

Future of Aviation Advisory Committee
Subcommittee on Competitiveness and Viability
Record of Meeting
October 15, 2010
Denver International Airport
Denver, Colorado

Public Announcement

The U.S. Department of Transportation (DOT), Office of the Secretary of Transportation, informed the public of this Future of Aviation Advisory Committee (FAAC) Subcommittee on Competitiveness and Viability meeting in a Federal Register notice published September 30, 2010 (75 FR 60492).

Subcommittee Members in Attendance

Name		Affiliation(s)
Glenn Tilton, <i>Subcommittee Chair</i>	Chairman, President, and Chief Executive Officer	UAL Corporation (UAL)
Susan Baer	Director, Aviation Department	Port Authority of New York & New Jersey (PANY/NJ)
Severin Borenstein	Professor	Haas School of Business, University of California, Berkeley
Patricia Friend	International President	Association of Flight Attendants (AFA) Communication Workers of America, American Federation of Labor–Congress of Industrial Organizations
Ana McAhron-Schulz	Director, Economic and Financial Analysis	Air Line Pilots Association, International (ALPA)
William McGee	Travel and Aviation Consultant	Consumers Union
Daniel McKenzie	U.S. Airlines Research Analyst	Hudson Securities, Inc.
Jack Pelton	Chairman, President, and Chief Executive Officer	Cessna Aircraft Company (Cessna)
Frank Quinn, ¹ <i>alternate for Chris Williams</i>		Williams Capital Group

Committee Members Not in Attendance

Name		Affiliation(s)
Bryan Bedford	Chairman, President, and Chief Executive Officer	Republic Airways Holding, Inc.

¹ By Phone

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Other Officials Present

Name	Affiliation(s)	
Susan Kurland, <i>FAAC Committee Chair</i>	Assistant Secretary for Aviation and International Affairs	DOT
Todd Homan, <i>Designated Federal Official (DFO)</i>	Director, Office of Aviation Analysis	DOT

Other Persons Present

Name	Affiliation(s)	
Mark Anderson	Vice President, Government Affairs	United Air Lines, Inc. (United)
Aleta Best	Transportation Industry Analyst	DOT
Bill Bottoms	Executive Vice President	Team SAI Inc.
Chris Brown	Senior Advisor	United
Mary Buckley	Director, Government and Community Affairs	Denver International Airport
Patty Clark	Senior Advisor to the Aviation Director	PANY/NJ
Ashleigh de la Torre	Director, Government Affairs	Bombardier
Paul Feldman	Vice President for Government Affairs	General Aviation Manufacturers Association
Neil Modzelewski	Director, Regulatory Affairs	PAI Consulting
Robert Peterson	Technical Fellow, Air Transportation Industry Infrastructure Research, Aviation Security	The Boeing Corporation (Boeing)
Lisa Piccione	Senior Vice President, Government Affairs	National Business Aviation Association
Kristi Warden	Program Manager	Federal Aviation Administration (FAA)
Stephen Welman	Principal Economics and Business Analyst	The MITRE Corporation
Jeffrey Wharff	Senior Economic Advisor	FAA

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BACKGROUND AND WELCOMING REMARKS

Mr. Glenn Tilton, Subcommittee Chair, UAL, welcomed the participants. He stated that work had progressed satisfactorily since the subcommittee's previous meeting. Mr. Tilton also noted Dr. Severin Borenstein, University of California–Berkeley, had requested time on the agenda to address the subcommittee. He suggested Dr. Borenstein speak following a presentation by Mr. Bob Peterson, Boeing.

Mr. Tilton then turned the meeting over to Ms. Susan Kurland, DOT, and Mr. Todd Homan, DOT, subcommittee DFO.

DOT REMARKS ON FAAC PROCEDURES

Ms. Kurland noted that the fourth meeting of the full FAAC was scheduled for the following week. She reviewed charge given to the full FAAC by Secretary of Transportation Raymond LaHood at the first meeting of the FAAC. Ms. Kurland stated that Secretary LaHood had convened the FAAC to obtain the advice and recommendations of its 18 expert members and had presented them with powerful options. She reiterated that he had requested actionable, concrete recommendations, and she thanked the FAAC members for demonstrating cooperation and compromise necessary to development of meaningful recommendations.

Mr. Homan read the formal statement required under the Federal Advisory Committee Act. He noted that, although the meeting was open to the public, participation in the meeting was limited to subcommittee members, their alternates, and Federal officials. Mr. Homan added that only subcommittee members and their alternates were entitled to vote on subcommittee business. He stated that interested people have the opportunity to submit comments before each meeting, either by email at faac@dot.gov or by submission to the regulatory docket at <http://www.regulations.gov> (Docket No. DOT–OST–2010–0074). He noted that the meeting minutes will be made available both in the regulatory docket and on the FAAC Web site at <http://www.dot.gov/faac>.

Mr. Homan stated that corrections to the draft minutes of the August 4, 2010, meeting of the subcommittee had been received, and the corrected minutes had been circulated, ratified, and certified. He noted that draft minutes of the August 24, 2010, meeting had been circulated to the subcommittee members and requested that any comments or corrections be submitted by close of business, Friday, October 22, 2010. Mr. Homan added that a revised draft of the minutes would be circulated by close of business, October 27, 2010, and, barring any further comment, would be ratified and certified on November 3, 2010.

DISCUSSION

Liberalization of Air Traffic Markets

Mr. Tilton introduced Mr. Peterson, who offered a presentation to the subcommittee on open skies and the significance of capacity in the air carrier industry. Mr. Peterson noted that his

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data and conclusions were developed based on studies conducted by the Massachusetts Institute of Technology (MIT) and InterVISTAS, and Boeing's own monitoring of markets.

Mr. Peterson first addressed the topic of open skies. He noted that a 2008 study by the World Trade Organization indicated that, as the level of liberalization of air traffic markets increased from the 25th percentile to the 75th percentile, there was a corresponding 30 percent increase in air traffic. Mr. Peterson posited that this increase in air traffic resulted not from new demand, but from the removal of impediments to existing demand.

Mr. Peterson offered a brief synopsis of the level of liberalization present in various markets. He noted that the United States has now entered into "open skies" aviation relationships with 99 other countries. Mr. Peterson presented charts and tables which indicated the current worldwide level of liberalization in various air traffic markets. He noted that the agreements entered into by the United States are among the most open in the world. Mr. Peterson also stated that the openness of agreements tends to be a function of geopolitical factors rather than of market forces; there is no significant correlation between traffic volume and level of liberalization.

Mr. Peterson next addressed arguments in support of and in opposition to liberalization. He stated that, historically, the basis of air service agreements has been the 1944 Chicago Convention. At that time, Mr. Peterson noted, the majority of air service worldwide was provided by U.S. air carriers. He stated that safety and other considerations tended to discourage open markets. Mr. Peterson added that safety and security considerations continue to provide a rationale for keeping markets closed. He stated that mitigating forces, such as the International Civil Aviation Organization standards, have diminished the significance of such considerations with respect to openness of markets.

Mr. Peterson next examined the beneficial impacts of opening air traffic markets. Although markets with relaxed restrictions generally experience an increase in air traffic volume, he noted that this increase is not a direct result of liberalization; rather, it is the result of increased economic activity resulting from liberalization. Mr. Peterson noted that the economic impact from market liberalization differs significantly between mature markets, such as those in the United States and Europe, and markets in other parts of the world. He stated that the change in air traffic volume experienced following liberalization differs widely.

Mr. Peterson presented findings from a case study of the United States–United Kingdom market, which he asserted supported the proposition that civil aviation positively affects economic conditions. He stated that, following a 1995 agreement between the United States and the United Kingdom, both nations saw job growth, an increase in gross domestic product (GDP), and corresponding increases in air traffic. Of particular note was increased air traffic between 2006 and 2008, despite a general economic downturn.

Mr. Peterson also discussed the results of the MIT study. He stated that this study indicated the results of market liberalization are not uniformly positive, and he noted some countries have experienced decreasing air traffic and service volumes following liberalization of markets. Mr. Peterson suggested that one explanation for such decreases is that markets providing substitute services for closed air markets lose traffic when those air markets open up.

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Mr. Peterson ended his discussion of open skies by concluding that the removal of impediments to free air travel and trade is generally beneficial. In his view, liberalization has little negative effect, with the exception of the increased environmental impact resulting from increased air traffic volume.

Mr. Peterson next discussed factors and conditions affecting the level of capacity in the air carrier market, including overcapacity and undercapacity. He noted that demand for air travel generally follows business cycles, including trends in GDP growth. Mr. Peterson stated that as GDP increases, air travel demand and air travel increases, and increased demand influences air carriers to increase capacity, first through increased fleet utilization and then through orders for new aircraft.

