ORDER 2007-6-8

UNITED STATES OF AMERICA
DEPARTMENT OF TRANSPORTATION
OFFICE OF THE SECRETARY
WASHINGTON, D.C.

Issued by the Department of Transportation
on the 15th day of June, 2007

ALASKA AIRLINES, INC., ET AL.,	:	
v.	:	DOCKET NO. OST-2007-27331
LOS ANGELES WORLD AIRPORTS, ET AL.	:	

FINAL DECISION

Table of Contents

Summary

A. STATUTORY AND REGULATORY BACKGROUND. 7

B. ORIGINS OF THIS CASE. 10

1. The Fee Increases. 10

2. The Complaints and LAWA's Response. 12

3. The Instituting Order. 15

4. The Administrative Law Judge's Recommended Decision. 17

C. THE CHALLENGED FEE ELEMENTS. 19

1. New and Increased Maintenance and Operations Costs. 19

2. Rentable Space Methodology. 23

3. Market Value Methodology. 26

D. THE DEPARTMENT'S DECISION. 31

1. The Burden of Proof. 31

2. T1/T3 Carriers' Motion for Reconsideration of Instituting Order. 31

3. LAWA's Motion to Dismiss Based on Written Agreement. 32

4. Credibility of Witnesses and LAWA's Financial Data. 37

5. New and Increased Maintenance and Operations Costs. 47

6. Rentable Space Methodology. 50

7. Market Value Methodology. 53

8. Other Issues:

a. Airlines Making Similar Use of the Airport. 58

b. LAWA's Monopoly Power and Surplus 66

c. Appendix A to Recommended Decision. 66

d. Other Matters Outside the Scope of Instituting Order. 67

9. Calculation of the Refund Amount. 67

FINAL DECISION

Summary

The Department of Transportation, pursuant to 49 U.S.C. § 47129(c)(2) [hereinafter "§ 47129"], determined that a February 16, 2007, complaint filed by seven domestic airlines (collectively the "T1/T3 Carriers") against the Los Angeles World Airports[1] ("LAWA" or "Respondents") challenging increased fees charged at Los Angeles International Airport ("LAX"), presented a significant dispute over the reasonableness of increased airport terminal fees. The T1/T3 Carriers are: Alaska Airlines, Inc., AirTran Airways, Inc., ATA Airlines, Inc, Frontier Airlines, Inc., Midwest Airlines, Inc, Southwest Airlines Co., and US Airways Group, Inc.[2] The Recommended Decision ("RD") of the Administrative Law Judge ("ALJ") found against LAWA and in favor of the complaining carriers on most issues raised, including that the new and increased fees were unreasonable and unjustly discriminatory. The ALJ recommended that the Department order refunds to the complaining carriers for the disputed fees paid. This Final Decision finds that: (1) the new and increased maintenance and operations ("M&O") charges are reasonable; (2) the rentable space methodology is reasonable as imposed by LAWA on T1 but unreasonable as imposed on T3 (due to an improper application of the market value methodology); (3) LAWA's imposition of the rentable space methodology on the T1/T3 Carriers is unjustly discriminatory; (4) the market value methodology is reasonable, but not as applied by LAWA; and (5) the T1/T3 Carriers' claims are not barred by the "written agreement" exclusion found in § 47129(e)(1).

The Complaints and Instituting Order: The complaint by the T1/T3 Carriers charged that LAWA, which – through the Los Angeles Board of Airport Commissioners ("BOAC" or "Board") is responsible for establishing the fees in dispute at LAX – violated the DOT Policy Regarding Airport Rates and Charges, 61 Fed. Reg. 31994, June 21, 1996 ("DOT Policy Statement"), because LAWA has improperly imposed new, increased fees at terminals 1 and 3. The new fees include higher M&O charges and higher terminal rental fees that were being imposed for previously excluded square footage. The T1/T3 Carriers claim that these new fees are unreasonable and unjustly discriminatory.

The new M&O fees replace a prior uniform 15 percent M&O surcharge, and include new charges to cover previously unallocated airport administrative costs, roadway access costs, and airport security costs. The T1/T3 Carriers' alleged that LAWA calculated the M&O fee with a new methodology that is unjustly discriminatory vis-à-vis airlines operating at the other LAX terminals and is unreasonable because it generates excessive revenues for the airport. They have the same concern with the higher rental fees under which LAWA is replacing its current "usable" space methodology (under which the

[1] In addition to LAWA, other named Respondents include the airport's owner, the City of Los Angeles, California, and the Board of Airport Commissioners, discussed infra.

[2] Southwest Airlines and US Airways operate out of terminal 1. Alaska Airlines, AirTran Airways, ATA Airlines, Frontier Airlines, and Midwest Express operate out of terminal 3, in addition to five other carriers who have not joined in the T1/T3 Complaint. See Instituting Order at 1.

airlines compensate the airport solely for the space they occupy) with a "rentable" space methodology, whereby the airlines are charged not only for their occupied space but also for their allocable portion of public-use space (such as corridors). The new rentable space formula applies not only to the terminal rentals but also to the M&O charges.

The T3 Carriers' have an additional claim concerning LAWA's imposition of the market value method to determine the base rent portion of terminal charges.[3] They say it is unreasonable because it is not cost-based. They also argue that it was imposed based on LAWA's subjective opinion of what constitutes "market value" rather than pursuant to an agreed-to market value. The new terminal M&O fees, which were established using the new methodologies and cost components, went into effect February 1, 2007, in the form of a tariff because the T1/T3 Carriers refused to enter into LAWA's proposed five-year Airline Terminal Space Lease and License Agreement. T1/T3 Complaint, at 10. LAWA made the new and increased fees retroactive (excluding use of the rentable space and market value methodologies) to January 1, 2006.

The T1/T3 Carriers generally alleged that the new terminal charges are significantly higher and therefore unreasonable, unjustly discriminatory, and employ a new methodology that is both unreasonable and unjustly discriminatory in its application vis-à-vis the long-term leaseholders at LAX occupying terminals 2 and 4-8, which are generally paying lower fees under long-term leases with LAWA that began in 1981, or earlier, and will not expire until 2023. These complainants also claim that the increased fees are being imposed to fund unidentified future projects, which is impermissible.

In addition, on February 23, twenty-two airlines filed a follow-on complaint. These carriers operate out of the Tom Bradley International Terminal ("TBIT") at LAX and are all foreign air carriers. They will be collectively referred to in this decision as the "TBIT Carriers".[4] The TBIT Carriers generally allege that LAWA has dramatically increased their terminal M&O costs, which they claim is unreasonable and unjustly discriminatory vis-à-vis the carriers at LAX with long-term leases and that LAWA is improperly raising the fees to fund unidentified future projects, rather than only seeking to recoup its operating costs.

Several parties filed petitions to intervene, which the Department granted. The two trade association Intervenors are: Airports Council International – North America ("ACI-NA")

---

[3] At the time the complaint was filed, only T3 Carriers challenged the market value method as it did not apply to the T1 Carriers. As explained in greater detail, infra, during the hearing before the ALJ, LAWA corrected the base rent calculation for T1 and then applied the market method to them as well. Tr. 727-730 (Rosenthal).

[4] The TBIT Carriers are: Aer Lingus Group, PLC, Air Pacific, Air Tahiti Nui, All Nippon Airways Co., Ltd., Asiana Airlines, Inc., British Airways, Plc., Cathay Pacific Airways Limited, China Airlines, Ltd., China Eastern Airlines, Compania Mexicana De Aviacion, S.A. de C.V., Deutsche-Lufthansa AG, El Al Israel Airlines Ltd., Eva Airways Corp., Japan Airlines Corporation, Korean Air Lines Co., Ltd., LAN Airlines S.A., Philippine Airlines, Inc., Qantas Airways Limited, Singapore Airlines Limited, Swiss International Air Lines Ltd., and Thai Airways International Public Co., Ltd. China Southern Airlines Company Limited subsequently withdrew from this proceeding, so that at the time of this Final Decision, there are 21 TBIT Carriers.

and the Air Transport Association of America, Inc. ("ATA"). In addition, the airline tenants at LAX with long-term leases were also granted leave to intervene: American Airlines, Inc., Continental Airlines, Inc., Delta Air Lines, Inc., Northwest Airlines, Inc., and United Air Lines, Inc., which are collectively referred to as the "T2/4-8 Carriers" because they use terminals 2 and 4-8.

In an Instituting Order issued on March 16, 2007, pursuant to the requirements of § 47129, the Department concluded that the facts alleged met the criteria for a significant dispute, e.g., size of the airport (the nation's third largest serving the nation's second largest metropolitan area), amount in dispute (alleged to be up to $55 million for the first year alone), relative size of the increased fees (alleged to be up to 100% percent more), questions regarding new fee methodologies (new "M&O charges, change from "useable" to "rentable/commercial compensatory" methodology for both M&O and base rent), and the number of carriers complaining about the increased fees (more than 30 including the Intervenors, discussed infra). See Instituting Order at 19-21. The Department assigned the matter for a hearing before an ALJ and specifically defined the scope of the issues to be investigated, as set forth more fully infra.

ALJ Recommended Decision: The ALJ assigned to this case, Richard C. Goodwin, convened a hearing on March 26, continuing through April 20, with sixteen days of hearings, and issued a Recommended Decision on May 15. The ALJ determined that the new and increased terminal charges at terminals 1, 3 and TBIT are unreasonable and unjustly discriminate against the complainants. The ALJ further found that LAWA is not justified in imposing a "rentable space" methodology on the T1/T3 Carriers when the airport is retaining the "useable space" methodology for the T2/4-8 Carriers. Thus, he found the imposition of the "rentable space" methodology to be unreasonable and unjustly discriminatory as applied against the T1/T3 Carriers. As to the airport's use of the "market value" methodology on the T3 Carriers,[5] the ALJ found LAWA's application of the methodology to set a component of terminal rent to be unreasonable for T3. The ALJ determined that LAWA's new M&O methodology imposed on the T1/T3 and TBIT Carriers to be unreasonable, unjustified, and unjustly discriminatory. RD at 9.

Department's Final Decision: On review of his Recommended Decision, the Department has determined that: (1) the new and increased maintenance and operations ("M&O") charges are reasonable; (2) the rentable space methodology is reasonable as imposed by LAWA on T1 but unreasonable as imposed on T3 (due to an improper application of the market value methodology); (3) LAWA's imposition of the rentable space methodology on the T1/T3 Carriers is unjustly discriminatory; (4) the market value methodology is reasonable, but not as applied by LAWA; (5) the T1/T3 Carriers' claims are not barred by the "written agreement" exclusion found in § 47129(e)(1); and (6) the TBIT Carriers' claims are barred as described below.

---

[5] During the hearing LAWA expanded its use of the "market method" to include the T1 Carriers. Tr. 727-730 (Rosenthal). The reasonableness of the market method to the T1 Carriers, however, is outside the scope of this proceeding.

A supplemental proceeding within the next thirty (30) days will be used to determine the appropriate amount of refunds due to the complainants. The Department has determined that the complainants failed to meet their burden of proof to show that LAWA's fees are unreasonable with respect to all other issues raised. The Department has further determined that the T1/T3 Carriers are due a refund and interest for certain amounts set forth more fully below.

A. STATUTORY AND REGULATORY BACKGROUND

In determining whether the increased airport terminal fees are reasonable and not unjustly discriminatory, the Department relies on various guidance including: statutes, Department policy statements, bilateral agreements, administrative and judicial case law, and rules of practice.

Statutory Guidance: In the 1994 Federal Aviation Administration Authorization Act ("1994 Authorization Act"), Congress gave airlines and airport operators the ability to obtain prompt resolution of significant disputes over the reasonableness of new or increased airport fees. 49 U.S.C. § 47129. This section—the basis for this proceeding—requires the Secretary to determine the reasonableness of a challenged fee or fee increase within 120 days after the complaint is filed.[6]

While the complaint is pending, the carriers must pay the new fee, albeit under protest, and the airport may not block the airlines from using the airport. The amounts paid under protest "shall be subject to refund or credit to the air carrier in accordance with directions in the final order of the Secretary…." 49 U.S.C. § 47129(d)(1)(B). Unless the airport and the air carriers agree otherwise, the airport must obtain a bond, letter of credit, or other credit facility that is sufficient to cover the amount in dispute that is due during the 120-day period the Department has to decide the matter. 49 U.S.C. § 47129(d). The airlines are entitled to a refund or credit if we ultimately determine that the new fee is unreasonable. 49 U.S.C. § 47129(d).

In addition to the 1994 Authorization Act, the Anti-Head Tax Act, 49 U.S.C. § 40116, provides guidance in our decision making. The Anti-Head Tax Act allows the local airport authority to collect only reasonable rental charges, landing fees, and other service charges from aircraft operators for the use of airport facilities. See Northwest Airlines v. County of Kent, 114 S.Ct. 855 (1994) ("County of Kent); see also Second Los Angeles International Airport Rates Proceeding, Order 97-12-31 (December 23, 1997) ("LAX II Remand Decision"); Miami International Airport Rates Proceeding, Order 97-3-26 (March 19, 1997).

DOT Policy Statement: In response to the 1994 Authorization Act's mandate that we publish guidelines for determining whether a fee is reasonable, 49 U.S.C. § 47129(b), we

[6] The Secretary has delegated her authority under 49 U.S.C. § 47129 to the Assistant Secretary for Aviation and International Affairs. 49 C.F.R. § 1.56a, as amended by 60 Fed. Reg. 11046 (March 1, 1995).

issued the DOT Policy Statement.[7] The DOT Policy Statement sets forth Departmental guidelines for assessing the reasonableness of airport fees. As we noted in the March 16 Instituting Order at 3–5, when an airport sponsor accepts federal grant money for an airport improvement, it must give certain assurances, including the assurance that the airport will be available for public use on fair and reasonable terms and without unjust discrimination. 49 U.S.C. § 47107. The sponsor of the airport, here LAWA, is obligated to the Transportation Secretary and the FAA Administrator to assure compliance with its federal airport grant obligations. 49 U.S.C. § 47107(g).[8] The FAA has accordingly developed a standard set of assurances by which a recipient of an AAIA grant must abide. 62 Fed. Reg. 29,761 (1997). For instance, under Standard Assurance 22a, an airport sponsor agrees to "make its airport available * * * for public use on reasonable terms and without unjust discrimination, to any person, firm, or corporation to conduct or to engage in any aeronautical activity for furnishing services to the public at the airport." Id. at 29,766. An airport "may prohibit or limit any given type, kind or class of aeronautical use of the airport if such action is necessary for the safe operation of the airport or necessary to serve the civil aviation needs of the public." Ibid. (Standard Assurance 22i). If an airport violates the statute or a grant assurance, the FAA may seek enforcement in federal district court, or it may conduct an administrative proceeding and issue any orders necessary to carry out the airport grant program. 49 U.S.C. §§ 47111(f), 47122(a); see 14 C.F.R. Pt. 16.

In examining fee increases within this statute, the Department may determine whether the new fee is reasonable, but may not prescribe a fee. 49 U.S.C. § 47129(a)(3). When determining whether airport fees are reasonable, the guidelines established in the DOT Policy Statement shall be used. § 47129(b)(2). The parties have not disputed the principle that the DOT Policy Statement should be applied in deciding this case, but they have disputed whether the decision in Air Transport Ass'n v. Department of Transportation, 119 F.3d 38 (D.C. Cir. 1997) (hereinafter "ATA v. DOT"), as amended by 129 F.3d 625 (D.C. Cir. 1997), vacated the ability of an airport proprietor to impose a market method approach for terminal charges.[9] The DOT Policy Statement expressly

---

[7] The 1994 Authorization Act required the Department to issue standards or guidelines for determining whether airport fees are reasonable. The Department issued its Policy Regarding Airport Rates and Charges, 60 Fed. Reg. 6909, on February 3, 1995. The Department subsequently issued a revised Policy Statement. 61 Fed. Reg. 31994 (June 21, 1996). The DOT Policy Statement was vacated in part, by the U.S. Court of Appeals for the D.C. Circuit, as discussed infra.

[8] "To ensure compliance with" the statutory grant requirements, Congress directed the FAA to "prescribe requirements for [airport] sponsors that the [FAA] considers necessary" and authorized the agency to "approve an application for a project grant only if the [FAA] is satisfied that [those] requirements * * * have been or will be met." 49 U.S.C. 47107(g)(1)(A) and (2).

[9] ATA v. DOT, vacated "challenged provisions of the Final Policy[], the Secretary's supporting discussion in the preamble, and any other portions of the rule necessarily implicated by the holding of [the court's] opinion. . . " 129 F.3d 625 op cit. [emphasis in original] The decision accordingly vacated, as arbitrary and not justified, the Policy's requirement that an airport may use only historical costs for airfield fees and may use "any reasonable methodology" for non-airfield fees. The court decision vacated § 2.6 of the DOT Policy Statement, which permitted the airport proprietor to use "any reasonable methodology to determine [non-airfield] fees, so long as the methodology is justified and applied on a consistent basis to comparable facilities. . . " 61 Fed. Reg. at 32020-32021. The T1/T3 Carriers point out however, that the court did not vacate § 2.6.1 of the Policy Statement which permits an airport proprietor to charge non-airfield fees based on direct negotiations with an airline user or based on an objective determination of fair market value.

reaffirms an airport's statutory right to choose a fee methodology (compensatory, residual, hybrid, or another rate-setting methodology), 49 U.S.C. § 47129(a)(2), and gives each airport substantial discretion in calculating the fees as long as the methodology is applied consistently to similarly situated aeronautical users, properly allocated and otherwise conforms to the Policy Statement.[10]

Bilateral Agreements: The United States' air service agreements with many foreign countries also require U.S. airport fees to be reasonable and non-discriminatory. Department policy likewise endorses reasonableness and non-discrimination in airport fees. Consistent with bilateral obligations, the DOT Policy Statement § 3.3 expressly provides that:

> [C]harges imposed on foreign airlines must not be unjustly discriminatory, must not be higher than those imposed on domestic airlines engaged in similar international air services and must be equitably apportioned.... Charges to foreign air carriers for aeronautical use that are inconsistent with these principles will be considered unjustly discriminatory or unfair and unreasonable.

The Department takes into consideration obligations under the bilateral agreements whenever foreign air carriers file a complaint, such as the TBIT Carriers here. E.g., Brendan Airways, LLC v. The Port Authority of New York and New Jersey, Instituting Order 05-3-21, at 9-10, 21 (March 16, 2005).

Case Law: Our past cases have also established some guidelines for our analysis of airport fees challenged by airlines. See, e.g., Second Los Angeles International Airport Rates Proceeding, Order 97-12-31 (December 23, 1997);[11] Miami International Airport Rates Proceeding, Order 97-3-26 (March 19, 1997);[12] Brendan Airways, LLC v. The Port Authority of New York and New Jersey, Order 05-6-11 (June 14, 2005).[13]

Rules of Practice: Pursuant to the requirements of the 1994 Authorization Act, we also adopted Rules of Practice for Proceedings Concerning Airport Fees, Subpart F, 14 C.F.R. Part 302. 60 Fed. Reg. 6919 (February 3, 1995). Those rules, as well as Subpart A of the Department's Rules of Practice, have governed the conduct of this proceeding. Under our rules, and in order to satisfy the burden of proof, airline complainants must set forth their case in their complaint and the accompanying briefs and evidence submissions: "Carriers filing complaints ... will generally be expected to submit documentation that contains the filing party's entire position and supporting evidence." 60 Fed. Reg. 6923; 14 C.F.R. § 302.603(a). However, airport owners or operators may not undermine the air carriers' ability to meet such burdens by withholding financial information or data that

---

Specifically, § 2.6.1 provides that "[r]easonable methodologies may include, but are not limited to, historic cost valuation, direct negotiation with aeronautical users, or objective determinations of fair market value." 61 Fed. Reg. 32021. The Department has not revised this portion of the Policy Statement.

[10] § 2.1, Policy Statement, 61 Fed. Reg. 32019.

[11] Aff'd, City of Los Angeles v. DOT, 165 F.3d 972 (D.C. Cir. 1999).

[12] Aff'd, Air Canada v. DOT, 143 F.3d 1142 (D.C. Cir. 1998)

[13] Aff'd in part, rev'd in part, Port Auth. of N.Y. and N.J. v. DOT, 479 F.3d 21 (D.C. Cir. 2007).

support a new or increased fee. If they do so, they run the risk that the new fee will be found to be unreasonable. 61 Fed. Reg. 32018, § 1.1.1 (June 21, 1996).

B. ORIGINS OF THIS CASE

LAWA operates LAX, which consists of eight terminals designated here as T1, T2, etc., plus the Tom Bradley International Terminal. The carriers operating out of the various terminals have different terminal space use arrangements with LAWA. The T1/T3 Carriers operate out of terminals 1 and 3 until recently under holdover tenancies due to lengthy negotiations over the new five-year leases proposed by LAWA. The TBIT Carriers operate out of the Tom Bradley International Terminal under written leases with LAWA that expired on March 31, 2007. The T2/4-8 Carriers operate out of terminals 2 and 4-8 pursuant to long-term (40-year) leases entered into in the mid-1980's that will not expire for another 15-19 years.

1. The Fee Increases:

LAWA's costs for security after the 9/11 terrorist attacks increased substantially. Tr. 2425:6-14 (Pan); Tr. 1646:12-18 (Berg); LAX 184 (Cushine Decl.) ¶ 24; LAX-008-0001; LAX-009-002-3. According to LAWA, its security costs for 1997 were approximately $25 million, but by 2004 had soared to $93.2 million, and by 2006, they were up to $119 million. LAX-048-0003-0009 & 0014; Tr. 2425:6-14 (Pan).

Shortly after the leases for several[14] of the T1/T3 Carriers expired in May 2001, LAWA began discussing with airline tenants the security cost increases. LAX-013-0002; LAX-177 (Pan Decl.). LAWA accelerated these discussions following the receipt of a study it commissioned on this issue, referred to as the "Matrix Study". LAX-48 "Cost Allocation Study of Law Enforcement Services at Los Angeles International Airport." The Matrix Study, dated December 14, 2005, found that LAWA recovered only 45% of its total law enforcement costs at LAX.

In addition, LAWA has incurred increased costs to operate the terminals, must pay for deferred maintenance, and needs to make substantial capital investments in order to implement the LAX Master Plan. The LAX Master Plan is the first comprehensive improvement for the airport since 1956; with the last major renovations occurring before the 1984 Olympics in Los Angeles.[15] LAWA claims that it needs to increase cost recovery from its airline users to pay for LAX's increased operating expenses and to be able to issue debt for necessary capital investment. Id. at 23.

In November 2005, LAWA began explaining to the airlines its New Lease Form and New Lease Terms. LAX-177 (Pan Decl.) ¶¶ 46-63. On November 20, 2006, BOAC formally approved the new Leasing Policy. LAX-002; LAX-003; LAX-177 (Pan Decl.) ¶

---

[14] Alaska Airlines, ATA Airlines, Frontier Airlines, and Midwest Airlines. See Respondents' Brief to ALJ at 3.

[15] See Respondents' Brief to ALJ at 27-29 for more details on the LAX Master Plan, the litigation that ensued, and the resulting Master Plan Settlement.

65. The new Leasing Policy, among other things, limits the duration of written leases to five years, increases terminal base and M&O fees, establishes new fee methodologies and allocates costs in a manner which raises virtually all terminal fee components.

On December 18, 2006, BOAC voted to approve new terminal rates and methodologies to apply to the T1/T3 Carriers, including new terminal M&O charges, which were retroactive to January 1, 2006.[16] The new terminal fees include three new or increased M&O charges: access costs, security costs, and additional indirect administrative costs not previously charged to the airlines. These new or increased M&O fees replace the prior M&O rates which charged the airlines 15% of direct terminal costs as a proxy for actual M&O costs. LAWA previously charged the airlines 15% of the direct M&O costs arising from the terminal cost center.[17] The Board also voted to approve new methodology for setting elements of the terminal fees based on what LAWA terms "rentable" space and "market value" formulas. LAX-011, LAX-013, LAX-015, LAX-017. Additionally, the Board approved the extension of its 2001 leasing policy to charge terminal base rent on the greater of fully allocated capital costs and expenses or fair market rental value plus fully allocated expenses.[18] The market value methodology uses the fair market value of the terminal space to establish the terminal fee, and results in the T3 Carriers paying terminal rents based on the market method.

