Order 97-12-31

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

Issued by the Department of Transportation
on the 23rd day of December, 1997

LOS ANGELES INTERNATIONAL AIRPORT RATES PROCEEDING	:	Docket OST-97-2329 (Docket 50176)
SECOND LOS ANGELES INTERNATIONAL AIRPORT RATES PROCEEDING	:	Docket OST-95-474

FINAL DECISION ON REMAND

The Department of Transportation issued final decisions under 49 U.S.C. 47129 on the reasonableness of the landing fees charged at Los Angeles International Airport ("LAX") from July 1, 1993 through June 30, 1995, and from July 1, 1995 to the present. We determined that the fees were unreasonable insofar as they included a rental cost for the airfield and apron land based on the land's estimated fair market value. Los Angeles International Airport Rates Proceeding ("First LAX Rates Proceeding"), Order 95-6-36 (June 30, 1995); Second Los Angeles International Airport Rates Proceeding ("Second LAX Rates Proceeding"), Order 95-12-33 (December 22, 1995). On review the U.S. Court of Appeals for the District of Columbia Circuit remanded our decision in the First LAX Rates Proceeding on that issue, although it affirmed our decision insofar as the airline complainants had challenged it. City of Los Angeles Dept. of Airports v. Dept. of Transportation ("LAX I"), 103 F.3d 1027 (D.C. Cir. 1997). The Court directed us to reexamine the City's arguments in favor of using fair market value for the airfield land in calculating the landing fees.

The Court's decision caused us to ask the Court to remand our decision on the land valuation issue in the Second LAX Rates Proceeding, since we based that decision on our rationale in the First LAX Rates Proceeding. See Order 95-12-33

at 17. The Court granted our request on March 7, 1997. Air Transport Ass'n et al. v. Dept. of Transportation, D.C. Cir. Nos. 96-1018 et al. ("LAX II") (March 7, 1997 order).

In response to the Court's remand, we asked the parties to submit briefs on the land valuation issue and tentatively determined to decide the issue on the basis of the existing record. Order 97-4-12 (April 10, 1997).

In their briefs the City of Los Angeles ("the City"), which owns and operates LAX, argues that its charge for the fair market value of the airfield land is reasonable, while the airline complainants argue that the charge is unreasonable. The Airports Council International -- North America ("ACI"), an airport trade association that intervened in this case, supports the City's position. The parties agree that we should decide the issue without additional evidence.

After considering the briefs and the record in light of the Court's decision, we have determined that the airport's charge for the land's fair market value is unreasonable, as explained in detail below. In summary, the issue is whether the City may include in the landing fee a rental charge for the airfield land based on the land's estimated fair market value, that is, whether the charge represents a cost that may reasonably be imposed on the airlines using the airfield. In concluding that this charge is unreasonable, we rely on several factors. Among other things, the charge cannot be justified as compensation for the airport's opportunity costs in using its land for airport facilities, since the City made a commitment to continue using LAX as an airport and the airport's overall revenues compensate the City for using the land as an airport. There is no economic policy reason for allowing the use of fair market value, because the City needs no additional incentive to use its property at LAX as an airport, for the airport provides significant economic benefits to the Los Angeles area. There is also no evidence that the fair market value charge is needed to deter excessive use of LAX. Finally, the use by every other U.S. airport of historic cost, not fair market value, in valuing its airfield assets for landing fee calculations further supports our decision.[1]

BACKGROUND

1. Regulatory Background

[1] As indicated, our decision on the land valuation issue in the Second LAX Rates Proceeding relied on the findings in the First LAX Rates Proceeding, since none of the parties submitted additional evidence on that issue in the second case. Unless stated otherwise, all of the record citations in this order are citations to the evidence in the First LAX Rates Proceeding.

Like LAX, most airports used by commercial airlines are operated by a state or local government. Airports such as LAX charge airlines landing fees for using the airfield and different fees for using other airport facilities and services. Airport operations, like airline operations, have long been subject to extensive federal regulation. Federal law also authorizes airports to charge passenger facility charges ("PFC's").

Among other things, two federal statutes allow airports like LAX to charge airlines only reasonable landing fees. Section 511 of the Airport and Airway Improvement Act of 1982, now recodified as 49 U.S.C. 47107, which authorizes the airport grant program, requires airports that accept federal grant money for an airport improvement to give certain assurances to the Department. LAX, like most airports used by commercial airlines, has received substantial grants of federal funds for airport improvements.[2] One such assurance requires the airport to be available for public use on fair and reasonable terms and without unjust discrimination. This obligation to make the airport available on reasonable terms includes an obligation to charge aeronautical users only reasonable fees. See 61 Fed. Reg. 31994, 31995 (June 21, 1996).

Section 511 of the Airport and Airway Improvement Act of 1982 also provides, with some exceptions, that all revenues generated by a public airport, and any local taxes on aviation fuel, will be expended for the capital or operating costs of the airport, the local airport system, and other local facilities owned or operated by the airport that directly and substantially relate to the air transportation of passengers or property. As a result, under current law, LAX's revenues -- whether derived from aeronautical or non-aeronautical users -- may only be used for airport purposes and may not be diverted, for example, to the City's general fund.

The second statute allowing airports to charge only reasonable fees is section 1113(b) of the Federal Aviation Act, the Anti-Head Tax Act, recodified as 49 U.S.C. 40116. The statute allows publicly-owned airports 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, 510 U.S. 355 (1994) ("Kent County").

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[2] From 1973 to 1993 the City entered into federal grant agreements enabling it to obtain $300 million in federal funds. and it had received over $175 million of these amounts by September 1993. Exhibit ATA-1. In the 1993-1994 fiscal year, the City's Department of Airports received $38 million in federal grants and $53 million from PFCs. Exhibit ATA-98 at 225.

Neither the airport grant statute nor the Anti-Head Tax Act restricts the airport fees charged non-aeronautical users, such as restaurants, stores, and parking lots.

To give airlines a more effective method for enforcing the airports' obligation to charge only reasonable fees, Congress enacted 49 U.S.C. 47129 in 1994. That statute requires us to decide whether a new or increased airport fee is reasonable in an expedited proceeding if an airline files a complaint against the fee and the complaint involves a significant dispute. See First LAX Rates Proceeding, Order 95-4-5 at 2-5. The statute, however, does not change the substantive rights and duties of the airports or the airlines. Id. at 3, 12-13.[3]

While the statute requires us to determine whether a fee is reasonable and to award refunds to the extent that the fee is unreasonable, the statute also bars us from setting the fee. As a result, in cases decided under 49 U.S.C. 47129 we determine whether the airport's fee methodology and calculation are reasonable.

The new statute, 49 U.S.C. 47129, also required us to publish guidelines for determining whether a fee is reasonable. We first issued an interim policy statement on airport rates and charges, 60 Fed. Reg. 6909 (February 3, 1995) ("the Interim Policy Statement"), petition for review dismissed, City of Los Angeles v. DOT, D.C. Cir. Nos. 95-1188 et al. (July 1, 1996), and then a final policy statement on airport rates and charges, 61 Fed. Reg. 31994 (June 21, 1996) ("the Final Policy Statement"), vacated in part, Air Transport Ass'n et al. v. Dept. of Transportation, 119 F.3d 38 (D.C. Cir. 1997), as modified on rehearing, October 15, 1997 order. Both the interim and final policy statements required landing fees to be based on the historic cost, not the fair market value, of airfield assets. The Final Policy Statement allowed airports to use any reasonable methodology to set non-airfield fees. The Court of Appeals vacated the Final Policy Statement's provision allowing airports to use any reasonable method for setting non-airfield fees and vacated the historic cost requirement for airfield fees because the Final Policy Statement had not adequately justified the distinction between airfield and non-airfield fees. The Court's decision on the Final Policy Statement does not control this decision, since we have not based our decision on the LAX land valuation issue on the policy statements' guidelines. See First LAX Rates Proceeding, Order 95-6-36 at 19-26; LAX I, 103 F.2d at 1030, n. 1.

2. The First LAX Rate Proceeding

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[3] When Congress enacted 49 U.S.C. 47129, it also amended the airport grant statute's policy statement so that it states that airports "in establishing new fees, rates, and charges, and generating revenues from all sources, . . . should not seek to create revenue surpluses that exceed the amounts to be used for airport system purposes and for which airport revenues may be spent under [49 U.S.C. 47107(b)(1)], including reasonable reserves and other funds to facilitate financing and cover contingencies." 49 U.S.C. 47101(a)(13).

For many years the City used a residual fee methodology to calculate LAX's landing fees under an agreement with the airlines. Under that methodology, the airport's profits from non-airfield sources were used to reduce the airlines' landing fees. On the other hand, the airlines made a commitment to pay higher landing fees when needed to offset any losses on the airport's non-airfield activities. Because the airport's non-airfield revenues in recent years have exceeded its non-airfield costs, the airlines' fees for using the airfield in the last years of the residual fee system were significantly lower than the airport's airfield costs. See First LAX Rates Proceeding, Order 95-6-36 at 5. The residual fee agreement additionally gave the airlines an ability to veto major capital improvements at LAX. Exhibit LAX-C1 at 2.

In 1993 the airport switched to a compensatory methodology for calculating its landing fees. That methodology based the fees on the airport's costs of providing airfield facilities and services. The airport's calculation of those costs included a charge reflecting the fair market value of the airfield land. First LAX Rates Proceeding, Order 95-6-36 at 19. The City originally bought the land at an average cost of $2,427 per acre and estimated the land's current fair market value at $150,000 per acre. The annual rental charge based on this estimated value was $14,861,900. LAX I, 103 F.3d at 1031.