Mr. Peterson noted that there is a natural lag between changes in economic factors and resultant increases in demand and capacity. He stated the time required for manufacture and delivery of new aircraft introduces additional lag before increased capacity is realized. Mr. Peterson stated that these lags put capacity out of phase with demand. He added that when capacity increases lag behind demand, periods of undercapacity occur; conversely, when peak capacity is reached, GDP and demand growth will have slowed or reversed, resulting in overcapacity.

Mr. Peterson observed that the cycle of demand and lag in capacity adjustment presents a challenge for the industry. He stated that manufacturers have sought to dampen the negative effects of by limiting reaction to short-term trends. Mr. Peterson also suggested that air carriers would continue to order some aircraft even during unfavorable economic conditions, in anticipation of future economic growth and increased demand.

Mr. Peterson then took questions from the subcommittee. Mr. William McGee, Consumers Union, noted that, historically, economic conditions have not been global, with some local economies performing well while others faced difficulties, mitigating fluctuations in demand for aircraft. He asked whether this continues to be the case. Mr. Peterson responded the economy is now more global, and more volatile, than in the past. He noted that geographic demand for new aircraft has changed dramatically since the mid-to-late 20th century. Mr. Peterson stated that, previously, demand for new aircraft came primarily from air carriers in the United States and Europe, while air carriers in much of the rest of the world tended to purchase used aircraft. He noted that this is no longer the case.

Mr. Daniel McKenzie, Hudson Securities, Inc., observed that traffic between the United States and London Heathrow Airport has increased dramatically as that market has been liberalized. He noted a steep increase in capacity which has been driven by market share battles between Delta, Continental (now UAL), and British Airways. Mr. McKenzie pointed out that the trends we're seeing today lend support to Mr. Peterson's analysis of the impact of market liberalization.

Mr. McKenzie also asked Mr. Peterson if there is any correlation between traffic growth and economic restrictions, such as capital inflow or outflow restrictions. Mr. Peterson responded that such restrictions undoubtedly impact traffic. He noted the greatest impact of such restrictions is in determining what air carriers serve the markets in question, rather than whether or not service exists.

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Mr. Tilton noted that in previous discussions, the Subcommittee had framed the subject as “beyond open skies.” He asked for Mr. Peterson’s view on how market liberalization may evolve. Mr. Peterson noted he had both positive and negative observations in response to the question. He reiterated his earlier conclusion that removal of impediments to open skies generally helps all parties. Mr. Peterson cautioned that the impact on all stakeholders should be examined when setting policy to avoid benefit to one party to the detriment of others. He also noted safety and security infrastructures are not uniform worldwide, and he expressed concern that liberalization of specific markets may cause traffic to increase faster than some local infrastructures can accommodate. Mr. Peterson therefore advocated a paced approach in further liberalizing markets.

Mr. Tilton followed on his question by asking whether market liberalization might evolve differently in different parts of the world, or whether much of the world would pursue the liberalization model of the United States. Mr. Peterson expressed a strong belief that different nations would pursue different strategies with respect to liberalization and competition. He cautioned against an assumption that the approach taken by the United States would be best for all nations. Mr. Peterson observed that nations would pursue strategies that work best for the markets serving them.

Mr. McKenzie asked whether Mr. Peterson had any predictions about current political changes in Brazil affecting its relatively closed market. Mr. Peterson stated it would be premature to make any definitive analysis, but he noted there appears to be some recognition in Brazil that the past lack of liberalization has hurt international trade. He stated the political situation in Brazil is complex and there is a good deal of inertia with respect to policy. Mr. Peterson expressed the belief that Brazil’s market will gradually become more open. Ms. Ana McAhrn-Schulz, ALPA, noted the merger between LAN Airlines S.A. of Chile (LAN) and TAM Airlines of Brazil (TAM) could also affect the Brazilian government’s willingness to liberalize. Mr. Tilton stated in light of the merger, both Chile and Brazil might experience some pressure from private industry to liberalize markets. Mr. Peterson concluded the discussion and his presentation by reiterating that there is increasing recognition by policy makers of the wider impacts of the level of air service.

Alternative Viewpoint

Dr. Borenstein prefaced his presentation by stating his wish to respond to circulated proposals and to offer some balance that he perceived to be lacking in them. He expressed disappointment with both the substance and development process of the proposals. Dr. Borenstein noted, while a member of the U.S. Aviation Industry Viability Working Group, he was not consulted about the proposals developed by that group. He stated a belief that the subcommittee’s discussions in previous meetings regarding jet fuel price fluctuations had also been unbalanced in terms of time allotted to differing viewpoints, and the presentations by United employees and consultants at the FAAC meeting in Chicago, Illinois, in August 2010 were similarly biased.

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Dr. Borenstein stated an objective of presenting an alternative view of the subcommittee's proceedings. He noted he had expressed his views in previous meetings, but these views did not appear to be included in the subcommittee's work product.

Dr. Borenstein stated a relative lack of resources limited the depth of his analysis and qualified the results of his presentation by noting the factual data were somewhat dated. He expressed a hope the DOT would update his research with more current data. Dr. Borenstein also clarified he has little or no economic stake in the aviation industry.

Dr. Borenstein began his presentation stating that, since deregulation, fares declined in real terms and passenger traffic has increased. He noted these movements represent the continuation of trends predating regulation, and the event of deregulation did not have any measurable impact on these trends. Dr. Borenstein therefore challenged any notion that price competition is driving fares to unreasonable levels.

Dr. Borenstein acknowledged that fares are below the standard industry fare level (SIFL) used by the DOT as a benchmark for fares. He noted that while the SIFL takes into account factors such as fuel costs and capital finance costs, it does not account for load factors. Dr. Borenstein stated approximately two-thirds of the decline in fares since deregulation can be attributed to corresponding increases in average load factors over the same time period. He observed that, at the time of deregulation, average load factors were approximately 50 percent, while average load factors today are approximately 80 percent.

Dr. Borenstein also stated, despite periodic financial difficulties, there is no sign of reduced investment in the air carrier industry or reduction in passenger air service. He therefore disagreed with portrayals of the industry as one in decline or facing an imminent significant decrease in service. Dr. Borenstein noted, with the exception of the period immediately following the terrorist attacks of September 11, 2001, there were no periods in which air service decreased to any significant extent, although there had been periods of relatively flat growth.

Dr. Borenstein confirmed that low cost carriers (LCC) are growing; he stated, as of his most recent data, LCCs account for approximately one-third of domestic passenger traffic. He noted his analysis measures traffic in terms of revenue passenger miles (RPMs), rather than passenger segments. As such, he noted that his calculation of the market share of LCCs is lower than those some studies, largely because the shorter stage lengths flown by Southwest Airlines (Southwest) skew the numbers downward.

Dr. Borenstein criticized the Air Transport Association of America, Inc. (ATA)'s claim that 80 percent of all passenger routes flown by legacy carriers are subject to competition by LCCs. He stated ATA's analysis consolidates departures and arrivals from multiple airports within metropolitan areas. Dr. Borenstein noted that United had, in support of its merger with Continental Airlines, Inc. (Continental), presented testimony by consultants that the competitive value of service to and from an adjacent airport is approximately half that of service offered at the same airport. He noted if the analysis were performed airport to airport, rather than city to city, only approximately 60 percent of routes flown by legacy carriers are subject to LCC competition.

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Dr. Borenstein stated that on routes with LCC competition, fares charged by legacy carriers average 18 percent higher than fares charged by LCCs. He stated that this challenges the contention that competition for passengers is built solely on ticket price. Dr. Borenstein posited there is some product differentiation between service offered by legacy carriers and LCCs, although passenger service is increasingly viewed as a commodity.

Dr. Borenstein stated that LCCs have lower operating costs than legacy air carriers do. He also noted, when adjusted for the shorter stage lengths typically flown by LCCs, which have higher per available seat mile costs than longer stage lengths, LCCs have significantly lower costs than legacy air carriers. Dr. Borenstein stated the expert presenters at the FAAC meeting held in August 2010 at Chicago, Illinois, failed to point out the cost disparity between legacy air carriers and LCCs in their analyses, and that the recommendation proposal developed by the U.S. Aviation Industry Viability Working Group had treated the higher costs of legacy air carriers as unavoidable. He questioned whether this was a valid assumption, and noted such cost disparity is rarely seen in other industries because organizations with higher costs are typically driven out of the market.