LAWA previously assessed terminal rent on the T1/T3 Carriers based upon a "useable" space formula whereby terminal costs were allocated to the carriers based upon their usable space only, i.e., ticket counters, gates, hold rooms, baggage claim, and other terminal areas used by each carrier. Under the rentable space formula, LAWA will assess terminal charges based upon the space occupied by the airlines plus an additional allocation of non-airline terminal common-use space, such as corridors and restrooms.[19] The rentable space formula increases the allocable terminal space over which LAWA charges terminal rent and M&O fees. On December 22, 2006, LAWA notified all T1/T3 Carriers that they would be subject to the new Tariff if they did not sign the New Lease. Under the Tariff, all terms and conditions of the New Lease Terms, except for the five-year duration, apply to the carriers. LAX-024, C-29, C-35. On January 22, BOAC formally approved the new Tariff for terminal fees. LAX-024; LAX-025; LAX 177 (Pan Decl.) ¶ 65. By April 1, all carriers operating out of LAX – except the seven carriers with long-term leases – became subject to the Tariff. Respondents' Post-Hearing Brief to ALJ at 6.

---

[16] See Respondents' Brief to ALJ at 4-6, for a detailed explanation of the various BAOC actions implementing the new fees, methodologies, and the terminal leasing/tariff policies.
[17] LAX-009-0006; LAX-184 (Cushine Decl.) ¶¶ 20-23.
[18] LAX-002-005; LAX-011-0003-0004.
[19] LAWA, in its Glossary contained in its Brief to ALJ, defined the "common areas" subject to the rentable space methodology as :

> Space within the terminal (excluding the airline exclusive use areas, the airline joint use areas, the international joint use areas, [such as gate areas, hold rooms, ticket counters, and baggage handling and claim areas], the retail and concession areas, the landlord proprietary areas, and vertical areas) that is used for lobbies, corridors, Travelers Aid offices, restrooms, custodial facilities, utility closets, and mechanical rooms, as shown in the Master Lease Exhibits.

The TBIT Carriers were advised by LAWA in letters dated December 27, 2006, that their M&O charges, which LAWA said were established in their written lease agreements, would increase based upon the new charges of access costs, security costs, and previously unallocated indirect administrative costs.[20] On February 28, 2007, after the TBIT Complaint in this docket was filed, LAWA notified the TBIT Carriers that they would also be subject to the new rentable space methodology.[21]

The Board also made effective, as of January 1, 2006, the increases in M&O rent to the carriers occupying terminals 2, and 4-8 under long-term leases. Prior to this, they paid only the M&O 15% surcharge. Several of the carriers have brought a federal court proceeding challenging LAWA's attempt to impose the new M&O fees on them, on the basis of lease violation, and those under Chapter 11 reorganization have complained about LAWA's new Leasing Policy in bankruptcy court where LAWA has defended its new methodologies. See, e.g., T1/T3 Ex. F-14, F-16.

On January 8, 2007, BOAC formally authorized LAWA to pursue defeasance of bonds associated with T5 and T2. LAX-020 through LAX-023; LAX 177 (Pan Dec.) ¶ 65. LAWA states that it intends to buy back the remaining portions of most, if not all, of the long-term leases at LAX and subject those carriers to the new Leasing Policy. Until then, LAWA states that it may not impose the rentable space and market value methodologies on the carriers with long-term leases.

2. The Complaints and LAWA's Response

The T1/T3 Carriers' Complaint: The T1/T3 Carriers claim in their complaint that the new, higher terminal charges and the "rentable space" methodology imposed by LAWA unjustly discriminate against them based solely on lease expiration dates as compared with other carriers with long-term leases who are not subject to the increased fees for up to 19 years. The T3 Carriers also dispute the reasonableness of LAX's imposition of fair market value rates for terminal space.[22] The T1/T3 Carriers dispute LAWA's claim that the new fees are for the legitimate recovery of costs, but rather, LAWA's impermissible

---

[20] LAWA conceded an error in this initial notification of M&O costs to the TBIT Carriers. In estimating the M&O expenses, LAWA staff inadvertently omitted the joint use space of a large TBIT airline. Tr. 2446:4-12 (Pan). Thus, although the total amount of M&O rent did not change, the allocation among individual airlines was incorrect in the December 27, 2007 letters. Tr. 2446:13-23 (Pan). Correction letters were sent to the TBIT Carriers in January 2007. See Respondents' Brief to ALJ at 5, citing Tr. 2446:24-2447:6 (Pan).

[21] The TBIT Carriers subsequently filed on April 30 their "Joint Complaint in Opposition to New Terminal Charges at Los Angeles International Airport" to dispute the application of the rentable space methodology to them. That proceeding has been docketed as OST No. 2007-28118. LAWA responded to that filing on May 9, and requested the Department to dismiss the complaint on various bases. See Respondents' Answer to 'Joint Complaint in Opposition to New Terminal Charges at Los Angeles International Airport' Purportedly Filed on April 30, 2007", and accompanying motions and briefing. The Department has not yet made any rulings on the complaint.

[22] During the hearing before the ALJ, LAWA's counsel informed all parties that LAWA corrected an error in the base rent calculation for the T1 terminal so that the market value method would be used for that terminal rather than the fully allocated cost method. Tr. 727-730 (Rosenthal).

effort to fund unidentified future airport projects. The Carriers also claimed that the airport did not provide them with all the information they needed and requested on the fee increases.

The TBIT Complaint: The TBIT Carriers filed a follow-on complaint on February 23, 2007, pursuant to 14 C.F.R. § 302.603(b), which claimed that the increased M&O costs applied to them are unreasonable and unjustly discriminatory vis-à-vis the T2/4-8 Carriers with long-term leases. The TBIT Carriers also claim that LAWA is improperly raising the fees to fund unidentified future projects, rather than seeking only to recoup its operating costs. The TBIT Carriers also said that the airport did not provide them with information they requested about the fees.

LAWA's Answers, Brief and Motions: On March 2, LAWA filed its answer to both complaints, a brief in opposition to the complaints, and several motions to dismiss. In its answer to the T1/T3 Carriers' complaint, LAWA generally denied the allegations of fee unreasonableness and unjust discrimination and claimed that the new fees and methodologies are reasonable and are intended to have the airlines' pay their full and fair share of terminal costs instead of being cross-subsidized by the airport, which occurred under the prior 15% proxy system whereby terminal costs were not fully charged to the terminals and allocated in proportion to the space utilized by theT1/T3 Carriers under their leases. LAWA admits that the effect of the terminal increase in terms of cost per enplaned passenger ("CPE") will increase, but claimed that increased CPEs are comparable to 2005 CPEs of between $12 and $21 at other large U.S. airports in Miami (MIA), San Francisco (SFO), Denver (DEN), New York (JFK), Washington (IAD), and Seattle (SEA). In addition to its Answer to the T1/T3 Complaint, LAWA asserted six affirmative defenses.[23]

LAWA answered the TBIT Complaint by asserting that the fees are reasonable, not unjustly discriminatory, and the new M&O rates are the product of applying to terminal costs the same methodology that LAWA uses to allocate costs to direct and indirect cost centers for the landing fees.[24] LAWA further answered that the TBIT Carriers have written leases expiring March 31, 2007 and thus are precluded from challenging the new fees. LAWA also stated that the increased terminal charges are needed for cost recovery to pay for LAX's increased operating expenses and to be able to issue debt to pay for necessary capital investments and to remedy inadequate infrastructure at LAX terminals. LAWA said that no costs from any of the Capital Improvement Projects will be included in the new fees until facilities are built and operating, and that the new terminal charges will not even allow LAX to recover 100% of its operating costs. LAWA further answered that LAX's exceptionally low level of outstanding debt and sustained low levels of capital investment have resulted in deteriorating facilities and resultant low

---

[23] A full discussion of LAWA's affirmative defenses to the T1/T3 complaint is set forth in the Instituting Order at 11.

[24] See infra § C(1) (explaining LAWA's direct and indirect cost center allocations using landing fee methodology.

terminal charges. In addition to its Answer to the TBIT Complaint, LAWA asserted seven affirmative defenses.[25]

In addition to its Answer, LAWA filed one brief in opposition to the two complaints. Initially, LAWA contended that the M&O charges were imposed pursuant to leases and, thus, were not properly before the Secretary and should be dismissed. LAWA claimed that the M&O fees charged by LAWA before February 1, 2007, and now disputed by the T1/T3 Carriers, were subject to the terms of written leases, albeit expired leases, governing their holdover tenancy, until January 31, 2007, and therefore are not properly before the Secretary. LAWA further claimed that the M&O fees disputed by the TBIT Carriers were also improperly raised because the M&O fees charged retroactive to January 1, 2006 were imposed pursuant to a written agreement and, thus, are outside the scope of § 47129. LAWA further argued that the complaining carriers and the long-term carriers are not similarly situated due to differing lease expiration dates. LAWA concluded that the new rates are reasonable because they are cost-based.

LAWA filed three motions to dismiss the complaints, which expanded upon the points made in LAWA's answer and opposition brief.[26] The complainants opposed LAWA's Motions to Dismiss.[27]

The Complainants' Replies: On March 5, the T1/T3 Carriers and the TBIT Carriers submitted replies to LAWA's Answer. The T1/T3 Carriers denied that the retroactive M&O fee increase was proper because they never consented to it; and argued that LAWA has monopoly power, which it abuses, and cannot set fees like a private commercial landlord. The TBIT Carriers replied, among other things, that LAWA failed to consult adequately with the carriers about the proposed change in fee methodology, including by refusing to produce accurate information requested by them; they also urged that the Secretary must look into possible surplus accumulation because the fees paid by the TBIT Carriers exceed the costs attributable to their use of the terminal.

---

[25] A full discussion of the affirmative defenses to the TBIT complaint is set forth in the Instituting Order at 12.

[26] First, LAWA filed "Respondents' Motion To Dismiss Air Pacific, China Southern Airlines Company Limited and Philippine Airlines, Inc. as Complainants For Failure To Comply With The Department's Rules Concerning The Contents Of Complaints Filed Under 49 U.S.C. § 47129" because the complaint did not include the airport's written notices to these three carriers of the imposition of the fee increase and, thus, failed to comply with 14 C.F.R. § 302.603(a). Second, LAWA filed "Respondents' Motion To Dismiss Claims Concerning Charges Imposed Pursuant To A Written Agreement As Improper Under § 47129" and argued that the disputed M&O charges were imposed pursuant to a written agreement in effect between January 1, 2006 and February 1, 2007, and thus were not properly before the Secretary pursuant to 49 U.S.C. § 47129(e)(1). Finally, LAWA filed "Respondents' Motion to Dismiss Add-On Complaint Because Foreign Air Carriers Are Improper § 47129 Complainants". In support of this motion, LAWA argues that the TBIT Carriers, as foreign air carriers, do not qualify as "air carriers" under the rates and charges statute, and thus, it is beyond the Secretary's discretion to interpret the statutory language as including the foreign air carriers. LAWA also cites to the recently-issued Port Authority decision by the Court of Appeals to support its motion. See infra § B(3).

[27] A full discussion of the complainants' oppositions to Respondents' Motions to Dismiss is included in the Instituting Order at 14-16.

3. The Instituting Order

Finding of Significant Dispute: As previously noted, we determined that the dispute over the new and increased fees at LAX must be sent to an ALJ for a hearing under the statutory procedures because the complaint was within our jurisdiction under 49 U.S.C. § 47129 and presented a significant dispute. Order 2007-3-13 (March 16, 2007). We earlier required LAWA to provide the financial security required by the statute. Scheduling Notice, Docket No. OST 2007-27331-2 (February 16, 2007). On March 8, LAWA filed two letters of credit in the amounts of $23,830,000 for the claims of the T1/T3 Carriers and $11,510,000 for the claims of the TBIT Carriers. On March 16, the Department issued its Notice on Security Requirement, acknowledging LAWA's filing. On that same date, as a result of the Department's determination in the Instituting Order that the TBIT Carriers were not "air carriers" under § 47129, the Department found that "LAWA is not required to post a letter of credit for the fees disputed by [the TBIT Carriers] as that statutory requirement applies only to parties in a § 47129 proceeding but not to parties included in the proceeding pursuant to the Secretary's discretionary authority under 49 U.S.C. §§ 40116 and 47107." Instituting Order at 23. We therefore acknowledged that LAWA could cancel the security it posted on March 8 for the TBIT Carriers.

Rulings on Motions: As noted above, LAWA filed three motions to dismiss the complaints. The first motion[28] sought to dismiss three foreign carriers for failing to comply with the procedural requirements of including a notice of the fee increase with the complaint. We denied the motion and allowed two of the carriers to include previously omitted notices.[29]

We deferred a ruling on LAWA's second motion to dismiss, i.e., "Respondents' Motion To Dismiss Claims Concerning Charges Imposed Pursuant To A Written Agreement As Improper Under § 47129" where LAWA argued that the M&O charges being complained of were imposed pursuant to a written agreement in effect between January 1, 2006 and February 1, 2007, and thus were not properly before the Secretary pursuant to 49 U.S.C. § 47129(e)(1). The Department deferred a ruling on this motion because it presents an important policy question and the Department wanted more input from the parties and the ALJ before making a determination. See Instituting Order at 18-19.

Finally, the Department denied LAWA's third motion to dismiss, i.e., "Respondents' Motion to Dismiss Add-On Complaint Because Foreign Air Carriers Are Improper § 47129 Complainants," which was based on the recently-issued Port Authority decision by the Court of Appeals. See Port Auth. of N.Y. & N.J. v. DOT, 479 F.3d 21, 33 (D.C. Cir. 2007) (hereinafter "Port Authority")("the language of § 47129 leaves us no choice but to

---

[28] See Respondents' Motion To Dismiss Air Pacific, China Southern Airlines Company Limited and Philippines Airlines, Inc. as Complainants For Failure To Comply With The Department's Rules Concerning The Contents of Complaints Filed Under 49 U.S.C. § 47129."

[29] See Instituting Order at 19. The third carrier, China Southern Airlines Company Limited, subsequently withdrew from the proceeding and the ALJ granted the Stipulate Motion of Voluntary Dismissal by Order dated March 22, 2007.

infer that Congress intended to limit § 47129 procedures to U.S. carriers"). The Department denied the motion because it desired to give the foreign air carriers the opportunity to seek a fee reasonableness determination on the same schedule as the domestic air carriers, particularly because of the unique circumstance that the Port Authority decision was not issued until after the TBIT Carriers filed their complaint. Also, the Secretary has ample longstanding authority to enforce the statutory requirements that airport fees be reasonable and non-discriminatory so consolidation of the complaints was warranted. See Instituting Order at 17-18.

Rulings on Document Production: The complaining carriers also charged that LAWA failed to produce requested information to support the new fees and new methodologies. Consistent with prior practice, the Department directed limited additional document production and directed the ALJ to make the ultimate determinations on document issues and order the parties accordingly. See Instituting Order at 27-28.

Issues to Investigate: In the Instituting Order the Department directed the ALJ to investigate at the hearing the general issue of whether the new and increased terminal charges at terminals 1 and 3 and at the TBIT terminal, respectively, are unreasonable, and/or whether they unjustly discriminate against the respective complaining carriers and are therefore unreasonable. The Department directed the ALJ to make findings on the following sub-issues, as well:

1. whether the airport is justified in imposing a "rentable space" formula on the T1/T3 Carriers when the airport is retaining the "usable space" formula for the T2/4-8 Carriers and whether the imposition of that formula on the T1/T3 Carriers is unjustly discriminatory;
2. whether the airport's imposition of the "rentable space" formula on the T1/T3 Carriers is reasonable;
3. whether the airport's use of market method to set a component of terminal rent for T3 is reasonable;
4. whether the airport's new M&O methodology for the T1/T3 Carriers is reasonable, justified, and not unjustly discriminatory;
5. whether the airport's new M&O methodology for the TBIT Carriers is reasonable, justified, and not unjustly discriminatory; and
6. whether T1/T3 and TBIT Carriers' new and increased M&O fees are a "fee imposed pursuant to a written agreement with air carriers using the facilities of an airport", as set forth in § 47129.

Instituting Order at 24-26.

Issues Not to Investigate: In addition to the issues to investigate, the Department also outlined several issues which the ALJ was directed not to investigate.[30] The ALJ was not to investigate the effects of the new fees on the complaining carriers for the next 15-19 years, which we deemed speculative, but rather, to limit his investigation to the next five

[30] Id. at 26-27.

years, which is the duration of the leases proposed by LAWA.[31] The Department also directed the ALJ not to investigate the rentable space or market value issues with respect to the TBIT Carriers as those issues were not properly before the Department. The ALJ was further directed not to investigate the issue raised by the carriers that LAWA failed to engage in meaningful discussions for the reasons set forth in the Instituting Order at 27.

4. The Administrative Law Judge's Recommended Decision

On May 15, 2007, after 16 days of hearings and the filing of numerous pleadings and exhibits, Judge Goodwin issued his Recommended Decision. The Recommended Decision found against LAWA and in favor of the T1/T3 and TBIT Carriers on virtually all issues raised. Specifically, he found that the new and increased terminal charges at terminals 1, 3 and TBIT are unreasonable and unjustly discriminate against the complainants. The ALJ further found that LAWA is not justified in imposing a "rentable space" methodology on the T1/T3 Carriers when the airport is retaining the "useable space" methodology for the T2/4-8 Carriers. He found the imposition of the "rentable space" methodology to be unreasonable and unjustly discriminatory as applied against the T1/T3 Carriers. On the airport's use of the "market value" methodology on the T3 Carriers, the ALJ found LAWA's application of the methodology to set a component of terminal rent to be unreasonable for T3. The ALJ determined that LAWA's new M&O methodology imposed on the T1/T3 and TBIT Carriers to be unreasonable, unjustified, and unjustly discriminatory. RD at 9.

The Instituting Order also directed the ALJ to investigate whether the new and increased M&O fees should be dismissed on the basis that they constitute "a fee imposed pursuant to a written agreement with air carriers using the facilities of an airport", as set forth in § 47129(e)(1), which the statute precludes from consideration in an expedited § 47129 proceeding. On that point, the ALJ determined that the new and increased M&O fees imposed on the T1/T3 and TBIT Carriers were not "a fee imposed pursuant to a written agreement . . ." under the applicable statute because the lease terms did not permit the new and increased M&O fees. RD at 10.

Based on his findings of unreasonableness and unjust discrimination noted above, the ALJ found that LAWA should refund to the T1/T3 Carriers any sums attributable to the new M&O fees, including the new rentable space and market value methodologies, with the proviso that LAWA should be credited for any sums due under the prior M&O methodology. He further recommended that LAWA's obligation and credit should apply retroactively and prospectively. The ALJ further stated that LAWA should refund to the

[31] The Department recognizes that under the Tariff imposed by LAWA, there is no five-year durational limit to the Tariff, although significant components of the fees imposed do, indeed, have a five-year duration. E.g., LAX-011-0002, 0004 (base rent effective for a five-year period); LAX-013-0003, 0004. The Department stands by its initial ruling, as described infra, in response to the T1/T3 Carriers' Petition for Review to the United States Court of Appeals for the D.C. Circuit (No. 07-1142)(Filed May 16, 2007).

carriers[32] any fees associated with the fair market value computations used to set the new terminal fees. RD at 10.

On the issue of refunds for the TBIT Carriers, the ALJ found provisionally that LAWA should refund to the TBIT Carriers any fees associated with the new M&O methodology, unless LAWA prevails in the U.S. District Court lawsuit involving the T2/4-8 Carriers.[33] On this point, he also found that LAWA should be credited for amounts due on M&O from 2006, and that LAWA's obligation is retroactive and prospective. RD at 10. The ALJ recommended that LAWA should pay interest on the sums due.

The ALJ concluded his recommended findings that LAWA's new terminal fees and methodologies are unreasonable, unjustified and unjustly discriminatory against the T1/T3 Carriers regardless of the outcome of the U.S. District Court lawsuit; that LAWA's new M&O fees and rentable space methodology is unjustified, unreasonable, and unjustly discriminatory against the TBIT Carriers only in the event that the T2/4-8 Carriers prevail in their U.S. District Court lawsuit. Finally, the ALJ found that LAWA's new M&O fees and rentable space methodology would not be unjustified and unjustly discriminatory against the TBIT Carriers in the event LAWA prevails in the U.S. District Court lawsuit. RD at 10.

In support of these findings and the Recommended Decision, the ALJ set forth evidence from the record including submissions by the parties and testimony from the hearing. The evidence supporting his rulings on each issue is set forth below to accompany each issue discussed in this decision. In addition, the ALJ provided a summary analysis of the testimony of each of the key witnesses, RD at 18-28, of LAWA's financial data, RD at 28-31, and of the leases between LAWA and the airlines, RD at 31-32. With regard to the witness testimony, the ALJ generally found the testimony of the Complainants witnesses to be more credible than that of LAWA's witnesses. He found the testimony to be consistent, direct, unbiased and trustworthy. The ALJ generally did not find the testimony of LAWA's witnesses, except for Karl Pan, CFO of LAWA, to be credible or plausible. In addition to his concerns about LAWA's witness testimony, the ALJ found "the financial information supplied by LAWA is not credible and cannot be relied upon to make accurate, substantive recommendations . . . [and gave] the financial information supplied by LAWA diminished weight due to [his] belief that it is inherently suspect, inconsistent and inaccurate." RD at 31. The ALJ's findings concerning the credibility of LAWA's witnesses and financial data played a significant role in his conclusions concerning the reasonableness of LAWA's new and increased fees.

---

[32] The ALJ referred to "carriers", but we will assume that he refers to the T1/T3 Carriers because, as noted above, during the hearing LAWA changed the methodology applicable to the T1 Carriers and made the "market value" methodology applicable to them as well as the T3 Carriers. Tr. 727-730 (Rosenthal).

[33] American Airlines, Inc. v. City of Los Angeles, CV-07-0461DDP (C.D. Cal., filed January 18, 2007).

C. THE CHALLENGED FEE ELEMENTS

The complainants have challenged all elements of LAWA's new New Leasing Policy[34] The New Leasing Policy, also referred to as the Terminal Regular Expense ("TRE") by LAWA, consists of three components: 1) the new and increased M&O fees; 2) the "rentable space" methodology – also referred to as the "commercial compensatory" methodology; and 3) the "market value method" for establishing base rents, which is also referred to as "fair market value" or "FMV".[35] On December 18, 2006, BOAC formally approved this new methodology for recovering M&O costs for all LAX terminals. LAX-008; LAX-009. The new M&O fee structure is retroactive to January 1, 2006, except that for the 2006 retroactive fees, LAWA did not impose the rentable space or market value methodologies on any of the carriers. The new M&O rates became effective for the TBIT Carriers after their leases expired on March 31, 2007. LAX-177, at 29; Tr. 2488 (Pan).

1. New and Increased Maintenance and Operations Costs

Prior to the enactment of the new and increased M&O fees, LAWA determined M&O costs by totaling all costs directly attributable to the terminals and adding a 15% markup as a "proxy" for all otherwise unallocated direct and indirect costs attributable to the terminals. LAX-008-001; LAX 186; Tr. 1339-40 (Tardiff); Tr. 3073 (Cushine). LAWA changed from the old to the new method because the former method significantly underestimated the airlines share of direct and indirect security expenses, indirect administrative costs, and indirect access costs for the terminals. LAX-008; LAX-009; LAX 184, at 7; Tr. 1340-41 (Tardiff); Tr. 2452 (Pan).

