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Honorable Susan L. Kurland
Assistant Secretary for Aviation and International Affairs
Office of the Secretary
United States Department of Transportation

Filed with www.regulations.gov & Docket Operations
M-30 West Building Ground Floor
Room W12-140
1200 New Jersey Avenue, SE 20590

Re: Docket DOT-OST-2000-6773, Pacific Wings, LLC Petition for Reconsideration of Order 2011-11-27

Dear Assistant Secretary Kurland:

Pacific Wings hereby petitions the Department to reconsider Order 2011-11-27 (“Order”), in which the Department selected Schuman Aviation Company Ltd. d/b/a Makani Kai Charters (“Makani Kai”) to provide subsidized Essential Air Service at Kalaupapa, Hawaii, for a two-year period, over the objection of Pacific Wings, which since April 1, 2007 has provided subsidy-fee service.¹

The Order selecting Makani Kai relies, as it must,² on the Department’s interpretation and application of a provision in the EAS statute that defines “basic essential air service” to

¹ Counsel acknowledges that the Department’s rules of practice require a petition for reconsideration to be filed within 20 days of the service date of the order, in this case, by December 12. Counsel hereby seeks leave to file this petition because: (1) it was the undersigned counsel’s – not Pacific Wings’ – mistake in believing the deadline was 30 days instead of 20; (2) the Department’s acceptance of this tardy filing will not prejudice any party to this proceeding; (3) it will allow Pacific Wings to respond to the Department findings, not previously discussed in its Order Requesting Proposals (Order 2011-4-7)(“Order Requesting Proposals”); and (4) it is in the public interest for the Department to correct the errors in its Order, thereby promoting the efficient operation of the Essential Air Service program.

² This is the only possible lawful basis for the Department’s subsidy award. Under the EAS statute, where a carrier provides basic essential air service without a subsidy, there is no authority to subsidize a competing carrier. See 49 U.S.C. §41733(c); and (d)(“The Secretary shall end payment of compensation to an air carrier for providing basic essential service to an eligible place when the Secretary decides the compensation is no longer necessary to maintain basic essential air service to the place.”)

include “flights at reasonable times considering the needs of passengers with connecting flights at the airport and at prices that are not excessive compared to generally prevailing prices of other air carriers for like service between similar places.”³ Notwithstanding Pacific Wings’ expressed intention to continue providing subsidy-free service at Kalaupapa, the Order Requesting Proposals was predicated on two findings: (1) a decrease in enplanements and flight completion percentages; and (2) continuing service complaints “from the community.” The Order selecting Makani Kai is more narrowly predicated on the Department’s finding that Pacific Wings’ fares are too high.

The Order is flawed in two major respects. First, the subsidy calculations include several glaring mistakes, the most notable of which is that the rates for Makani Kai (\$932,772 for the first year and \$923,509 for the second year) include a profit margin of 31%, a margin that violates the EAS limit of a 5% margin set forth in Part 271. Second, the Department’s unprecedented foray into fare regulation, while in furtherance of statutory direction, is provided without meaningful standards, and is flawed. In its consideration of what are the “generally prevailing prices of other carriers for like service between similar places,” the Department erred by failing to recognize the stark differences between Kalaupapa and the other Hawaiian markets.

1. Makani Kai’s subsidy calculations contain significant errors, which result in a taxpayer subsidy that wildly exceeds the Department’s EAS guidelines.

The most egregious error in the Department’s Order is the award of subsidy amount that includes a profit of over 30%. Set forth below is a table comparing the subsidy bid submitted by Makani Kai with the calculation required by Part 271.

Makani Kai calculations:

<i>Element</i>	<i>Dollar amount</i>
Operational expenses	\$981,864.40
Less 5%	-\$49,093.22
Subsidy requested and awarded	\$932,771.18

³ The Department did not reference this statutory provision in its Order Requesting Proposals (Order 2011-4-7). While Order 2011-4-7 referenced unspecific complaints from the community, there was no mention of any concern over fares. Although Pacific Wings believed – correctly – that the community’s “service” complaints were simply a concern over fare increases, this Petition is the first opportunity for Pacific Wings to respond to the Department’s finding that Pacific Wings’ fares have been “excessive” per the definition of “basic essential air service.”

Calculations required by Part 271:

<i>Element</i>	<i>Calculations per Part 271</i>
Operational expenses	\$981,864.40
Return at 5% of operational expenses	+\$49,093.22
Total economic costs	\$1,030,957.62
Less revenue	-\$355,680.00
Subsidy required	\$675,277.62

As is apparent, Makani Kai ignored its projected revenues in calculating the subsidy amount. The subsidy awarded by the Department would result in a return of 31.2%, overcharging the Government \$257,493.56 in the first year and nearly as much in the second year.

The Essential Air Service statute directs the Department to prescribe guidelines governing the rate of compensation (49 U.S.C. §41737(a)), and for the Department to pay the rate of compensation provided for under these guidelines (49 U.S.C. §41733(c)(2)). The Department's regulations in Part 271 are straightforward:

In establishing the subsidy for an air carrier providing essential air service at an eligible place, the Department will consider the following:

- (a) The reasonable projected costs of a carrier in serving that place;
- (b) The carrier's reasonable projected revenues for serving that place;
- (c) The appropriate size of aircraft for providing essential air service at that place; and
- (d) A reasonable profit for a carrier serving that place.