Dr. Borenstein raised the question as to how legacy air carriers remain in business while paying higher operating costs. He offered several explanations:

- Market exclusion—Dr. Borenstein stated efforts to keep LCCs from operating out of specific airports protect legacy air carriers. He noted such efforts were more common in the past, but implementation of policies, such as passenger facility charges (PFC), have curtailed them.
- Product bundling—Dr. Borenstein stated strategies such as corporate discount programs have been effective at retaining business traffic on routes with LCC competition, largely by predicated discounts on corporations' brand loyalty. He suggested, from an economic standpoint, such practices are anticompetitive, though none ever incurred legal action. Dr. Borenstein also noted frequent flyer programs are extremely effective at consolidating traffic at hub airports, and that roundtrip fare restrictions discourage splitting travel between multiple carriers.
- Incentive payments—Dr. Borenstein noted that in previous times, payments to brokers, such as override payments to travel agents for sales in excess of existing market share, effectively influenced agents to sell fares on a particular air carrier. He stated that the capability of fare research and purchasing via the Internet means that passengers have much greater access to comparative fare information, and that passengers rarely use travel agents to purchase airfare. Dr. Borenstein noted that frequent flyer miles awarded to business travelers serve largely the same purpose, in that they influence travelers to travel primarily on a single carrier in exchange for a benefit. He also opined that frequent flyer awards constitute an untaxed benefit to passengers, but the U.S. Internal Revenue Service has not elected to pursue inclusion of such benefits in income.

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Dr. Borenstein expounded on his concerns with product bundling practices. He noted that product bundling could be beneficial for both the consumer and the provider of services, because it results in a cost saving to both parties. Dr. Borenstein stated that in the air carrier industry, product bundling does not result in an economy of scale, does not help economic efficiency, and only acts as a restraint on competition.

Dr. Borenstein expressed the belief that subsidization of the air carrier industry is not appropriate, and stated that a form of subsidization is implicit in proposed recommendations calling for government funding of aircraft equipage necessary for operation under the Next Generation Air Transportation System (NextGen). By way of analogy, Dr. Borenstein noted that automobile owners bear economic responsibility for ensuring that their vehicles are sufficiently equipped and maintained to travel on public roadways, and suggested air carriers should be similarly responsible.

Dr. Borenstein also urged that the DOT not be encouraged to take steps that hinder entry in to the air carrier market. He stated such action would enhance the viability of existing air carriers, but argued the objective of the DOT is to ensure the viability of the entire air carrier industry, not that of individual carriers. Dr. Borenstein noted an industry in which the market share of LCCs grows to, for example, 80 percent would still be viable.

With respect to the tax burden on air carriers, Dr. Borenstein stated that taxation should fairly reflect the burden imposed on society. He expressed disappointment with the proposal produced by the U.S. Aviation Industry Viability Working Group because he felt there was no meaningful analysis of the relationship between taxes levied on the air carrier industry and the societal costs created by the industry.

Dr. Borenstein also challenged the proposition that price competition prevents air carriers from passing tax increases through to the consumer. In support of his argument, he presented the results of his analysis on the impact of PFCs on traffic and fares within markets.

Dr. Borenstein stated because PFCs are implemented at specific airports rather than system-wide, the impact of a PFC change at a given airport can be compared against a control group of routes of similar stage lengths originating from airports where PFCs did not change. He added because PFCs are only charged by origin airports, the fares in one direction can be compared with fares in the other direction in the same city pair.

Dr. Borenstein stated that for nonstop fares, 90 percent of the increase in PFCs passed through to passengers within 2 quarters of the change. He noted he had determined a standard error of approximately 0.2 in this analysis. Dr. Borenstein stated when considering only one-way nonstop fares, the pass through was approximately 120 percent; that is, more than the full PFC passed through to passengers within 2 quarters. Dr. Borenstein noted a standard error of approximately 0.1 with this analysis.

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Dr. Borenstein stated his analysis demonstrates that passengers, not air carriers, bear the direct burden of PFC increases. He added the actual impact on air carriers was limited to a reduction in ticket sales because of price elasticity, which he estimated at between 1 and 1.5. Mr. Borenstein concluded that taxes influence the size of the air carrier industry, but do not affect its overall viability.

Dr. Borenstein entertained questions from the subcommittee. Mr. McKenzie questioned Dr. Borenstein's conclusion that LCC operations at an airport have a limited impact on legacy air carrier fares at an adjacent airport. In support of his position, Mr. McKenzie noted Continental routinely lowered fares at its hub in Newark to within \$15 to \$30 of fares offered by JetBlue Airways (JetBlue) operating at nearby John F. Kennedy International Airport. He also noted Northwest Airlines, Inc., had reduced fares substantially between Minneapolis-St. Paul International Airport (MSP) and Los Angeles International Airport (LAX) following Frontier Airlines, Inc.'s introduction of connecting service between MSP and LAX through Denver.

Dr. Borenstein stated that the examples Mr. McKenzie provided were anecdotal, and reiterated that analysis done by consultants to United Airlines indicates the competitive impact of service to an adjacent airport is roughly half that of similar service at the same airport, and that only 60 percent of airport-to-airport markets served by legacy carriers include LCC competition. He noted both he and ATA use a standard of 10 percent of market share to determine whether an air carrier offers service within a particular market. Dr. Borenstein also stated, while the ATA included all routings from all airports within a metropolitan area in its analysis, his analysis, while excluding service to and from adjacent airports, did include both direct and connecting service between the same two airports. He stated that, like ATA, he calculated his percentage based on passenger boardings. Dr. Borenstein added, by not including the impact of service at adjacent airports, his result of 60 percent likely understated the true extent of LCC competition with legacy air carriers, but argued that the 80 percent figure quoted by the ATA likewise overstated the extent of competition.

Mr. Tilton stated he had no significant reservations with the content of Dr. Borenstein's presentation and conclusions, largely because he did not believe it affected the substance of the recommendation proposals that the working groups had developed. He disagreed that the proposed recommendations implicitly call for subsidy of the air carrier industry. Mr. Tilton stated that he perceived the goal of the subcommittee is to proposed recommendations reflecting the importance of the industry in a global context, and the collateral economic benefit rendered to the United States.

Mr. Tilton stated the subcommittee had not addressed a number of areas where consensus was unlikely, such as air carrier consolidations and acquisitions and convergence of business models. He suggested that recent changes to the business model of Southwest, and the prospect of a merger with AirTran Airways (AirTran), represent a more significant event than the merger of United and Continental. Mr. Tilton also stated that many of the concerns expressed by Dr. Borenstein were raised and addressed as part of proceedings before the DOT and the Department of Justice leading up to the approval of the United-Continental merger.

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Mr. Tilton reiterated his view that Dr. Borenstein's concerns were not at odds with the recommendations under development by the subcommittee. He stated he and Dr. Borenstein continued to disagree regarding the scope of the subcommittee's activities with respect to the charge given to the FAAC by Secretary LaHood. Mr. Tilton asserted that many of the recommendation proposals, such as consumer issues, were outside the scope of the subcommittee as created. He expressed the viewpoint that it would still be reasonable to present those proposals to the FAAC, with the understanding that rejection by the DOT as being out of scope was possible.

Dr. Borenstein observed the topic of air carrier consolidation is included and supported in the recommendation proposal developed by the working group, and expressed concern about the content of the recommendation proposal. Mr. Tilton suggested it would be more appropriate to discuss the proposal directly, with an eye toward modifying it, and stated that he looked forward to vigorous debate.

Mr. McGee urged the subcommittee to consider the broader view when discussing issues such as scope and propriety of recommendations. He observed that the FAAC's report and recommendations will become an historical document. Mr. McGee stated that what the FAAC fails to address is as important as what it chooses to address, and suggested a failure to address important issues not strictly within the scope of the subcommittee, such as consumer concerns, might be viewed unfavorably in the future.

Ms. Susan Baer, PANY/NJ, expressed agreement, and suggested the subcommittee might be remiss in remaining silent on consolidation in an era of historic mergers. She noted the United-Continental merger had only proceeded after the parties committed to certain actions protective of competition. Ms. Baer also expressed her interest in the content of Dr. Borenstein's presentation, particularly his analysis of the impact of PFC changes, and suggested it offered fertile ground for further study by the DOT. She noted that the analysis was not broad enough to warrant definitive conclusions, but did raise questions regarding the industry's position that the taxes imposed on it are excessive.

Mr. Tilton expressed agreement with Ms. Baer's characterization of Dr. Borenstein's analysis. He stated that the industry's primary concern in the area of taxation is the number of government entities levying taxes and fees without apparent consideration of the aggregate impact on the industry. Mr. Tilton stated that the proposed recommendation is for a comprehensive understanding of all of the taxes and fees affecting the industry. He noted if, after acquiring such an understanding, the DOT reached a determination that the level of taxation is not punitive to a particular industry, no further action by the DOT would be appropriate.