LAWA's cost recovery system allocates all LAX costs attributable to air carriers through "cost centers". LAX-184; Tr. 3068 (Cushine). It divides these cost centers into "direct" and "indirect". Direct cost centers are generally related to specific geographical areas of the airport, whereas indirect cost centers denote cost categories that cannot readily be tied to the specific areas because they generally concern the entire airport. Indirect cost centers support the direct cost centers. Costs accumulated in indirect cost centers are redistributed to direct cost centers on the basis of formulae, which are intended to apportion fairly the costs accumulated by indirect cost centers among the direct cost centers they support. LAX -184 (Cushine Decl.) at 6; Tr. 2406 (Pan); Tr. 3068 (Cushine). Airport revenues are collected from the direct cost centers and airport costs are allocated from the indirect cost centers to the direct cost centers.

Direct Cost Centers: LAX uses five direct cost centers: (1) "airfield", which refers to areas supporting flight activities and primarily includes runways and taxiways; (2) "apron", which includes aircraft parking areas adjacent to passenger terminals as well

---

[34] The RD explained the new M&O costs at length, at 51-54; we borrow extensively from the ALJ's factual discussion here for evidentiary consistency.
[35] Respondents' Brief to Sec. at 13 n.16.

as remote areas for parking and loading passenger aircraft;[36] (3) "aviation", which includes cargo, hangar, aircraft maintenance, and other ancillary aviation-related activities; (4) "commercial", which consists of land and facilities supporting non-aeronautical commercial activities not located in passenger terminals, such as parking lots, garages, rental car facilities, and the like; and 5) "terminal" – which is at issue in this proceeding – consisting of the nine passenger terminals, T1-T8 and TBIT. LAX-048-0010-0011; LAX-185; Tr. 3069 (Cushine).

Indirect Cost Centers: LAX uses four indirect cost centers: 1) "access", which refers to the LAX roadway system; 2) "systems", which includes the utility systems; 3) "general maintenance", which includes maintenance that cannot be directly assigned to other cost centers; and 4) "administration", which consists of overhead and general support, including executive staff. LAX-048-0011; Tr. 3069-70 (Cushine).

The new M&O methodology employed by LAWA for terminal costs is based on LAX's landing fee methodology. LAX-008-0001; LAX-009-0003; Tr. 2444 (Pan). The LAX Landing Fee Methodology initially allocates costs at LAX among five Direct Cost Centers and four Indirect Cost Centers. Tr. 3068:25-3070:4 (Cushine). The five Direct Cost Centers relate to defined geographical areas of the airport that serve a particular function and the two Indirect Cost Centers consist of service-type functions that support those Direct Cost Centers. The five Direct Cost Centers are Airfield, Apron, Aviation, Commercial and Terminal. The four Indirect Cost Centers are Access, Systems, General Maintenance, and General Administration. LAX-184 (Cushine Decl.) ¶ 18; Tr. 3068:35-3070:4 (Cushine); Tr. 2405:20-22, 2435:2-10 (Pan). Under the landing fee methodology, the costs that are collected in the Indirect Cost Centers are then allocated to the five Direct Cost Centers using two different methodologies. Tr. 3072:5-15 (Cushine). See also Respondents' Brief to ALJ at ¶¶ 30-34.

The new M&O methodology allocates three new and/or increased cost allocations to the terminal cost center: general administrative, access costs, and security costs. LAX-148, at 8; Tr. 2096 (Hubbell).

General Administrative Costs: LAWA distributes its general administrative costs among six cost centers: the five direct cost centers and the access cost center. The latter, although an indirect cost center, is utilized because the general administration of the airport supports the access areas upon which this cost center is based as well as the five direct cost centers. Tr. 3081 (Cushine). The methodology allocates these costs to the six cost centers based on the percentage of LAX's total operating expenses attributable to each of these cost centers.[37]

---

[36] The landing fee is derived from the airfield and apron cost centers.

[37] The ALJ provided an example from fiscal year 2005 to illustrate how the process works and the results. For FY 2005, LAWA determined that LAX's total operating expenses were $280,805,773. Tr. 3086 (Cushine); LAX-027. Of that amount, the terminals absorbed $121,487,904, or 43.26% of the total. Administrative expenses in FY 2005 totaled $113,021,570. The methodology takes the percentage of total airport operating expenses for which the terminals have been deemed responsible, 43.26%, and applies it to total administrative expenses in order to determine the terminals' share of those expenses. General

<u>Access Costs</u>: These costs were formerly absorbed by LAWA.[38] Under the new M&O methodology, access costs are allocated to the five direct cost centers according to the landing-fee methodology allocation percentages, discussed above. The methodology takes the operating expenses attributable to the access cost center and then applies the percentage of these expenses to total airport operating expenses in order to determine the access cost center's share of total airport administrative expenses. Those totals, added together, constitute the total direct and administrative expenses attributable to the access cost center.[39]

<u>Security Costs</u>: These costs are comprised of Los Angeles Police Department ("LAPD") and LAWA airport police costs. Tr. 2424-25 (Pan). A detailed explanation of the manner in which these costs were compiled and allocated for FY 2004 (July 1, 2003 through June 30, 2004) is contained in the record in the Matrix Study commissioned by LAWA. LAX-048; Tr. 2727 (Pan). At that time LAX had absorbed a total of $93.2 million in security costs. $64.1 million of that was attributable to airport police and $29.1 million was attributable to LAPD. Air carriers only paid those costs deemed part of the landing fee. Tr. 2427 (Pan).[40] The prior M&O system charged these costs only through the 15% proxy, and so allocated but a small amount of security costs attributable to the terminals. LAX-048-0009; Tr. 2427 (Pan). LAWA's concession revenues absorbed the rest. Tr. 2838 (Pan).

<u>The ALJ's Recommended Decision</u>: The ALJ found that LAWA did not support or explain its derivation of alleged FY 2006 M&O costs of $118-$119 million. RD at 54. He found LAWA's revised allocation plan implausible on its face because, he asserted, it

---

administrative costs allocated to the terminal cost center in FY 2005 were found to be $48,897,690 ($113,021,570 x .4326). LAX-27; LAX-184; Tr. 3082-86, 3168 (Cushine).

[38] That is, other than those access costs attributed to the airfield cost apron and placed in the landing fee rate base. Tr. 3090 (Cushine); RD at 53.

[39] The ALJ provided an example from fiscal year 2005 to illustrate how the process works and results. For FY 2005, the access cost center absorbed $45,545,231 in operating expenses. This figure represents 16.22% of the LAX's total operating expenses of $280,805,773. That percentage is then applied to the airport's administrative expense total, $133,021,570, in order to determine the access cost center's proper share of total administrative expenses. In this case that share totals $18,331,509 ($113,021,570 x .1622). Operating expenses attributable to the access cost center $45,545,231, are then added to its share of administrative expenses ($18,331,509) to determine the access cost center's total costs. That total is $63,876,740. LAX-27. The next step is to allocate this total into each of the direct cost centers, which is done initially by using the ratio of the direct cost center's land area to the total airport land area. Because the airfield by its nature, contains so much more land area than the other cost centers without a corresponding increase in access costs reasonably attributable to it, the ratio is then modified to equalize the terminal and airfield land areas. LAX-184, at 12-13; Tr. 2345 (Pan). The land area of the airfield and terminal cost centers as a percentage of the total airport land area is computed and equalized in this case at 25.24% each. Tr. 3087-89, 3168 (Cushine); LAX-27. As such, the terminal cost centers share of total costs attributed to the access indirect cost center is $16,120,809 ($63,876,740, representing total access costs, x .2524).

[40] Those costs, allotted through the airfield direct cost center and the portion of access indirect costs allocated to the airfield (no costs had been allocated to the apron), totaled $41.8 million, or 45% of total LAX security costs. Terminal security costs had totaled $33.3 million, or about 36% of LAX's $93.2 million total, but none of these costs had been recovered directly.

would place "about $17 million of about $33 million in increased security costs attributable to the terminal cost center, or more than half of these cost increases, in just two terminals, T1 and T3." Id. The ALJ also found the methodology unreasonable because he found it was not "comparable to [any] other methodology in the industry. . . and was not designed to, nor does it fairly cover costs. . ." Id. He concluded that the new M&O methodology should not be upheld because it is imposed and not negotiated.

T1/T3 and TBIT Carriers' Arguments in Support of the ALJ's Recommended Decision: The T1/T3 and TBIT Carriers both urge the Department to adopt the ALJ's Recommended Decision finding that the methodology for M&O costs as applied at LAX was unreasonable, implausible and extreme. They assert five arguments to show that it is unreasonable. First, they claim that it is unreasonable for LAWA to apply M&O costs on them using the rentable space methodology when LAWA uses only the useable space methodology for the T2/4-8 Carriers; second, they allege it is unreasonable for LAWA to increase the M&O fees given LAX's "current strong financial position"; third, they claim that LAWA is using the fee increase improperly to attract financing for future, unapproved airport capital projects; fourth, they argue the M&O increase is unreasonable because of LAWA's alleged "failure to enter into good faith negotiations"; and fifth, they argue that the new M&O methodology is extreme and radical and is not comparable to any other methodology in the industry. T1/T3 Brief to Sec. at 45-46.

TBIT Arguments in Support of the ALJ's Recommended Decision: The TBIT Carriers also claim that the M&O fee increase is unreasonable because it was imposed unilaterally, without justification and based upon flawed financial data. TBIT Brief to Sec. at 6-7. They cite to the testimony of Dennis Olson and Patricia Tubert to show the lack of negotiation or compromise. The TBIT Carriers then cite to LAWA's alleged refusal to provide sufficient data to justify the costs. Id. at 7. The TBIT Carriers argue that LAWA's financial data errors: including three separate letters to correct the values for M&O fees, a $6 million overcharge to them due to a "data entry error", and a doubling of base rents by failing to account for a $26 million reduction in debt service. Id. at 8. They also state that the increased fees are unreasonable and unjustly discriminatory because they will add to an already illegal surplus and the TBIT Carriers already cover more than their direct costs. Id. at 12-16.

The TBIT Carriers also claim that the three new M&O cost components are unreasonable for them because their leases are silent on M&O fees, the new cost categories reflect a new methodology – not just an adjustment to fees – which occurred periodically, and the TBIT Carriers never agreed to them. Id. at 10-12. Based on these facts, they urge the Department to adopt the ALJ's finding and reject the increased M&O fees.

Intervenor's Arguments in Support of the ALJ's Recommended Decision: ATA requests that the Department uphold the Recommended Decision's holding because, they argue, the airlines met their prima facie case to establish unreasonableness, which LAWA failed to rebut with any evidence showing that the increases were cost-based. They claim that the airlines showed that the increase was not rational or justifiable because of its size –

increasing from $20 million to $55 million – under the new fee system, and due to a surplus accumulation of more than $300 million. ATA Brief to Sec. at 3-5.

LAWA's Arguments to Reject the ALJ's Recommended Decision: LAWA asks the Department to reject generally the ALJ's Recommended Decision that the M&O fee increases are unreasonable. LAWA, however, asks us to uphold the portion of the ALJ's determination finding that the cost center allocations based on the landing fee methodology are reasonable and were not challenged by the airlines. Respondents' Brief to Sec. at 12. LAWA argues that the ALJ's rejection of the increased M&O costs lacks any analysis and that, in fact, it is commonplace for airports to allocate access, general administrative and security costs for terminal users. Respondents' Brief to Sec. at 13. LAWA claims that there is no evidence that the new M&O fees are not designed to cover costs. LAWA also disputes the airlines' arguments that the new M&O methodology is unreasonable because it is profitable. LAWA points to the fact that it lost money in 2006, that its surplus is less than the $566 million alleged by the TBIT Carriers, that LAWA's gross operating expenses will exceed gross operating revenue in 2012, that TBIT is wrong about LAWA's debt service coverage, and that LAWA cannot finance the South Airfield Improvement Project without depleting cash reserves. Respondents' Brief to ALJ at 23-27. LAWA also adopted the ACI-NA arguments in favor of the M&O fee increase on the basis that, inter alia, airports have the right to adopt different rate-making methods for different types of carriers and that it is reasonable to adopt rate-setting methods not used elsewhere. ACI-NA Brief to Sec. at 6-12.

2. Rentable Space Methodology

The second element of LAWA's new Terminal Regular Expenses cost allocation system is its use of a new rentable space methodology to determine the amount of terminal costs assigned to each carrier that also includes both M&O costs and base rent. Previously, LAWA established its M&O cost recovery method based on the "useable space" method. According to this system, "a particular air carrier's cost area was considered to be its exclusive space plus a pro rata share of joint-use space. The 'rentable space' method, also referred to as the "commercial compensatory method", adds to that cost area a share of all common areas – public spaces such as corridors and restrooms." RD at 54. The rentable space methodology thus increases the amount of terminal area costs allocated to the air carriers for purposes of base terminal rent and for M&O cost recovery.[41] In other words, the carriers pay for the costs of additional space beyond "useable space", even though they do not exercise exclusive use over that space. At the hearing, witnesses for Alaska Airlines and Southwest testified to the increase in their allotted percentage of terminal space costs due to the new methodology: Alaska Airlines' increased from 60% to 88%; Southwest's increased from 50% to 88%. Tr. 1625, 1632-33, 1639 (Berg); Tr. 682-83 (Kasper). The T1/T3 Carriers presented evidence showing that the switch from

[41] Areas used exclusively by the airport (such as office space) and voids, such as utility areas, stairwells and elevators, as well as area exclusively used by other airline tenants are not included in the common areas for purposes of calculating airline cost recovery under the rentable methodology. LAX-195 at 13-14 (Tubert Decl.); Tr. 967 (Barger).

"useable" to "rentable" space method increased their allocated aggregate terminal space costs from 52% to 87% and 61%-81%, respectively. T1/T3 Ex. A-1-a at 5.

The common areas accounted for approximately one third of the "utilizable" space in T1, and 38% in T3, exclusive of voids. LAX-011-0003; LAX-013-0003.

By virtue of the new M&O charges, the increased space cost allocations also apply to airport-wide expenses allocated to the T1/T3 terminals. These include security expenses, for example.[42] The access component of M&O charges also would include costs associated with the planned "people mover" that will transport passengers to the central terminal area.[43]

The ALJ's Recommended Decision: Based upon this evidence, the ALJ found that, "as a general proposition, the concept of "rentable space" as an allocation for cost recovery is reasonable" because the areas over which the T1/T3 Carriers have cost responsibility "bear a rational relation to the purpose of LAWA's formula". RD at 55, citing Tr. 358 (Kasper). Specifically, he found that the T1/T3 Carriers use a portion of the common spaces; they benefit from having that space, RD at 55, citing LAX-011-0003; LAX 122; Tr. 3159 (Cushine); and thus "may be reasonably allocated a portion of TRE fairly reflecting their use of those areas." RD at 55.

The ALJ rejected the testimony of the airlines' expert, Dr. Timothy Tardiff, who said that because concessionaires rely on the airlines' presence for their business they could fairly be charged M&O costs over a larger area than LAWA uses in the terminals – and thereby reduce the amount of common space costs allocated to the airlines. RD at 55, citing (Tr. 1515-16) [sic].

The ALJ did, however, find the imposition of the "rentable space" methodology unjustly discriminatory and unreasonable on any carrier at LAX "while not imposing the same methodology on another carrier – in this case the T2/4-8 carriers.. . ." He based this finding, in part, on the testimony of LAWA's witness who admitted that "we cannot change the square footage that we charge them (the long-term lease holders) . . . that's not something that the lease permits us to do." RD Ex. B-9, at 10. The ALJ also noted that several of the complaining carriers had expired leases, while some did not, and that LAWA was attempting to impose the new rentable space methodology on the carriers through the new leases. He concluded: "I find the unilateral imposition of the rentable space methodology on any carrier is a violation of the letter and intent of the DOT Policy and is therefore unjustly discriminatory and unreasonable. Pursuant to DOT Policy leases should be negotiated. LAWA is attempting to impose, not negotiate. It may not stand." RD at 55.

T1/T3 Carriers' Arguments in Support of the ALJ's Recommended Decision: The T1/T3 Carriers urge the Department to adopt the ALJ's Recommended Decision on the new "rentable space" methodology which found that the rentable space methodology as

---

[42] Tr. 2521-24 (Pan).
[43] Tr. 2526:9-2527:21 (Pan).

applied at LAX was unreasonable and unjustly discriminatory. The T1/T3 Carriers argue that LAWA is not a commercial landlord, but rather, "a monopolist control of a public-use airport that is essential for airlines seeking to provide effective service to the Los Angeles area." T1/T3 Brief to Sec. at 39. They say that they never agreed to the methodology and LAWA has not offered any financial offsets or mitigating provisions, such as those commonly-used "revenue sharing approach." Id. at 40. They also argue that LAWA's witnesses could not identify another airport using a comparable system, that compensatory fee approaches do not typically extend to "rentable" space,[44] that the airlines are not like commercial building tenants who can respond by moving to another building, and that LAWA is a public utility with monopoly power and should be subject to the same restraints from pricing abuses. Id. at 41.

The T1/T3 Carriers also assert that the disparities in fees between the T1/T3 terminals and the T2/4-8 terminals are excessive and unjustly discriminatory, due in large part to the fact that it will take a significant amount of time for the long-term tenants' leases to expire and for them to "catch up" with the "rentable space" formula imposed on the T1/T3 carriers. The T1/T3 Carriers claim that LAWA has not been paying for the common spaces from its own funds or cross-subsidizing the airlines at LAX because the revenues to pay for M&O in the common areas comes from concession revenue generated from passengers brought into the airport by the airlines. Id. at 42. The T1/T3 Carriers also point out that under the rentable space method, costs of future capital improvement projects, such as the people mover to transport passengers to the central terminal area, will disproportionately fall on them as part of the new access charges based on the larger, rentable space allocation method. T1/T3 Brief to Sec. at 8, citing Tr. 2526:9-2527:21 (Pan).

ATA's Arguments in Support of the ALJ's Recommended Decision: The intervenor, ATA, argues that the rentable space methodology is unreasonable because it raises the amount of T1 space for which it pays rent from 52%, which the T1 Carriers actually use and occupy, to 87 percent. For T3 the Carriers actually use and occupy 61% of the space, but under the rentable methodology, must pay for 80% of the T3 terminal space. ATA Brief to Sec. at 16-17. They say that when the "market method" and "rentable space" methodologies are combined, the unreasonableness is compounded and results in a methodology not used at any other airports. Id. at 17.

LAWA's Arguments to Adopt Some but Reject Other Portions of the ALJ's Recommended Decision: LAWA urges the Department to adopt the ALJ's Recommended Decision that the rentable space methodology is reasonable, because the airline users benefit from the public space, but also urges the Department to reject the specific finding that the methodology is unjustly discriminatory as applied in this case. LAWA notes that other airports use the "rentable space" methodology. In support of its

[44] They cite to "Airport Business Practices and their Impact on Airline Competition," FAA/OST Task Force Study, T1/T3Ex. E-21 (LAX 055) at 8 (stating that, "[u]nder compensatory use and lease agreements, airlines typically pay only for the facilities and services they actually use"); Cf. Rise J. Peters, Northwest Airlines v. County of Kent, Michigan: More Than You Ever Wanted to Know About Airport Rate Setting, Part One, 22 Transp. L.J. 291 (1994).

position, LAWA cites to the DOT Policy Statement, which it claims authorizes airport operators to impose fees where an agreement with airlines cannot be reached. DOT Policy Statement at Introduction (discussing standards applicable to "fees imposed for aeronautical use") and § 1.1.4 ("Absent agreement, airport proprietors are free to act in accordance with their proposals. . ."). It also cites County of Kent, supra, 510 U.S. 355, for the proposition that an airport is entitled to impose compensatory fees. Further, the fact that no other airport utilizes the same type of rentable space methodology should not be determinative of the reasonableness of the methodology, stating that each airport has it own business terms and practices.[45] LAWA concludes by urging the Department to reject the ALJ's findings that fees imposed by airports are not unreasonable because they are "imposed." Respondents' Brief to Sec. at 11-12.

ACI-NA's Arguments to Adopt Some but Reject Other Portions of the ALJ's Recommended Decision: ACI-NA, in support of LAWA's position argues that there was no claim, proof, or finding that rentable space, also referred to by LAWA as "commercial compensatory rate-setting" methodology is unlawful per se. ACI-NA Brief to Sec. at 12. It argues that commercial compensatory methods are widely used, in various forms, throughout the airport industry. ACI-NA Brief to Sec. at 12-13 citing LAX-178, ¶ 4 (Eaton Decl.); Tr. 3221:19-20 (Eaton). ACI-NA argues that air carriers have no right to have their passengers use public airport space without paying for it; and that because LAWA assigned this public space cost by allocation based on revenue-generating space, the methodology is "transparent, reasonable, and not unjustly discriminatory" consistent with the DOT Policy Statement, §§ 3.4 and 3.4.1. Id. at 13. ACI-NA concludes by noting that the Policy Statement § 2.1.1 does not obligate an airport proprietor to cross-credit the airlines unless the airport proprietor agrees, which LAWA has not. Id. at 14.

3. Market Value Methodology

LAWA's third change in methodology for establishing terminal fees involves the use of a "market value method" to calculate base rent. (This method is also sometimes referred to as "fair market value" or "FMV".) "Base Rent" is defined as "the rental payable by a tenant for use of the Demised Premises, Airline Joint Use Areas, and International Use Areas."[46] It is "rent for the facility building itself (including land rent for the land underneath the terminal). LAX 011 at 2. The market value methodology was established under the new LAWA Leasing Policy adopted by BOAC, and has been in place since 2001. Respondents' Brief to Sec. at 15. Effective February 1, 2007 it was only recently applied by LAWA to the T3 Carriers. Tr. 727-730 (Rosenthal). Under the market method, "Base rent is required to be the greater of (a) fully allocated capital costs and expenses, or (b) fair market value plus fully allocated expenses.[47] LAX-002-0005; Tr. 3303:23-24. LAWA established the base rent for the TBIT Carriers' leases in 2002 using

[45] Tr. 3144:6-17 (Cushine).

[46] Respondents' Brief to Sec. at ix. With the introduction of the rentable space methodology after January 31, 2007, the base rent is now calculated using each airlines' "rentable" area in the terminal and, thus, is larger than previously established before the leases were terminated by LAWA. LAX-016, LAX-017.

[47] A full explanation of the establishment and calculation of the base rent under the market value method can be found at LAX-011 and LAX-013.

the market value methodology. Tr. 1155-1156 (Idy). One element of T2/4-8 Carriers' base rent is also established using "fair rental value," which LAWA views as akin to its market value method.[48]

LAWA detailed its process for determining base rent for T1 and T3 in its exhibits and brief to the Secretary:

> LAWA considered the range of negotiated and agreed-upon fair rental value base rents in T2, T4, T5, T6, T7 and T8 that had been approved by BOAC in January 2006. Tr 3305:9-16 (Tubert). These rents ranged from $17.50/ft.2 to $23.50/ft.2. LAWA staff then considered the condition of T1 and T3 and compared them to comparable properties. Tr. 3305:17-25 (Tubert). LAWA staff determined that the FMV rent for T1 was $20.00/ft.2, and the FMV rent for T3 was $17.50/ft.2. Tr. 3306:1-6 (Tubert). This evaluation is also described in Base Rental Rate Board Reports for T1, LAX 011-0004, and T3, LAX013-0004. These two values were compared to the base rent determined from the Terminal Capital Charges ("TCC") method, and the greater of the two numbers was set as base rent.[49]

The ALJ's Recommended Decision: The ALJ concluded that "LAWA's use of market rent in setting terminal fees is unreasonable. It is not designed to, nor does it fairly, cover cost; and it has no other uses properly applicable to airport fee-setting schemes. It may not stand." RD at 58. In support of this conclusion, the ALJ disagreed with the appraisal being performed by LAWA staff because "property values simply cannot fairly be determined unilaterally by an interested party." RD at 56. He asserted that "a true market value determination, absent the parties' agreement, may not be set in the absence of independent review." Id. The ALJ found that LAWA's denial of the right of the T1 Carriers' request to obtain an independent appraisal precludes a finding that LAWA's rate was reasonable." Id. at 58. He noted that the market value of the other terminals used to determine the market value for the T1 and T3 terminals were derived after negotiation with the airline tenants in those other terminals. Tr. 3305-06 (Tubert). The ALJ reasoned that fair market value in the commercial context cannot be established if opposing sides fail to agree. He cited to LAWA's own witness, Terry Barger, a commercial real estate expert who stated "unequivocally" that fair market value is determined "when a deal is struck." RD at 57, citing Tr. 989. The ALJ stated that "[a]bsent a meeting of the minds, there is not FMV." RD at 57.