14 C.F.R. 271.3. Makani Kai's subsidy bid does not include projected revenues in its subsidy calculations, and for this reason alone the Order is infirm.

As for profit, 14 C.F.R. 271.6 provides that "[t]he reasonable return for a carrier providing essential air service at an eligible place will be set at a flat percentage, typically 5 percent of that carrier's projected operating costs as established under §271.4, plus any applicable interest expenses on flight equipment." Makani Kai's subtraction of 5% is nonsensical.

Pacific Wings is unaware of any instance in which the Department has authorized a rate of return above 5% of the carrier's projected operating costs, and neither the Order nor the Makani Kai submission explains why any higher rate of return is necessary or appropriate. In

any event, the 31.2% rate of return appears to be the result of a misapplication of the Department's regulations and must be corrected.

Other errors include:

Makani Kai has estimated that it will carry 2,496 passengers the first year, while operating 2,616 flights. Even if the average occupancy of a Makani Kai flight is just one passenger, that still means 120 flights at a minimum will be operated with no passengers.

But the Department also has stated that Makani Kai will operate 12 roundtrips per week to Honolulu and 18 roundtrips per week to Molokai. This is 60 departures a week or 10 departures per day (6 days per week). In 2012, there are 313 service days, meaning 2,973 departures (at a 95% completion rate) or 3,099 departures (at a 99% completion rate). (The Department's annual compensation assumes a 95% completion rate, while the Department's calculation of the subsidy per flight assumes a 99% completion rate).⁴

Again, assuming that the average occupancy of a Makani Kai flight is just one passenger, that would mean between 477 and 603 flights will be operated without a single passenger.

The numbers presented by Makani Kai do not make sense.

2. The Department's finding that Pacific Wings' fares were "excessive" is flawed because it failed to consider the relevant factors.

To our knowledge, the Department has never before decided an EAS proceeding on the basis that an EAS carrier's non-subsidized fares are "excessive." Congress added the relevant

⁴ See Order, at Appendices B and C.

provision in 1987.⁵ From a review of the legislative history, it is apparent that Congress intended to provide that EAS fares could not be markedly higher than non-EAS airlines' fares for similar routes. The only discussion of this provision is in the section-by-section summary of the Essential Air Service amendment ("Subparagraph (k)(1)(B) requires . . . that the fares be comparable to fares on similar routes.") 100 Cong. Rec. H8023 (Oct. 1, 1987). Additional remarks, made in extension or made during House and Senate Hearings on the EAS program, indicate that this language was meant to prohibit fares from an EAS point to a non-EAS point from being markedly higher than fares between two non-EAS points on a similar route.

For example, Rep. Oberstar stated that one of the problems with EAS service was that fares were often excessive. 100 Cong. Rec. E1639 (Extension of Remarks by Rep. Oberstar). His legislation proposed to require that fares "would have to be in line with those charged elsewhere for such services." *Id.* This indicates that the comparison is between fares on EAS flights with fares on non-EAS flights. Similarly, in the hearing before the Senate Aviation Subcommittee regarding Essential Air Service, Senator Exon remarked that the fact that it would cost him more to fly from Omaha, Nebraska to Scottsbluff, Nebraska than it would to fly from Washington, D.C. to Omaha was an "unfair disparity" in air fare. *Essential Air Service: Hearing on S. 582 and S. 876 Before the S. Subcomm. on Aviation of the Comm. on Commerce, Science, and Transportation*, 100th Cong. 302 at 73 (1987). He continued that "a combination of a whole series of things, including extremely high fares, compared with the rest of the country" prohibited people from using EAS points, even if they wanted to use the airline at issue. *Id.* at 74-75.

Accordingly, the language that fares must not be excessive when compared to the generally prevailing fares of other air carriers for like services between similar points was intended to mean that EAS airlines' fares could not be markedly higher than non-EAS airlines' fares for similar routes.

Yet this legislative history does not aid the Department in its analysis, much less dictate the result in this proceeding. First, there is no discussion in the legislative history of a carrier providing EAS service without a subsidy. Second, the statements in House and Senate reports

⁵ Public Law No. 100-223, 101 Stat. 1517, § 202(k)(1)(B) (" . . . at rates, fares, and charges which are not excessive when compared to the generally prevailing fares of other air carriers for like services between similar pairs of points."). The language was introduced as part of amendments, on the floor, to both House and Senate FAA reauthorization legislation. See 100 Cong. Rec. H8018 (Oct. 1, 1987) (Rep. Hammerschmidt offering the Essential Air Service provisions as an amendment to H.R. 2310); 100 Cong. Rec. S15257 (Oct. 28, 1987) (Sen. Exon offering the "Small Community Air Service Improvement Act of 1987" as an amendment to H.R. 2310). The House Conference Report noted that the House and Senate provisions contained the same language. H.R. Rep. No. 100-484, at H11499 (Dec. 15, 1987) (Conf. Rep. on H.R. 2310).

and of Members of Congress provide no meaningful standards for the Department to use in determining what fare is "excessive," what is considered to be "generally prevailing prices," what is considered "like service" and what is considered "similar places." The Department's Essential Air Service regulations at Part 271 neither address the 1987 amendment nor define any of these terms.