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Mr. McKenzie discussed the subcommittee's mandate to make recommendations that enhance competition and help the industry remain viable. He expressed confidence that Dr. Borenstein's concerns could be accommodated in the subcommittee's recommendation proposals. Mr. McKenzie noted, before the merger of LAN and TAM, that TAM enjoyed a duopoly in the Brazilian market with Gol Airlines. He stated although such limited competition would be expected to result in relatively high fares and margins, the disparity in operating cost between the two air carriers' results in fierce price competition for market share. Mr. McKenzie suggested a similar relationship exists between Southwest and the legacy carriers in the United States. He offered his opinion that Southwest is evolving, and is roughly 40 percent of the way to the form and market position it will eventually adopt. Mr. McKenzie also forecast significant competition from the growing Virgin America, Inc., brand.

Mr. Tilton suggested that the growth of Virgin America, Inc., demonstrated the importance of air carrier alliances because Virgin Atlantic Airways had seen rapid changes in its fortunes by not being part of an alliance. He stated that one point Dr. Borenstein raised with which the subcommittee might agree was the air carrier industry is highly dynamic. Mr. Tilton stated his view that the industry would continue to change, and that change outside the United States would be more dramatic than change in the domestic industry. He commented that this speaks to Secretary LaHood's charge to recommend ways in which the industry can remain competitive globally in the absence of foreign ownership.

Mr. Tilton and Dr. Borenstein engaged in a brief debate over the international competitive marketplace. Mr. Tilton suggested that Dr. Borenstein's conclusion that legacy carriers could not continue to exist without market protections was equally valid in the global competitive market. Dr. Borenstein disagreed, noting that European air carriers have higher operating costs than legacy carriers and that South American air carriers lack the route networks to compete effectively. Mr. Tilton stated that the rapid evolution of other international carriers, such as Emirates Airways, could change those relationships. He also observed that labor-management relations in the U.S. air carrier industry could well play a part in future events.

Mr. Tilton returned to the subject of the scope of the subcommittee's considerations and disagreements on important issues. He suggested that the subcommittee would be remiss in failing to report on important issues on which it failed to reach consensus, and suggested if a decision could not be made at the subcommittee level, then the competing viewpoints should be presented to the FAAC and, ultimately, the DOT for a decision. Ms. Kurland confirmed that, while the FAAC was charged with seeking actionable, concrete recommendations on which its members can achieve consensus, the subcommittees should also discuss more controversial topics and report on them to the FAAC.

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Mr. McKenzie returned discussion to the comparative operating costs of legacy carriers and LCCs. He noted he had recently consulted with a committee of the Allied Pilots Association responsible for negotiating with AMR Corporation (AMR). Mr. McKenzie stated that the committee asked for his opinion whether AMR would file for bankruptcy. Mr. McKenzie answered he had assigned a 60 percent probability that AMR would file for bankruptcy within 3 to 5 years. He stressed that expenses could not exceed revenues on a long-term basis. Mr. McKenzie expressed his belief that cost reductions would take place at legacy carriers, but the process would take time.

Dr. Borenstein clarified that, while other costs might be lower, Southwest wages for pilot and flight attendants are about equal to industry average for similar aircraft. Ms. Patricia Friend, AFA, stated that many carriers aspire to Southwest's low-cost structure, but do not appreciate the hard work that Southwest has expended to achieve it. She stated that characterizations of Southwest as having low labor costs are inaccurate, and attributed its success to its overall business model, including its culture of flexibility and respect. Mr. Tilton wrapped up discussion on the topic by noting that it will be interesting to see how Southwest handled the incorporation of two extremely different operational structures and marketing approaches as part of its merger with AirTran.

Airline Competition and Passenger Protections Working Group

Mr. Tilton then turned the meeting over to Mr. McGee to discuss the draft recommendation proposals developed by the Airline Competition and Passenger Protections Working Group.

Mr. McGee stated that the working group's proposed recommendations address two topics: (1) the essential air service (EAS) program and (2) passenger issues. Ms. Kurland noted the comment period on a proposed rulemaking on customer service enhancements had just closed, and that any discussion of passenger issues in this meeting would be included in the docket for that rulemaking as well. Mr. Tilton inquired as to whether what Mr. McGee intended to present was already in the docket for the rulemaking. Mr. McGee stated that Consumers Union had filed comments in connection with the rulemaking, but much of what he would say at this meeting would go beyond the scope of the rulemaking.

Dr. Borenstein spoke on the subject of service to small communities. He stated the working group's proposal is not to phase out the EAS, but to redirect it and eliminate practices that create obvious inefficiencies, such as subsidies of small airports in reasonable proximity to larger airports, where the benefits of service are not in proportion with the cost of subsidization.

Mr. McGee added at the previous meeting, the subcommittee discussed a process concept modeled on military base closings, where decisions on markets come before Congress for determination. He stated the working group had received feedback from the DOT suggesting the concept was not viable. Dr. Borenstein sought clarification on the impact of such feedback, given earlier statements that the subcommittee should have a free hand in discussing and reporting to the FAAC on controversial topics. Ms. Kurland clarified that there were no limits on what subcommittees can discuss or propose, but suggested that subcommittees be cognizant of ideas that are not practical or that the DOT is unlikely to endorse.

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Mr. McGee stated the working group had discussed the possibility of recommending intermodal solutions with respect to essential air service. He noted that DOT representatives advised him that implementation of such recommendations would fall outside the existing scope of the EAS program's legislative mandate. Ms. Kurland noted that any changes to the EAS program would require legislative action, and indicated that it would be within the subcommittee's purview to present recommendations that would require legislative action.

Ms. Kurland also noted that broader discussions relating to intermodalism were underway. Ms. Baer stated that she wished to create an intermodalism focus area, to present a context for aviation interests to comment on intermodalism. Mr. Tilton asked whether Ms. Baer felt there would be convergence between the EAS discussion and a discussion of intermodalism. Ms. Baer responded that she believed there would and that intermodal options could play a part in redefining criteria for inclusion in EAS. She added that changes in the nation's transportation infrastructure since the creation of the EAS program presented opportunities for different ways to serve communities.

Ms. Friend stated that she fully supported an expansion of intermodalism, but did not support the proposal to freeze eligibility for the EAS program without having a specific plan for what form service to small communities would take in the future.

Ms. Friend also noted that Mr. McGee and Dr. Borenstein apparently had had previous communications with the DOT regarding the EAS program, of which she had not been aware. Mr. McGee clarified that the contact he and Dr. Borenstein had had with the DOT predated the formation of the working groups. Mr. Tilton further clarified that the discussions in question had taken place between the subcommittee and representatives of the DOT present at the August 4, 2010, meeting of the subcommittee. He stated the discussions focused on two basic points: (1) a need for changes to the EAS program has been evident for quite some time, and (2) that change to the program would be difficult because of political implications. Dr. Borenstein added that the program's costs were expected to increase dramatically in the near future. He further observed that the cost of the program was not significant in comparison to overall Federal spending, but was an inefficient use of funds.

Ms. Friend questioned whether freezing the EAS program would address the inefficiencies. Ms. Baer stated freezing the program would mitigate unnecessary expenditures while a permanent strategy is developed. Dr. Borenstein clarified the proposal would not freeze the budget, but would prevent new communities from being added to the program. He suggested if there were any concerns about the prospects for such a long-term solution, the freeze on eligibility could include a sunset provision. Dr. Borenstein also offered examples of communities eligible for EAS that, given the totality of the circumstances, may not warrant assistance.

Ms. Kurland summarized the discussion by stating the EAS program serves an important purpose by ensuring air service to persons situated in remote communities, but an examination of the specific provisions of the program and the possible unintended consequences is worthwhile. Ms. Friend expressed support for such an examination, but stated she could not similarly support

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a freeze in eligibility pending examination. She also expressed interest in hearing proposals about intermodalism and how it might be involved in future EAS initiatives. Ms. Kurland offered to arrange a discussion between Ms. Friend and representatives of the DOT, allowing her to receive the same information that had been presented to other members of the working group and broadening her background on the issues surrounding EAS.

Status of Proposals

Ms. McAhron-Schulz sought clarification on the status of the proposals under development by the subcommittee and working groups. She noted that the proposals would be presented for discussion at the next meeting of the full FAAC the following week, and asked whether the proposals would be subject to further development and evolution before the final meeting. Ms. Kurland stated the DOT's desire that the subcommittees finalize the proposals by the third week in November 2010 so all proposals could be combined for presentation to the full FAAC at its final meeting on December 15, 2010.

Ms. McAhron Schulz asked whether the proposals presented to the FAAC would explicitly state that all proposals were subject to further development and modification. Ms. Kurland and Mr. Tilton confirmed the language would be clear so the proposals remain fluid, and, in most cases, do not yet have the approval of the full subcommittee.