The ALJ also disagreed with LAWA's defense of market value based on "opportunity costs", which is an economic concept defined as "the highest-valued alternative use of a resource." Id.; Tr. 364 (Kasper). The ALJ found that opportunity cost has limited value in an airport setting because airports are not typical commercial properties, but rather,

---

[48] Respondents' Brief to Sec. at 15, citing T1/T3 Ex. D-1 at JC-00921 ("Shall be adjusted to a fair rental value" every five years)(LAXTWO); T1/T3 Ex. D-3 at JC-01097 (same) (American); T1/T3 Ex. D-5 at JC-01331 (same)(Delta); T1/T3 Ex. D-10 at JC-01454 (same)(Continental); T1/T3 Ex. D-12 at JC-01670 (same)(United).

[49] Respondents' Brief to Sec. at 15-16, accompanying footnote regarding TBIT Carriers' market rate is omitted as not part of this proceeding, but testimony regarding the TBIT base rent calculation was the subject of testimony at the hearing. The TBIT Carriers pay base rent according to market value.

facilities that are "invested with public functions" and "subject to extensive regulatory oversight." RD at 57. Thus, the ALJ found that the possibility of an airport demolishing a terminal needed to get passengers on an aircraft in favor of amenities such as restaurants or snack bars to be unreasonable because the airport would soon lose any benefit to be gained from the alternative use. He concluded that the use of opportunity costs at airports to be unlawful as against the DOT Policy Statement which provides that an airport sponsor is "committed to operate [its] airports as airports" in exchange for Federal grant money and Federal land. Id.; DOT Policy Statement, 61 Fed. Reg. 31994, 32011.

The ALJ also found unpersuasive LAWA's contention that other airports use a market-based recovery method and such a generally accepted practice is a strong indication of reasonableness.[50] The ALJ determined that LAWA's market methodology was unreasonable based on the testimony of many carrier representatives that the LAX overall cost-recovery system is "unique." RD at 58; Tr. 2290 (Southwest); Tr. 1678-79 (Alaska); Tr. 1819 (Frontier); Tr. 2187 (Air Tran); Tr. 2236 (ATA); see also Tr. 448-49 (Kasper). The ALJ noted that the LAWA's expert could only point to one airport operator – the Port Authority of New York and New Jersey – which uses the market value method[51]; however, there it is "combined with incentives which act to drive down air carrier costs.

T1/T3 Carriers' Arguments in Support of the ALJ's Recommended Decision: The T1/T3 Carriers urge the Department to adopt the ALJ's Recommended Decision finding that the market value methodology is unreasonable. The T1/T3 Carriers claim that LAWA's use of the market method to set the base rent in their terminals "violates the requirement that the fee-setting methodology be based on the airport's actual costs. . . and that the resulting base rent that is two to five times higher than LAWA's fully allocated costs . . . does not result in fees that are cost-based." T1/T3 Carriers' Brief at 9, 10, 42. The T1/T3 Carriers cite to LAX II in particular, where the Department found it was unreasonable for LAWA to use fair market value to set rates for landing charges. Id. at 43. The T1/T3 Carriers further cite to the Port Authority Final Decision, supra, at 25, and City of Los Angeles v. DOT, 165 F.3d 972 (1999), as legal authority in support of their position. They also contend that while the decisions cited address the use of fair market value applied to landing charges, "they are fully applicable to LAWA's use of fair market value to calculate the terminal charges at T1/T3." T1/T3 Brief to Sec. at 43.

The T1/T3 Carriers also disputed LAWA's alleged "lost opportunity" claims by noting that LAWA's leasing of terminal space to concessionaires "does not represent an actual cost incurred by LAWA to provide the space to the carriers." Id. The T1/T3 Carriers also dispute the reasonableness of converting airline space, such as hold rooms, into concession space. T1/T3 Brief to Sec. at 10. The T1/T3 Carriers concluded by noting that LAWA's subjective opinion of "fair market value" was an abuse of monopoly power; and LAWA's unilateral imposition of the market value was properly rejected by

---

[50] See LAX II, Remand Decision at 23; 61 Fed. Reg. 31994, 32007.

[51] Tr. 3092 (Cushine) (identifying Kennedy, Newark and LaGuardia as airports which operate under the market value methodology).

the ALJ because, among other reasons, LAWA's market method was not commonly used at other airports. Id. at 44.

Airline Intervenors' Arguments in Support of the ALJ's Recommended Decision: In support of the T1/T3 Carriers' position, ATA argues many of the same points, and in addition, states that historic cost is the standard used by public utilities in establishing valuations and that LAX is a public utility with de facto monopoly power that charges a monopoly price for the use of its airport, unless forbidden by law from doing so. ATA Brief to Sec. at 10-12.

ATA devotes its entire brief to the issue of fair market value. It urges the Department to uphold the RD on this issue. It argues that fair market value is not cost-based and, therefore, should not be upheld. It also criticizes as unreasonable LAWA's establishment of fair market value through its internal staff. ATA's Brief to Sec. at 3-5. ATA also assails as unreasonable LAWA's "opportunity cost" justification because LAWA is not a private commercial landlord and, in fact, has no opportunity to use its LAX property for non-airport use, particularly in view of its grant assurances. Id. at 7-8. Further, ATA argues that even if LAX has an opportunity cost the City and residents derive enormous benefits from using the terminals for air transport services. Id. at 10. It also contends that that use of the market value by LAWA is compounded by the progressively accumulating surplus as a result of excess aeronautical revenue. Id. at 12.

ATA also urges the Department to require LAWA to use historic costs even if it can show opportunity costs incurred. Id. at 13. It claims, for example, that the very reason concessionaires are there is because the airport brings in passengers. Next, ATA says that permitting the unilateral imposition of market value by airports discourages airports from negotiating in good faith. Id. at 14. ATA also cite to Supreme Court precedent specifically approving the use of historic costs in public utility rate cases. Id. at 12, citing Hope Natural Gas Co. v. FPC, 320 U.S. 591, 605 (1944); Duquesne Light Co. v. Barasch, 488 U.S. 299, 308-309 (1989). ATA further argues that it was improper for LAWA to impose unilaterally market rate rents on the T1/T3 Carriers – who will pay rent based on their rentable floor space – using rates negotiated by the T2/4-8 Carriers who pay rent based on their useable floor space. Id. at 16. ATA also argues that LAWA is a de facto locational monopolist so the unilateral imposition of market value rates is unfair. Id. at 17. Finally, they argue that the relative administrative ease of determining historic costs weighs in favor of using a fully allocated cost methodology rather than market methodology. Id. at 18.

LAWA's Arguments to Reject the ALJ's Recommended Decision: LAWA urges the Department to reject the ALJ's determination that market value is unreasonable. LAWA argues, first, that fair market value "is used as a component of terminal rentals at all LAX terminals" so that it is not unjustly discriminatory. Respondents' Brief to Sec. at 16 (emphasis in original). LAWA derived the market value T3 based on the low end of the

range of market values applicable to the T2/4-8 Carriers' terminals, due to the condition and age of the T3 terminal.[52] Tr. 3305:9-20 (Tubert).

Second, LAWA argues that its market value method must be upheld as a matter of law and that the T1/T3 Brief either misconstrues the applicable legal authority or erroneously relies on portions of the DOT Policy Statement which have been vacated.[53] LAWA notes that in "ATA v. DOT the D.C. Circuit expressed no view on the lawfulness of FMV, much less did it prohibit use of FMV for terminal charges." Respondents' Brief at 17, quoting relevant provisions of ATA v. DOT. LAWA relied on the LAX II Remand Decision, at *6-7, for the proposition that the courts have not held that FMV is prohibited by law. The Department stated:

> We cannot agree with the airlines' position that the fair market value charge is clearly barred by the terms of the statutes governing airport fees. The Court has already held that the applicable federal statutes do not prohibit the use of opportunity costs in calculating airport fees. Given the Court's ruling, we could not adopt the airline complainants' position in this case even if we agreed with it.

LAX II Remand Decision at *6-7.

LAWA further cites to the DOT Policy Statement as expressly permitting the use of market value. "Reasonable methodologies may include, but are not limited to, historic cost valuation, direct negotiation with aeronautical users, or objective determinations of fair market value." DOT Policy Statement, ¶ 2.6.1 (emphasis added).

LAWA refutes the other arguments levied against its use of market value as "essentially policy arguments" advanced by the airline intervenors, which they claim are better addressed in a rulemaking proceeding.[54] Respondents' Brief to Sec. at 18-19.

ACI-NA Arguments to Reject the ALJ's Recommended Decision: ACI-NA, in support of the LAWA position, urges the Department to reject the ALJ's conclusion that the use of fair market value for establishing terminal rents is unreasonable. ACI-NA argues that the Department has never ruled against the use of fair market value in setting fees for non-airfield facilities and should not establish the per se rule recommended by the ALJ even if the Department finds that LAWA's use of fair market value at LAX produced unreasonable results. ACI-NA urges the Department instead to address this question in a deliberative rulemaking proceeding. ACI-NA Brief to Sec. at 15-17.

---

[52] Because the issue of market value was raised only regarding T3 in the Joint Complaint, we address this issue with regard to T3, but note that LAWA explained at the hearing its derivation of market value method for T1 and TBIT as well.

[53] On the latter point, see Respondents' Brief to Sec. at 17 n.23.

[54] LAWA refutes the other arguments against market value asserted by the Intervenors and the ALJ in its Brief, at 20-25, which are not repeated here in the interest of brevity, but are incorporated by reference.

D. THE DEPARTMENT'S DECISION

1. The Burden of Proof

When an airline seeks a determination as to the reasonableness, or unjustly discriminatory nature, of a fee imposed on the airline by an airport, the airline bears the burden of proof. The airline complainants must submit evidence sufficient to show that the challenged fees are unreasonable or unjustly discriminatory. Los Angeles International Airport Rates Proceeding, Order 95-6-36 at 17–18 (citing APA, supra at § 556(d) ("the proponent of a rule or order has the burden of proof") and Director, OWCP v. Greenwich Collieries, 114 S. Ct. 2251 (1994)); see also Air Canada v. DOT, 148 F.3d 1142, 1155–56 (D.C. Cir. 1998), and Port Authority, 479 F.3d at 42-43. If the airline complainants present a prima facie case that a fee is unreasonable or unjustly discriminatory, then we may hold the fees to be unlawful unless the airport submits sufficient evidence rebutting the airlines' assertions.

2. T1/T3 Carriers' Motion for Reconsideration of Instituting Order

Immediately after the Instituting Order was issued, the T1/T3 Carriers filed a motion "Request for Correction of Significant Factual Error in Instituting Order." (OST 2007-27331-64). In the Motion, the T1/T3 Carriers claimed that the Department erred in stating that LAWA had imposed the disputed terminal charge on complainants "for a five-year term", and thereafter directing the ALJ "to make findings as to the reasonableness and/or justification for the disputed fees for a five-year term." Instituting Order at 27. The T1/T3 Carriers claim it was error not to consider the reasonableness of the fees for the 19-year duration remaining on the long-term leases in T2/4-8. They claim that the new tariff imposed by LAWA has no duration. The Department issued an Order denying the motion. Order 2007-4-1 (March 26, 2007)(OST-20007-27331-132). On May 16, the T1/T3 Carriers filed a Petition for Review with the U.S. Court of Appeals for the District of Columbia Circuit to challenge the Department's ruling. See Alaska Airlines, Inc. v. DOT, No. 07- 1142 (filed May 16, 2007).

The Department stands by its original decision to limit the scope of the ALJ's determination of the reasonableness of the new and increased fees to a five-year duration as set forth in the Instituting Order. While it is true that the new tariff imposed by the airport has no specific duration, the lease that the airport attempted to negotiate with the carriers was for a five-year duration. LAX-002-0009; LAX-007; LAX-011; LAX-013. The Carriers chose not to enter into the leases offered. The Department, in fact, purposely made the decision to limit the scope of the ALJ's inquiry to a five-year duration for a variety of reasons based on policy, the facts presented in the Complaints, the need to streamline the hearing, and the desire to limit redundancy and "piling on", to limit speculative evidence, and the recognition of the airport's need to be flexible in its terminal planning for rate-setting and capital improvements. For example, it was clear from the Complaints that LAWA sought to establish the new terminal leasing policy for a five-year duration for all carriers regardless of when their leases expired. T1/T3 Joint

Complaint at 5, n.1.[55] Next, the airport, in its answer and responsive filings to the Complaints, as well as evidence presented at the hearing, noted that it will be undergoing major capital planning projects and part of that effort included the attempted defeasance of bonds for other terminals, so that it can better control and allocate gate utilization, among other things. Respondents' Brief to ALJ at 27-29, ¶¶ 84-92.

In addition, the Complaints alleged, and the evidence presented at the hearing further established, that over a five-year timeline, the Carriers subject to the tariff faced significant cost differentials between themselves and the Long-Term Carriers due to the different lease arrangements. Adding evidence of any economic disparity beyond the five-year duration proposed by the airport appeared simply to "pile on" anticipated costs, without adding any value to our analysis. At the time the Instituting Order was issued, the Department recognized that if we found unjust discrimination or fee unreasonableness based on the evidence from a five-year duration, we could reasonably extrapolate and find that the unjust discrimination or fee unreasonableness would continue for up to 19 years.

3. <u>LAWA's Motion to Dismiss Based on Written Agreement</u>

On December 18, 2006 BOAC approved new terminal M&O charges that were implemented by LAWA at LAX upon the T1/T3 and TBIT Carriers effective February 1, 2007 (LAX-009, LAX-177), and retroactive to January 1, 2006. (Respondents' Brief to ALJ at 4, ¶ 6.) The T1/T3 Carriers stated that they had been occupying the terminals pursuant to month to month "tenanc[ies] at will." (Complaint at ¶¶ 8, 20.) Some Carriers' leases expired as far back as 2001.[56] They assert that the application of the new and increased M&O charges, as of February 1, 2007 and retroactive to January 1, 2006 were not imposed pursuant to a written agreement. The TBIT Carriers also assert that the new and increased M&O charges, effective February 1, 2007 and imposed retroactive to January 1, 2006, were not imposed pursuant to a written agreement.

Section 47129 requires us to resolve airport-air carrier fee disputes on an expedited basis, and it affords certain protections to the airlines (e.g., upon payment of the disputed fee under protest the airline may not be locked out of the airport; and the airline shall receive a refund or credit of a disputed fee deemed by DOT to be unreasonable). These procedures do not apply to "a fee imposed pursuant to a written agreement with carriers using the facilities of an airport." § 47129(e)(1). Our Instituting Order asked the ALJ to make findings on whether the T1/T3 and TBIT Carriers' new and increased M&O fees are a "fee imposed pursuant to a written agreement with air carriers using the facilities of an airport" as set forth in 47129. Order 2007-3-13 at 26, 32 (ordering ¶ 4).

---

[55] For example, the T1/T3 complaint alleges that "[f]or the next five years (the term proposed by LAWA for a negotiated agreement; the BOAC tariff is simply month-to-month), the amount of discrimination can be calculated from LAWA's most recent, unilaterally imposed terminal charges. . . The numbers referenced herein are calculated only on the charges in place for the first five years of the 'duration'. . . there is no guarantee that LAWA will allow the T1/T3 leases to continue at five year intervals."

[56] The leases for Alaska Airlines, ATA Airlines, Frontier Airlines, and Midwest Airlines (<u>i.e.</u>, four of the seven T1/T3 Carriers) expired in May 2001. LAX-013-0002.

The ALJ found that new and increased M&O fees imposed upon both the T1/T3 Carriers and the TBIT Carriers do not constitute "a fee imposed pursuant to a written agreement with air carriers using the facilities of an airport" and therefore may be considered within this proceeding. We find, as discussed below, that the new and increased M&O fees imposed retroactive to January 1, 2006, on the T1/T3 Carriers were not "imposed pursuant to a written agreement;" however, the M&O fees imposed on the TBIT Carriers retroactive to January 1, 2006, were imposed "pursuant to a written agreement."

The ALJ found that many of the T1/T3 Carriers were operating at LAX on expired leases in holdover status.[57] The ALJ termed these "Evergreen clauses" and interpreted pertinent lease provisions so as to preclude LAWA from imposing changes in fee methodology, such as new and increased M&O charges, during the period of the holdover tenancy. RD at 42-48 and Appendix A.[58] The ALJ interpreted the terms of the leases and found that they did not permit LAWA to impose new and increased M&O charges.[59] He found that the lease clauses permitting LAWA to "adjust" the rental rates only authorized modifications to the existing fees and precluded imposition of a new fee methodology. RD at 42-43. With respect to those leases not containing Evergreen clauses, the ALJ determined that the new and increased M&O charges were unreasonable and unjustly discriminatory and could not be imposed by LAWA pursuant to the governing federal statutes.

The T1/T3 Carriers urge us to affirm the ALJ's finding that the fees were not imposed by a written agreement. The carriers state that they agreed to be bound by the expired leases during their month to month tenancy while negotiating a new lease but they did not agree to the increased M&O charges. They contend that these charges were not a mere rate increase or an annual reconciliation of charges as was LAWA's customary practice at LAX. Rather LAWA substituted an entirely new methodology. LAWA did not produce

---

[57] The holdover provisions provided that the tenancy was from month-to-month only and did not constitute a renewal of the lease or an extension for any further term, and in such case, the rent and other monetary sums due shall be payable in the amount and at the time specified in the lease. Further, the tenancy shall be subject to every other provision, covenant and agreement contained in the lease.

[58] The ALJ also interpreted the T2/4-8 leases with respect to whether the terms preclude LAWA from imposing the new and increased M&O fees. RD at 44-45. We reject this portion of the RD as outside the scope of the proceeding. Section 47129 permits the Department to adjudicate the reasonableness of fees upon complaints brought by affected airline parties, § 47129(a)(1)(B). The T2/4-8 airlines were not parties to this proceeding, only Intervenors for purposes of briefing, and stated in their request to intervene that they did not intend to adjudicate lease issues already in litigation. E.g., Petition of American Airlines, Inc. For Leave to Intervene at 2 n.1 (OST-2007-27331-23). The Instituting Order did not direct the ALJ to consider the reasonableness of their fees at LAX. For the ALJ to rule on the reasonableness of fees imposed on airlines that are not parties to this proceeding is contrary to the provisions of the Administrative Procedure Act protecting rights of parties, 5 U.S.C. §§ 551(3), 554-557, and affects the due process rights of both those airlines and the airport.

[59] The ALJ erroneously conflated the 'written agreement' issue with the rentable space and market methodology issues. This was clearly outside the scope of the Instituting Order, which directed the ALJ to consider the written agreement exclusion of § 47129 only in the context of the T1/T3 and TBIT Carriers' new and increased M&O charges. Instituting Order at 25. The new rentable space and market methodologies were not applied retroactively to the M&O fees calculated from January 2006 to February 2007. See LAX-013-0001, 0004, calculating the initial base rental rate for T3 for the five-year period beginning February 1, 2007 through January 1, 2012 using the market value method.

any written language signifying consent by T1/T3 Carriers to the new M&O methodology.

The TBIT Carriers also assert that the Recommended Decision correctly concludes that LAWA's change to its M&O methodology was not contemplated under the terms of the TBIT Carriers' leases. They also claim that LAWA's unilateral imposition of significantly increased M&O fees was not done pursuant to the TBIT Carriers' leases. The TBIT brief goes on to state that the leases are silent regarding M&O fees.[60]

LAWA argues that the ALJ impermissibly examined the written agreements in finding that the lease agreements do not authorize LAWA to impose M&O charges that would cover security, roadway access, and administrative costs during the holdover period in issue. LAWA argues that the new M&O charges simply are a retroactive adjustment pursuant to the leases, that the airlines had agreed, under the expired leases, to pay M&O costs, and that they never objected to LAWA's past practice of retroactively reconciling the M&O amounts.[61] LAWA also asserts that Cal. Civ. Code § 1945 governs the terms of expired real property leases in the State of California.[62] It claims, therefore, that each of the leases remained operative, on a month-to-month basis, for calendar year 2006 through January 31, 2007. LAWA also disputes the TBIT assertion that their leases contained no reference to M&O fees, referring to provisions in those leases on M&O charges.[63]

ACI-NA suggests that we should not decide the reasonableness of the new and increased M&O fees imposed retroactively by LAWA. ACI contends that the dispute between the airlines and LAWA dispute over whether or not the month to month leases authorize the new M&O charges is one of State contract law to be decided in the courts not in the context of a § 47129 case, citing Delta v. Lehigh Northampton Airport Authority, OST-95-80; 50264 Order of Dismissal (Order 95-5-8) (May 4, 1995).

---

[60] The TBIT Carriers state that their lease agreement does not mention M&O but they have paid M&O based on past practice and precedent. Tr. 1920:12-21 (Clark). The former M&O fees were based on a methodology that had remained constant from 2002-2005. Tr.1890: 16-21 (Clark).

[61] LAWA states that "the majority of the leases" require the airline to pay the M&O charges listed on the lease schedules and that the rental rates are subject to "annual adjustment." [FF 17, LAX-150-0006, 151-0006, 152-0006, 153-0006, 154-0006, 155-0006, 156-005-6, 157-0006, 158-0006, 159-0003, 160-0006, 161-0005-6, 162-0005, 163-0006, 164-0006, 165-0006-7, 166-0006, 176-0005, 168-0006, 179-0022, 170-0006.] LAWA further asserts that most of the T1/T3 leases expressly recognize LAWA's ability to adjust the M&O rates after January 1 of any year and would be applied retroactively. T1/T3 Exh. D-15 at JC-01920, LAX 142-0002, 143-0002, 144-0002, 145-0002 146-0002, 149-0002. Other leases recite variations of these provisions, namely LAX-147-0005, 0006, (Southwest) 070-0005, 0009 (AirTran).

[62] The California Code provides:

> RENEWAL OF LEASE BY LESSEE'S CONTINUED POSSESSION. If a lessee of real property remains in possession thereof after the expiration of the hiring, and the lessor accepts rent from him, the parties are presumed to have renewed the hiring on the same terms and for the same time, not exceeding one month when the rent is payable monthly, nor in any case one year

[63] LAWA points to provisions in TBIT Carriers' leases (Exhibits B to LAX 150 – 170) containing rate schedules that expressly list M&O fees. We agree with this proposed finding by LAWA. The testimony of the LAXTEC representative as to his recollection and understanding of M&O fees is not dispositive as the TBIT leases contain express references to M&O fees charged by LAWA.

The Department finds that the M&O fees imposed by LAWA on the T1/T3 Carriers, as of February 1, 2007 and retroactive to January 1, 2006, were not imposed pursuant to "written agreement." Rather, they were imposed after expiration of the lease agreements, pursuant to the standard holdover clauses in the lease agreements or pursuant to statute, the California Civil Code § 1945. We have held in past cases, as discussed below, that such standard ("boilerplate") clauses are not "written agreements" within the meaning of § 47129(e)(1) because they are not predicated upon a knowing and consensual agreement by an airline to a specified fee, fee schedule or fee methodology and for a fixed term.