After Congress enacted 49 U.S.C. 47129, sixteen airlines jointly filed a complaint alleging that the LAX landing fees charged since July 1, 1993, were unreasonable, in part because of the airport's inclusion of the charge representing the estimated fair market value for the airfield land. First LAX Rates Proceeding, Order 95-4-5 at 7. Our Order 95-4-5 set the airlines' complaints for hearing under 49 U.S.C. 47129.

The Department's Chief Administrative Law Judge, John J. Mathias, held a hearing and issued a recommended decision finding that the landing fees were unreasonable insofar as the City had used the airfield land's fair market value instead of the land's historic cost in calculating the fees. See First LAX Rates Proceeding, Order 95-6-36 at 19-20.

On review we affirmed his decision on this issue. In determining that the airfield land should be valued at historic cost, not fair market value, we relied on the use of historic cost by all other airports, the relative administrative ease of determining historic cost, and the airport's ability to recover its out-of-pocket costs by using historic cost. First LAX Rates Proceeding, Order 95-6-36 at 19-26.

The City and the airline complainants sought judicial review of our decision, which led to the Court's LAX I decision. While the court case was pending, we

held a new proceeding under 49 U.S.C. 47129 on the reasonableness of new LAX fees, as discussed next.

3. The Second LAX Rates Proceeding

The City adopted higher landing fees at LAX for the fiscal year beginning July 1, 1995, just before we issued our final decision in the First LAX Rates Proceeding. The new fees also included a charge for the fair market value of the airfield land.

Fifty-nine airlines filed a complaint alleging that the new LAX landing fees were unreasonable. We issued a decision under 49 U.S.C. 47129 that found that the fees were unreasonable because, among other things, the airport had valued the airfield land at fair market value, not historic cost. We based our decision on the latter issue on the rationale and evidence used in the First LAX Rates Proceeding, since the parties had submitted no new evidence on this issue in the second proceeding. Second LAX Rates Proceeding, Order 95-12-33 at 17.

The City and the airline complainants sought judicial review of our decision. Air Transport Ass'n et al. v. Dept. of Transportation, D.C. Cir. Nos. 96-1018 (filed January 22, 1996) ("LAX II"). The Court stayed the proceedings in that case pending its decision on review of our decision in the First LAX Rates Proceeding.

4. The Court of Appeals' Remand

On review of our decision in the First LAX Rates Proceeding, the Court concluded that we had wrongly concluded that federal law prohibited the use of fair market value in calculating landing fees. In the Court's view we therefore had not given adequate consideration to the City's arguments defending its use of fair market value. LAX I, 103 F.3d at 1032. The Court remanded the land valuation issue to us so that we would consider the City's arguments.

The Court further questioned two elements of our rationale for disallowing the fair market value charge: our reliance on the universal practice of other airports of using historic cost for calculating landing fees, and our reliance on the relative difficulty of determining the fair market value of airfield land. 103 F.3d at 1033.

We did not seek rehearing or rehearing en banc of the Court's decision. We asked the Court to remand the land valuation issue in LAX II so that we could examine in a single proceeding the reasonableness of the airport's fair market value charge in the fees adopted in 1993 and those adopted in 1995.

5. Proceedings on Remand

To carry out the Court's remand order, we issued an order asking the parties to file briefs and reply briefs on the issue of the reasonableness of the airport's fair market value charge for the airfield land. Order 97-4-12 (April 9, 1997). The parties entitled to file briefs would be the airline complainants in each case that were eligible to receive refunds (together with the Air Transport Association, an intervenor), the City, and ACI. Id. at 6.

We tentatively determined not to reopen the record in these cases, since our procedural rules for cases heard under 49 U.S.C. 47129 require parties in such cases to submit all of their evidence (subject to certain exceptions not relevant here) before we referred the case to an ALJ. Id. at 6-7.

We also ruled that we would reexamine only the land valuation issue -- since the Court had remanded only that issue, our decisions on all other issues in the two LAX cases were final. Id. at 7.[4]

In their briefs the airline complainants continue to argue that the fair market value charge is unreasonable while the City and ACI contend that the charge is reasonable. In our analysis of our decision we will summarize the parties' positions on each of the issues.[5]

All of the parties agreed with our tentative decision that no new evidence should be introduced in this case and that we should decide the land valuation issue on the basis of the original record. Airlines Brief at 2, n. 1; LA Brief at 5, n. 3.

OUR DECISION

The question on remand is whether the landing fee calculation, based on a compensatory methodology, may reasonably include the charge for the fair market rental value of the airfield land. After considering the record in these cases on this issue and the points that the Court directed us to examine, we conclude again that the fair market value charge for the airfield land is unreasonable. Among other things, the City has no opportunity to use its LAX property for a non-airport use, so the City incurs no opportunity cost from using

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[4] We also extended our stay of the City's obligation to refund the portion of the landing fees representing the charge for the fair market value of the airfield land. Order 97-4-12 at 8. No one objects to that action. Due to that stay and the escrow agreement between the airport and the airlines, the airport has not yet had to repay the portion of the fees charged since 1993 that represent the fair market value charge, since there has been no final decision on whether the charge is reasonable. See Order 97-4-12 at 4, 8.

[5] The airline complainants and the City filed motions for leave to file unauthorized documents. We will grant these motions.

the property for an airport. The City needs no additional incentives to operate LAX as an airport, since the Los Angeles area obtains substantial economic benefits from the airport's operation. We also find that the historic cost requirement is consistent with the Constitution's prohibition against the taking of property without just compensation.

In explaining our decision, we will begin by discussing the airlines' statutory claims and the scope of our authority to review an airport's fee methodology under 49 U.S.C. 47129, and by explaining why Professor Arrow's declaration -- a declaration originally submitted by the City and later withdrawn -- is not properly within the record of this case. We will then address the City's principal justification for the fair market charge -- its claim that the charge compensates the City for using LAX as an airport. After explaining why we find that claim untenable, we will show that there is no other economic justification for the charge (for example, the City needs no additional incentive to use its property at LAX as an airport), and that the LAX charge is contrary to the practice of all other U.S. airports. We will then explain why the City's takings clause argument is without merit. Finally, while our decision in this proceeding would not be affected by the issue of whether calculating the fair market value of airfield land is substantially more burdensome than calculating the land's historic value, we discuss the record on this issue since our analysis may provide guidnace in future proceedings.

We have analyzed the reasonableness of the City's fair market value charge for the airfield land on the basis of the record in this proceeding, not on the basis of the Interim or Final Policy Statements. Our decision in this case does not foreshadow our eventual decision on airfield fee guidelines in our forthcoming proceeding for adopting such guidelines, a proceeding required by the Court's decision in Air Transport Ass'n partially vacating the Final Policy Statement. The airport parties are urging that those guidelines not require the use of historic cost for airfield fees. We will consider their proposals -- and those of all other parties in that proceeding -- on the basis of the record in that proceeding.[6]

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[6] As we stated earlier, we did not apply the Interim Policy Statement's historic cost requirement in our original decision on the LAX fair market value charge. In its brief the City argues that our determinations on reasonableness in the Final Policy Statement support its position, but this argument is based on a mischaracterization of the Final Policy Statement. On the ground that we recognized that fair market value can be a reasonable method of calculating non-airfield fees (but not airfield fees), the City wrongly claims that we are committed to allowing the use of fair market value for calculating airfield fees. LA Brief at 5. The City similarly errs in claiming that our decision in the policy statement rulemaking to allow imputed interest on some airfield investments means that we have effectively rejected our decisions in these cases to require LAX to value the airfield assets on the basis of historic cost. LA Brief at 6-7.

1. The Statutory and Regulatory Provisions on Allowable Costs

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 calculation of compensatory landing fees and that the statutes may allow an airport to recover such costs as opportunity costs. LAX I, 103 F.2d 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. Airlines Brief at 3-9.

We agree with the airline complainants that Congress intended to limit airport fees and did not intend to give airports complete discretion over the level of their fees. Congress, after all, included a reasonable fee requirement in both the Anti-Head Tax Act and the airport grant statute and created procedures in 49 U.S.C. 47129 for ensuring that airlines complaining about the reasonableness of a new or increased fee will obtain a hearing before an administrative law judge and a prompt decision in cases satisfying the jurisdictional requirements of that section. As we stated at the beginning of the First LAX Rates Proceeding, Congress created the expedited procedures required by 49 U.S.C. 47129 in the expectation that we would closely examine airport fees to ensure that they met the statutory standard. Order 95-4-5 at 26. But Congress' overall goal of limiting airport fees to reasonable amounts does not answer the question of whether the LAX fees are reasonable.

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.

Instead of defining reasonableness by statute, Congress chose to give the Secretary the discretion to determine reasonableness. The statute requires the Secretary to adopt guidelines for use in determining whether airport fees are reasonable without limiting his discretion in choosing those guidelines, except by expressly giving airports the right to choose a compensatory or residual fee methodology or a hybrid of those methodologies. The statute's history confirms Congress' intent to give the Secretary the authority to define reasonableness.

See, e.g., 140 Cong. Rec. S6986 (June 16, 1994) (Senator Feinstein); 140 Cong. Rec. S7030 (June 16, 1994) (Senator Boxer); 140 Cong. Rec. S6658 (June 9, 1994) (Senator Pressler). We therefore have the authority to determine whether an airport's fee methodology is reasonable or not, and that discretion applies to the issue remanded by the Court.

2. Our Authority to Review an Airport's Fees

ACI and the City contend that the Anti-Head Tax Act, the airport grant statute, and 49 U.S.C. 47129 require us to defer to the airport's judgment on the reasonableness of its fees, that we do not have the authority to set binding standards governing airport fees, and that an airport's fee methodology decisions are entitled to a presumption of validity. LA Brief at 13; LA Reply Brief at 11-12; ACI Brief at 2-4.