Passenger Protections

Mr. Tilton then invited Mr. McGee to discuss the subject of passenger protections. Mr. McGee began his presentation by noting that two questions remain: (1) whether passenger protection issues are appropriate for discussion by the FAAC, and, if so, (2) whether the Subcommittee on Competitiveness and Viability represents the most appropriate forum. In response to the first question, Mr. McGee noted the fact that he, as a consumer advocate, had been selected to participate in the FAAC indicated an intent on the part of the Secretary of Transportation that consumer protection issues be discussed. He went on to state, out of the topics of the five subcommittees, the only two that arguably encompass consumer-related issues are the Aviation Safety Subcommittee and Subcommittee on Competitiveness and Viability. Mr. McGee acknowledged consumer issues are tenuously related to competitiveness and viability, but pointed out that U.S. air carriers are at a competitive disadvantage with most foreign air carriers with respect to consumer protection issues.

Mr. Tilton agreed that the relationship between companies and their customers relates to competitiveness. He also stated that, if any subject area, otherwise worthy of consideration, does not clearly fall under any of the five subcommittees, there is nothing to prevent the full FAAC from discussing that subject and reaching consensus on a proposal.

Mr. McGee applauded the attention that Secretary LaHood has given to consumer protection issues, and cited the DOT Tarmac Delay Task Force and the pending consumer rulemaking as examples. He urged however that more could be done by DOT and carriers to protect the interest of the traveling public.

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Mr. McGee briefly summarized the highlights of the proposals and recent history on the topic. He noted that the concept of passenger rights did not meaningfully exist until a period of extremely poor customer service in the late 1990s and early 2000s. Mr. McGee stated that Consumers Union met with FAA Administrator Jane Garvey and air carrier industry representatives in 2000 to discuss consumer concerns. He stated that the outcome of that discussion was a commitment by industry to address the issue internally.

Mr. McGee also summarized the European Union's (EU) approach to passenger protection issues. He stated that the provisions of the EU approach are clear, simple, and uniform, making it easy for passengers to understand their rights in the event of a delay, cancellation, or other issue. Mr. McGee stated that this represents a significant difference from the confusing contracts of carriage available to passengers on U.S. air carriers.

Mr. McGee stressed that while the EU approach provides an excellent model to work from, he does not suggest that the United States duplicate it. He stated there certainly is a possibility of improvement on the EU model. Mr. McGee stated that, even from his viewpoint as a consumer advocate, the EU rules may not treat air carriers equitably at times, particularly in cases involving force majeure. He noted an example where significant flight disruptions resulting from the ash cloud emitted by an Icelandic volcano in April 2010 and May 2010 were clearly outside the control of air carriers, but the air carriers still incurred significant liabilities under the EU rules.

Mr. McGee reiterated that the contracts of carriage available to passengers on U.S. air carriers over time have become so lengthy and complex as to be unusable by the majority of passengers. He also stated that during flight disruptions, there is usually a lack of meaningful information provided to passengers about the cause of the disruption, the anticipated duration of the disruption, the anticipated curative action, or the compensation available to passengers. Mr. McGee offered a personal anecdote of a recent experience involving flight disruptions as an illustration. He stated his belief that it is necessary to unify and clarify passenger contracts of carriage, and that this is not addressed in the pending rulemaking.

Mr. McGee also expressed concern over a subtle hierarchy resulting in disparate treatment of passengers, depending on their frequent flyer status or the forum where passengers purchased their tickets.

In the interest of time, Mr. McGee summarized his remaining observations by stating that there is an apparent disconnect between (a) the level of dissatisfaction evident among passengers and b) the air carriers' response. He stated that the primary driver of this dissatisfaction is not the introduction of new ancillary fees, such as checked baggage fees, but rather the lack of transparency and dearth of information available to passengers.

Mr. McGee then presented the recommendation proposal developed by the working group. He stated that a unified passenger bill of rights should involve these components:

- Transparency in pricing—Mr. McGee stated that consumer advocates desire greater transparency in air carrier pricing at the time of purchase, including transparency about

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ancillary fees. He disputed the contention that ancillary fees are only charged for optional services, adopting the position that carriage of checked baggage cannot be categorically deemed optional. Mr. McGee also speculated that if voluntary action is not taken to improve pricing transparency, public dissatisfaction may induce legislative or regulatory action.

- Transparency in flight operations—Mr. McGee advocated clearer disclosure to passengers when flights are operated by code-share partners or commuter operations. He stated that this issue also related to safety, given the disparity in safety records between individual air carriers, and between major air carriers and commuter operations. Mr. McGee added that he would be presenting the same proposal to the Aviation Safety Subcommittee. He also noted that the National Transportation Safety Board would be conducting a forum on this issue shortly after the next meeting of the full FAAC.
- Lengthy flight delays and flight cancellations—Mr. McGee stated the pending rulemaking focuses primarily on compensation due to passengers denied boarding on overbooked flights, and does not adequately address the rights of passengers on delayed or cancelled flights.
- Overhaul of DOT and FAA customer service record-keeping—Mr. McGee offered praise for the monthly air travel consumer reports produced by the DOT. He noted, however, that the number of code-share and commuter operations has increased dramatically, to the point that regional air carriers now represent 50 percent of air carrier departures. Mr. McGee stated that these increases have affected the utility of the DOT reports to consumers, who may not be aware that a ticket purchased from a legacy carrier will actually be operated by a separately reporting regional operator or code-share partner.

Mr. McGee stated that a similar issue exists with FAA safety statistics. He noted that family members of passengers killed in accidents involving regional operators flying on behalf of legacy carriers have taken offense at FAA and DOT statements that there have been no fatal major air carrier accidents in the United States since 2001.

Mr. McGee acknowledged the difficulties in reporting safety or consumer service statistics for regional operators who serve more than one legacy carrier, but urged that reporting of statistics be realigned to reflect operations grouped by branding, rather than by operating certificate.

Mr. McGee then solicited questions from the subcommittee members. Ms. Friend questioned how the proposed provisions would affect the lack of information available to passengers on delayed flights. Mr. McGee stated the proposed recommendations regarding transparency of flight operations and rights of passengers on delayed flights would require air carriers to classify every delay under one of a number of categories, such that passengers have a clear understanding of their rights. Ms. Friend expressed skepticism that such provisions would improve the quality of information provided to passengers at the airport. She further stated that the AFA has declined to support efforts to implement a passenger bill of rights because flight attendants are

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often the focus of passenger dissatisfaction following delays or cancellations, despite the fact that neither they nor, in many cases, customer service representatives at the airport are provided with the information sought by passengers.

Mr. McGee stated that he envisioned rules similar to those covering tarmac delays, requiring certain actions or declarations based on the length of the delay. He stated that a requirement to classify a delay at a specific time would encourage better communication of information within the air carrier. Mr. Tilton added that information technology advances are improving the availability of information on flight delays. He stated that most of the United ground staff are now issued BlackBerry devices, which allow operations and dispatch personnel to keep customer service personnel informed. Ms. Baer commented there are cultural differences between air carriers, and some have demonstrated a greater ability than others to communicate relevant information to passengers.

Mr. Tilton stated that because of technological, procedural, and other improvements, air carrier on-time performance is improving. He noted that the industry has commented on the pending rulemaking, and is not entirely in agreement with Consumers Union regarding the success of the EU consumer rights requirements. Mr. Tilton acknowledged that the DOT's charge to the FAAC makes clear that further improvement of consumer rights is desired, but expressed optimism that things are already moving in the right direction.

Mr. McGee stated that he is sympathetic to the difficulties encountered by air carriers in operating to a schedule, and stated he had drawn criticism for speaking out against tarmac delay regulations in the past. Mr. McGee added his view that the industry has failed to make the necessary efforts to improve.

Mr. McKenzie agreed with the need for air carriers to better address customer concerns, and referred to a statement by Mr. Doug Parker, Chairman and Chief Executive Officer of the US Airways Group, that nothing is more expensive for an air carrier than running a bad operation. He noted that US Airways and United have demonstrated turnarounds from very poor customer service records and have become profitable in the process.

Mr. McGee observed that air carriers are faced every day with irregularities, unforeseen events, or circumstances beyond their control. He expressed his opinion that the determinant of success is not in the events themselves but how air carriers respond to them. Mr. Tilton agreed, and noted air carriers could serve their own interests and those of passengers by being proactive in advance of anticipated events such as adverse weather.

Ms. Baer reiterated that technology offers potential solutions to many of the consumer issues, not only because of greater communication within air carrier organizations, but because passengers increasingly have better access to information because of resources such as online check-in.

Following Mr. McGee's presentation, the subcommittee adjourned for lunch, and reconvened at 12:45 p.m.