In addition, the carriers on holdover status were operating only on a month-to-month basis pursuant either to the holdover clause in their leases or pursuant to the Civil Code provisions. As we have discussed above, the T1/T3 Carriers were operating under a "tenancy at will".[64] There was no "written agreement" pursuant to which LAWA could impose a fee for the following month. The statutory language removes from § 47129 proceedings circumstances under which the airline has already consented to airport fees, pursuant to written agreement. The language therefore anticipates a written agreement containing a certain term and duration sufficient in length for the airport to bill, and the carrier to pay, the fee imposed. A month-to-month tenancy does not fit within this description because the fees typically are billed for the next month, there is no certain term, and the relationship could be terminated at any time, by either party.

Moreover, there is no evidence that Congress intended for such holdover arrangements to be precluded from the Department's review. These types of tenancies do not rise to the 'written agreement' contemplated by the exception to § 47129 because: (1) they are outside of the term of the original written agreement that the parties had planned for and consented to; (2) their duration is too short a duration for the fee to be imposed pursuant to a written agreement; and (3) the parties do not contemplate that these tenancies will govern their long-term contractual obligations, as they would with current leases.

The term "written agreement" is not defined in § 47129 and thus it is the responsibility of the Department to construe the statutory language and arrive at an interpretation of that term. As long as the agency's construction of the term is a reasonable one, it is entitled to deference. Chevron USA, Inc. v. NRDC, 467 U.S. 837, 842-43. The Department's power to administer a congressionally created program such as the fee dispute program requires the agency to formulate policy and make rules to fill any gaps left by Congress. Chevron, 467 U.S. at 843-844. Pursuant to this delegation of authority, the Department has construed whether or not certain airport-airline documents constitute "written agreements" for purposes of adjudicating a disputed fee imposed upon an airline. "[The Supreme Court has] long recognized that considerable weight should be accorded to an executive department's construction of a statutory scheme it is entrusted to administer, [footnote omitted] and the principle of deference to administrative interpretations." Chevron, 467 U.S. at 844.

[64] See also RD at 45-46.

We have found in past fee dispute cases that when a lease contains express terms denoting schedules of fees, methodologies, or charges, is duly signed, for express term, and contains standard and customary airport-airline lease clauses, a written agreement exists and we would consider a fee imposed pursuant to such written agreement to be excluded from § 47129.[65] Additionally, we held that due to the expedited timeframe in § 47129 cases, we would not attempt to further analyze disputed contract terms or issues related to contract formation. We explained in the DOT Policy Statement[66] that § 41729(e) was enacted to prevent airlines from attempting to improve on the bargain they had made with the airport. Thus, airlines could not bring an administrative complaint after they had reached an agreement with the airport proprietor, during the period of that agreement. To allow otherwise, we said, would be unfair to airport proprietors who bargain in good faith. It would also upset the expectations of both parties as to the terms of their agreement, leading to uncertainty in the lease arrangements.

We have determined, however, that in limited circumstances we may invoke the § 47129 procedures to determine the reasonableness of an imposed fee, despite the existence of a written airport-airline lease. These have been situations where the lease does not establish the fee or the methodology for determining the fee. For example, we considered lease clauses that conferred general authority on the airport owner/operator to assess fees, without referring to specific fees, schedules, or methodologies, to be outside the scope of a "fee imposed pursuant to a written agreement." Similarly, we advised that lease clauses empowering an airport to charge fees pursuant to statutory authority would not constitute fees imposed pursuant to a "written agreement." In these situations, we found that there was no particular "agreement" by the airline as to the "fee imposed" by the airport and therefore a disputed fee—even one imposed during the course of the agreement—could be heard under the § 47129 procedures, and was not one "imposed pursuant to a written agreement." By allowing a § 47129 fee complaint in these situations the Department would not undermine good-faith bargaining efforts by the airport since there is no "bargained-for" or "negotiated" fee at issue. The disputed fee would be one imposed unilaterally by the airport proprietor without the advance consent of or consultation with the airline complainant.

For example, in Air Transport Ass'n of America v. City of Los Angeles, Instituting Order 95-4-5 (April 3, 1995), we found that fees imposed by City ordinance and paid by the complaining airlines under protest, pursuant to a standstill agreement were not fees "imposed pursuant to a written agreement." Id. at 15 n.11.

---

[65] In Continental Micronesia, Inc. v. Commonwealth of the Northern Mariana Islands and Commonwealth Ports Authority, Order of Dismissal 95-4-14 (April 10, 1995), we found that fees set forth in an 'airline use agreement (AUA) and lease of premises' constituted fees imposed pursuant to a written agreement which are excluded from the expedited statutory procedures. The agreement was signed by the chairman of the Commonwealth Ports Authority and by the president and CEO of the complainant airline, approved as to form by the staff attorney for the authority, had an express term, and was renewable on a year to year basis. The AUA explicitly required the airline to pay specific charges in the amounts specified in the Authority's Airport Rules and Regulations.

[66] 61 FR at 31998.

Additionally, we determined in the Miami International Airport Rates Proceeding, Order 97-3-26 (March 19, 1997), that lease agreements committing airlines to pay the "fees set by the airport" constituted a "standard" agreement requiring the payment of fees set by the airport, and, as such, would not bar an airline from obtaining any relief under 49 U.S.C. § 47129." Id. at 14.

Consistent with our prior decisions, we did not direct the ALJ to engage in interpretation of the terms of a written agreement, but rather, directed him to "consider" the terms of the leases under the statute, as the Department has previously done when such a defense was raised by airport operators, such as the cases cited supra.

Accordingly, we find that LAWA did not impose the new and increased M&O fees on the T1/T3 Carriers pursuant to a "written agreement" as that term is used in § 47129(e)(1). A standard or boilerplate "holdover" agreement, creating a tenancy at will on a month to month basis, subsequent to a lease expiration, does not constitute the type of written agreement that forecloses a § 47129 proceeding. Similarly, a holdover tenancy created to pursuant to State Code does not constitute a 'written agreement' whereby the airlines agreed to be bound by a fee certain after expiration of the written lease.

LAWA imposed the new M&O fees on the TBIT Carriers pursuant to BOAC action taken December 18, 2006, effective February 1, 2007. This fee imposition therefore took effect during the pendency of the TBIT Carriers' leases, which expired on March 31, 2007. The TBIT Carriers claims, as to the fees retroactive to January 1, 2006, should therefore, be excluded because under the Department's reasoning, the dispute about the TBIT Carriers' M&O fees is covered by a "written agreement." The fact that the TBIT Carriers are not proper § 47129 complainants is an additional reason why we would not consider their complaint under § 47129 procedures. Even if we were to consider their complaint under our discretionary authority, we cannot afford them greater rights than proper parties under § 47129.[67]

4. Credibility of Witnesses and LAWA's Financial Data

In the Recommended Decision to the Department, the ALJ made sweeping conclusions with regard to both the credibility of witnesses and the reliability of the financial information provided by LAWA. The ALJ generally found the testimony of the Complainants witnesses to be more credible than that of LAWA's witnesses,[68] and generally did not find the testimony of LAWA's witnesses, except for Karl Pan, CFO of LAWA, to be credible or plausible.[69] In doing so, the ALJ made unusually harsh

[67] We make no findings regarding the new and increased M&O fees imposed by LAWA on the TBIT Carriers under the tariff because that issue was not included in the TBIT Complaint.

[68] He found the testimony to be consistent, direct, unbiased and trustworthy. He also noted that the testimony of certain airline witnesses in particular to be persuasive and highly credible based on the extensive knowledge of the witnesses, their ability to withstand cross-examination, and the congruity of the testimony with other evidence and testimony in the proceeding. RD at 19.

[69] In the case of Mr. Pan, the ALJ found his testimony to be credible; but when viewed with other LAWA evidence and testimony, the ALJ found Mr. Pan's testimony more supportive of the airlines' case. RD at 19-20.

statements about Ms. Patricia Tubert, LAWA's principal witness and Deputy Director for Real Estate at LAWA, as well as the two consultants involved in developing the new terminal charges and methodology at LAX, Mr. Cushine and Mr. Eaton.

With regard to Ms. Tubert's, the ALJ began his evaluation of her credibility by discussing the content of her testimony, upon which he apparently based his subsequent conclusions. He stated that "Ms. Tubert was the witness to whom other LAWA witnesses deferred when asked about the LAWA's alleged failure to collect sufficient costs, justification for the new methodology, or other information associated with the new methodology." RD at 22-23. The ALJ found that her testimony did not support LAWA's various allegations about increased costs, proper allocations, or LAWA's alleged need for the new methodology. Id.

The ALJ stated numerous times in the RD that Ms. Tubert engaged in "deliberate attempts to avoid fully answering the questions in an honest, complete and straightforward manner." RD at 25; see also RD at 24, 27. He also stated that on cross-examination Ms. Tubert "repeatedly failed to directly answer questions and volunteered unasked information well beyond the context of and parameters of the questions." RD at 27. Overall, the ALJ found Ms. Tubert's answers to be self-contradictory and evasive as well as "inconsistent with the entire testimonial record and exhibits of this case when taken as a whole." RD at 27.

The RD also claims that Ms. Tubert "knowingly and intentionally omitted, withheld, left out, and otherwise misstated important facts or information in an attempt to bolster her position that new methodology needed to be imposed on the airlines." RD at 26-27. The ALJ makes this statement without providing evidentiary support. The ALJ also stated that "Ms. Tubert attempted to knowingly and/or intentionally misrepresent, or mischaracterize facts in my hearing in an attempt to gain an advantage in her testimony." RD at 27. As a result of these conclusions, the ALJ generally gave her testimony no weight. RD at 28.

The Recommended Decision found the testimony of Mr. Cushine and Mr. Eaton to be implausible as well, and the ALJ generally discredited it. Upon reaching this conclusion, the ALJ stated about each of these witnesses that "he did not readily and directly answer questions, avoided questions or volunteered unasked information. His demeanor and conduct were more consistent with a witness intent on an agenda and/or a witness who is biased or untrustworthy." RD at 21 (discussing Mr. Cushine), RD at 22 (Mr. Eaton). In addition, the ALJ stated that Mr. Eaton's testimony was "implausible and entirely incredible," RD at 22, and that Mr. Cushine's was "incredible, implausible, inherently improbable and entirely inconsistent with the other testimony and evidence in this proceeding." RD at 21. While the RD contains harsh conclusions about the credibility of these witnesses, it contains little in the way of support for these determinations. Aside from conclusory statements, the ALJ included only brief examples of testimony, the content of which he concluded was incredible, and discussed what he seemed to view as a general lack of preparedness by these witnesses. See RD 21-22.

The ALJ also called into question the accuracy and credibility of the financial information provided by LAWA. He stated that he "found disturbing the fact that errors persisted in the financial data utilized and relied upon by LAWA in its decision making process." RD at 19. The ALJ ultimately concluded that "the financial information supplied by LAWA is not credible and cannot be relied upon to make accurate, substantive recommendations . . . [and that he therefore gave] the financial information supplied by LAWA diminished weight due to [his] belief that it is inherently suspect, inconsistent and inaccurate." RD at 31.

The ALJ noted that after notifying the airlines of changes in their rents in December 2006, "LAWA subsequently adjusted the figures three times – the last coming days after the hearing had begun." RD at 28 (emphasis in original). The first two corrections adjusted the M&O rents, with an increase of 40%-60%. LAWA's third adjustment changed its estimate of the budget FY 2007 base rent component of terminal rent to a degree greater than 65% of the original total, albeit downward by more than $24 million. RD at 28. The ALJ noted that this adjustment resulted in the change for T1's base rent from the total terminal capital charges method to a market rent estimate. According to the ALJ, "[t]he mistake in LAWA's calculation of terminal capital charges, significant in itself, was exacerbated by the fact that LAWA staff had first uncovered the error for the better part of a year before Complainants learned of it. . . LAWA had failed to adjust it for the new terminal fee calculation for more than nine months." RD at 29.

In another error noted by the ALJ, "in calculating the amount of debt service in the TBIT Carriers' terminal capital charge, it inputted a figure of $31.1 million for the debt service on certain refunded bonds. . . when the correct amount was in fact $4.8 million, resulting in an error of $26.3 million, or 54% of the total debt service expenses budgeted to the TBIT Carriers in fiscal year 2007." RD at 29.

The ALJ also found implausible that "LAWA indicates that about $17 million of the $33 million in increased Airport security costs attributable to the terminals is allocated to just two [of nine] terminals, T1 and T3." RD at 30. The ALJ notes that "[n]o reasonable explanation is given as to why more than half of these increased costs are slotted to just two of the nine LAX terminals" and concludes that "[t]he numbers on their face are implausible." RD at 30.

The ALJ concluded, based on such examples, that the financial information presented by LAWA to be "inherently inaccurate . . . not credible and cannot be relied upon to make accurate, substantive recommendations". He thus accorded the financial information diminished weight due to his belief that it was "inherently suspect, inconsistent and inaccurate." RD at 31.

LAWA's Arguments to Reject the ALJ's Recommended Decsion: LAWA provided a lengthy response to the ALJ's determinations of witness and financial data credibility. LAWA argues that many of the conclusions regarding testimonial credibility are "unsupported, uncalled for and, invariably, factually wrong." Respondents' Brief to Sec. at 35. It contends that "taken as a whole, the RD's treatment of LAWA's witnesses is

unjustified and erroneous." Respondents' Brief to Sec. at 35. LAWA addresses the testimony and ALJ's credibility determinations of Mr. Cushine, Mr. Eaton, and Ms. Tubert, at length in an effort to dispute the ALJ's findings.

LAWA notes that while the ALJ found the testimony of Mr. Cushine to be "incredible, implausible, inherently improbable and entirely inconsistent with the other testimony and evidence in this proceeding," RD at 21, only one item of testimony is cited to be implausible and nothing is provided to support the rest of this conclusion. The testimony that the ALJ found to be implausible related to whether there had been a change in methodology. RD at 21. Mr. Cushine testified that LAWA's decision to stop using a 15% proxy was not a change in methodology since the landing fee methodology had always allocated costs to the Terminal Cost Center. RD at 21, citing Tr. 3075: 22-25.[70] LAWA argues that, while the ALJ may have disagreed with his characterization of this shift, it was not implausible testimony and did not merit sweeping conclusions about his credibility as a witness. Respondents' Brief to Sec. at 35-36.

While the ALJ took issue with Mr. Eaton's testimony regarding other airports "use [of] rentable area as a divisor for purposes of collecting terminal rent from tenant airlines," RD at 22, citing Tr. 3219-3222, LAWA points out that Mr. Eaton "was not tasked with, and did not attempt to, identify airports with a 'similar' terminal rental methodology to LAX." Respondents' Brief to Sec. at 38. The ALJ stated that the "substance of his declaration and comments were almost entirely hearsay," RD at 22, to which LAWA responded that reliance on research conducted by his staff does not render that testimony unreliable or hearsay. Respondents' Brief to Sec.at 37. Further, LAWA notes that expert testimony can be based on facts or data not themselves admissible as evidence. Respondents' Brief to Sec. at 37, citing Fed. R. Evid. 703.

With regard to Ms. Tubert, LAWA devoted a full twelve pages of its opening brief to addressing the credibility of her testimony and disputing the ALJ's conclusions. See Respondents' Brief to Sec. at 38-50. It methodically addressed each of the findings in the RD with regard to her credibility and the testimony cited by the ALJ in support of them, in an effort to show that Ms. Tubert was in fact truthful, credible, and answered questions directly. The ALJ had pointed to testimony that he believed to be "entirely fabricated, contrived, implausible and incredible in comparison to other testimony and evidence I find to be more credible in this proceeding." RD at 23-24. LAWA responded with record evidence to show that her testimony was not implausible,[71] inconsistent, fabricated, or contrived.[72] With regard to the ALJ's finding that she engaged in

---

[70] See also Tr. 3076: 1-7 (Mr. Cushine explains his reasoning for this answer).

[71] For example, the ALJ called into question the truth and plausibility of her statement that she was aware of the substance of a memorandum of a meeting in October of 2005, given that she had not been listed as one of the individuals to receive the memo. RD at 23, citing Tr. 3489: 6-7 (Tubert). LAWA submits that "it is by no means implausible that Ms. Tubert would have been informed of the substance of a file memo sent to her immediate predecessor, especially considering that the memo documented ongoing lease negotiations with the airlines, a task that was part of her job." Respondents' Brief to Sec. at 40.

[72] The RD cited testimony by Ms. Tubert about whether the airlines were pleased with five year leases, which the ALJ believed to be inconsistent with testimony by Mr. Montgomery. RD at 23. The ALJ deemed Montgomery to be a "highly credible [witness] who had personal knowledge of the negotiation of the 1985

"deliberate attempts to avoid fully answering the questions in an honest, complete and straightforward manner," RD at 25, LAWA argued that the example cited by the ALJ was taken out of context and selectively edited, which made it appear that Ms. Tubert was evasive and avoiding the question. Respondents' Brief to Sec. at 43-44. However, LAWA argues that when read in its entirety, the testimony was full and truthful.[73] LAWA also argues that the ALJ ignored record evidence which corroborated her factual testimony, particularly the numerous BOAC resolutions in the record. Respondents' Brief to Sec. at 39; LAX-002 through LAX-025.

LAWA also argued that it is not necessary to give the ALJ's findings of credibility special weight, as is usually the case, since a DOT representative was present to observe the witnesses testify and because the ALJ's determinations do not rest on the actual demeanor of the witnesses while testifying, but rather "erroneous interpretations of the substance of LAWA's witnesses' testimony, which is captured in the record and fully available for DOT to review." Respondents' Brief to Sec. at 51.

As to the financial data, LAWA argued that the RD overreaches in its conclusions and that they are not adequately supported by evidence. Respondents' Brief to Sec. at 51. LAWA states that the errors noted in the RD do not highlight flaws in the methodology or accounting system used, as the judge indicates, but rather are data input errors, which have now been corrected. Respondents' Brief to Sec. at 52.

LAWA stated that, while the RD makes it seem as though there was a pattern of errors, there were in fact only two. Respondents' Brief to Sec. at 54-60. LAWA concedes that "there were in fact two mistakes that LAWA made in translating its costs, as taken from the accounting system, into amounts that the individual Airlines owed in the increased rents taking effect." Respondents' Brief to Sec. at 54.

The first error addressed by the ALJ related to the December 2006 rent letters. LAWA explains that "this mistake resulted from the omission from the rent of costs allocated to joint use space." Respondents' Brief to Sec. at 54, citing Tr. 2446:2-23 (Pan). There were two subsequent corrections because "initially, no joint use space costs were included in the rent letters...and [a second correction was necessary because] one airline was left out of the allocation." Respondents' Brief to Sec. at 54, referring to TBIT-52

---

lease between Southwest Airlines and LAWA." RD at 23, <u>citing</u> Tr. 2311: 10-2313 (Montgomery), and therefore discredited Ms. Tubert's testimony as "entirely fabricated, contrived, implausible, and incredible in comparison to testimony and evidence I found more credible in this proceeding." RD at 23. LAWA responds by saying that "[i]t is true that the testimony differed, but Ms. Tubert's testimony concerned lease negotiations in 2005 while Mr. Montgomery's testimony concerned lease negotiations 20 years earlier, in 1985." Respondents' Brief to Sec. at 41. LAWA asserts that the ALJ's conclusions are unwarranted.

[73] In this instance, the ALJ had stated that "when asked to '...name a single airport that has a terminal charge setting methodology identical to the one now in place at Terminals 1 and 3..." Ms. Tubert testified that she 'relied on the financial staff and our consultants.'" RD at 25. The ALJ deemed this to be a "deliberate attempt to avoid answering the question." RD at 25. LAWA asserts that this was a case of selective editing and that she had provided a more complete answer than was reflected in the RD. Respondents' Brief to Sec. at 43. LAWA therefore provided her full answer: "I am not aware of specific term – methodology used at other airports. I've relied on the financial staff and our consultants for that information." Respondents' Brief to Sec. at 43, <u>citing</u> Tr. 3391:23-3392:5 (Tubert).

and TBIT-53. LAWA argues that this mistake does not reflect the accuracy of its accounting system but rather was a transcription error that was ultimately corrected. LAWA notes that "since the TBIT letters were corrected, the accuracy of the TBIT Carriers' M&O rent has not been challenged. Moreover, the T1/T3 carriers have never challenged the accuracy of their M&O rent, and no mistakes related to that portion – by far the largest portion – of the terminal rent have been identified." Respondents' Brief to Sec. at 54. Thus, LAWA rejects the ALJ's contention that "errors persisted in the financial data utilized and relied upon by LAWA in its decision making process." RD at 19.

The second error related to debt service. LAWA admits that a mistake occurred, but stresses that it was also only one, isolated mistake. While it involved a significant sum, LAWA argues that "the sum involved...should not cause this single error to be treated as more than just one error; unfortunately, the RD does just that." Respondents' Brief to Sec. at 55.[74]

Further, LAWA addresses the ALJ's statement that "LAWA indicates that about $17 million of the $33 million in increased Airport security costs attributable to the terminals is allocated to just two [of nine] terminals, T1 and T3." RD at 30. LAWA argues that "the 'allocation' which the RD found implausible is derived from a flawed hypothetical presented by the T1/T3 Carriers" and was not in fact set forth by LAWA. Respondents' Brief to Sec. at 57. LAWA explains that this misinterpretation arose because "the T1/T3 Carriers asserted that they collectively had been subjected to 2007 Terminal Regular Expenses increases of some $34 million, and that because Mr. Pan had testified that about half of the 2007 Terminal Regular Expenses increase had been caused by additional security expenses, they could conclude that about half of the $34 million, or $17 million in 2007 increases, had been due to additional security costs." Respondents' Brief to Sec. at 57, citing Tr. 2673:5-16 (Pan). Because the Matrix study indicated that the additional security costs at the airport were a total of $26 million, the T1/T3 Carriers concluded that they were covering over half of this additional cost. Respondents' Brief to Sec. at 57, citing RD at 54, 54 n. 224; Tr. 2675:4-15 (Goldberg) (Matrix Study).

LAWA insists, however, that this is a misinterpretation which fails to account for several important factors. First, the Matrix Study involved security costs from July 1, 2003 to June 30, 2004. LAWA states that security costs are far higher in 2007 and thus this is an inaccurate measure of the total costs at the airport. Respondents' Brief to Sec. at 58. Second, Mr. Pan testified only about direct security costs, which does not account for additional costs related to indirect access and administrative cost centers. Respondents' Brief to Sec. at 58. Therefore, LAWA argues that this is a faulty argument and is based on a hypothetical that was adopted by the ALJ as fact and treated as though LAWA made this implausible argument. LAWA stresses that security costs at LAX, as part of the overall terminal M&O expenses, are well distributed across terminals based on the number of passengers and flights at each terminal. Respondents' Brief to Sec. at 58.

---

[74] LAWA notes that the ALJ seemed to believe that there were at least two debt service errors when, in fact, it was the same error. Respondents' Brief to Sec. at 55.

In sum, LAWA argues there was a misinterpretation of the allocation of security costs and that the ALJ "describes a pattern of errors when there were in fact only two, unrelated mistakes." Respondents' Brief to Sec. at 59. Moreover, LAWA urges that mistakes in input are not synonymous with a flawed accounting system. See Respondents' Brief to Sec. at 52. In support of the credibility of its accounting system and financial statements, LAWA asserts that annual financial audits conducted by outside auditors have never uncovered systemic problems. Respondents' Brief to Sec. at 52-54. LAWA also notes that "the Airlines themselves relied without any reservation on LAWA's public announcements and published financial statements…" Respondents' Brief to Sec. at 52, citing T1/T3 Ex. A-1 ¶ 41 (Kasper Decl.); TBIT-60 (Wikel Decl.) at 9-12, Tables 1, 2. There has been no evidence of any intentional manipulation of financial data by the airport. Respondents' Brief to Sec. at 53. Neither outside auditors nor the airlines themselves have doubted the accounting system, and LAWA argues that there was not sufficient evidence for the ALJ to make sweeping judgments about the accuracy and credibility of the accounting system and financial data it generates. Respondents' Brief to Sec. at 53-54.