The airline complainants contend that the issue of the scope of our authority is an issue that we need not and should not consider here, since we had decided that issue in the earlier orders in the First LAX Rates Proceeding, the City did not seek review of our decision on that issue, and our decision therefore became final. Airlines Sur-Reply Brief.

We agree with the airline complainants' position. We held in the First LAX Rates Proceeding that Congress had intended us to examine in detail the reasonableness of an airport's fees, Order 95-4-5 at 26-27 and Order 95-6-36 at 15, and the City did not ask the Court to review that holding in LAX I.

The Court of Appeals, moreover, resolved this dispute over the scope of our authority in Air Transport Association, where it rejected the City's contention that we could not adopt reasonableness standards that would be binding on airports. Air Transport Association, 119 F.3d at 41. See also New England Legal Foundation v. Massachusetts Port Authority, 883 F.2d 157, 168-170 (1st Cir. 1989), affirming Investigation into Massport's Landing Fees, FAA Docket 13-88-2, Opinion and Order (December 22, 1988) at 8-9 (the First Circuit held that the Secretary had the responsibility and the expertise for administering the reasonable fee requirement in the airport grant statute).

Although the Court's opinion in Air Transport Association seems to suggest that the statutory reasonable fee requirements may require airport fees to be based on costs and require us to adopt precise standards for all fees charged aeronautical users, not just for airfield fees, 119 F.3d at 41, 43, the Court also suggests that we chose to submit fees "to something approaching de novo review" and thereby "seem[ed] to have burdened [ourselves] with administrative difficulties," 119 F.3d at 44, n. 7. The latter suggestion appears inconsistent with Congress' purpose in enacting the statute. As we have explained before in this proceeding,

it is our view that Congress intended us to closely examine airport fees in cases heard under 49 U.S.C. 47129. First LAX Rates Proceeding, Order 95-4-5 at 26. Congress must have adopted the extraordinary procedures imposed by that statute, which include strict deadlines and a requirement to hold hearings before an administrative law judge on complaints satisfying the statute's jurisdictional requirements, with the expectation that we would resolve disputes over airport fees without presuming that the airport's judgment was likely to be correct. Nothing in the terms or legislative history of the statute indicates that we should defer to an airport's judgment. The Court, moreover, gave no explanation for its suggestion that we should have chosen to construe the statute in a different manner. Even if the Court's suggestion represents a reasonable reading of the statute, our construction is certainly a permissible construction.

3. Burden of Proof

The airline complainants have the burden of proof in this proceeding, but, if they present a prima facie case that a fee is unreasonable, the burden shifts to the airport. First LAX Rates Proceeding, Order 95-6-36 at 17-18, citing the Administrative Procedure Act, 5 U.S.C. 556(d). The City contends that we must uphold the reasonableness of the fair market value charge because the airline complainants assertedly have failed to satisfy their burden of proof. LA Brief at 4-5. We disagree. The airline complainants have submitted evidence demonstrating that the charge is unreasonable, for example, evidence showing that no other U.S. airport calculates landing fees on the basis of fair market value.

4. Evidence within the Record

As noted above, all of the parties agreed with our tentative decision that the land valuation issue should be decided on the basis of the existing record and that no new evidence should be submitted in this proceeding. The only disagreement concerns the question of whether the record includes the declaration of Professor Kenneth Arrow, a Nobel laureate in economics.

The City's response to the complaint filed in the First LAX Rates Proceeding included the declaration from Professor Arrow. In directing us to examine the City's economic arguments in favor of the charge, the Court of Appeals cited Professor Arrow's testimony. LAX I, 103 F.3d at 1034. The Court assumed that his declaration was part of the record in this proceeding, since the City had cited it in its brief (pages 8, n. 5, and 23). Neither our brief nor the airline complainants' brief had noted that his declaration was not properly part of the record.

In their brief in this remand proceeding, the airline complainants assert that Professor Arrow's declaration is not part of the record, since the City withdrew it before the hearing. Airlines Brief at 15. The City concedes that it withdrew his declaration before the hearing but argues nonetheless that we must consider it. LA Brief at 7, n. 9.

We agree with the airline complainants.

While the City's response to the airline complainants' amended complaint in the First LAX Rates Proceeding included Professor Arrow's declaration, the airline complainants objected before the hearing to his declaration. Complainants' Objections to Respondents' Exhibits (April 19, 1995) at 1. The City then agreed with the airline complainants that it would not submit Professor Arrow's declaration for purposes of the hearing. April 19, 1995 Letter from Steven Rosenthal to Allen Snyder (the City filed the letter in this docket). See also Respondents' Opposition and Response to Complainants' Objections to Respondents' Exhibits (April 21, 1995) at 2.

On the first day of the hearing, the Chief Judge therefore stated as to the airline complainants' objection to Professor Arrow's declaration, "[T]hat declaration has been withdrawn so the objections are moot." Tr. 25. Professor Arrow never appeared at the hearing, the City's final exhibits omitted his declaration, and the City's briefs to the Chief Judge and to us did not cite his declaration. Since the City withdrew the declaration and never made Professor Arrow available for cross-examination, his declaration is outside the record in this proceeding.

Despite this history, the City now argues that its initial filing of his declaration means that it is in the record before us. LA Reply Brief at 7, n. 9. The City's contention is plainly wrong. The evidence of record in a formal hearing case like this generally consists of the testimony and exhibits accepted at the hearing. A party's initial submission of a declaration (or an exhibit) does not make it part of the record if the testimony is not submitted at the hearing and the witness is not made available for cross-examination. See, e.g., Tr. 12. Professor Arrow's declaration therefore cannot be part of the record.

We recognize that the Court's opinion cited Professor Arrow's declaration, but the Court did not rule that the record included the declaration and was not told that the City had withdrawn it. In these circumstances the Court's opinion cannot be construed as a ruling that we must treat Professor Arrow's declaration as part of the record. However, we would not find the airport's fair market value charge reasonable if his declaration were in the record, as explained below in our discussion of opportunity costs. In particular, he undertook no analysis of the revenues and benefits obtained from using the LAX property as an airport

before concluding that the City was incurring an opportunity cost by using the property for an airport.

5. The City's Opportunity Cost Argument

The Court remanded the case to us primarily so that we would consider the City's justification for its fair market value charge for the airfield land. The City's principal justification is its claim that the charge compensates the airport for its opportunity costs. Requiring the airport to use historic cost would allegedly deny the airport any compensation for its alleged opportunity costs incurred by using the land as an airfield. LA Brief at 5-11. According to the City, the fair market value charge "reflects the actual economic worth of the land and serves as a basis to calculate the opportunity costs associated with the use of the land." The City defines its opportunity cost as the value the City would have obtained from using the land in the best alternative use. LA Brief at 5.

In response the airline complainants argue that the airport is incurring no opportunity costs and that the fair market value charge is therefore unreasonable. Airlines Brief at 3-6.

We conclude that LAX incurs no opportunity cost when the airfield land is used for the airfield and that the charge cannot be upheld on that basis. The City has made a commitment to the FAA that it will continue operating LAX as an airport for a number of years to come. As a result of the City's agreement to continue using its LAX property as an airport, the City has no other opportunity for use of the airfield land. Thus, whether or not opportunity costs are relevant in determining the reasonableness of airport landing fees, LAX's fair market value charge is unreasonable.[7]

The City has defined its opportunity cost as "the income forgone annually in order that the land be used as an airport . . . ." LA Brief at 5. Or, as the City stated in its reply brief, "LAX land is optimally employed as an airport if and only if it is at least earning the return it could receive in its best alternative employment (i.e., its opportunity cost)." LA Reply Brief at 5. One of the City's economics experts, Professor Levy, similarly testified, "The opportunity cost of

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[7] Alternatively, if the City were deemed to have opportunity costs, its charge would still be unreasonable for two reasons. First, as explained below, the airport generates such large profits for the City's Department of Airports (and benefits for the Los Angeles area) that any opportunity costs are already covered by the airport's existing revenues from airfield and non-airfield sources. Secondly, it would be unreasonable for us to allow the City to charge for opportunity costs based on estimated earnings from non-airport usage when the City voluntarily agreed with the FAA that it would only use the property as an airport.

an asset or resource is its forgone value in its best alternative use." He reasoned that resources were optimally allocated "when the opportunity costs of their ownership is zero or negative; that is, when the present owner is deriving the maximum of all possible benefits from ownership." Exhibit LAX-F1 at 7.

When the City accepted federal grant funds for LAX, it gave the FAA the assurances required by the airport grant statute, 49 U.S.C. 47107. One of those assurances requires the grant recipient to continue operating the airport as an airport, 49 U.S.C. 47107(a)(1): "[T]he airport will be available for public use on reasonable conditions and without unjust discrimination." Another assurance requires the airport operator to maintain a current layout plan approved by the Secretary; it further bars the airport operator from making any change in the airport or any of its facilities if the change does not comply with the approved plan, if the Secretary decides that the change "may adversely affect the safety, utility, or efficiency of the airport." 49 U.S.C. 47107(a)(16).[8]

The City has accepted grant funds for LAX. In the eleven years ended September 1993, the City received more than $70 million in grants for LAX and had contracts with the FAA entitling LAX to additional grant funds. In every year during that eleven-year period the City signed at least one grant agreement for LAX. The most recent grant agreement was signed in September 1993 and authorized LAX to obtain up to $18 million in federal funds. Exhibit ATA-1 at 2-3; Exhibit ATA-71 at 3, 6. That agreement included a commitment that the City would operate LAX as an airport. Id. at 19, 25-26. The assurances would remain in effect for the life of the projects or twenty years, whichever is less. Id. at 20.