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Administrative Matters

Following lunch, Mr. Tilton addressed several administrative matters. He clarified to the subcommittee members that, although the subcommittee's recommendation proposals would be going forward to the full FAAC meeting the following week, the proposals were not final, and the members would have a further opportunity to comment. He also advised that Ms. Baer would act as subcommittee chair in his stead, and report out to the FAAC.

Mr. Tilton stated the subcommittee's briefing to the full FAAC would clearly indicate that there is disagreement among the subcommittee members, to varying extents, in each of the subject areas. He noted that the report out to the full FAAC would serve the dual purpose of advising it of the concepts under consideration, and of possibly obtaining feedback and input from the committee members not on the subcommittee.

Dr. Borenstein questioned whether concepts under discussion by the subcommittee, but lacking any significant member support, should be presented to the full FAAC. Mr. Tilton suggested the subcommittee should perhaps only report at a high level on the topics of discussion and spectrum of viewpoints, without articulating specific recommendation proposals. He stated that it would be useful to obtain the input of the full FAAC. Mr. Tilton also noted there might be some areas where the subcommittee's discussions overlap with those of other subcommittees, and that it would be helpful to clarify which subcommittee would address them.

Effects of Taxation

Mr. Tilton turned the meeting over to Mr. McKenzie to discuss the impact of taxation on the aviation industry, and jet fuel price volatility.

Mr. McKenzie commented that the air carrier industry has been candid regarding the amount of taxes imposed on airfares. He added that the low profit margins of the air carrier industry amplify the significance of incremental costs, including taxes.

Mr. McKenzie shared that, since the subcommittee began its discussion of taxation, he had reversed his position. He noted the subcommittee's mandate was to examine ways to make the aviation industry more competitive, while ensuring it remained financially viable.

Mr. McKenzie suggested that any freeze or reduction of taxes would be beneficial both to consumers, in that net fares would be lower, and to the industry. He contended that price competition prevents air carriers from passing on the entirety of airfare taxes to consumers, meaning that any new or increased tax results in higher costs for air carriers to the extent that they are unable to pass on the tax.

Mr. McKenzie stated his view that pricing in the air carrier industry bears little relation to cost, and is largely a function of the surplus of capacity in a given market. Mr. McKenzie argued that historically higher taxes have not been passed on and have instead been absorbed by the airlines.

Mr. McKenzie presented three possible recommendation proposals—

- Freeze taxes at their current rates —Mr. McKenzie stated the industry has adjusted to current airfare taxation, and the first proposal would freeze taxation.

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- Endorse a determination that ancillary fees are not subject to the 7.5 percent ticket tax—Mr. McKenzie stated that profits for many air carriers are currently dependent on ancillary revenues, and that taxing such revenues would impact their economic viability.
- Allocate the cost of aviation security as a national defense function benefitting the entire nation—Mr. McKenzie stated that the bulk of aviation security requirements today can be traced back to the terrorist attacks of September 11, 2001. He stated that those attacks have been deemed an act of war, and that security efforts aimed at protecting the American people as a whole should be borne by the general fund, rather than by imposition of specific ticket taxes.

Mr. McKenzie invited questions and comment on the proposals. Dr. Borenstein stated a concern that Mr. McKenzie's statements lacked a factual basis. He noted he had conducted a study of the result of changes in taxes, and had concluded that air carriers are able to pass taxes through to consumers. He asked whether Mr. McKenzie had any analysis to support his position.

Mr. McKenzie responded the air carrier industry has lost \$36 billion in the past 10 years. He added that if taxes could be passed on to consumers, when taxes are raised across the industry, the expectation is that fares would rise correspondingly. Mr. McKenzie stated this has not occurred. Dr. Borenstein countered there are too many variables to attribute resultant fare prices to the single input of an across-the-board increase in taxation. He reiterated among airfare taxes, only PFC increases are not nationwide, and can be isolated to specific markets permitting meaningful analysis. Dr. Borenstein stated that analysis of PFC increases leads to the conclusion that taxes can be passed through to consumers.

Mr. Tilton requested the subcommittee members to remain respectful of each other. He also stated his view that Dr. Borenstein's study was not entirely persuasive, in part because he himself had qualified his remarks by noting that he did not have sufficient resources to update his data. Dr. Borenstein noted the data used in his study of PFCs was valid through 2009.

Mr. Tilton stated that, if there are honest disputes regarding the validity of data or analysis, the subcommittee may recommend that DOT conduct a study to determine whether the impact of taxation is an issue of concern relative to its charge to the FAAC.

Ms. Baer agreed with Mr. Tilton's suggestion. She also expressed reservations with an outright moratorium on tax increases. Ms. Baer noted that such an action could have unintended consequences, and, once imposed, might be difficult to modify or reverse. She also counseled caution in advocating a transfer of responsibility for aviation security funding to the general fund. Ms. Baer stated aviation security would become subject to competition from other transportation modes, which could result in lower funding. She concluded by suggesting that the complete picture of taxation on the air carrier industry be framed in the context of the distinction between taxes and user fees, drawn by Professor Kenneth Button, George Mason University, at the previous meeting of the subcommittee, and presented to the DOT for further study.

Mr. McKenzie conceded that he had not conducted the tax analysis that Dr. Borenstein had, but noted some of the markets cited as examples by Dr. Borenstein were not ideal subjects for study,

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in that they were subject to extraordinary competitive activity by carriers wishing to maintain dominance. He stated Delta Air Lines, in an effort to protect markets between Atlanta, Georgia, and many destinations, would engage in extremely competitive pricing by adding a tremendous amount of capacity in its competitors' markets in order to drive out competition, namely AirTran. Naturally, after a competitor is driven out of a market or is forced to downsize from the resulting losses, an airline, Delta in this case, is in a position to raise fares and subsequently pass along higher costs from increased taxes. In fact, AirTran has been downsizing at Atlanta over the past couple of years. So it thus becomes problematic to extrapolate nationally from one or even a few market examples.

Ms. Baer and Ms. McAhron-Schulz returned to the suggestion that the issue be couched as a recommendation for further study. Mr. Tilton agreed, stating that the differing positions, including Dr. Borenstein's analysis, could be included in a recommendation that the DOT conduct further study.

Mr. McGee agreed with Ms. Baer that a distinction should be drawn between true taxes and user fees. He stated, from a consumer prospective, that the use to which fees or taxes are devoted is of interest. Mr. McKenzie offered, from an analytical perspective, that whether a charge is classified as a fee or a tax is immaterial. Mr. McGee countered that, from a consumer perspective, the difference could be significant. Ms. Baer added that the actual allocation and application of funds collected as a user fee or tax, and their relationship to the stated purpose, is of significant interest to the industry, as well as passengers.

Mr. Tilton stated that transparency in imposition and application of incremental taxes and fees is desirable. He stated a view that there is currently a lack of knowledge of the taxes and fees imposed on a given flight segment by various taxing authorities, and that if a single entity, such as the DOT, was mindful of their aggregate effect, the situation might be improved. Mr. Tilton noted that taxation which results in restricting traffic also restricts the contribution of aviation to the collateral gross domestic product in that market, which ultimately reduces revenues to the community.

Ms. Friend raised the question of whether the subcommittee's discussion is affected by the debate regarding reauthorization of the FAA's budget. Ms. Baer and Mr. McKenzie responded that while some true user fees were involved in that debate, taxes and passenger fees of the type under discussion were not.

Dr. Borenstein asked whether the outcome of the subcommittee's discussion would be to abandon the three proposed options presented by Mr. McKenzie and instead propose a study by the DOT. Mr. Tilton stated that if there is no agreement on the data, it would be nonsensical to present specific proposals based on that data. However, he suggested that some acknowledgement be given to the possible chilling effect on the air carrier industry if tax increases continue unabated and without a justifying rationale.

Mr. Tilton asked the working group to revise its briefing on taxation to reflect the decision reached. Dr. Borenstein asked what the timeframe of the revisions would be. Mr. Tilton expressed optimism that appropriate language could be prepared before the full FAAC meeting

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the following week, but noted that preparation of a final recommendation proposal for delivery in November 2010 would require communication and effort in the interim.

Jet Fuel Price Volatility

Mr. McKenzie then turned to the subject of jet fuel price volatility. Mr. McKenzie prefaced his discussion of the working group's proposals by stating that it is common for Federal agencies to comment on other agencies' proposed rulemaking. He stated the U.S. Department of Treasury and the U.S. Department of Commerce, as well as the U.S. Securities and Exchange Commission, had commented on rules proposed by the U.S. Commodities Futures Trading Commission (CFTC). Mr. McKenzie stated he was aware CFTC Chairman Gary Gensler would welcome input from the DOT on a number of proposals. He also noted that Secretary LaHood has a history of actively working with the CFTC.