T1/T3 Carriers Position as to the ALJ's Credibility Findings: In its opening brief, the T1/T3 Carriers merely cite case law related to generally accepted principles regarding the Department's review of the ALJ's credibility findings. T1/T3 Carriers Brief to Sec. at 17. However, they do not make any arguments based on this case law in either their opening brief or reply brief.[75]

The Carriers point out contradictions in testimony, but do not explicitly seek to discredit LAWA's witnesses or suggest that all of their testimony was incredible. In fact, the T1/T3 Carriers frequently rely on the testimony of Ms. Tubert to support their arguments, particularly those related to unjust discrimination. E.g., T1/T3 Brief to Sec., passim.

The T1/T3 Carriers do not address the financial data at length. They merely state in a footnote that they "share the Judge's concern that LAWA 'financial data' is not credible." T1/T3 Brief to Sec. at 35, n.18. However, they state that "this finding is not essential to the T1/T3 Carriers' Case, and the Department does not need to reach the same conclusion to find the T1/T3 charges unjustly discriminatory, unreasonable and otherwise unlawful." Id. at 35-36, n.18.

TBIT Carriers' Position as to the ALJ's Credibility Findings: The TBIT Carriers argue that "Judge Goodwin's credibility determinations are accurate, based on substantial

---

[75] In the reply brief of the T1/T3 Carriers, they attack "LAWA's claim that Judge Goodwin did not, in fact, have the opportunity to observe the demeanor of the LAWA witnesses." T1/T3 Reply Brief to Sec. at 3, citing Respondents' Brief to Sec. at 51. However, it seems that T1/T3 has misinterpreted LAWA's statements. But LAWA does not argue that the ALJ lacked the opportunity to observe the witnesses and judge their demeanor. LAWA instead argues that the ALJ's credibility findings do not rest on the actual demeanor of the witnesses, defined as "physical appearance" while testifying, but rather, rest on his "erroneous interpretations of the substance of LAWA's witnesses testimony," which can be "captured from the record and [are] fully available for DOT to review." Respondents' Brief to Sec. at 51. Both LAWA and the T1/T3 Carriers provide definitions of demeanor that identify it as outward physical appearance or behavior while testifying. See T1/T3 Brief to Sec. at 3; Respondents' Brief to Sec. at 51.

evidence and should be affirmed." TBIT Brief to Sec. at 4. The Airlines urge that "the crux of Judge Goodwin's Recommended Decision…is that the testimony from the Complainant's witnesses was more credible than that of Respondent's witnesses." TBIT Brief to Sec. at 4, citing RD at 2, 8. In the their reply brief, they reiterate that the ALJ's credibility determinations were sound and that "these findings go to the heart of the TBIT Airlines' case." TBIT Reply Brief to Sec. at 8.

TBIT Carriers also argue that the financial errors made were "pervasive, substantial and persist to this day" TBIT Reply Brief to Sec. at 10. They argue that financial data is central to this case and its accuracy is therefore key. TBIT Brief to Sec. at 3. The TBIT Carriers stress that the error related to the M&O fees required three corrections and that number of magnitude of the mistakes supports the ALJ's determination that the financial data supplied by LAWA is questionable. TBIT Brief to Sec. at 8-9.

In its reply to Respondent's Brief to the Secretary, the TBIT Carriers argue that the financial data provided by LAWA is misleading and incomplete. TBIT Reply Brief to Sec. at 11. They dispute LAWA's statement that outside auditors have not identified systemic problems in the accounting system, pointing to a December 2005 report which identified flaws that TBIT argues remain today. TBIT Reply Brief to Sec. at 11-12. The TBIT Carriers also argue that testimony did raise questions about the reliability of the accounting system and that the Airlines have not relied upon it without reservation. TBIT Reply Brief to Sec. at 12, citing Tr. 1344:1-4 (Tardiff).[76]

Intervenors ACI-NA and ATA Positions as to the ALJ's Credibility Findings: ACI-NA argues in general that the Department should reject the ALJ's recommendations and the ALJ merely discredited "all of LAWA's evidence that contradicts his findings." ACI-NA Brief to Sec. at 19, citing RD at 19.

ATA essentially argues that the credibility findings, as to both witnesses and the financial data, should be accepted by the Department. ATA Brief to Sec. at 5. ATA argues that none of LAWA's witnesses, including Mr. Pan, whom the ALJ found to be generally credible, were sufficiently credible to allow LAWA to meet its burden in this case. ATA Brief to Sec. at 5.

The Department's Decision with Regard to the Credibility of the Witnesses and Financial Data: The Department's decision on this issue is guided by the Administrative Procedure Act, which provides that an agency, when reviewing the recommended or initial decision of a hearing officer, "has all the powers which it would have in making the initial decision." APA § 557(b). Therefore, the Department has conducted a de novo review in reaching the Final Decision and, in doing so, is in the position to review not only findings of fact but also findings of credibility. See, e.g., Howard v. Heckler, 782 F.2d 1484, 1487 (9th Cir. 1986) (recognizing that "the ALJ's credibility findings are not binding.").

It is true that an ALJ in conducting a hearing "sees the witnesses and hears them testify" and is therefore in a good position to evaluate demeanor. NLRB v. Walton Mfg. Co., 369

---

[76] The Department notes that the correct citation to this testimony is Tr. 1244:1-4 (Tardiff).

U.S. 404, 408 (1962). However, it is equally true that "the significance of his report…depends largely on the importance of credibility in the particular case." NLRB v. Walton Mfg. Co., 369 U.S. at 408 (citing Universal Camera Corp. v. NLRB, 340 U.S. 474, 496 (1950)).[77] Where the outcome of the matter the agency is reviewing rests largely on the credibility of the person testifying or the veracity of his statements, credibility determinations are entitled to a greater degree of deference. However in a case such as this, credibility determinations are not the basis upon which a decision is reached. Moreover, as LAWA pointed out, the ALJ's findings of credibility rest more on his conclusions regarding the content of their testimony than their physical demeanor during testimony. See Respondents' Brief to Sec. at 51.

As was noted by the T1/T3 Carriers, "'demeanor' means 'outward appearance such as facial expressions, tone of voice, gestures, and the hesitation or readiness to answer questions.'" T1/T3 Carriers Brief to Sec. at 3, citing Black's Law Dictionary (8th ed. 2004). The deference generally afforded to the hearing officer is based upon the rationale that he is able to observe the physical mannerisms and behavior of the witness while on the stand. See e.g., NLRB v. Walton Mfg. Co., 369 U.S. at 404. While the ALJ did find that some witnesses were evasive, which would perhaps fall within the latter part of the Black's Law definition, he supported this conclusion with testimony which he believed demonstrated incomplete answers, or those which showed an agenda that the witness was attempting to advance.[78] The Department is in a position to review that testimony, which is captured in the record, as well as all other testimony which forms the basis upon which the ALJ's credibility determinations rest. Because his findings are based upon testimonial content rather than demeanor, to a large degree, and because credibility is not central to the outcome of this case, the Department does not rely on the ALJ's findings on credibility.

The Department believes that there is substantial evidence supporting its decisions in this case, notwithstanding the testimony of the witnesses about whom the ALJ made adverse findings. While the parties' briefings and the record itself present a basis upon which the Department could deviate from the ALJ's findings of credibility, and it would be well within its authority to do so,[79] the Department does not see it as necessary to reach its

[77] The previously cited case of Howard v. Heckler, 782 F.2d 1484, 1487 (9th Cir. 1986) provides an example of a dispute in which the ALJ's credibility determinations are afforded greater weight because the claimant's "claim to disability benefits turn[ed] on whether his testimony about pain is to be believed." The current dispute before the Department presents a very different situation; the outcome does not depend on whether the testimony of a key witness is to be believed. Rather, it rests on a careful and thorough review of the entire record and supporting exhibits, which present the methodology, costs and other evidence that supports the Department's final decision.

[78] LAWA argued that such testimony was selectively edited and taken out of context, which made it appear evasive when in fact it was not. Respondent's Brief to Sec. at 43-44. As a result, the Department has reviewed the full testimony from the transcripts. This perhaps highlights the fact that the ALJ's determinations rest upon the content rather than the demeanor of the testimony, which the Department can review to make its own findings.

[79] See e.g. Greater Boston Television Corp. v. FCC, 444 F.2d 841 (D.C. Cir. 1970). In Greater Boston, the D.C. Circuit made clear that an agency may depart from the examiner's findings, so long as there is "attentive consideration to the Examiner's decision." Id. at 853. The court explained that "the Examiner's decision is part of the record, and the record must be considered as a whole in order to see whether the

decision in this case since substantial record evidence supports the outcome of this case, totally apart from the testimony of the witnesses at issue. In particular, the BOAC resolutions outline the costs, methodology, and matters which are the crux of this dispute, and they were heavily relied upon by the Department in resolving this dispute. E.g., LAX-002 through LAX-025. While the LAWA witnesses, particularly Ms. Tubert, testified on cross-examination about the BOAC resolutions, established the foundation for this evidence, and provided a context for understanding the methods and actions of BOAC and LAWA, the Department has not determined this case based solely or principally on her testimony. Rather, it has solid grounding in the record evidence submitted by LAWA as explained throughout this Final Decision. Moreover, even if the ALJ was concerned about Ms. Tubert's motives or testimonial demeanor, that does not discredit the reasonableness of BOAC's actions or change the underlying facts, evidence, and costs that determine the outcome of this case. Therefore, unless otherwise noted, the Department is disregarding the ALJ's findings of credibility in this case and the conclusions reached by the ALJ based upon those findings.

While the ALJ reached the conclusion that two of LAWA's other witnesses, Mr. Cushine and Mr. Eaton, experts who assisted in the development of the new terminal charges and their calculation, were not credible either, see RD 21-22, the Department does not believe that these conclusions were adequately supported by the RD. The ALJ largely took issue with their preparation for their role as experts and the content of certain elements of their testimony, but said little about their actual physical demeanor during testimony. Id.

Therefore, the Department is disregarding the ALJ's findings of credibility with regard to these two witnesses, since it does not believe that they are central to the determination of this case, nor are they adequately supported by the RD.

The Department has examined the entirety of the record and will also disregard the ALJ's finding that "the financial information supplied by LAWA is not credible and cannot be relied upon to make accurate, substantive recommendations". RD at 31. The Department disagrees and finds there is substantial evidence supporting, and justification to rely on, LAWA's financial data presented in this case. For example, LAWA corrected all errors and, in fact, voluntarily admitted to errors in calculations about which it immediately notified the parties and corrected on the record in open court. E.g., Tr. 727:9 – 730:11 (Rosenthal). The DOT Policy Statement encourages transparency in establishing airport rates and chares. DOT Policy Statement at § 2.7.1. The Department particularly encourages airports and air carriers in § 47129 proceedings to correct data errors wherever possible in order to promote the policy goal of transparency. The Department looks favorably on those parties who voluntarily correct the record. Port Authority Recommended Decision at 22 (OST 05-20407-116) (May 9, 2005). To do otherwise may dissuade future parties from voluntarily correcting errors and engaging in transparent accounting practices.

---

result is supported by substantial evidence." Id. In considering the entire record, the agency is free to reverse the hearing examiner's decision, demonstrating "its awareness of what the Examiner had concluded…[and] also its reasons for taking a different course." Id.

In addition, the record shows that the financial records of LAWA undergo regular audit by independent auditors, TBIT Ex. 27 (LAWA's "Annual Financial Report For the Years Ended June 30, 2006 and 2005"), and that no arose issues concerning the overall reliability or accuracy of LAWA's accounting system or financial records.

> [Moreover,] its outside auditors have given LAWA's financial statements unqualified opinions in all relevant periods, going back at least five years, and the Airlines themselves relied without any reservation on LAWA's public announcements and published financial statements going back to 2002. See T1/T3 Ex. A-1 ¶ 41 (Kasper Decl.) (relying on LAWA press release reporting financial results); TBIT-60 (Wikel Decl.) at 9-12, Tables 1, 2 (relying on LAWA's Annual Financial Reports without reservation).

Respondents' Brief to Sec. at 52-53. The Department believes it is reasonable to rely on LAWA's financial data that is fully audited, rather than indict the entire system based on a handful of errors that were voluntarily corrected and explained by LAWA.

The Department also believes it is reasonable to rely on LAWA's financial data because in its briefing LAWA reasonably explained all of the errors and rebutted the specific criticisms of the ALJ with satisfactory factual responses. See Respondents' Brief to Sec. at 51-60. LAWA even showed that one significant point of criticism of its financial data was not due to its financial system, but due to an allocation "fiction authored by the T1/T3 Complainants, and adopted by the RD in slightly modified form." Respondents' Brief to Sec. at 57 (referring to an erroneous allocation of $17 million of $33 million in total security expenses to just two of nine terminals at LAX).

5. New and Increased Maintenance and Operations Costs

The Department finds that there is substantial evidence in the record to reject the M&O portion of the ALJ's Recommended Decision, which found that the new and increased M&O costs are unreasonable, because the fees are cost-based and the Carriers generally did not dispute the fee elements. RD at 54.[80]

The Department reaches this conclusion because the complainants do not dispute the specific cost elements of the increased M&O fees, their calculation, or allocation to the various cost centers other than to dispute the reasonableness of their application based on the rentable space methodology, which we have noted is a separate and distinct issue. Neither do the complainants dispute the landing fee methodology used by LAWA to calculate and allocate the new and increased M&O fees.

Therefore, as an initial matter, the Department finds that the cost center allocation percentages used by LAWA are reasonable because the complainants did not take issue

---

[80] This section of the decision does not address the "rentable space" component of the M&O fees, which is discussed below, but rather, addresses only the reasonableness of the three components of the M&O costs disputed by the airlines: access, security, and general administrative costs.

with them. Tr. 339-40 (Kasper); RD at 52 n.221. The allocations are also reasonable because they are treated and applied consistently with the allocation of M&O costs under LAX's landing fee methodology, which have been in use for at least ten years. LAX-008-0001; LAX-009-0003; Tr. 2444 (Pan); RD at 52 n.221. The new M&O methodology thus reasonably allocates the three new and/or increased cost allocations to the terminal cost center. LAX-148, at 8; Tr. 2096 (Hubbell).

The Department further finds that the new and increased M&O fee components of access, security, and general administrative are reasonable because the evidence presented by LAWA shows that they are based on costs. As noted in the record, LAWA previously charged the airlines 15% of the direct terminal M&O costs as a "proxy" in place of charging the carriers the actual costs incurred by LAWA according to the landing fee methodology. LAX 184 (Cushine Decl.) ¶¶ 23-25; Tr. 3008:16-20 (Pan); Tr. 3073:6-14 (Cushine). The proxy resulted in LAWA not charging airlines their full share of the terminal costs, which LAWA paid by cross-crediting, i.e., using concession revenue to make up the shortfall. LAX 184 (Cushine Decl.) ¶ 36; Tr. 3075:6-18 (Cushine); Tr. 2426:6-2429 (Pan); LAX-048-0014-21: LAX 177 (Pan Decl.) ¶ 14. The new M&O fee system is based on actual costs using the landing fee methodology, not 15% the proxy. Tr. 3148:24-3149:4 (Cushine); LAX-008-001. Basing M&O charges on actual costs, as opposed to the 15% proxy approach, is a reasonable and permissible methodology.

LAWA first informed the airlines in November 2005 of this change to using actual costs. Tr. 695:8-11 (Hubbell); LAX 184 (Cushine Decl.) ¶ 27. LAWA presented evidence that using the landing fee methodology allowed it to include in the M&O fee the previously unallocated indirect M&O costs now in dispute: general administration, access, and security costs. LAX-184 (Cushine Decl.) ¶ 27; LAX-009-0005-6. In January 2006 LAWA gave the airlines spreadsheets based on preliminary fiscal year 2005 financial data to demonstrate the allocation of general administration and access costs under the landing fee methodology. LAX-184 (Cushine Decl.) ¶ 28; LAX-026 (Exhibit A.10); LAX-027 (Exhibit A.2). That direct cost center/indirect cost center allocation method was described in greater detail above, at § C(1).

With regard to the security cost component of the M&O fee, substantial record evidence also supports that it is reasonable because it is cost-based. Security costs for LAX soared dramatically following the terrorist attacks of September 11, 2001. Tr. 2425:6-14 (Pan). Security costs, which consist of airport police and the Los Angeles Police Department, went from $25 million in 1997 to approximately $119 million in 2006. LAX-048-0014; Tr. 2425:6-14 (Pan).

Some airline witnesses agreed that security costs have increased. E.g., Tr. 1646:12-18 (Berg); Tr. 1136:9-12, 1155:12-18 (Idy); Tr. 1046:7-15; Tr. 1087:18-21 (Reiser). LAWA commissioned the Matrix Security Study to review its security costs and allocations. The Matrix Study determined that in fiscal year '03-'04 LAWA collected only $41.8 million of the $93.2 million it spent on security, and the bulk of that amount was recovered through the LAX landing fee. LAX-048-0009; LAX-177 (Pan Decl.) ¶ 14. The Matrix Study also found that, during the same time period, $25.9 million of total LAX security

costs were attributable to the terminal cost center, but were not fully collected because of LAWA's use of the 15% proxy instead of actual, allocated costs. LAX-048-0021; Tr. 3076:24-3077:12 (Cushine).

With the new M&O cost allocation based on the landing fee methodology, LAWA charges those costs instead of the 15% proxy. Tr. 2428:2-25 (Pan). LAWA estimated that "approximately 50% of the total increase in M&O recovery is attributable to the collection of security expenses from the airlines. Tr. 2429:7-23 (Pan); see also LAX-045-0003 ('60% of the increase was due to security costs')." Respondents' Brief to the ALJ at 16. The evidence further showed that the new M&O costs also reasonably allocated the general administrative and access costs to the terminal cost center by the landing fee methodology and not by the 15% proxy. LAX-184 (Cushine Decl.) ¶¶ 27, 35.

Finally, the evidence showed that LAWA calculates the M&O charges based on budgeted data for the year, which includes multiple reconciliations, exactly as done in the landing fee methodology, and provides three opportunities annually for the airlines to review and comment on the costs. Tr. 2448:19-2449:4, 2451:9-2452:1 (Pan).

The Department finds that the T1/T3 Carriers did not establish a prima facie case as to the unreasonableness of the new and increased M&O fees. Air Canada v. DOT, 148 F.3d at 1155-56 (in § 47129 cases, proponent has burden to show prima facie case of unreasonableness). The T1/T3 Carriers cited to LAWA's "current strong financial position," alleged LAWA is improperly using the fees to attract future financing for unapproved capital projects, claimed that LAWA failed to enter into good faith negotiations, and that the methodology is extreme, radical and not comparable to any other methodology in the industry. None of these arguments, however, directly shows that the new and increased M&O costs, consisting of the access, security, or general administrative costs, are unreasonable and not based on actual costs. Such cost-based charges and the methodology supporting them are reasonable because the amount of the costs and their allocation can be readily established and reflect the typical elements of a compensatory fee-setting method.

The TBIT Carriers made similar arguments as the T1/T3 Carriers, plus they noted that the fees were unreasonable because they included financial data errors. The record shows, however, that LAWA corrected the errors noted by the TBIT Carriers. The TBIT Carriers also claimed that the new M&O costs are unreasonable because their leases were silent as to the three components of the M&O fees. TBIT Brief to Sec. at 10-12. But, the record shows that the TBIT Carriers paid M&O fees for all prior years that their leases were in effect. Additionally, as we note supra, at note 60, the TBIT leases contain provisions expressly listing M&O fees. Exhibits B to LAX 150-170. In light of our determination that the TBIT Carriers' claims as to the M&O fees retroactive to January 1, 2006 should be excluded because those fees are covered by a "written agreement", we make no determination as to the reasonableness of the increased M&O fees for the TBIT Carriers. See § D(3) supra.

6. Rentable Space Methodology

The conversion from the useable to the rentable space methodology is described in the BOAC management recommendation for the December 18, 2006 meeting.[81] That evidence demonstrates that the T1 and T3 tenants previously had been charged rent for their "exclusive and airline joint-use" areas and not for their share of "terminal common areas" or for M&O and custodial expenses incurred in the terminal common areas. Those costs "have been absorbed by LAWA."[82]

The management recommendation described its rationale for recommending a rentable space methodology, as follows:

> Under the City of Los Angeles Charter, LAWA must adjust rents at LAX no less frequently than every five (5) years. Accordingly, the new Base Rental Rate []is simply consistent with LAWA's obligations to adjust rents at least every five years.
>
> In addition, although prior leases at LAX did not specifically allow LAWA to charge any rent to "public" areas of the Terminal—"common areas," that practice was inconsistent with normal commercial practices. Normal commercial practices permit a landlord (LAWA) to recover rent for all space in a building, not just space specifically leased by tenants. Staff's recommendation [] to allocate common space to tenants on the basis of "rentable" space, rather than on the basis of "usable" space is consistent with this practice.
>
> Finally, Staff has considered and rejected the argument advanced by T3 airlines that if LAWA is to charge them Base Rent using the Market Method, that LAWA must obtain an independent appraisal. In circumstances where there is no information available concerning the value of property, an appraisal may be warranted. Here, however, market data exists. Specifically, Staff has determined the fair market value of terminal space in T1 [sic] by reviewing recently negotiated rents with other airlines in the other LAX terminals.[83]

The staff "current action" with respect to rentable space was described as follows for both T1 and T3:

> [I]t is proposed that the Base Rent be calculated on a "rentable" square foot basis, rather than based solely on the number of square feet in a

---

[81] LAX-011 and -013 contain BOAC management recommendations to impose the rentable space methodology on the T1 and T3 tenants, respectively. The recommendations were approved by Ms. Tubert in her capacity as Deputy Executive Director.

[82] LAX-011-002; LAX-013-002.

[83] LAX-0110-002-003; LAX-013-002-003

> tenant's "exclusive area" and, for airline tenants, a share of the number of square feet in the "airline joint use areas." Basing the Base Rent on "rentable" space would allow LAWA to allocate a share of T1 common areas to all tenants--both airline and non-airline—and thereby also allow LAWA to charge M&O Rent for those common areas.

The T1 common areas were calculated as one-third of useable space:

> Since the common areas are about one-third of the usable space in T1 (108,649 sq. feet of a total of 326,588 sq. ft), allocating a portion of common areas of T1 to T1 tenants is consistent with prudent management of the facility and sound real estate practices since it will allow LAWA to recover M&O Expenses associated with those common areas from tenants who benefit from having them.[84]

The T3 common areas were calculated at about 38% of the useable space:

> Since the common areas are about 38% of the usable space in T3 (109,649 sq. feet of a total of 289,362 sq. ft), allocating a portion of common areas of T3 to T3 tenants is consistent with prudent management of the facility and sound real estate practices since it will allow LAWA to recover M&O Expenses associated with those common areas from tenants who benefit from having them.[85]

LAWA, in addition to charging the T1/T3 Carriers base rent for the rentable space, also charges their share of the M&O costs for the direct and indirect cost centers. LAWA allocates other shares of cost to concessions and non-airline tenants, and it bears the risk that these tenants will generate sufficient revenues to pay their portion of costs. Tr. 3091:9-16 (Cushine). LAWA had charged US Airways and Southwest M&O costs (including costs for electrical, heating, air conditioning, elevator-escalator and plumbing systems and general overhead including building repairs, outside cleaning, re-lamping and custodial services) for common areas in the 1985 leases. LAX-120 at 9; LAX-133 at 9 (1985 leases). These leases have expired.