As a result, the City is legally required to continue using its property at LAX for airport purposes. This commitment means that the City has no opportunity to use the airfield land for any other purpose. The City therefore may not charge the airlines for its alleged opportunity costs when it has agreed to forgo the opportunity of using the property for any non-airport purpose. See also Tr. 429 (there is no opportunity cost, if the owner of land has no opportunity to change the use of the land).[9]

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[8] The grant assurance requirements make up part of Congress' overall regulation of airport development and operations, regulation designed to create an efficient national air transportation system. Other grant assurances prohibit most airport operators, including the City, from diverting airport revenue to non-airport purposes. 49 U.S.C. 47107(b). Congress has similarly authorized airports like LAX to charge passenger facility fees for airport projects. 49 U.S.C. 40117. The City has imposed a passenger facility fee on travellers using LAX and obtained FAA approval for that fee on the condition that part of the fee revenues would be used for LAX airfield projects. See Second LAX Rates Proceeding, Order 95-12-33 at 36-41.

[9] In reviewing the Final Policy Statement's historic cost requirement for airfield fees, the Court noted that the Final Policy Statement had observed "that since airports are obliged to use their property as an airport, the concept of opportunity cost, and therefore fair market value, does not

The City concedes that the assurances given by it as a condition to the federal grants require the City to maintain LAX as an airport, subject to certain exceptions. LA Brief at 8. The City nonetheless suggests that it has some ability to close LAX, an argument based on the closing of airports by other cities, LA Brief at 7-8, citing Denver's closing of Stapleton Airport when it opened Denver International Airport. The City, however, could close LAX only with FAA approval. The City has not shown that there is any realistic possibility that the FAA would approve the closing of LAX. After all, the record indicates that LAX is the only practical site for an airport for Los Angeles. Denver, in contrast, could close Stapleton because it replaced it with a new airport, Denver International.

The City additionally notes that the grant conditions will not obligate it to operate LAX at its existing location "forever." LA Brief at 7-8. However, the grant conditions typically last for twenty years (and the City has cited nothing in the record indicating that its grant assurances will have a shorter term). Furthermore, the City began charging the fees at issue in this proceeding in 1993,

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quite fit." Air Transport Ass'n, 119 F.3d at 44. And, if the City were viewed as having an opportunity cost, the City's commitment to continue using the land for an airfield would make it unreasonable for the City to charge airlines for revenues that it allegedly could obtain from non-airport use, since the City has agreed not to make any such use of the land.

and the City is currently obligated by its assurances to continue operating LAX as an airport.[10] Finally, nothing in the record indicates that the City is seriously thinking of abandoning LAX.[11]

We find similarly unpersuasive the City's contention that someone may incur an opportunity cost after choosing to use a property or resource for a specific purpose and legally obligating itself to continue that use. LA Brief at 8-9. The City voluntarily chose to obligate itself to continue operating LAX as an airport. When it did so, it presumably concluded that using its property at LAX for the airport was the property's best use and that the benefits obtained from the airport amply covered the cost of using the LAX property for the airport. Furthermore, in return for the City's commitment, the City received large amounts of federal funds for the airport. We think that the City therefore could incur no opportunity cost, even if it were not otherwise compensated by using its LAX property as an airport. And in any event the federal grant funds received by the airport have compensated the City for maintaining LAX as an airport.

We are not persuaded, furthermore, that opportunity costs should be used in valuing airfield land in calculating landing fees. We are aware that, as the Court stated, a number of economists believe that regulatory agencies should use opportunity costs in setting rates or determining whether rates are reasonable. See, e.g., William J. Baumol and J. Gregory Sidak, Transmission Pricing and Stranded Costs in the Electric Power Industry at 139 et seq., cited at 103 F.3d at 1032. However, as the Court recognized, there are substantial benefits from using historic cost in ratemaking cases. Alfred E. Kahn, The Economics of Regulation, vol. 1 at 41 ("[T]he transformation of the rate base by most state commissions from a hypothetical or imaginary to an actual book figure, representing actual money outlays, introduced a strong element of stability and predictability into the regulatory process"), cited at 103 F.3d at 1032. See also Missouri ex rel.

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[10] According to the airline complainants, during the argument on review of the Final Policy Statement, the City's counsel implied that the restrictions on its use of the LAX land might end in about eight years. Airlines Reply Brief at 4, n. 4, citing Air Transport Ass'n v. Dept. of Transportation, D.C. Cir. Nos. 96-1253 (argued May 15, 1997). The Court's opinion seems to assume that the grant assurances either do not bind the City now or will soon become inapplicable. Air Transport Ass'n, 119 F.3d at 44. Any belief that the restrictions on the City's use of LAX have ended or will end within a few years would be wrong. The assurances created by the 1993 grant should in fact remain in force past 2010.

[11] In that regard we note that the City is developing a master plan for the airport that will enable LAX to accommodate the growth in passenger and cargo traffic expected during the next twenty years and is using its Internet website to promote the plan and seek comments on it. The City's development of the plan is consistent with the complete lack of record evidence supporting the City's claim that moving the airport would be a realistic possibility.

Southwestern Bell Telephone Co. v. Public Service Comm'n, 262 U.S. 276, 292-308 (1923) (Brandeis, J., dissenting).

The Court of Appeals has recognized that regulatory agencies normally use historic costs for rate cases. Jersey Central Power & Light Co. v. FERC, 810 F.2d 1168, 1175 (D.C. Cir. 1987) (en banc) ("The Supreme Court cases of the 1940's eliminated the requirement that the market value of the property be recovered, and regulated industries now collect rates calculated to generate a reasonable return on the original cost of the investment") (emphasis in original). See also Exhibit ATA-D2 at 2. And, as shown below, no other U.S. airport has used the fair market value of land in setting landing fees.

Thus, as shown, while economists believe that historic cost has significant disadvantages when used in setting rates, regulatory agencies generally and airports almost universally continue to use historic cost in setting rates. We need not decide here, however, whether we would allow LAX to include opportunity costs in setting its landing fees, because the record demonstrates that LAX incurs no opportunity costs.[12]

6. The City Needs No Additional Incentives To Operate LAX as an Airport

We see no other economic justification for the City's fair market value charge for the airfield land. As directed by the Court, 103 F.3d at 1034, we have considered the City's claim that the fair market value charge is necessary to give the City "the proper incentive" to continue operating the airport. We find that the City has not shown that it needs any such incentive. The airport provides major benefits for the Los Angeles area's economy, generates large earnings, and cannot practicably be replaced or moved, as shown next.

LAX's Economic Benefits for the City's Economy and Residents. The record indicates that using the LAX land for LAX is economically desirable since the Los Angeles area needs a major airport and has no other practicable location for a major airport.

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[12] The airline complainants contend that Professor Baumol and Mr. Sidak stated that opportunity costs should not be allowed in rates when the regulated firm has a monopoly and can charge monopoly prices. Airlines Brief at 12-13. This point seems irrelevant here, since our implementation of the reasonableness requirement for landing fees is intended to keep LAX from charging monopoly prices. The airline complainants also note that Professor Kahn argued that allowing regulated firms to charge prices based on factors like market prices creates the danger that the regulated firm will exaggerate its cost of service. Airlines Brief at 14. While this observation would be relevant in other cases to a decision on whether we should opportunity costs to be used in landing fee calculations, the City has failed to show here that it has incurred any opportunity costs.

As an important and dynamic city Los Angeles obviously must have an airport. Without an airport few travellers could easily reach the city, Angelenos could not conveniently travel to other cities, and Los Angeles could not be a significant commercial and industrial center or enjoy a substantial convention and tourist trade.

As demonstrated by the record, the airport greatly benefits Los Angeles. John Driscoll, the Executive Director of the City's Department of Airports, thus stated, "The Department fully recognizes the value of the Airport, the gateway to Southern California, as a tool of economic development for the community." Exhibit LAX-C1 at 4. One of the City's experts similarly testified that LAX was "an important economic asset of the City," that there was "no doubt" about that, and that without it the City "would not be what it is today." Second LAX Rates Proceeding, Tr. 379.

The record provides some evidence on the size of the benefits created by LAX. In 1994 the Los Angeles area had 25 million visitors who spent $7.2 billion, and almost seventy percent of all of its overnight visitors travelled by air. Exhibit ATA-98 at 117. And a memorandum prepared for the City stated, "The economic benefit of LAX to the Los Angeles area, however, may be quantified in terms of jobs (402,000); direct, indirect, and induced economic impacts ($37 billion per year); and state and local taxes ($1.7 billion per year), according to a 1992 study
. . . ." Exhibit ATA-5 at 71, n. 34.

Secondly, no airport or combination of airports in the Los Angeles metropolitan area could substitute for LAX if the City were able to close LAX and use its land for non-airport purposes. The area contains other airports -- Ontario, Hollywood-Burbank, Long Beach, and Orange County, but they are relatively small and could not handle the volume of passengers and cargo served by LAX. In 1993, for example, seventy-three percent of the domestic passengers using an airport in that area used LAX, and virtually all of the international passengers using a Los Angeles area airport used LAX. None of the area's other airports served as much as ten percent of the area's total domestic passengers in that year. Exhibit ATA-98 at 103-104. LAX in fact was the world's fourth largest airport in 1993, based on total passengers. Id. at 120. See also Exhibit ATA-7 at 43, n. 45. Thus, in terms of the City's own economic interests, it could close LAX only if it could create a replacement airport of comparable size.

The record indicates, however, that LAX is the best possible location for a major airport for Los Angeles and that there is no good alternative site for an airport. The City's appraisal firm thus stated in their report, Exhibit LAX-14 at 20,

> [T]he relocation of the Los Angeles International Airport (LAX) is practically impossible. There are no urban sites in Los Angeles that can provide an alternative airport development site. In addition, the costs to acquire such a site would be prohibitive. Thus, from a financially feasible view, the current airport use of the site is the highest and best use. . . . In sum, based upon our research and analysis of the subject property, it is our opinion that the highest and best use of the subject property is the current airport use.