Mr. McKenzie laid out the five proposals developed by the working group. The first was for the DOT to liaise with the CFTC with respect to aspects of rulemaking under Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, such as financial soundness, clearinghouse requirements, transparency of trading of custom-made derivative products, and scrutiny of petroleum trading on foreign exchanges. Mr. McKenzie noted the air carrier industry generally, and the ATA specifically, are already in consultation with the CFTC on this issue, and the involvement of the DOT would be consistent with those efforts. Ms. Kurland stated the DOT had filed a letter in support of the most recent relevant CFTC rulemaking.

Mr. McKenzie explained that the second proposal was for the DOT to assume a lead role in conveying to the CFTC and other federal agencies the adverse impact that aviation and other transportation fuel price volatility has on the economy and transportation industries. He noted the CFTC's understanding that fuel costs represent 30 percent of the air carrier industries costs is critical.

Mr. McKenzie noted that the third proposal was to ensure, through regulatory action if necessary, vigorous competition within the jet fuel supply chain at the nation's airports, and consider permitting use of FAA discretionary grant funds for on-airport and off-airport jet fuel infrastructure development to help bolster the nation's jet fuel supply capacity. He noted these proposals do not fall within the purview of the CFTC.

The fourth proposal was for the DOT to advocate for the expansion of the strategic petroleum reserve (SPR) program to include jet fuel, and for the DOT, the U.S. Department of Energy, and aviation stakeholders to develop a policy for the drawdown of jet fuel reserves when faced with circumstances that may influence the availability of jet fuel.

Mr. McKenzie stated that the fifth proposal was for the DOT to request the CFTC to impose position limitations on institutional investors capable of holding positions large enough to distort jet fuel prices. He added that he had communicated with CFTC Commissioner Bart Chilton to validate the theory that the majority of excessive speculation in the oil commodities market is not by hedge fund managers, but by large institutional investors employing indexing strategies.

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Mr. McKenzie stated Mr. Chilton agreed and that such investors had invested over \$200 billion in index funds over the last few years.

Mr. McKenzie stated that Pub. L. 111-203 requires the CFTC to issue proposed rulemakings within 30 categories, which may require up to 60 individual rulemakings, within 1 year of passage of the Pub. L. 111-203. He stated that the next proposed rulemaking will be published in November 2010, with an implementation date in January 2011. Mr. McKenzie added that the rulemakings present a timely opportunity for the Secretary of Transportation to have a meaningful impact on the process.

Mr. McKenzie solicited questions and comments from the subcommittee. Ms. McAhron-Schulz asked for a clarification of the intent of the fifth recommendation. Mr. McKenzie stated the primary concern of the air carrier industry with respect to jet fuel pricing is not high price levels, but price volatility. Dr. Borenstein questioned that statement. Mr. McKenzie replied while high jet fuel prices impose difficulties in the short term, in the long term, air carriers can adapt to high fuel prices, through capacity reductions, more readily than they can adapt to volatility. Mr. Tilton pointed out that capacity reductions due to higher prices would ultimately lead to a slowing of economic growth, reducing overall demand for petroleum. He stated that petroleum suppliers therefore have a disincentive to impose long-term price increases.

Mr. McKenzie noted there is sincere and vigorous debate on the factors driving jet fuel price volatility. He stated this makes it extremely important the issue be aired, with a proposed recommendation to determine the true causes of volatility.

Dr. Borenstein stated that the working group's proposals contained a number of factual conclusions that were subject to debate, and asked whether they could be rewritten to pose neutral questions. Mr. McKenzie indicated that he had no objection to such an approach. Dr. Borenstein suggested that the proposal be revised to recommend that the DOT participate in a CFTC investigation of whether speculative investment activities are the cause of excessive oil prices. Ms. Friend suggested that the proposal include conditional recommendations, only applicable if an investigation results in a conclusion that such activities significantly contribute to price levels. Ms. Kurland cautioned against being overly prescriptive as to actions to be undertaken by the Secretary of Transportation, and suggested that proposals include general recommendations. Ms. Baer suggested that the proposal include a recommendation that the Secretary participate in an investigation, and, based on the results of that investigation, advocate on behalf of the interests of the industry. Ms. Friend noted that the proposal could include examples of the type of actions the Secretary might take, without recommending them.

Mr. Tilton discussed the viewpoint that opacity and excessive manipulation in commodities trading markets resulted in an inequitable transfer of wealth from industry and consumer stakeholders to traders and, ultimately, suppliers of petroleum. He noted that CFTC Chairman Gensler has endorsed such a viewpoint, and that interaction between the DOT and the CFTC would be in the context of this viewpoint.

Dr. Borenstein expressed some reservations regarding the discussion. He expressed the opinion that the transfer of wealth resulting from petroleum trading activity in recent years was to

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suppliers, with traders only receiving a slim fraction of the amount involved. Dr. Borenstein agreed that there are valid public policy reasons to seek to lower fuel prices, but stated he did not believe the proposed actions would be effective at controlling price levels or volatility because he disagreed with the underlying assumption that speculative activity was the cause of volatility and price increases. Mr. McKenzie noted there are differing opinions on the validity of that assumption. Mr. Tilton suggested, rather than state the assumption, the proposal only include a recommendation that the Secretary of Transportation interact with the CFTC.

Dr. Borenstein also noted the assumption does not lead logically to the third and fourth proposals, regarding the jet fuel supply infrastructure and the SPR. He stated there has been no previous discussion of those proposals and questioned their inclusion in the overall proposal.

Mr. Tilton stated that manipulation of the SPR, or, in some cases, even the potential for such manipulation, in the past has reduced volatility in petroleum markets. He stated that the proposed inclusion of jet fuel in the SPR might similarly reduce volatility in the jet fuel market. Dr. Borenstein stated any impact would be on the margin between crude oil and jet fuel, and added he was unaware of any concerns regarding volatility in the crack spread on jet fuel, and therefore questioned the usefulness of the proposal.

Mr. Tilton stated that because jet fuel represents the smallest physical supply of any crude oil derivative, there is a tendency to amplify its volatility. He also stated that in past years, there was a view that distillate heating oil is a suitable proxy for jet fuel. Mr. Tilton said this viewpoint is flawed because the delivery infrastructure for jet fuel is alarmingly antiquated. He added that infrastructure limitations preclude availability of sufficient volume to dampen volatility. Mr. Tilton noted the archaic nature of the infrastructure and the lack of alternative methods of delivery make certain geographic areas vulnerable to significant disruption.

Dr. Borenstein requested that he be permitted to write the revised proposal in a simplified fashion. Ms. Friend expressed reluctance to abandon the work to date without presenting it to the full FAAC for discussion. Mr. Jack Pelton, Cessna, was in favor of a simplified recommendation, because he viewed the existing proposal as air carrier-centric. He recommended the proposal encompass all aviation fuels, and not solely jet fuel. Mr. Tilton suggested that Dr. Borenstein prepare draft language aimed at encouraging engagement between the Secretary of Transportation and the CFTC, and present it to the subcommittee for comment and revision before the full FAAC meeting.

Dr. Borenstein continued to express apprehension regarding the inclusion of the third and fourth proposals. Mr. Tilton suggested they could be incorporated into infrastructure recommendations, rather than recommendations regarding jet fuel price volatility. Dr. Borenstein expressed reservations regarding a recommendation to modify the SPR. He indicated more willingness to endorse a proposal regarding the jet fuel delivery infrastructure, but noted a desire to see some substantiation of Mr. McKenzie's and Mr. Tilton's assessment of the infrastructure as lacking. Mr. Tilton suggested this concern could be overcome by phrasing the proposal to recommend that the DOT "ensure" the adequacy of the fuel delivery infrastructure is sound.

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Ms. Friend raised the question of whether individual members of a subcommittee could voice dissenting or differentiated views from those presented by the subcommittee. Ms. Kurland stated, in general, subcommittee members, like any member of the FAAC, could offer differing opinions at the full FAAC meeting.

Mr. Homan noted premeeting materials were already being distributed to FAAC members, and Ms. Pam Hamilton, DFO for the full FAAC, Director of the FAA Office of Rulemaking, intends to distribute supplemental materials, including the subcommittee's proposals, on Monday, October 18, 2010. Mr. Tilton suggested that Dr. Borenstein could circulate his draft of the jet fuel price volatility proposal for comment over the weekend so a meeting-ready version could be distributed at the October 18, 2010, meeting. Ms. Kurland and Ms. Baer reiterated that it would be made clear at the meeting that all proposals presented by the subcommittee were to be viewed as works in progress, subject to modification based on further discussion by the subcommittee.