The ALJ's Recommended Decision: The ALJ found the new rentable space methodology reasonable but unjustly discriminatory in its application only to the T1/T3 Carriers "while not imposing the same methodology on another carrier – in this case the T2/4-8." RD at 55. He found that the "rentable space" method adds to the air carrier's prior "usable space" (i.e., its exclusive space plus a pro rata share of joint-use space) a share of all "common areas"—public spaces such as corridors and rest rooms.[86] Excluded from the "rentable" space are areas used exclusively by the airport (such as

---

[84] LAX-011-003
[85] LAX-013-003
[86] RD at 54, citing LAX-011-0003; 013-00002; Tr. 849, 911 (Hubbell).

offices) or other tenants and "voids" (stairwells, elevators, utility areas and the like used by other tenants).[87]

The ALJ found this change in methodology to have significantly increased the terminal areas allocated to air carrier M&O cost recovery. He found that Alaska Airline's allotted percentage of terminal space increased from 60% to 88%, Rd at 55, citing Tr. 1625, 1634-33, 1639 (Berg) and Southwest's area increased from 50% to about 88%. RD at 55, citing Tr. 682-83 (McGlade).

The ALJ found it reasonable for the airport to impose costs for these common areas on the airlines because the airlines benefit from having them.[88] He also found it reasonable for LAWA to allocate a portion of its costs fairly reflecting their use of those areas. The ALJ also found that, although it may be reasonable for LAWA to use a residual methodology to recover common area costs, the new compensatory approach is just as reasonable.[89]

The Department's Finding: The Department adopts the ALJ's findings, in part, as discussed below.

We agree with the ALJ that it is reasonable for LAWA to impose compensatory costs on the T1/T3 Carriers for their share of the common areas in their terminals. We agree that they and their passengers make use of and benefit from the common areas (the lobbies, for example, provide access to gates and other facilities). We therefore find that LAWA is justified in charging the airline tenants for their proportional share of the actual costs incurred in maintaining and operating the common areas.

More specifically, we find that a fee methodology designed to capture costs using a compensatory method is generally reasonable. Policy Statement §§ 2 - 2.1.3. Compensatory rates also are consistent with the requirement that an airport maintain a fee and rental structure that in the circumstances of the airport makes the airport as financially self-sustaining as possible. Policy Statement § 4. Accordingly, even though the T1/T3 Carriers complained that the rentable space methodology would produce fees significantly in excess of those they currently pay, there was no evidence that the cost-based base rent fees imposed on the T1 Carriers, and the M&O fees imposed on the T1/T3 Carriers, for the proportionate share of the common use areas were not reasonable.

LAWA urges us to find the rentable space methodology to be reasonable based on testimony that other airports engage in similar practices. It did present evidence that 19 our of approximately 400 commercial service airports in the United States utilize a type of rentable space methodology.[90] The record was developed, however, to show that at most of those airports there was an agreed-upon form of financial mitigation for the airlines, either through revenue-sharing, majority-in-interest clause power over capital

---

[87] Rd at 54, citing LAX-195 at 13-14 (Tubert); Tr. 800-01; 967 (Barger); Tr. 358 (Kasper).
[88] RD at 55, citing Tr. 358 (Kasper)
[89] RD at 55.
[90] LAX-178 (Eaton Decl.) ¶ 4; Tr. 3240:4-6 (Eaton).

projects, reduced charges for debt service coverage, or other forms of financial mitigation or credits to the airlines.[91] Further, there was no evidence that any of the 19 airports had imposed the rentable space methodology; rather that methodology was part of a lease or arrangement between the airports, on the one hand and the airlines operating at the airport, on the other hand. Additionally, there was no evidence that any of the airports used a market value methodology in combination with a rentable space formula.

We have said in past cases that "practices of other airports are not necessarily decisive for reasonableness determinations."[92] Rather, we must base our decisions on fee reasonableness on the specific facts of the cases before us. Although a compensatory methodology for rentable space, including maintenance and operations expenses, is reasonable if applied proportionately to the air carriers serving the terminals, that was not the case here. The net result of the "rentable space" approach to cost allocation, when applied selectively on some carriers, but not on others, is to inflate artificially costs for common areas for the one group (in this case the T1/T3 Carriers), but not the others (the T2/4-8 Carriers). Because carriers making similar use are not being charged on a comparable basis, and because LAWA has not offered an adequate justification for this practice, we think the use of the rentable space methodology in the context of this case violates the prohibition against unjust discrimination. For a more detailed discussion of the Department's decision on rentable space and unjust discrimination, see § D(8)(a) infra.

7. Market Value Methodology

As we described above, LAWA imposed the market value methodology on the T3 Carriers for base rent which included not only "useable" spaces, but also "rentable" spaces. LAWA set the market value by considering the range of negotiated and agreed-upon fair rental value base rents in T2/4-8 for those airlines'useable space. The ALJ concluded that use of fair market value was unreasonable because it was not cost-based and was set unilaterally by LAWA staff. He also disagreed with the "opportunity cost" justification because airports are not typical commercial properties. RD at 57.

The Department finds that there is substantial evidence in the record to affirm, in part, the ALJ's Recommended Decision to the extent that he found that LAWA's application of a market value methodology for T3 is unreasonable. RD at 56-58. But we reject the ALJ's findings that the market value method is not appropriate for aeronautical users at airports. Specifically, the Department finds that it is permissible for airports to use a market value methodology based on what other airport tenants pay so long as those charges are based on negotiated agreements and the rates are supported by a neutral third party appraisal. Thus, airports may charge based on the "opportunity cost" involved in renting out airport space to an air carrier, but the foregone opportunity needs to be based on other, potential aeronautical uses. Thus, it is critical that there be an outside, third party appraisal to determine what the aeronautical market is as to any particular terminal facility.

[91] Tr. 2299:14-25 (Montgomery); 3251:13-21 (Eaton); 3523:10-23 (Eaton)
[92] Miami International Airport Rates Proceeding, Order 97-3-26 at 34 (March 19, 1997).

The Department also finds, therefore, that the application of the market value methodology in this case was unreasonable because it was imposed, rather than negotiated, and established unilaterally by LAWA staff rather than by objective third party appraisers. The Department also finds LAWA's application of the market value method unreasonable here because it was determined based upon the negotiated base rents paid by carriers at other terminals based on their "useable" space, yet applied to T3 based on its "rentable" space. LAX-013-003 ("Staff has determined the fair market value of terminal space in T1 [sic] by reviewing recently negotiated rents with other airlines in the other LAX terminals."); Tr. 3305:9-16 (Tubert).

We note at the outset that LAWA did not rely on the use of commercial retail space in implementing its "fair market value" ("FMV") for terminal base rent. Commercial real estate appraisals may not be considered reasonable by the Department for the establishment of FMV because airports have grant assurance obligations to operate the facility for aeronautical purposes. Thus, while the Department finds that airports have "opportunity costs", those opportunity costs are limited because an airport's ability to use terminal space for non-aeronautical purposes is limited by its obligations to continue to operate the airport as an airport. Policy Statement, 61 Fed. Reg. at 32011.

In determining FMV here, LAWA says that it relied on its direct negotiations with airlines in other LAX terminals to obtain an agreed-upon fair rental value. These negotiations, according to LAWA, were based on other aeronautical use properties and were adjusted to conform to the comparative condition of the properties. See LAX-011, LAX-013. LAWA however admits that it did not directly negotiate with the T3 carriers but simply imposed upon them an appraisal performed by LAWA staff. Respondents' Brief to ALJ at ¶ 59; LAX-011, LAX-013.

The Department has reviewed the record for itself and considered the arguments advanced by the parties. Based upon this review, the Department finds substantial evidence and legal authority to reject the ALJ's Recommended Decision on this issue and find reasonable LAWA's use of a market value method, except insofar as: (1) LAWA imposed rather than negotiated the FMV; (2) LAWA's appraisal failed to use an objective appraiser who was not part of LAWA staff; and (3) LAWA's imposed FMV rate was based on the rates paid by other terminal users on their "useable" space, yet imposed on the T3 Carriers for their larger "rentable" space.

Turning first to the legal authority applicable to this issue, the Department finds that neither the Policy Statement nor controlling decisional guidance precludes the use of FMV. Section 2.6.1 of the Policy Statement clearly permits an airport to use FMV to establish fees for non-airfield facilities, such as the terminals. "Reasonable methodologies may include, but are not limited to, historic cost valuation, direct negotiation with aeronautical users, or objective determinations of fair market value." Policy Statement at § 2.6.1 (emphasis supplied).

The cases which have addressed the use of fair market value in airport terminal rate setting have not prohibited the use of fair market value. In the case of ATA v. DOT, 119

F.3d 38 (D.C. Cir. 1997), the court found arbitrary and capricious the DOT's Policy Statement provision that an airport could use only historical costs for airfield fees but could use "any reasonable methodology" for non-airfield fees.

The Department subsequently acknowledged in the remand of ATA v. DOT that the Court did not prohibit the use of fair market value:

> The Court remanded this case since it believed that we had wrongly read the statutes as prohibiting the use of the fair market value charge. The Court held that the applicable federal statutes do not exclude all costs but out-of-pocket costs from an airport's calculations of compensatory landing fees and that the statutes may allow an airport to recover such costs as opportunity costs. LAX I, 103 F.3d at 1032.
>
> Notwithstanding the Court's decision, the airline complainants argue that the airport's fair market value charge is prohibited by the federal statutes, since those statutes assertedly require airport fees to be based on costs and since opportunity costs are not a legitimate cost within the meaning of these statutes. Congress allegedly intended to keep airports from making a profit from their aeronautical fees, including their landing fees. . . .
>
> * * *
>
> We cannot agree with the airlines' position that the fair market value charge is clearly barred by the terms of the statutes governing airport fees. The Court has already held that the applicable federal statutes do not prohibit the use of opportunity costs in calculating airport fees. Given the Court's ruling, we could not adopt the airline complainants' position in this case even if we agreed with it.

LAX II Remand Decision at *6-7 (emphasis supplied). The Department has not made any changes to the Policy Statement since the ATA decision or the LAX II Remand Decision, which was issued on December 23, 1997.

The court's ruling as to fair market value in ATA v. DOT, and the Department's interpretation of that case was further explained in City of Los Angeles v. DOT, 165 F.3d 972, 976 (D.C. Cir. 1999):

> In June 1996, the Secretary published a regulation entitled the "Policy Regarding Airport Rates and Charges." See 61 Fed. Reg. 31,994 (June 1996). The regulation required airports to value their airfield assets at historic cost, but allowed airports to use "any reasonable methodology" in valuing their non-airfield assets. Id. In Air Transport Association v. DOT, 119 F.3d 38 (D.C. Cir. 1997), we vacated the regulation, challenged both by the airlines and Los Angeles, because, inter alia, the Secretary "simply ha[d] not explained why fair market valuation may be appropriate for other portions of the airport, but too difficult to use in valuing airfield assets."

Id. at 44.

Further, airport charges that exceed costs have not been barred judicially. See City of Los Angeles v. DOT, 165 F.3d at 978-80 (discussing the needs of an airport to maintain its credit-worthiness for its bondholders and to generate revenues to "assure confidence in the financial integrity of its enterprise") Id. citing with approval FPC v. Hope Natural Gas Co., 320 U.S. 591, 602 (1944); 49 U.S.C. § 47101(a)(13) (providing that the policy of the United States is that "airports should be as self-sustaining as possible"). Permitting LAWA to impose these fees under the methodology we have prescribed is within our discretion. We are not fashioning this holding because we believe that LAWA's financial integrity is in jeopardy. Our holding however is based on the Policy Statement and on our finding that airports may charge a measure more than historical costs for airline use of aeronautical facilities, provided of course, that other aspects of the Policy Statement are followed, such as the requirement that there be no unjust discrimination and that the fees do not result in excessive accumulated surpluses as determined by the FAA.

The T1/T3 Carriers further claim, in agreement with the ALJ's RD at 57-58, that "LAWA's 'lost opportunity' from leasing airport hold rooms and other airline space to the carriers rather than concessionaires does not represent an actual cost incurred by LAWA to provide the space to the carriers." T1/T3 Brief to Sec. at 44. We find that it is critical that there be an outside, third party appraisal to figure out what the aeronautical market is as to any particular piece of real estate. For example, it may be that in a particular case an appraiser would determine that a greater portion of a terminal would ordinarily be devoted to higher income/square foot uses, and thus that the opportunity cost for renting out a disproportionately high proportion of a terminal to an air carrier needs to be accounted for in determining market value. That finding, however, should be based on an objective and transparent survey of other terminals.

The Department's decision to find the application of fair market value by LAWA in this case to be unreasonable is based on the record evidence showing that LAWA's establishment of fair market value was not an objective determination, but rather, a determination established by in-house LAWA staff. As a general matter, the evidence in the record shows that LAWA's Leasing Policy for base rent provides for use of the greater of either: fully allocated capital costs and expenses or fair market value plus fully allocated expenses. LAX-002-005 at ¶ 2.4; LAX-013-004; Tr. 3303:19-27, 3304:2-5 (Tubert). The evidence further shows that the leases between LAWA and the TBIT Carriers and the T2/4-8 Carriers use a type of FMV to establish base rent. T1/T3 Exs. D-1 at JC-00921; D-3 at JC-01097; D-5 at JC-01331; D-10 at JC-01454; D-12 at JC-01670. See also Respondents' Brief to Sec. at 15. This evidence shows that LAWA applies a market value component to the base rent of all carriers at the airport.

LAWA's evidence submitted in this case also established the process for determining T1/T3 base rents according to the market value method and was explained in Respondent's Brief to Sec. at 15-16:

> LAWA staff considered the range of negotiated and agreed-upon fair rental value base rents at T2, T4, T5, T6, T7 and T8 that had been approved by BOAC in January 2006. Tr. 3305:9-16 (Tubert). These rents ranged from $17.50/ft^2$ to $23.50/ft^2$. LAWA staff then considered the condition of T1 and T3 and compared them to comparable properties. Tr. 3305:17-25 (Tubert). LAWA staff determined that the FMV rent for T1 was $20/ft^2$, and the FMV rent for T3 was $17.50/ft^2$. Tr. 3306:1-6 (Tubert). This evaluation is also described in the Base Rental Rate Board Reports for T1, LAX-011-0004, and T3, LAX-013-0004. These two values were compared to the base rent determined from the Terminal Capital Charges ("TCC") method, and the greater of the two numbers was set as base rent.

The Department finds, consistent with its prior determination in LAX II Remand Decision and as explained above, that fair market value is not barred by the statutes governing airport fees. Therefore, fair market value is permissible for airport operators to use to determine base terminal rent and LAWA is not barred per se from using its "market value" methodology. Rather, LAWA should either negotiate the fair market rate, or if it must be imposed, should use an independent appraisal to determine the fair market rate. LAWA's failure to use an objective measure, i.e., an independent appraiser basing the fair market value on other comparable aeronautical terminal facilities, renders LAWA's determination of fair market value as unreasonable. Likewise, LAWA's use of comparable rental rates from other LAX terminals based on "useable" space to apply to T3's "rentable" area is also unreasonable.

In addition, as discussed above, BOAC staff recommended the T3 Base Rent to be set pursuant to the fair market rental value of T3, including land and improvements. This was estimated to be $17.50 per square foot annually, effective for a five-year period, subject to annual CPI adjustments. This was compared to the $2.45 current capital charges method. Staff acknowledged that no agreement had been reached with the T3 airlines over the proposed rental rates for the rentable area.[93]

BOAC staff justified its rentable space methodology proposal as follows:

> LAWA is legally required to adjust rental rates for facilities at LAX no less frequently than every five years. LAWA is also required by federal law to make LAX as self-sustaining as possible. As such, LAWA is required to recover expenses it incurs in operating the terminals at LAX from the users of those terminals. See 49 U.S.C. § 47107(b); City of Los Angeles v. FAA, 239 F.3d 1033, 1034 (9th Cir. 2001). Thus, the alternatives to Staff's recommendation—to not adjust the Base Rental Rate for the facility and to collect rent on only a portion of the terminal—would not be consistent with these mandates.[94]

[93] LAX-013-004-005

[94] LAX-011-0005; LAX-013-0005.

We do not find record evidence to support the BOAC staff recommendation that LAWA is required to adopt a market-based methodology to comply with the self-sustaining grant assurance.[95] Our Policy Statement expressly indicated that an airport proprietor is not compelled by the obligation on self-sustainability to use fair market value to establish aeronautical fees. Policy Statement at § 4.1.1(b). We further explained, in our Policy and Procedures Concerning the Use of Airport Revenue, that the self-sustaining clause would generally require FMV commercial rates for non-aeronautical uses of airport property. We stated that, in contrast, in light of the "reasonableness" standards for aeronautical use, the Policy on Airport Revenue permits an airport operator to charge fees to aeronautical users that are less than FMV but more than nominal charges. 64 Fed. Reg. 7696, 7710 (Feb. 16, 1999). Moreover, the case cited by BOAC staff (City of Los Angeles v. FAA, supra , merely stands for the proposition that the FAA Policy on revenue-use (and self-sustaining) obligations are not reviewable in the Court of Appeals. The Ninth Circuit Court of Appeals did not substantively address the self-sustaining obligation in its review of the City's petition. Therefore, the case does not compel an airport proprietor to use FMV for aeronautical uses.

We find therefore that LAWA's imposition of a market-based methodology for the terminal base rent is unreasonable because it did not comply with the Policy Statement. Our Policy Statement permits an airport proprietor to negotiate such a methodology, but if it wishes to impose this approach, then it must first obtain an independent objective appraisal for FMV.

8. Other Issues:

a. Airlines Making Similar Use of the Airport

The Instituting Order directed the ALJ to determine whether the airport's new M&O methodology for the T1/T3 Carriers and the TBIT Carriers is reasonable, justified, and not unjustly discriminatory. Instituting Order at 26. We also directed the ALJ to consider, in investigating the alleged unjust discrimination, the comparability of facilities used, the similarity of use of the airport, and differences justifying reasonable classifications, as between the T1/T3 Carriers, on the one hand, and the T2/4-8 Carriers, on the other hand, and as between the TBIT Carriers, on the one hand, and the T2/4-9 Carriers, on the other hand. Id.

The ALJ's Recommended Decision: The ALJ found that all the airlines occupy essentially comparable facilities and that all terminals have essentially the same passenger amenities. RD at 49. The ALJ compared the size, scope, finish and furnishings of the terminals, and their roadway access. He found the TBIT terminal was substantially larger than the others and that none of the terminals are deficient. As to whether the T1/T3, TBIT, and long-term carriers are "similarly situated," the ALJ found that they all

[95] The AIP grant assurances require an airport to certify, among other things, that : "the airport owner or operator will maintain a schedule of charges for use of facilities and services at the airport—that will make the airport as self-sustaining as possible under the circumstances existing at the airport, including volume of traffic and economy of collection. § 47107(a)(13)(A).

have similar and comparable facilities and make similar use of the airport. The fact that the T2/T4-8 carriers have long term leases and the T1/T3 carriers have expired or short-term leases is, in the view of the ALJ, an artificial classification and "a distinction without a difference." RD at 5.

In particular, the ALJ found that LAWA unjustly discriminated against the T1/T3 Carriers by imposing fees on them for the common use areas, pursuant to the rentable space methodology. The ALJ found that otherwise the rentable space methodology was reasonable.

LAWA's Exceptions to the ALJ's Recommended Decision: LAWA states that the issue is whether, when it entered into 40 year leases in the 1980s with the long-term carriers, it bound itself not to change the methodology by which terminal rents are calculated for any other airline during the pendency of those leases. LAWA asserts that it is not engaging in "unjust discrimination" in violation of the federal grant assurances [(§ 47107(a)(1)] by imposing different fee methodologies on the T1/T3 and TBIT Carriers (vis-à-vis the long-term carriers). It asserts that it may reasonably classify these carriers as non-tenant/non-signatory carriers and therefore apply a new leasing methodology to them, in accordance with our Policy. §§ 2.1, 3.1. The Policy, it asserts, allows the airport to make distinctions between tenants and non-tenants and signatories and non-signatories. LAWA considers the complaining airlines, by virtue of not having signed the New Lease, to be non-tenant/non-signatories since they could leave at any time. LAWA further claims that it can reasonably distinguish between airlines who signed long-term leases in the 1980s under the residual rate methodology, on the one hand, and airlines who did not sign leases of that duration and whose five year leases had expired, on the other hand.

LAWA cited to public utility case law for the proposition that the mere fact of a rate disparity between similarly situated parties does not establish unlawful rate discrimination where the rate disparity results from arms-length private contractual arrangements. Cities of Bethany v. FERC, 727 F.2d 1131 (D.C. Cir.), cert. denied, 469 U.S. 917 (1984); City of Frankfort v. FERC, 678 F.2d 699, 707 (7th Cir. 1982). LAWA referred to Supreme Court precedent recognizing a regulated utility's right to change rates or contracts for prospective customers while being limited by contracts for existing customers. United Gas Pipe Line Co. v. Memphis Light, Gas & Water Div., 358 U.S. 103, 113 (1958)

LAWA also relied on several fixed base operator ("FBO") cases which held that an airport had not engaged in unjust discrimination by offering more expensive lease terms to newer tenants. The airport was not bound to apply the terms of its existing contracts, negotiated in previous times and under different circumstances, to newer FBOs. Penobscot Air Servs., Ltd. v. FAA, 164 F.3d 713 (1st Cir. 1999); Wilson Air Ctr., LLC v. FAA, 372 F.3d 807 (6th Cir. 2004). LAWA also claimed that a California State court case permits it to apply a new leasing policy to an airline tenant operating without a lease while abiding by leases negotiated earlier with existing tenants. San Francisco v. Western Air Lines, Inc., 204 Cal. App. 2d 105 (Cal. Ct. App. 1962).

LAWA also disputed the ALJ's implicit finding that the complaining airlines have established a prima facie case of unjust discrimination. LAWA asserted that the airlines presented no evidence comparing the current facts and circumstances with those that existed in the 1980s in connection with the long-term carriers' contracts.

T1/T3 Carriers' Position in Support of ALJ's Recommended Decision on Unjust Discrimination: The T1/T3 Carriers oppose a per se rule that would permit an airport proprietor to impose significantly disparate rates on airlines simply because of the date they commenced their leases. The Carriers state that they recognize that an airport proprietor would be justified by circumstances in charging relatively small rate differentials for a temporary period of time. They claim that the magnitude and duration of the increased charges on the T1/T3 Carriers (new and increased M&O; rentable space formula with new and increased M&O and FMV component; and FMV on T3, for the 15-19 years remaining for the long-term carriers) and the absence of any cost justification results in unjustly discriminatory treatment for them.

The T1/T3 Carriers state that LAWA, as an airport proprietor, is bound by the federal grant assurances prohibiting unjust discrimination and requiring substantially comparable treatment of similarly situated carriers. § 47107(a)(1), (2) and (3) and by Grant Assurance 22, "Economic Nondiscrimination." The grant assurances, they claim, require that an airport not withhold from airlines the ability to be treated the same as their competitors are treated.

The T1/T3 Carriers urge us to find that they presented a prima facie case of unjust discrimination compared with the long-term carriers, due to the fact that all the carriers use the same types of facilities, the new terminal charges imposed on the T1/T3 Carriers are significantly higher than those charged the long-term tenants, and the duration of the disparity is significant (up to19 years). The T1/T3 Carriers calculate that the rate disparity (assuming the long-term carriers remain obligated to pay the new M&O fees) will be as high as five times. These Carriers claim that LAWA cannot regard them as non-signatories because they have been signatories and tenants for many years and have refused to sign the New Lease only because of its discriminatory and unreasonable terms. They point out that they were not given an opportunity to sign up for a lease term comparable to what the long-term carriers enjoy. Tr. 3359:14-23 (Tubert). Additionally, they were not offered longer term leases back in the 1980s. Tr. 2313:9-11 (Montgomery).

The T1/T3 Carriers are concerned that LAWA may increase their terminal charges even further to cover the costs of new projects, such as the "people mover" system, while the long-term carriers will pay considerably less under the "useable space" formula.