See also Exhibit ATA-48; Exhibit ATA-E2 at 5.[13]

The City's past conduct confirms that the City requires no additional incentives to use its land at LAX for the airport. Before the City switched to the compensatory fee methodology in 1993, it charged landing fees set under a residual fee methodology, which, as shown, ensured that the City would obtain no profits from the airport's operation. That did not deter the City from operating and expanding the airport. The airport had to offset its profits from non-airfield operations against its airfield costs in calculating its landing fees. The City nonetheless agreed to that restriction in order to ensure its ability to obtain the financing necessary for the airport's development and expansion. Exhibit LAX-C1 at 3. The City's willingness to forgo profits from airport operations indicates that the City believed that the airport's benefits to the City were great enough to amply justify LAX's operations even though the airport's aeronautical users did not pay fees covering their share of the airport's out-of-pocket costs under the residual fee agreement.

Furthermore, the City continues to operate three other airports -- Ontario, Palmdale, and Van Nuys -- although none of these airports seems to generate significant earnings. In the fiscal year ended June 30, 1994, for example, all three of those airports had an operating loss. Exhibit ATA-11 at 23.

LAX Produces Profits for the City. In addition, under the compensatory fee methodology the airport generates substantial profits for the City's Department of Airports, as we pointed out earlier in the First LAX Rates Proceeding, Order 95-6-36 at 22:

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[13] The City has not cited any evidence indicating that the airport could be moved. The City's Department of Airports owns a large amount of land at Palmdale, but nothing in the record indicates that the City is considering using that land for an airport or that doing so would be practicable. We note, among other things, that Palmdale is farther from downtown Los Angeles than LAX and has limited highway access from Los Angeles. As noted earlier, the City is currently developing a master plan for expanding LAX's facilities, which indicates that the City recognizes that LAX is the only possible site for the area's major airport.

> [T]he City's financial statements show that LAX has been quite profitable. For example, in the 1993-1994 fiscal year, the first year of the compensatory fees, the airport's net income from all operations was $71 million, and its operating revenues were almost forty percent greater than its operating expenses. The airport's landing fee revenues were $35 million higher in that year than in the previous year, the last year of the residual fees, but, even if the landing fee revenue had not increased, the airport's operating revenues would still have been twenty percent greater than its operating expenses. Exhibit ATA-11 at 23, 25.

The airport's operating earnings without the fair market value charge and net of the airport's $25 million interest expense, moreover, would still be $31 million, an amount that substantially exceeds the $15 million rental charge for the airfield land.

We have calculated these benefits on the basis of the airport's overall profits, not its earnings from airfield sources. Our analysis is consistent with the City's own definition of its incentives in terms of the overall airport. The City thus stated in its reply brief, "LAX land is optimally employed as an airport if and only if it is at least earning the return it could receive in its best alternative employment (i.e., its opportunity cost)." LA Reply Brief at 5.

Even if the City had not so stated the issue, we could consider the airport's overall earnings in assessing the reasonableness of the fair market value charge for the airfield land. The airfield services and the non-airfield services provided by the airport are joint products -- the airport can obtain revenue from its non-airfield services only by providing the airfield services. The airport, after all, could not operate without runways and taxiways. Since the use of the airfield land for runways and taxiways is essential to the City's ability to obtain profits from other airport operations, any alleged revenue losses involved in that use of the land are amply compensated by the airport's overall earnings. Thus, while the profits derive from the airport's non-aeronautical activities, we may reasonably consider them in determining whether the City's use of the land for the airport imposes opportunity costs on the City.

The City's calculation of its alleged opportunity costs gave no recognition to the benefits it receives from the airport. The City's position essentially assumes that the City's use of the land as an airport creates no benefits at all for the City, a statement which, as shown, is contrary to the record and common sense. See Airlines Brief at 22; Airlines Reply Brief at 8-9.

The benefits provided the City and its economy by its operation of LAX undermine its opportunity cost claims. The City's expert, Professor Levy, stated

that a person's use of a property incurs no opportunity costs if that use generates more revenue than the person could obtain from any other use of the property: "the opportunity cost of an asset to its owner can be seen to be measured by the difference between the asset's market value or market stream of income and its value or stream of income to the owner." Exhibit LAX-F1 at 7. See also Pennsylvania Electric Co. v. FERC, supra (utility is not entitled to receive compensation for its alleged opportunity costs when its rates already compensate it for its costs of providing service). Thus, whatever opportunity costs are associated with the use of the land as an airfield are already covered by the airport's earnings.

The City wrongly argues that we may not consider the airport's value for the City as an offset to the City's claim for a charge equal to the fair market rental value of the land. According to the City, such a recognition of the airport's value would be contrary to the Supreme Court's decision in Kent County that federal law does not require an airport to use its earnings from non-aeronautical sources to lower its aeronautical fees. LA Brief at 9-10. This argument misconstrues our analysis and, as shown, ignores the City's own definition of opportunity costs. In considering the City's economic justification for the fair market value charge, we must determine whether the benefits currently obtained by the City for using the LAX property as an airport exceed the estimated amount of the land's fair rental value. Since we are not using the City's benefits to offset the City's other airfield costs, our analysis is consistent with the Court's holding in Kent County.

Similarly flawed is the City's contention that our consideration of the benefits provided by the City's use of the LAX property for an airport would result in the airport being unable to charge any fees. LA Brief at 10. We are considering those benefits only to evaluate the City's arguments, as required by the Court, that the City incurs an opportunity cost and needs additional incentives to operate LAX. Our analysis in no way precludes the airport from charging landing fees covering its other costs. Indeed, we have upheld over the airline complainants' objections most of the other charges included in calculating the LAX landing fees.

7. The City's Claims of Overuse and Subsidization

Another economic justification for the fair market value charge offered by the City is its assertion that the charge is necessary to keep the airlines from making excessive use of the airfield. If the City cannot impose landing fees reflecting the true cost of providing airfield facilities and services, the airlines will assertedly overuse the airfield. Since the City assumes that the airfield's true costs include opportunity costs based on the fair market value of the land, which could otherwise be used for a different purpose, the City contends that disallowing the fair market value charge

will cause airlines to make excessive use of the airfield. LA Brief at 12; Exhibit LAX-I1 at 4; Arrow Declaration at 4.

Nothing in the record indicates that the fair market value charge for the airfield land is needed to prevent overuse of the airfield or to correct a misallocation of resources. The City has presented no evidence that there has been excessive use of the airfield or that the higher fees are needed to prevent congestion. The City has also cited no
evidence suggesting that it adopted the fair market value charge in order to cause its facilities to be more efficiently used. In these circumstances the City has failed to justify the charge as a means of discouraging overuse of the airfield.[14]

We are similarly unpersuaded by the City's contention that we will be forcing the airport to subsidize the airlines' use of the airfield if we disallow the charge for the fair market value of the airfield land. LA Brief at 14. The airport would be subsidizing the airlines, however, only if the charge for the fair market value of the land reflected a cost borne by the airport. We do not believe there is any such a cost. As shown above, the City has failed to show that it incurs any opportunity costs by operating LAX as an airport. As a result, the landing fees, calculated under historic cost valuation, will cover the airport's costs of providing airfield facilities and services. We find, therefore, that the airport is not subsidizing the airlines.

8. Offset for Inflation

The City also contends that historic cost is an irrational cost standard to use since it does not account for general inflation. The City claims that the airport's cost of acquiring the airfield land should at least be adjusted to reflect inflation. The City's experts testified that general inflation was a factor that could be taken into account in valuing the land for purposes of the landing fee calculation. LA Brief at 12.

We recognize that economists consider that the valuation of an asset should reflect inflation, but we also know that regulatory agencies usually do not value assets at fair market value in ratemaking cases. But the fair market value charge -- based only on the rise in land prices in the Los Angeles area -- was never designed to offset general inflation and so cannot be justified on that basis.

Professor Ferdinand Levy, an economics expert for the City who helped develop the fee methodology, originally advised the City that his preferred methodology for valuing the land was "current cost," whereby the historic cost of the land would be

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[14] We have been willing to allow airports to charge fees that will encourage more efficient use of airport facilities. In particular the Final Policy Statement allows airports to charge peak-period prices when justified. 61 Fed. Reg. at 32016. The LAX landing fees do not include any peak-period charges.

adjusted by an increase based on the general rise in prices. Since the adjustment would reflect general inflation, not the increase in land values around the airport, he noted "a high probability that this method of valuation may not correspond closely to the market value of the land." Exhibit ATA-72 at 1, 6, 7.[15]

The airport's consulting firm rejected Professor Levy's recommendation on the ground that "we cannot identify an index capable of adequately adjusting historical costs . . . to something remotely close to current value." Exhibit ATA-75. In other words, the airport's consultants rejected his proposal solely on the ground that it would not generate enough income, not on the ground of economic theory.

As a result, we cannot agree with the City that the fair market value charge should be upheld as compensation for inflation. The City did not create the charge as such compensation and chose not to adopt the one valuation method which would have fairly reflected inflation. We also note, as discussed in the next section, that no other airport has found it necessary to use the airfield land's fair market value in calculating landing fees, which suggests that the use of a cost standard that does not reflect inflation will not interfere with the airport's ability to operate and finance capital improvements.

9. The Universal Use of Historic Cost by U.S. Airports

Our earlier conclusion that the fair market value charge was unreasonable relied in part on the record evidence that LAX was the first U.S. airport to base landing fees on the fair market value of the airfield land rather than the land's historic cost. The Court, as noted, remanded our decision on the ground that we had not adequately considered the City's arguments, because we wrongly believed that federal law did not allow the airport to charge a fee based on the airfield land's fair market value. The Court, however, also questioned our reliance on the practices of other airports. The Court stated that we had said that LAX was the first airport to switch from a residual fee methodology to a compensatory fee methodology. On that basis it considered our reliance on the practices of other airports unpersuasive. LAX I, 103 F.3d at 1033.