Dr. Borenstein stated his draft language would be roughly as follows:

“There is some concern that excessive volatility in the oil industry is caused by traders. This is a point of disagreement among economists and among members of the Subcommittee on Competitiveness and Viability. The DOT should work with the CFTC to help ascertain whether this is true or not. If they find that it is, the DOT should advocate for appropriate regulatory actions to restrain the behavior causing volatility.”

Dr. Borenstein agreed to circulate the language in written form following the meeting.

Ms. Baer noted that language regarding the jet fuel delivery infrastructure would also be necessary. Mr. McGee noted concerns regarding infrastructure relevant to the aviation industry are not limited to the jet fuel delivery infrastructure, and asked whether the subcommittee's proposal should be broadened.

Mr. McGee also observed that the Subcommittee on Financing might also be addressing this issue. He noted that most proposals by this subcommittee involve NextGen. Mr. Pelton stated that the subcommittee would propose a recommendation to expand the use of airport improvement program and PFC fees, and that this proposal would include funding of infrastructure improvements not limited to NextGen initiatives. Ms. Friend asked whether specific discussion of the fuel delivery infrastructure could be added to the proposal. Mr. Pelton stated this could be discussed at the full FAAC meeting.

Ms. Kurland stated that overlap between subcommittees' proposed recommendations could be resolved after the full FAAC meeting, but before the submission of final proposals on November 22, 2010.

Mr. Tilton suggested, even if another subcommittee would be addressing the subject, the Subcommittee on Competitiveness and Viability should address it at the upcoming meeting of the full FAAC as relevant to price volatility and availability volatility. He stated, despite the fact the topic had not been the subject of earlier discussion by the subcommittee, it was an important

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issue, and one that could form the basis of a clear, actionable recommendation for action by the DOT.

In response to a comment that a recommendation regarding the fuel delivery infrastructure could form a basis for economic stimulus funding, Ms. Kurland noted that aviation generally has a good track record using of such funding. Dr. Borenstein raised the question of whether jet fuel delivery pipelines are subject to oversight by the Federal Energy Regulatory Commission. He stated such an authority could be a good source of information regarding the scope of the issue.

Global Competitiveness Working Group

Mr. Tilton then turned the discussion to the proposal developed by the Global Competitiveness Working Group. He forewent review of the problem/challenge segment of the proposal, noting that it is not of particular significance, and moved immediately to discussion of the specific proposal points.

Mr. Tilton noted that the first and second bullet points in the proposals refer to the 1995 statutory obligations of the DOT. He stated those points propose recommendations to focus on existing responsibilities given the importance of the industry to the economic well-being of the nation.

Ms. Baer suggested the proposal also speak to the issue of competition for access to airports and airport facilities. Mr. Tilton stated that, to the extent that there is relevant statutory language, it could be likewise incorporated.

Dr. Borenstein questioned whether all of the proposal points represent existing statutory mandates. Mr. Tilton stated the first four bulleted proposals essentially represent a continuation of existing policy. Dr. Borenstein expressed reservations regarding the fourth bullet point, which proposes recommending the DOT “[p]romote efficient consolidation of the domestic aviation market if the proposed transaction will strengthen the viability and competitiveness of the air carrier and enhance the benefits and job security of the air carriers’ employees.” He stated that while he looked favorably on efficient consolidation, he did not view all consolidation as efficient. Dr. Borenstein requested that the bullet point be deleted.

Mr. Tilton noted that, at the request of ALPA, the proposal also calls for a level playing field for employees, as well as organizations. Mr. McGee suggested that the proposal contemplate the amount of air carrier work that has been outsourced in recent years. He asked whether item (4) under the second bullet point, which speaks to “encouraging fair wages and working conditions,” applies to organizations performing work for air carriers. Mr. Tilton confirmed that it does.

Ms. McAhron-Schulz noted that ALPA and AFA fully support air carrier participation in alliances, but wish to ensure that U.S. air carriers and workers retain a fair share of actual flight operations under alliances. She stated that the protections contemplated would apply to immunized alliances and joint ventures. Ms. McAhron-Schulz expressed concern that air carriers can now enter into an alliance or joint venture whereby the air carriers can share revenues and/or profits, but all of the flying is performed by one air carrier. She noted this has already occurred in some cases.

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Mr. McKenzie stated that ALPA's concern was largely moot, as U.S. air carriers have lower operating costs than many foreign carriers. Ms. McAhron-Schulz noted this dynamic may change in the future with respect to, for example, European air carriers, and that air carriers from, for example, China, already have lower costs than U.S. air carriers.

Dr. Borenstein cited ALPA's and AFA's concerns as an argument against permitting alliances. He stated alliances grant air carriers greater marketing power by allowing further bundling of services than a single air carrier can offer, while offering none of the efficiencies of larger organizations. In response to an observation that this is contrary to a free market philosophy, Dr. Borenstein stated he endorses a policy of optimal intervention, which acknowledges that free markets are imperfect, and balances mitigating regulation against powerful market incentives. He added for these reasons, he disagreed with the inclusion of the first bulleted proposal, which calls for the DOT to foster global alliances.

Ms. Kurland stated that the issues raised by Dr. Borenstein and by the bulleted proposal arise frequently in applications for antitrust immunity, and the DOT is familiar with them. With respect to ALPA's proposed language, Ms. Kurland stated that in the past, the DOT has determined that such issues are most appropriately addressed in the collective bargaining process. Ms. McAhron-Schulz posited that the issue transcends collective bargaining.

Mr. McGee stated that it would be virtually impossible to reach unanimous agreement on any issue, and suggested the subcommittee's proposals reflect the consensus, but note the concerns or differing opinions voiced by other members of the subcommittee. He also noted such concerns could be voiced in the forum of the full FAAC, even if not included in the subcommittee's proposals. Mr. Tilton expressed agreement, and noted that the language proposed by ALPA, in fact, notes a caveat held by "some members." Ms. Kurland stated that, similarly, the final report presented by the FAAC to the Secretary of Transportation will likely include consensus recommendations, but will also note dissenting viewpoints and caveats reserved by minority positions. Ms. Friend added, in some cases, the subcommittees may describe an issue identified by a subcommittee to be important, but offer no resulting recommendation because no consensus can be reached in the subcommittee.

Ms. Baer suggested that any subcommittee member wishing to note a dissent or caveat be required to substantiate his or her disagreement with a rationale, rather than simply note the dissent. Mr. Tilton also stated dissents and caveats should be used to reference incremental differences in the viewpoints of individual subcommittee members with respect to consensus recommendations, not outright ideological divides.

Dr. Borenstein expressed concern that the language of the problem/challenge section of the working group's proposal reflects an industry bias. Mr. Tilton offered Dr. Borenstein full editorial license in rewriting the section. Dr. Borenstein also continued to express reservations with the first and fourth bulleted proposals. Mr. Tilton stated the language of those proposals was, for the most part, excerpted from the DOT's statutory mandate. Dr. Borenstein pointed out that the first bulleted proposal references the statute selectively, and specifically disavows certain provisions of the statutory mandate.

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Mr. Tilton then turned the meeting over to Ms. Baer for a discussion of her desire to make intermodalism a separate focus area. Ms. Baer stated she had begun to prepare a proposal on intermodalism. She added it was not ready for circulation, and suggested the subcommittee only inform the full FAAC that work is underway.

Ms. Baer stated she does not envision the proposal will be prescriptive. She added it would instead reflect the industry's willingness to participate in intermodal initiatives that are dominated by high speed rail, and may offer opportunities to optimize use of limited-capacity facilities. Ms. Baer also suggested it may endorse existing recommendations that the DOT develop a cohesive intermodalism policy.

Ms. Friend suggested that the intermodalism proposal be offered in conjunction with the EAS proposal, because it represents a potential partial replacement for EAS. Ms. Baer noted intermodalism could support a standalone proposal, in that it speaks directly to competitiveness issues for both airports and air carriers. Mr. McGee noted he would like to participate in the development of the proposal.

CLOSING REMARKS

Mr. Tilton stated a need to have documents reflecting the subcommittee's draft proposals ready for distribution to the FAAC members by Monday, October 18, 2010, for discussion at the October 20, 2010 meeting in Los Angeles, California. He asked that the working group chairs provide revised proposals to Mr. Chris Brown, United, who would, in turn, coordinate with Mr. Homan to ensure that language is timely distributed.

ADJOURNMENT

Mr. Homan solicited a motion for adjournment. On motion, duly seconded and approved by the majority of the FAAC members present, the meeting was adjourned.

The meeting adjourned at 2:25 p.m.

I hereby certify that, to the best of my knowledge, the foregoing minutes are accurate and complete.

Approved by: 
Todd M. Homan, Designated Federal Official

Dated: December 14, 2010