They also claim that LAWA did not produce evidence rebutting their claim of unjust discrimination by showing that the increased charges to T1/T3 Carriers were comparable to those that the long-term carriers had paid for under their debt obligations for capital improvements at their terminals. They further point out that, in the context of attempting to terminate the Delta and Northwest leases in bankruptcy court, LAWA apparently

conceded that it may be engaging in unjust discrimination by imposing the new terminal charges on the T1/T3 Carriers but not on long-term carriers such as Delta and Northwest. T1/T3 Brief to Sec. at 33-34.

They further cite to a State court case finding that rate differentials between similar telegraph customers on the basis of the dates they entered into contracts with the utility to be unjust. Postal Telegraph-Cable Co. v. Associated Press, 127 N.E. 256 (N.Y. 1920). Additionally, they rely on a water utility case finding that the utility could not allocate the costs of new plant construction only to new customers. Corporation to Revise and Increase Rates Charged for Water Service v. Idaho Pub. Util. Comm'n, 916 P.2d 1259 (Idaho 1996).

Finally, they allege competitive harm resulting from the disparate fees, showing that their average cost per enplaned passenger will rise significantly, severely impacting their ability to operate as low cost/low fare airlines. Tr. 512:3-6 (McGlade).

The T1/T3 Carriers further assert that the increased fees are not necessarily for LAWA to be "self-sustaining" or to bolster its credit rating.

ACI Opposition to the ALJ's Recommended Decision: The ACI-NA is concerned that our adoption of the ALJ's RD would bind airports to give others the benefits of leases it negotiated with carriers 20 years ago, in the context of long-term commitments, and preclude an airport from changing rate setting methods for carriers using the airport in different circumstances. ACI-NA explains that the 'similarly situated' obligation recognizes that airports may make reasonable classification among airline users. It cites to our decision in Brendan Airways, LLC v. Port Auth. of New York and New Jersey, Order 2007-20407 (Order 05-6-11), aff'd in part, Port Auth., 479 F.3d 21, that an airline with a lease was eligible for 'preferential treatment' under our Policy, § 3.1.1 and differences in charges based on signatory or tenancy status are permitted. It further argues that the federal grant assurances prohibit an airport proprietor only from unreasonably withholding signatory status and non-signatory carriers have no right to demand the benefits of long-term leases entered into years ago.

ACI-NA argued that the ALJ was wrong in finding that the T1/T3 Carriers established a prima facie case on unjust discrimination since a disparity in rates between carriers not similarly situated is not sufficient to establish a prima facie case.

T1/T3 Carriers' Reply Brief: The Carriers argue that the cases cited by LAWA are inapplicable, pointing out that the court in Cities of Bethany referred to a Federal Power Act provision permitting classifications based on cost of service implications and temporary rate differentials. Neither of those situations is evident at LAX, according to the T1/T3 Carriers; rather demonstrated competitive harm exists. The Carriers argue that because the FAA employs different standards for considering the reasonableness of airport conduct toward FBOs as opposed to carriers, the FBO cases are inapplicable. The Carriers assert that the magnitude of discrimination they experience at LAX was not complained of in any of the FBO cases. Further, they state that the disparities were either

minimal, relatively short in duration, or based on non-comparable facilities. With respect to the San Francisco case, the T1/T3 Carriers point out that the evidence showed that the carriers under long-term leases had operated at SFO as scheduled airlines a decade before Western, under common use agreement, entered. The T1/T3 Carriers acknowledged that SFO would have been justified in classifying Western as a non-signatory airline and treating it differently.

ACI-NA's Reply Brief: ACI asserts that the ALJ diluted the prima facie case burden by considering only whether the disparity in the fee increases were justified by increased airport costs. ACI points out that airports may lawfully shift from residual to compensatory cost approaches to more appropriately recover costs from the airlines and there is nothing presumptively unreasonable about a rate increase without a corresponding cost-increase.

LAWA's Reply Brief: LAWA disputes the T1/T3 Carriers' contention that they have made a prima facie case of discrimination by proving the magnitude of the rate disparity. LAWA claims that the magnitude of the fee increases does not reflect their reasonableness or unreasonableness and contends that the concessions had been subsidizing the carriers for a long time. LAWA also disputes that merely making similar use of similar facilities makes the carriers similarly situated, particularly when the airlines did not establish comparability of facts and circumstances between the 1980s and today. LAWA cites to record evidence that the long term carriers had leases up to 40 years, at a time when LAWA needed to expand LAX for the 1984 Olympic Games, and because LAX , with its residual financing system, could not obtain bond financing on favorable terms. Respondents' Brief to ALJ at 34-36, ¶¶ 112-121.

Further, LAWA points out that inter- and intra-terminal rate disparities existed before the new fees were imposed. Respondents' Brief to ALJ at 38, ¶128.

Additionally, LAWA says it is not violating the grant assurances by unreasonably withholding from the T1/T3 carriers signatory status on the same terms as the long-term carriers. LAWA cannot reasonably give the T1/T3 carriers the same status as the long-term carriers and the complaining carriers cannot assume the same obligations as the long-term carriers." LAWA claims it is trying to impose the same lease terms on the Delta and Northwest terminals as the T1/T3.

The Department's Decision: We affirm in part the ALJ's findings that LAWA's selective imposition of the rentable space methodology on the T1/T3 Carriers for common space usage was unjustly discriminatory. There is substantial evidence to affirm the ALJ's findings that the T1/T3 Carriers made similar use of this common space as did the long-term tenants. The long-term tenants, however, were not subject to the rentable space fees. Conversely, there is a lack of evidence showing that LAWA's selective imposition of the common area fees on the T1/T3 Carriers was based on any differences in use made of those terminals by the T1/T3 Carriers. Also, there is a lack of evidence demonstrating that the imposition of the rentable space methodology was based on classifying the T1/T3 Carriers as Tariff Carriers or even as short-term tenants.

LAWA does not appear to dispute the ALJ's findings that the T1/T3 Carriers, on the one hand, and the long-term tenants, on the other hand, engage in similar use of the common space area of the airport. Rather, LAWA claims that the T1/T3 Carriers are reasonably classified as non-tenant/non-signatory airlines and that it therefore may impose the rentable space fee methodology on them for the common space area while it does not do so for the long-term tenants.

We find that the FAA grant assurances do not permit LAWA to impose a disparate fee methodology on certain air carriers when the fee methodology is not otherwise justified by contractual terms, conditions, or obligations associated with those air carriers.

LAWA is obligated to adhere to the following economic nondiscrimination grant assurances with respect to the operations at LAX:

> (1) the airport will be available for public use on reasonable conditions and without unjust discrimination;
> (2) air carriers making similar use of the airport will be subject to substantially comparable charges –
> (A) for facilities directly and substantially related to providing air transportation; and
> (B) regulations and conditions, except for differences based on reasonable classifications, such as between –
> (i) tenants and nontenants; and
> (ii) signatory and nonsignatory carriers;
> (3) the airport operator will not withhold unreasonably the classification or status of tenant or signatory from an air carrier that assumes obligations substantially similar to those already imposed on air carriers of that classification or status. § 47107(a); Grant Assurance 22c.

This assurance requires an airport proprietor to subject air carriers making similar use of the airport's facilities or a portion of the facilities to "substantially comparable charges." The charges need not be identical but must be "substantially comparable." We find substantial evidence that the T1/T3 Carriers and the long-term tenants make "similar use" of the terminal common areas. Tr. 685:24-868:6 (McGlade); Tr. 3371:15-3374:14 (Tubert).

We also find substantial evidence that the charges assessed the T1/T3 Carriers are not "substantially comparable" to those assessed the long-term tenants at T2/4-8. The rentable space formula charges for space that the long-term tenants are not charged for. This is a fundamental <u>non-comparable</u> charge that is not consistent with the grant assurance as to aeronautical users making similar use of the airport. The result is that the rentable space charges are as high as five times, or $220 million to $265 million in terminal charges for the T1/T3 Carriers compared to the long-term tenants for the first five years. Ex. A-16-a, at 2, ¶5.

The grant assurance requires that differences in air carrier fees, terms, or conditions be reasonably related to the reasonable classifications undertaken by the airport proprietor.[96] LAWA asserts that it may reasonably impose the rentable space methodology on carriers operating pursuant to a Tariff or a short-term lease since they are classified differently than carriers still serving the airport under long-term leases signed 20 years ago. LAWA, however, has not shown that the rentable space methodology is reasonably related to the carriers operating under a Tariff or short-term lease and therefore has not shown how it is justified in treating the T1/T3 Carriers differently than those in T2/T4-8.

LAWA has not shown any obligations undertaken by the airport, for example, that merit the additional fee imposition on the T1/T3 Carriers or, on the other hand, commensurate obligations undertaken by the T2/4-8 Carriers that warrant their exclusion from the rentable space methodology. Rather, LAWA simply justified the new methodology on the T1/T3 Carriers by explaining that its contractual commitments with the T2/4-8 Carriers do not permit the rentable space methodology. That reason alone is not sufficient to impose a new fee methodology on one group of carriers and not another when they both make similar use of similar "common space."

We agree with the T1/T3 Carriers that the FBO cases cited by LAWA for the proposition that an airport proprietor may impose different fee structures on aeronautical users based solely on dates of tenancy do not support LAWA's imposition of different methodologies here. The Penobscot case, for example, did not involve comparable leased premises, addressed minimal disparities in lease rates (2.5%), and was brought by an FBO that had agreed to the fees charged under its lease. 164 F.3d 726-726. The Wilson Air Center case also involved a situation of distinctly different leased premises and obligations undertaken by the long-term lessee.

The public utility rate cases cited by LAWA for the proposition that rate disparities for newer customers do not constitute unjust discrimination are not directly on point.[97] For one, the airport grant assurance statute contains protections to airline users in addition to the "unjust discrimination" safeguards that may not be afforded by the power and gas statutes.[98] Second, unlike natural gas companies (which had needed stable supply

---

[96] Grant Assurance 22 e. provides:
Each air carrier using such airport (whether as a tenant, non-tenant, or subtenant of another air carrier tenant) shall be subject to such nondiscriminatory and substantially comparable rules, regulations, conditions, rates, fees, rentals, and other charges with respect to facilities directly and substantially related to providing air transportation as are applicable to all such air carriers which make similar use of such airport and utilize similar facilities, subject to reasonable classifications such as tenants or non tenants and signatory carriers and non signatory carriers. Classification or status as tenant or signatory shall not be unreasonably withheld by any airport provided an air carrier assumes obligations substantially similar to those already imposed on air carriers in such classification or status.

[97] See, e.g., United Gas Pipe Line Co. v. Memphis Light, Gas & Water Div., 358 U.S. 103, 113 (1958); Cities of Bethany v. FERC, 727 F.2d 1131, 1140 (D.C. Cir.), cert. denied, 469 U.S. 917 (1984).

[98] Airports that accepted federal grants certify to the FAA that they will impose "substantially comparable" aeronautical fees and other terms and conditions on airlines making "similar use of the airport." § 47107(a)(2).

arrangements for the health of the industry),[99] airports rely not only on revenue generated by their long-term tenants but also on passenger facility charges, FAA grants, and concession revenues. Airports therefore are not as dependent upon a long-term customer as are natural gas companies. Moreover, the strength of the origin and destination market at LAX is of greater impact than an individual airline with a long-term lease. Airlines may come and go over time while the importance of the Los Angeles market to major air carriers can hardly be disputed. Third, the California State court opinion relied on by LAWA, holding that an airline operating at common-use facilities without a lease may be charged more than carriers that had leased facilities at the airport,[100] is not controlling. It analyzed State law on unjust discrimination and the FAA was not a party to the case. Moreover, the San Francisco case was adjudicated prior to the addition of the "substantially similar" clause in the grant assurances.[101]

We hold, however, that an airport proprietor does not engage in unjust discrimination per se by imposing different lease terms on carriers whose leases have expired. Not every difference is unjust discrimination. For example, by retaining a long-term lease with one airline tenant and negotiating shorter term leases that may reflect increased costs with new entrants is allowable. An airport may lawfully impose reasonable classifications on air carriers and negotiate different terms of use and charges for such use with them. Indeed, an airport that finances its gates with passenger facility charges is in fact obligated to negotiate short term arrangements with the tenants of those gates.[102] Furthermore, the FAA has found that an airport may reasonably assess fees on certain resident aircraft while not assessing fees on transient aircraft without engaging in unjust discrimination.[103] However, an airport proprietor may not impose a more burdensome fee structure on a new classification of airline user without demonstrating at least a reasonable correlation between the new fees and the airline classification.

Accordingly, we uphold the ALJ's conclusion that the T1/T3 Carriers were unjustly discriminated against by LAWA's imposition of the rentable space methodology. However, to the extent that the ALJ reached conclusions on other issues involving unjust discrimination, we do not agree and reject those findings. Apart from the use of the rentable space methodology, the Department does not find the new M&O fees or market value methodology unjustly discriminatory.

---

[99] Cf. City of Frankfort v. FERC, 678 F.2d 699 (7th Cir. 1982), discussing FPC v. Sierra Pacific Power, 350 U.S. 348 (1956).

[100] San Francisco v. Western Air Lines, Inc., 204 Cal. App. 2d 105 (Cal. Ct. App. 1962).

[101] See Pub. Law 94-353 (1976), § 10 adding the language currently codified as § 47107(a)(2).

[102] 49 U.S.C. § 40117(f)(2); 14 CFR part 158.

[103] The FAA, in R/T-182 v. Portage County, FAA Docket 16-05-14 (2007) found that a general aviation airport did not engage in unjust discrimination a by assessing resident aircraft a fee based on weight and landings and not subjecting similar charges on transient aircraft. The FAA found that transient users did not have the same type of business relationships nor impose the same types of costs on an airport as a based-aircraft user. The resident aircraft fee was not onerous and consisted of a low variable surcharge. (This decision has been appealed by the complainant, R/T-182 LLC, to the United States Court of Appeals for the Sixth Circuit, i.e., R/T-182 LLC v. FAA, Case No. 07-3678.)

b. LAWA's Monopoly Power and Surplus

The ALJ found that LAWA "is a monopoly with respect to air service in the Los Angeles area." RD at 65. This issue was not within the scope of the Instituting Order. The parties did not have the opportunity to brief this issue fully. Accordingly, the Department will disregard the ALJ's finding on this issue. RD at 65.

The complainants have also alleged that LAWA need not increase rates because it enjoys a large surplus. The ALJ did not address this because we did not include it in the Instituting Order. The issue of accumulation of surpluses is one we typically consider in the context of an airport's grant assurance to be "as self-sustaining as possible under the circumstances existing at each particular airport." 49 U.S.C. § 47107(a)(13). As stated in the "policies" section of the Airport Development chapter of Title 49, one of the policies of the United States is to assure that airports should not "seek to create revenue surpluses that exceed the amounts to be used for airport system purposes and for other purposes for which airport revenues may be spent . . . including reasonable reserves and other funds to facilitate financing and cover contingencies." 49 U.S.C.§ 47101(a)(13). The evidence submitted by LAWA showed that LAWA needs to increase cost recovery from its airline users to pay for LAX's increased operating expenses and to be able to issue debt for necessary capital investment. See Respondents' Brief to ALJ at 23. While the T1/T3 and TBIT Carriers contended to the contrary, in light of our decision in the Instituting Order, we need not resolve this issue at this time.

c. Appendix A to Recommended Decision

The ALJ included Appendix A to his Recommended Decision where he reviewed and made findings regarding the various terminal leases. As an initial matter, review of the T2/4-8 leases was not included in the scope of the Instituting Order. Therefore, we will disregard his findings and recommended conclusions relating to these leases. The T2/4-8 Carriers noted when petitioning for intervention in this proceeding that they did not intend to litigate their leases in this forum. Petition of American Airlines, Inc. for Leave to Intervene, at 2, n.1. Furthermore, because the T2/4-8 Carriers are operating under long-term leases, the Department does not have jurisdiction to address those leases under § 47129. LAWA has also raised constitutional due process arguments with regard to the ALJ's Recommended Decision on this point. See Respondents' Brief to Sec. at 32.

In addition, the ALJ set forth in Appendix A various factual information and findings regarding the T1/T3 and TBIT Carriers' leases. We have derived from Appendix A and set forth in the following chart the factual information relied upon for the determinations made in this Final Decision:

TERMINAL 1				
AIRLINE	**LEASE NO.**	**COMMENCE DATE**	**EXPIRATION DATE**	**TERM/EXPIRED**
America West	NBL 2399	9/1/1999	8/31/2004	5 years - yes
Southwest	LAA 4934	2/1/1984	N/A	5 years - yes
Southwest	NBL 2395	9/1/1999	8/31/2004	5 years - yes
Southwest	NBL 2866	12/10/2002	8/31/2004	N/A - yes
Southwest	NBL 2753	1/11/2002	8/31/2004	N/A - yes
US Airways	LAA 4935	2/1/1984	N/A	5 years – yes
US Airways	NBL 2396	9/1/1999	8/31/2004	yes
TERMINAL 3				
AirTran	NBL 2969	6/1/2003	5/31/2004	1 year - yes
Alaska	NBL 2439	5/16/2000	5/15/2001	month to month - Yes
ATA	NBL 2441	5/16/2000	5/15/2001	month to month - yes
Frontier	NBL 2442	5/16/2000	5/15/2001	month to month - yes
Midwest	NBL 2443	5/16/2000	5/15/2001	month to month - yes
TBIT				
All airlines	All leases	Various	3/31/2007	Approx. 5 years - yes

We adopt from Appendix A to the ALJ's Recommended Decision the information set forth in the chart above, and reject all other findings or determinations not included herein.

d. <u>Other Matters Outside the Scope of Instituting Order</u>

The ALJ's Recommended Decision included his recommendation that the Department investigate four additional issues: debt service coverage, charging Van Nuys Airport ("VNY") costs to LAX, whether regionalization violates DOT policy, and M&O set-aside. We will disregard these recommendations because the issues were not included in the scope of the Instituting Order. Instituting Order at 24-26.

9. <u>Calculation of the Refund Amount</u>

In accordance with 49 U.S.C. § 47129(c)(1), this order constitutes our final determination on whether the new and increased terminal fees at LAX are unreasonable or unjustly

discriminatory. We are directing LAWA to refund with interest the portion of the new or increased fees deemed unreasonable and/or unjustly discriminatory that have already been paid by the T1/T3 Carriers pursuant to the Tariff, effective February 1, 2007.

In order to carry out Congress' direction to direct the payment of refunds or credits when a fee is found unreasonable, we have concluded that we should determine the amount of the fees that must be refunded to the T1/T3 Carriers in a supplemental proceeding. We believe our decision to calculate the specific amount due is consistent with the statutory deadlines, because we have issued a Final Decision on whether the new and increased terminal fees are unreasonable or unjustly discriminatory within the 120-day period prescribed by 49 U.S.C. § 47129. We intend to issue an order establishing the exact amount due before the end of the 30-day period set by Congress for the payment of refunds or credits.

Our intention to hold a supplemental proceeding in this case is also reasonable because the Department has previously employed this procedure in similar cases, which we use to guide us now. See Port Authority, Order 05-06-11, at 28-30 (June 14, 2005); First Los Angeles International Airport Rates Proceeding at 60–62, Order 95-6-36 (June 30, 1995). We noted then that Congress did not prescribe specific procedures for the determination of the refund amount, and the parties in that case on their own did not submit the data needed for the calculation of the precise amount of refund due the airlines. Given Congress' clear directions to us to order refunds when we find a new or increased fee unreasonable or unjustly discriminatory in whole or in part, holding a supplemental proceeding within the 30-day time period for making refunds is reasonable when the record is insufficient to carry out that mandate. Also, we wish to provide the parties an opportunity to submit their calculations of the appropriate refund amount with supporting data.

Therefore, in order to fulfill our statutory mandate to the greatest degree possible, we are ordering LAWA to provide its calculations of the refunds due consistent with this Final Decision by Friday, June 22. LAWA should submit information in support of its position. The T1/T3 Carriers may then respond to LAWA's position by Friday, June 29, and LAWA may file a reply by Tuesday, July 3. The parties should not file any argument concerning our ultimate findings in this order. Their submissions should be limited strictly to a discussion and data concerning the amount of the refund. We will issue our decision on the refund amount within the 30-day period set by the statute for the making of a refund or credit.

ACCORDINGLY:

1. We affirm our prior order (Order 2007-4-1) to limit the review of the T1/T3 Carriers' evidence of Respondents' alleged fee unreasonableness and unjust discrimination at LAX to the five-year duration set out on the Instituting Order;

2. We deny, as to the T1/T3 Carriers, "Respondents' Motion to Dismiss Claims Concerning Charges Imposed Pursuant to a Written Agreement As Improper

Under § 47129" because we find that the T1/T3 Carriers' claims regarding new and increased M&O fees applied retroactively to January 1, 2006 do not pertain to a "fee imposed pursuant to a written agreement with air carriers using the facilities of an airport" under 49 U.S.C. § 47129(e)(1) and, thus, may be considered by the Department in the proceeding;

3. We grant, as to the TBIT Carriers, "Respondents' Motion to Dismiss Claims Concerning Charges Imposed Pursuant to a Written Agreement As Improper Under § 47129" because we find that the TBIT Carriers' claims regarding new and increased M&O fees applied retroactively to January 1, 2006 do pertain to a "fee imposed pursuant to a written agreement with air carriers using the facilities of an airport" under 49 U.S.C. § 47129(e)(1) and, thus, may not be considered by the Department in the proceeding for the reasons discussed herein;

4. We hereby dismiss the TBIT Carriers' claims regarding the retroactive imposition of the M&O fees;

5. We find that the new and increased M&O fees imposed by Respondents on the T1/T3 Carriers retroactive to January 1, 2006, and under the Tariff on the "useable" space, are reasonable and not unjustly discriminatory;

6. We find that the Respondents' "rentable" space methodology imposed on the T1/T3 Carriers for terminal M&O costs is reasonable but unjustly discriminatory, as described herein;

7. We find that the Respondents' "rentable" space methodology imposed on the T1 Carriers for terminal base rent is reasonable but unjustly discriminatory, as described herein;

8. We find that the Respondents' market value methodology imposed on the T3 Carriers for terminal base rent, for not only "useable" spaces but also "rentable" spaces, is unreasonable because the market value component does not constitute an objective determination of fair market value for terminal space, and that it is unjustly discriminatory, as described herein;

9. We find that a market value methodology otherwise may be a reasonable methodology to impose for terminal base rent if based on an objective determination of fair market value for terminal space;

10. We find that the seven T1/T3 complainants, Alaska Airlines, et al., and the twenty-one TBIT complainants, Aer Lingus, et al., have otherwise failed to show that the new and increased fees and methodologies are unreasonable or unjustly discriminatory;

11. We order the Respondents to refund with interest the base rent and M&O fees paid for the T1/T3 "common areas" pursuant to the "rentable" space methodology, for the period from February 1, 2007, for the following T1/T3 Carriers: Alaska Airlines,

Inc., AirTran Airways, Inc., ATA Airlines, Inc, Frontier Airlines, Inc., Midwest Airlines, Inc, Southwest Airlines Co., and US Airways Group, Inc.;

12. We order the Respondents to refund with interest the increased base rent fees paid on the "useable" space by the T3 Carriers based upon the difference between the imposed market value base rent and the fully allocated cost base rent, for the period starting February 1, 2007;

13. We will establish the refund amounts due under ordering paragraphs 11 and 12 in a supplemental proceeding as follows: Respondents must provide its calculation of the refund due consistent with this Final Decision on or before Friday, June 22. The complainants may then respond to Respondent's position on or before Friday, June 29, and Respondents may file a reply by Tuesday, July 3;

14. We reject the findings made by Administrative Law Judge Richard C. Goodwin in his Recommended Decision, including Appendix A, in this proceeding except to the extent that his findings are consistent with the analysis and findings set forth in this order; and

15. We deny all other pending motions not addressed in this order.

By:

ANDREW B. STEINBERG
Assistant Secretary for Aviation
and International Affairs

(SEAL)

Dated: June 15, 2007

An electronic version of this document is available on the World Wide Web at
http://dms.dot.gov//reports/reports_aviation.asp