Our order asking the parties to file briefs in this remand proceeding pointed out that the Court had erred when it assumed that LAX was the first airport to adopt compensatory fees. In fact, many airports had begun using the compensatory fee methodology before the City, as shown by the City's own evidence. Order 97-4-12

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[15] He further stated that the airport could obtain some compensation for the difference between the land's value determined under the current cost method and the land's actual value by increasing the rate of return allowed on the investment. Exhibit ATA-72 at 6. The City, however, chose not to include a rate of return in its fee calculation for its investment in the airfield land.

at 8, citing Exhibit LAX-A1 at 4-5. Indeed the airport fees challenged in Kent County were compensatory fees.

In its brief in this remand proceeding the City contends that other airports assertedly had so little ability to use compensatory fees that their practices can provide no guidance, while ACI contends that the failure of other airports to follow a certain practice cannot mean that the practice is unreasonable. LA Brief at 20-23; ACI Brief at 5-6. The airline complainants, on the other hand, argue that the universal use of historic cost by other airports is relevant and should be followed by us in this case. Airlines Reply Brief at 6-7. Neither the City nor ACI tries to defend the Court's assumption that LAX was the first airport to switch to a compensatory fee methodology.

After considering the parties' arguments, we conclude again that the practices of other airports on the land valuation issue are both relevant to this issue and support our conclusion that the airport's fair market value charge is unreasonable.

We begin with the undisputed fact that no other U.S. airport calculates its landing fees on the basis of the fair market value of its airfield land, as shown by the record. Tr. 643-644, 829-830. The City's consultant admitted that the City was the first airport in the United States to value its airfield land at fair market value. Tr. 646. See also Exhibit ATA-25 at 4.

We think the universal practice of other U.S. airports on valuing airfield land is entitled to considerable weight in determining whether the contrary practice adopted by LAX is reasonable. We view airport fee practices generally accepted by airports and airlines as a strong indication that they are widely considered reasonable by the industry, although, as noted by ACI, airport practices are not conclusive evidence on reasonableness issues. Cf. Miami International Airport Rates Proceeding, Order 97-3-26 (March 19, 1997) at 34-35, petition for review pending sub nom. Air Canada v. Dept. of Transportation, D.C. Cir. No. 97-1274. We have therefore taken airport practices into consideration in deciding other issues in these cases and used them as an indication of the types of fees and charges that are or are not considered reasonable. Second LAX Rates Proceeding, Order 95-12-33 at 33, 45; First LAX Rates Proceeding, Order 95-6-36 at 31. In addition, the use of a charge by only one of the many airports in the United States suggests that the charge is neither essential for airport operations nor generally viewed by other airports as desirable.

Our consideration of the practices of other airports is, of course, consistent with the Supreme Court's view on how the Secretary should exercise the authority to determine whether airport fees are reasonable. The Court thus stated in Kent County, 510 U.S. at 366-367:

> The Secretary of Transportation is charged with administering the federal aviation laws, including the [Anti-Head Tax Act]. His Department is equipped, as courts are not, to survey the field nationwide, and to regulate based on a full view of the relevant facts and circumstances.

We conclude, therefore, that our consideration of the practices of other airports properly carries out our authority under the Anti-Head Tax Act to regulate airport fees.

We find unconvincing the City's arguments that the practices of other airports do not support the airlines' position that its fair market value charge is unreasonable. First, on the ground that many airports use fair market value in valuing the land under terminals and other non-airfield facilities, the City claims that airports in fact commonly use fair market value in setting aeronautical fees. LA Brief at 21. But while many airports use fair market value for setting non-airfield fees, as we have recognized elsewhere, no other airport uses fair market value for setting airfield fees. The airports' practice of using different methodologies for non-airfield and airfield fees, moreover, is based on the differences between the airlines' use of non-airfield and airfield facilities. 61 Fed. Reg. at 32007.

Equally unpersuasive is the City's contention that other airports have not set landing fees on the basis of fair market value since many airports used a residual fee methodology for calculating landing fees and thus were not in a position to even consider using fair market value. LA Brief at 21. This contention is inaccurate. As demonstrated by the City's own evidence, many airports had adopted a compensatory fee methodology before LAX switched from residual fees to compensatory fees. See, e.g., Exhibit LAX-A1 at 4-5.[16] The City further suggests that few of the airports cited in the 1984 report were using "a true compensatory methodology," LA Brief at 22, n. 20, but it gives no record citation for that assertion or any explanation of what a "true" compensatory methodology would be.

Similarly irrelevant is the City's observation that relatively few airports impose compensatory fees by ordinance, as LAX did, since most charge compensatory fees under agreements with the airlines, which would never accept airfield fees based on fair market value. LA Brief at 22, n. 20. Some airports, however, have adopted

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[16] The City wrongly suggests that many airports could not consider using fair market value in calculating compensatory fees until the Supreme Court's Kent County decision rejected the airlines' argument that compensatory fees were unreasonable. LA Brief at 22. This assertion has no merit. Many airports -- including LAX itself -- were already using compensatory fees before the Supreme Court decided Kent County.

compensatory fees by ordinance. See, e.g., Second LAX Rates Proceeding, Order 95-12-33 at 45. Airports, moreover, generally have the right to adopt fees by ordinance, subject to any pre-existing agreements with airlines, so other airports could have used a fair market value charge if they had considered such a charge reasonable and desirable.

The City additionally asserts that we may rely on the practices of other airports in assessing the reasonableness of its fair market value charge only if we also take into consideration the relatively low level of LAX landing fees compared to the fees charged by other major airports. LA Brief at 23. This argument has no merit. As we have said before, LAX's fees under a compensatory fee methodology must be based on LAX's costs. If LAX has relatively low costs, as it has, then it must charge lower fees. First LAX Rates Proceeding, Order 95-4-5 at 25. See also Exhibit ATA-77 at 2.

The City further errs in arguing that its fees are reasonable under Supreme Court precedent, whatever the merits of the individual elements of its fee methodology. The City cites Supreme Court decisions like FPC v. Hope Natural Gas Co., 320 U.S. 591, 603 (1944), which hold that a court reviewing a regulatory agency's rate decision should affirm the decision if the result is reasonable, even if the method is imperfect. LA Brief at 23. These cases govern judicial review of a regulatory agency's decision and do not hold or imply that a regulated firm's rate methodology is insulated from review by a regulatory agency.

10. The Airport's Compliance with the Self-Sustaining Requirement

The City contends that the fair market value charge is necessary to fulfill the City's obligation under a section of the airport grant statute, 49 U.S.C. 47107(a)(13), to charge fees "that will make the airport as self-sustaining as possible under the circumstances existing at the airport." LAX Brief at 18-19

We considered and rejected that argument earlier in this proceeding. We held that landing fees must be based on costs and that the airport may not charge landing fees that will cause the airport to generate unreasonable surpluses. First LAX Rates Proceeding, Order 95-6-36 at 24. We reached the same conclusion in the policy statement rulemaking. 61 Fed. Reg. at 32010. The City has not shown any error in this reasoning.

11. Funding for Airport Capital Projects

ACI contends that we should give airports the option of charging landing fees based on the fair market value of airfield assets since airports must make substantial capital investments which they should be allowed to fund through higher fees. ACI Brief at 6-7. The City briefly notes that LAX has massive capital needs and that the

airport could invest funds derived from charging for opportunity costs in its capital projects. LA Brief at 9. In response the airline complainants contend that the airport's alleged capital needs cannot justify the charge, for the airport may not now charge airlines for the cost of future capital improvements not yet completed and in use. Airlines Reply Brief at 2.[17]

We agree with the airline complainants. First, ACI's argument is inconsistent with judicial interpretations of the Anti-Head Tax Act. City and County of Denver v. Continental Air Lines, 712 F. Supp. 834 (D. Colo. 1989). Indeed, in the Second LAX Rates Proceeding the City agreed that the landing fees could not include costs associated with capital projects that were not yet in use. Order 95-12-33 at 49-51.

Secondly, we are unaware of any evidence in the record in this case indicating that the airport developed the fair market value charge in order to fund future capital projects. The record does show that one of the City's two goals for switching from a residual fee methodology to the compensatory fee methodology was to give the airport "greater control over the scope and timing of airport development projects." Exhibit ATA-23 at 6. LAX's residual fee methodology had given the airlines the power to veto major construction projects, as is common in residual fee agreements. The record does not indicate, however, that the City took into consideration airport capital needs in choosing the specific fee formula adopted by LAX and, in particular, creating the fair market value charge for the airfield land. In contrast, the record suggests that the airport instead may have adopted that formula in order to raise funds that could be diverted off the airport if federal law were changed to allow that diversion of airport revenues. See, e.g., Exhibit ATA-4 at 4; Exhibit ATA-5 at 7. We are not deciding that the City adopted its fee methodology in order to raise funds available for diversion, but this evidence undermines any claim that the airport created the fair market value charge in order to fund airport improvements.

12. The Difficulty of Determining Fair Market Value

Our original decision disallowed the fair market value charge in part on the ground that calculating the fair market value of airfield land would be significantly more difficult than calculating historic cost. Order 95-6-36 at 21. The ALJ similarly found that determining the fair market value of airfield land would be more difficult. R.D. at 16.

