed an interim agreement with the City that included a commitment to pay the increased fees under protest.

In its decision, the district court took a position that was suggested but not adopted by the Supreme Court in *Grand Rapids*. The district court ruled that AHTA gives the airlines no private right of action to bring federal court litigation. Instead, the airlines must first challenge the airport rates in an administrative action before DOT/FAA.

The district court also considered the airlines' Commerce Clause argument and noted that, once Congress regulates an area of commerce directly, the courts will no longer allow an argument based on the implicit prohibition in the Commerce Clause. The district court ruled that AHTA is an example of such direct Congressional regulation, thus rejecting the airlines' "dormant" Commerce Clause argument.

Finally, the airlines argued that federal law preempted a lock-out by Los Angeles. The district court declined to decide this issue, ruling that it was mooted when the interim agreement was signed.

The airlines' response to the *Grand Rapids* and *LAX* decisions was swift and predictable. Guided perhaps by the historical precedent in which Congress responded to *Evansville* by legislatively reversing its outcome, they went to Capitol Hill seeking legislation that would give them the victory denied by the Supreme Court. In addition, the airlines saw the writing on the wall: if, as the *LAX* court had held, the future of airport ratesetting lay with DOT/FAA, it behooved them to persuade Congress to require DOT/FAA to limit airport rates. They sought a prohibition on lock-outs, permission to withhold payment of challenged rate increases, and a statutory entitlement to have airline rates set after consideration of concession revenues — in effect, a statutorily-mandated residual agreement that would shift to the airlines positive, but not negative, risks. What they won, however, fell short of those goals.

46. In addition to filing litigation against the rate increase, the airlines also claimed publicly that the asserted "cost recovery" nature of the fee increases was a smoke screen for the City's desire to accumulate revenue surpluses that could later be spent on non-airport related purposes. They pointed to statements by the Mayor of Los Angeles indicating that the City would seek a change in federal law that would allow the City to divert surplus revenue to fund additional police protection downtown.

As finally enacted on August 23, 1994, the Federal Aviation Administration Authorization Act of 1994 (FAAAA) included four sections (§§ 110-113) touching on airport rates and revenues. Section 110, headed "Airport Fees Policy," amends the policy provisions of the former Airport and Airway Improvement Act of 1982, as amended[47] to provide that it is the policy of the United States that airport fees, rates, and charges: must be reasonable, may only be used for purposes not prohibited by the Act, and should reinforce the requirement that airports should be as self-sustaining as possible.

Section 111 of FAAAA amends the grant assurance requirements codified at 49 U.S.C. § 47107(a) (1994) to require that airport owners submit annual reports listing intergovernmental payments and other transfers of assets, and to require that DOT/FAA prescribe a unified format for such reports. Section 112 of FAAAA further amends the requirements placed on the Secretary prior to approval of AIP grants by requiring, within ninety days of the enactment of the statute, the promulgation of policies and procedures to ensure enforcement of limitations on the use of airport revenue.

Section 113 of FAAAA grants airlines and airports the authority to ask DOT/FAA to determine whether an airport fee is reasonable, and requires DOT/FAA to establish procedures that will result in a final order within 120 days of a complaint. Regarding the substance of that determination, however, the new legislation provides explicitly that "[a] fee subject to a determination of reasonableness under this section may be calculated pursuant to either a compensatory or residual fee methodology or any combination thereof."

The regulations that will implement the Supreme Court's directive and the new legislation are not yet in place, but already have a tortuous history of their own. On June 9, 1994, after the decisions in *Grand Rapids* and *LAX* made clear the need for DOT/FAA policies and procedures governing airport rates, DOT/FAA published a Notice of Proposed Policy (NPP) Regarding Airport Rates and Charges,[48] and later extended the public comment period on that NPP until September 15, 1994,[49] and later to October 15, 1994.[50] Since FAAAA was enacted subsequent to publi-

47. Codified at 49 U.S.C. Subtitle VII Part B.

48. 59 Fed. Reg. 29874.

49. 59 Fed. Reg. 41192 (August 10, 1994).

50. At the same time, DOT/FAA also published a Notice of Proposed Rulemaking on a new 14 C.F.R. Part 16, Rules of Practice for Federally Assisted Airport Proceedings, to govern complaints against airports (the "NPRM"). 59 Fed. Reg. 29880. At this writing, proposed Part 16 Subpart J, which would have governed airport-airline rate disputes, has been withdrawn due to inconsistencies with the FAAAA, and DOT/FAA has announced that it will instead promulgate changes to 14 C.F.R. Part 302 in order to accommodate airline/airport rate disputes. 59 Fed. Reg. 47568 (September 16, 1994).

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cation of the NPP, DOT/FAA have extended the comment period and delayed final promulgation in order to assure that commenters, and the agencies, have had ample opportunity to take the provisions of the legislation into account. Comments filed in the docket thus far take strong exception to several provisions of the NPP, and it is unclear to what degree the final rules will vary from those proposed.

VI. Conclusion

In 1972, airport proprietors won a clean victory before the Supreme Court, only to see that victory snatched away two years later by passage of AHTA. Indeed, they lost more than they knew at the time; not only head taxes, but every charge placed on airlines and their passengers became subject to an ill-defined review under a vague "reasonableness" standard. Although that standard led to few actual court decisions, and even fewer losses, the *Indianapolis* decision, coupled with airlines' ability to avoid paying increased rates for years while federal litigation dragged on, led to a serious imbalance in negotiating power, and to airlines gaining increased control over airports' capital planning.

With the airlines' legislative response to the airports' success in *Grand Rapids*, it appeared that once again airports were poised to snatch defeat from the jaws of victory. Instead, the new legislation imposes no additional substantive standards, grants airports the right to collect challenged fees, and limits the financial exposure of airports planning new ordinance rates at a full cost-recovery level. Since, under compensatory rates, airports will still bear the risk of building unused capacity, the result should be an increased flexibility on the part of local airport proprietors to set full cost-recovery rates, to use concession revenues to support construction of additional capacity where needed, and to free their airport from the need for subsidies from local taxpayers. Whether that potential will be met depends in large part on how DOT/FAA resolve fundamental issues of airport ratemaking in promulgating a final policy on airport rates and charges. That final policy and its implications for the future of airport development will be the subject of Part Two of this comment.