The Court questioned our reliance on this factor, since the Court doubted that the valuation of airfield land would be difficult. The Court assumed that there

[17] The airline complainants additionally note that the City has been accused of diverting $90 million in airport funds, conduct which suggests that the City does not believe that the airport has insufficient funds for capital improvements. Airlines Reply Brief at 2, n. 2.

would be enough of a market in comparable land parcels to enable an appraiser to estimate the fair market value of the airfield land with some confidence. The Court reasoned that other regulatory agencies had stopped using fair market value because they typically dealt with assets such as utility plants that presented severe valuation difficulties. The Court noted, moreover, that the airline complainants in this proceeding had not challenged the City's estimated fair market value for the airfield land. The Court further assumed that the City would not recalculate the land's fair market value in future years, which would make the difficulty of valuing airfield land relatively unimportant. LAX I, 103 F.3d at 1033. In reviewing the Final Policy Statement the Court again expressed its doubt that resolving the value of airfield land would be difficult. Air Transport Ass'n, 119 F.3d at 44.

For the reasons discussed earlier in this opinion, we have determined that the City's fair market value charge is unreasonable. That determination essentially moots the issue of whether airfield land may be valued without undue difficulty. Moreover, as the Court pointed out, the airline complainants had not challenged the accuracy of the specific appraisal offered by the City in this case. Nonetheless, the question of the difficulty or lack of difficulty in valuing airfield land is likely to arise in future cases, since we cited the relative difficulty of determining the fair market value of airfield land as a factor supporting the historic cost requirement for airfield fees in these cases and in the Final Policy Statement. First LAX Rates Proceeding, Order 96-6-36 at 21; 61 Fed. Reg. at 32010. The question of the difficulty of determining fair market value is, of course, important in airport rate cases, since the expedited procedures required by Congress in cases heard under 49 U.S.C. 47129 make the resolution of complex factual issues a severe burden. We will discuss the evidence in this case since it may help our analysis in future proceedings, even though the issue is not material for our decision in this case.

First, the record indicates that determining the historic cost of land is relatively simple. See, e.g., Exhibit ATA-D2 at 2; Exhibit ATA-E1 at 6-7; Exhibit ATA-72 at 4 (the historical cost of an asset "is obviously quite easy to determine and to verify"). Determining the land's fair market value, on the other hand, is significantly more difficult. There is no easy objective method for determining the value of a large parcel of land like LAX's airfield.

Although the Court had assumed that airfield land could be appraised on the basis of comparable sales of land parcels, the appraisal firm used by the City determined that that approach should not be the primary basis for the appraisal. The firm instead based its fair market value estimate on "a hypothetical developmental approach." The firm stated that "meaningful analysis on a direct comparison basis is not possible" due to "the numerous differences in the development of such a large property and the current environmental and political considerations." Exhibit LAX-14 at 21. For example, the appraisal firm noted that the owners of a 1,000 acre

property just north of the airport had spent fifteen years trying to redevelop that property, formerly the Hughes Airfield, but had not succeeded due to "environmental and political roadblocks." Exhibit LAX-14 at 21. The appraisers indeed concluded that at that time -- January 1, 1993 -- the redevelopment of the airfield would not be feasible, since the market could not absorb more space and since financing for commercial/industrial projects was virtually non-existent. Id. at 19. For these reasons, the firm did not rely primarily on comparable land sales and development projects.

For its appraisal the firm instead used "the estimated anticipated revenues which would be derived from the sale of finished commercial/industrial sites of a theoretical development over the projected term of the project." The calculation reflected estimated land development and construction costs, indirect costs, financing costs, and a profit for the developer. Exhibit LAX-14 at 21.

Thus, while the Court assumed that calculating the fair market value of the airfield land should not be difficult because "there is no need to reconstruct a hypothetical asset in order to account for technological changes, and there is often (indeed, perhaps usually) a ready market in parcels sufficiently comparable for a professional appraiser to extrapolate with some confidence," at least in this case the appraisal firm conducted an analysis that was similar to the creation of a hypothetical asset.

Of course, even if the appraisal had been based on sales of other land parcels, as the Court assumed would be possible, there could still be major disputes about the accuracy of the fair market value estimate. As the Chief Judge pointed out in the First LAX Rates Proceeding, when the estimate of fair market value is based on land adjoining the airport, the estimate uses land parcels whose value is greatly influenced by their location near the airport, which can lead to "bootstrap" accounting. R.D. at 16. If the estimate is based on land that is not near the airport, as was largely true of the estimate made by the City's appraisal firm, the validity of the estimate will depend on whether the land used for the calculation is comparable to the airfield land, an issue which may be difficult to resolve. See also Exhibit ATA-E1 at 6-7.

In suggesting that the difficulties of revaluing the land should have little significance in airport rate cases, the Court also believed that "there was no record evidence to suggest that the airport intended to recalculate its rate base periodically in order to capture increases in the market value of the underlying land; for all that appears in the record, however, the City would appraise the market value of the

land only once, i.e., for the purpose of bringing that land into the rate base." 103 F.3d at 1033.[18]

The record in fact suggests that the City was planning to revalue the land periodically. Exhibit ATA-74 at 1. Indeed, the logic of the City's preferred rate methodology calls for a periodic revaluation of the land. After all, the methodology assumes that the airfield fees will be inaccurate if they do not reflect the airfield land's fair market value. See, e.g., Exhibit LAX-F1 at 16; Exhibit LAX-I1 at 2-3. Under this rate theory, the airport would have to revalue the land from time to time to ensure that the fee calculation used the correct value.[19] The airline complainants point out, moreover, that they should have the right to challenge a fair market value charge if the value of the land declines. Airlines Brief at 21-22.

The City's documents indicate that the airport had intended to periodically reexamine the land's fair market value. The City's consultants advised the executive director of the City's Department of Airports, Exhibit LAX-17 at 9:

> Having initially determined the appropriate return on airfield and apron land . . . , then re-determine an appropriate return on land every five years using a similar methodology. During the interim between formal re-determinations adjust land costs by an established economic index.

We note that the City's lease policy, as set forth in December 1986, similarly states that the property at each airport would be reappraised every five years. Exhibit LAX-31 at 4.

The City has essentially conceded that the record indicates that the land would be periodically revalued. LA Brief at 20, n. 18. The City nonetheless contends that we should ignore the record evidence because the airport has not yet undertaken any such revaluation. Ibid. However, if, as the record suggests, the airport intended to revalue the land only every five years, the first revaluation would not occur until 1998. The lack of any revaluation so far is entirely consistent with the intent to periodically reexamine the land's market value.

The record in this case accordingly shows that determining the fair market value of an airport's airfield land in a contested fee case will be difficult and may well cause periodic disputes requiring resolution, given the likelihood that an airport using fair

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[18] The Court did not explain the source of this belief. The parties' briefs had not addressed the point, and the record excerpts submitted to the Court did not discuss the matter.

[19] BAA, which operates airports in Britain and is the one airport operator identified in the record as basing its landing fees on fair market value, revalues its land annually. Exhibit LAX-D2 at 1-2.

market value would periodically revalue its land. Given the time deadlines imposed by statute on our decision of airport fee cases under 49 U.S.C. 47129, the difficulty of determining fair market value for airfield land rationally suggests that landing fees should not use a fair market value charge.

13. The City's Takings Clause Argument

The City claims that it is entitled to a return on its investment in the airfield land under the Fifth Amendment's Takings Clause. The Takings Clause requires the government to pay fair compensation when it takes private property for public use. The Supreme Court has held that the Takings Clause applies when the federal government condemns property owned by a state or local government. United States v. 50 Acres of Land, 469 U.S. 24 (1984). While the Court has not held that the Takings Clause applies to federal regulation of an activity carried out by a state or local government, we will assume here that the clause does apply to our regulation of airport fees.

The Takings Clause is generally viewed today as the source of the government's obligation to ensure that private utilities subject to rate regulation are allowed to charge rates that will give them the opportunity to earn a fair return on their investment. See, e.g., Tenoco Oil Co. v. Dept. of Consumer Affairs, 876 F.2d 1013, 1020-1021, 1022 (1st Cir. 1989), citing, inter alia, Pennell v. City of San Jose, 485 U.S. 1 (1988). The City assumes that the principles applicable to the regulation of rates charged by private utilities are fully applicable to landing fees charged by an airport owned by a state or local government. On that basis the City contends that LAX is entitled to a return on its investment in the airfield land. LA Brief at 23-25.

The issue in this remand proceeding is whether the airport may include the fair market value charge in the landing fee calculation or whether it must instead use historic costs in calculating the fees. The Supreme Court has held that a regulatory agency's use of historic cost valuation in rate-making cases does not violate the Constitutional principle that regulated firms must be allowed the opportunity to earn a return on their investment. See Duquesne Light Co. v. Barasch, 488 U.S. 299, 308-310 (1989). The Court's holding would seem to settle the issue. The City nonetheless argues that whenever the courts uphold rates based on historic cost the rates also provided for a return on the regulated firm's investment.

The airport, however, chose to include no return on investment in its fee methodology, except for an imputed interest charge for certain capital asset investments, a charge which we upheld. Although the City treats its fair market value charge as though it were the equivalent of a return on its investment, the City is not really seeking a return on its actual investment in the land, most of which was acquired many years ago. Instead, the City seeks to take advantage of the rise in land values in the area around the airport. Second LAX Rates Proceeding, Order 95-

12-33 at 17-18. Indeed, as discussed above, the City's consulting firm rejected Professor Levy's preferred approach to valuing the airfield land -- an approach based on the City's actual investment in the airfield adjusted for general inflation -- because it would not enable the airport to charge fees comparable to the estimated fair market rental value of the land. And the City's brief in this remand proceeding admits that an imputed interest charge on its actual investment would be "a pittance" compared to the land's estimated fair market rental value. LA Brief at 6, n. 6. The landing fees thus were not intended to enable the airport to obtain a return on its investment. Furthermore, the rise in value of the airfield land in large part stems from the airport's success and the resulting growth of the City's economy and population.

Nonetheless, since the City has raised the Constitutional issue, we will address its argument that the Takings Clause gives the airport the right to charge landing fees that will enable the airport to earn a return on its investment in the airfield. After considering the standards used by the Supreme Court for determining whether a taking has occurred, we find that our decision here on airfield fees does not constitute a taking of property without just compensation.[20] Our conclusion is based on an application of the Supreme Court's standards to airfield operations, so our conclusion does not cover non-airfield fees charged aeronautical users or fees charged non-aeronautical users. And our conclusion concerns fees that allow the airport to cover its out-of-pocket costs of providing airfield facilities and services, not fees that require the airport to charge less than those costs. Moreover, our analysis involves airports, which are different in important respects from typical governmentally-owned utilities, primarily because airports have long been subject to extensive federal regulation and have received large federal grants.

The City correctly points out that the courts have invariably held that private utilities have a right to an opportunity to earn a rate of return on their investment. The City is demanding that its operation of the LAX airfield be deemed the equivalent of a privately-owned firm's operations. Regulatory agencies must allow privately-owned firms to charge rates which give them an opportunity to earn a fair return on their investment. But this principle does not apply to a publicly-owned airfield.

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[20] We reached the same conclusion in our original decisions and in our policy statement rulemaking. First LAX Rates Proceeding, Order 95-6-36 at 22; Second LAX Rates Proceeding, Order 95-12-33 at 17-18; 61 Fed. Reg. at 32011. The Court did not need to reach the Takings Clause issue in LAX I, because the Court remanded the case on other grounds. Since the City has used its Takings Clause claim to support the fair market value charge and since the City will presumably raise the Constitutional issue on review, we have chosen to discuss our reasons for finding that no taking has occurred.

The federal courts have never decided whether a publicly-owned utility like an airport is entitled under the Takings Clause to earn a profit. Given the differences between publicly-owned airports and private utilities, it would be irrational to blindly apply the principles governing private utility rates to airport rates, as the City seeks to do. In particular, as explained below, airports have not been built as profit-making enterprises, even though a number of airports like LAX earn profits from their non-airfield activities. We therefore think that the proper approach on this issue is to determine whether a taking has occurred under the general standards established by the Supreme Court for deciding whether a regulatory action constitutes a taking.

The Supreme Court considers three factors in determining whether government action constitutes a taking: the action's character, its economic impact, and the extent to which the action interferes with investment-backed expectations. Connolly v. Pension Benefit Guaranty Corp., 475 U.S. 211, 224-225 (1986); Concrete Pipe & Products v. Construction Laborers Pension Trust, 113 S. Ct. 2264, 2291 (1993). Under these standards requiring the airport to value the airfield land at its historic cost cannot be deemed a taking.

On the first factor, the character of our valuation requirement, there is no physical invasion or permanent appropriation of an airport's property. Instead, as is typical of many regulatory programs, our historic cost valuation requirement adjusts the benefits and burdens of economic life in order to promote the common good. That type of regulation is not normally deemed a taking of property. Connolly, 475 U.S. at 225. That obviously does not end our inquiry, for regulatory decisions unreasonably limiting private utility rates can constitute a taking despite the lack of a physical invasion or permanent appropriation of the utility's assets and business. See, e.g., Duquesne Light Co. v. Barasch, 488 U.S. 299 (1989).

The second element of the Court's standard involves the economic impact of our decision. Requiring airport landing fees to be based on historic cost cannot have an unduly harmful impact on LAX. Even as limited by our decision, the airport's landing fees enable it to recover the out-of-pocket costs of its airfield investments and operations and to recover imputed interest on some capital investments. The airport may also include charges for reasonable reserve requirements and debt expense. Moreover, as shown, every airport in the United States except LAX has valued airfield land at historic cost in imposing fees. This indicates that a historic cost requirement does not conflict with an airport's ability to operate successfully. And since federal law does not limit the fees charged non-aeronautical users by LAX, the airport may -- and does -- charge fees for non-aeronautical facilities that make the airport's overall operations quite profitable.

The third element of the Court's standard concerns whether our decision has interferred with the City's investment expectations. Cf. Connolly, 475 U.S. at 226-

227. We find for two reasons that there will be no such interference. Cf. Connolly, 475 U.S. at 226-227. First, state and local governments invest in airports in order to further the well-being and general welfare of their citizens, not in order to make a profit. 61 Fed. Reg. at 32011. The City has cited no evidence in the record suggesting that the City's motives were any different when it created LAX. Indeed, for many years the airport used the residual fee methodology, which guaranteed that the airport would not earn significant profits, since the airport had to offset profits from non-airfield sources against its airfield costs in calculating landing fees. The City accepted that restriction on its ability to charge higher landing fees in order to obtain financing for capital developments. See, e.g., Exhibit ATA-9 at 1-2; Exhibit LAX-C1 at 3. The City's willingness to accept the residual fee methodology supports our decision that the City did not build the airport with an eye towards earning profits from airport operations. The City, moreover, continues operating its other three airports, even though none of them appears to generate significant operating profits, as shown above. And the City's agreements with the airlines using Ontario limited the landing fees to the amount needed to cover operating and debt expenses and debt service and did not provide for any return on investment. Exhibit ATA-7 at 13-14.[21]

Secondly, federal statutes have limited airport fees for many years and, as to airports like LAX that accepted federal grants, imposed other restrictions on the use of airport funds and property. In particular, the grant statute prohibits an airport owner (with a few grandfathered exceptions) from using airport revenues for non-airport purposes. As a result, the City could not transfer airport revenues to its general fund and could not have expected to earn any return on its investment in the airport. Nothing in the federal laws governing airports indicates that Congress expected that the state and local governments operating airports would derive earnings from airport operations and property. Public utilities, in contrast, expect to be able to pay out a substantial portion of their earning as dividends to their shareholders. Given these restrictions, a decision limiting the airport's landing fees to the amount needed to cover out-of-pocket costs, the funding of reserves, and imputed interest on certain investments cannot frustrate the City's investment expectations.

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[21] The California Supreme Court suggested that municipal water companies and similar types of municipal utilities in California historically included a rate of return element in setting rates. Hansen v. City of San Buenaventura, 233 Cal. Reptr. 22, 27 (Calif. 1986). Nothing in the record here indicates that airports in California ever followed that practice as to airfield fees. LAX, of course, did not when it operated under the residual fee methodology. An Illinois decision, moreover, suggests that a municipal utility serving its own residents is treated as acting in a governmental capacity and that rate of return considerations become relevant only when the municipal utility serves customers outside the city limits of the utility's owner. Village of Niles v. City of Chicago, 558 N.E. 2d 1331, 1335 (Ill. App. 1990). LAX's operations, of course, directly benefit the City's residents, even though many of its users are not Angelenos.

We also note that the City's claims assume that a privately-owned regulated firm is entitled to earn a return on all parts of its business. The contrary is the case. The courts have held that a rate decision may be Constitutional even though it causes the firm to operate part of its business at a loss. Baltimore & Ohio Railroad v. United States, 345 U.S. 146, 148 (1953); Metropolitan Transportation Authority v. ICC, 792 F.2d 287, 296-297 (2d Cir. 1986). Those decisions tend to support our decision here, although our decision will not force the City to operate any part of the airport at a loss. Any limitations imposed by us on LAX's airfield fees will not restrict the airport's non-aeronautical fees and fees for non-airfield facilities, and LAX earns large operating profits from its non-aeronautical revenues. And the airfield fees allowed by our decision will cover the airport's airfield costs as measured by the historic cost standard.

The City objects that the airport's earnings from non-airfield sources may not be considered in determining whether our decision disallowing the fair market value charge constitutes a taking. LA Brief at 24. In determining the reasonableness of a rate for an airport facility, we ordinarily may not offset the airport's earnings from other sources in determining whether the fee is reasonable. In this decision we made no such offset. But in determining whether the fee allowed by a regulatory agency is so low as to be confiscatory and a violation of the Takings Clause, the courts consider the total impact of the agency decision, which may involve a consideration of the regulated firm's earnings from related services.

Finally, we deny the City's claim that it is entitled to a hearing on a rate of return for the airfield fees. LA Brief at 25, n. 24. Requiring the landing fees to be based on historic cost does not violate the Takings Clause. Furthermore, the airport chose not to include a rate of return element in its fees, as shown above, except insofar as it charged imputed interest on a portion of its investment in airfield capital assets. Since the airport decided to calculate its fees in a different manner and since our decision on the fees is consistent with Constitutional and statutory requirements, we see no need for us to hold a proceeding to revise the City's chosen methodology.

ACCORDINGLY:

1. We find that the landing fees charged by the respondents, the City of Los Angeles, the City of Los Angeles Department of Airports, and the Los Angeles Board of Airport Commissioners, for Los Angeles International Airport for the period from July 1, 1993, through June 30, 1995, and for the period from July 1, 1995, were unreasonable and therefore unlawful under 49 U.S.C. 40116, 49 U.S.C. 47107, and 49 U.S.C. 47129, insofar as the respondents include in the rate base for such fees a fair market rental based on an estimated fair market value for the land underlying the airport's airfield and apron;

2. We order the respondents, the City of Los Angeles, the City of Los Angeles Department of Airports, and the Los Angeles Board of Airport Commissioners, to refund with interest the fees paid from August 23, 1994, to the extent that such fees are unreasonable due to the inclusion in the rate base for such fees of a fair market rental based on an estimated fair market value for the land underlying the airport's airfield and apron, as provided by our earlier orders in the Los Angeles International Airport Rates Proceeding and the Second Los Angeles International Airport Rates Proceeding; and

3. We grant all motions for leave to file unauthorized documents.

By:

PATRICK V. MURPHY
Deputy Assistant Secretary for Aviation
and International Affairs

(SEAL)