Without any legislative or regulatory guidance and in the absence of any Department precedent, the Department chose to compare Pacific Wings' unsubsidized fares to and from Kalaupapa (and the average yield) with four average fares and yields of other carriers that conduct inter-island flights to and from non-EAS places. In a note, the Department explained that it chose these four flight segments because they are of short stage length and have modest traffic levels.

This is not a fair comparison. The Department should have heeded its 1998 Rural Air Fare Study ("Study"), submitted to the House and Senate authorizing committees, pursuant to Section 1213 of the Federal Aviation Administration Reauthorization Act of 1996. With respect to fare analysis and comparison among markets, the Department finds (at pages 5-6)(emphasis added):

A notable feature of the available fare data is the wide variance in average fares and yields between communities as well as between city-pair markets at the same community. Fares and fare structures appear to be based on individual city-pair market circumstances, not generic or universal community factors. This appears to be the case for both small communities and hub communities. . . . Wide variances in average yields are fares occur in every mileage category for both hub and non-hub communities.

. . . [T]here are many characteristic differences between markets that may account for variations in fare and passenger levels. *These characteristics are not always reflected in comparisons of average fares/yields.* A more detailed analysis and comparison could take into account, for example, differences in the type of travel (e.g. discretionary vs. nondiscretionary), the types of tickets purchased (restricted/nonrefundable vs. changeable/refundable), the size of the market (density), the cost of providing service, and the level and type of competition, among other things.

Instead, the Department simply compared fares and yields in four Hawaiian city-pair markets, of similar mileage and "modest traffic levels." In fact, Pacific Wings fares are higher than these other markets, not because they are "excessive," but for exactly the reasons contained in the Study: the remoteness of Kalaupapa and the staggering expense of dealing with routine

mechanical issues (like a flat tire) at one of the world's most remote airstrip, with no facilities, mechanics, parts or assistance available. Regarding the "cost of providing service," everything from personnel to tools must be flown in to deal with the problem (often by helicopter, further compounding the expense). Pacific Wings has had planes disabled in Kalaupapa for days at a time due to simple things like a flat tire or a dead battery because of red tape and local Kalaupapa "customs" preventing Pacific Wings from resolving the problem sooner. The lost revenue and costs involved with getting mechanics, tools, supplies and parts over and back is significant.

All of the other markets cited in the Department's Order (other than Kalaupapa) have developed, full service airports with ready access to facilities and assistance necessary to deal quickly with any unforeseen problems, while they feature none of Kalaupapa's challenges (such as disabling the runway lights to prevent night or emergency landings), which protract, complicate, and increase the expense of dealing with routine mechanical issues there.

The Order also ignores the vastly different economies involved in operating under a Part 135 scheduled certificate and operating smaller aircraft, as compared with the other carriers operating in Hawaii with 25 seats or more, depending on the market, and vastly different market densities.

As for "the level and type of competition," Kalaupapa currently receives (and has been receiving) unsubsidized service from two carriers, Pacific Wings and Makani Kai, which has been operating daily tour flights ("scheduled service under both FAA and DOT interpretations) long before the Department's Order Requesting Proposals in April. This is another reason for declining enplanements that was not considered by the Department. Damien Tours sells Makani Kai's service for the air component of their tours; it is difficult for Pacific Wings to fly more Kalaupapa tourists when the community has struck a deal with Makani Kai to be the designated provider. All visitors must have prior authorization from the community to enter. Pacific Wing has no ability to grant such permission without a prior arrangement, like the one between Damien Tours and Makani Kai. Pacific Wings has always believed that as an EAS carrier it is important to have seats available for any patients, government workers, or medical personnel that need to travel. So another reason for higher fares is that Pacific Wings is deprived of tourist revenues to ensure the capacity is available for the community itself.

The Department also fails to note on March 26, 2011, when the Secretary of Transportation was in Hawaii to listen to community concerns, Hawaiian Airlines advertised fares in inter-island markets of similar stage lengths as those identified in the Department's Order that were

higher than Pacific Wings' fares.⁶ On March 26, 2011, Hawaiian's one-way fares to Molokai (an airport on the same island as Kalaupapa and just eight miles away) via Kahului was \$330, \$294 and \$320.

If this Order stands, what precedent is set? While the Department denies it is engaging in fare regulation, that is precisely what it is doing here. And it is doing so without any meaningful guidelines. Without any explanation in its Order of when a fare becomes "excessive," what fare comparisons are appropriate, what service is considered "like" and what places are considered "similar," the Department's Order looks like a *post-hoc* justification of a pre-determined result. We recognize that the legislative history of the 1987 amendment provides scant guidance, but this should give the Department more pause before engaging in a foray of regulation in an otherwise deregulated industry.⁷

If the Department considers the Kalaupapa market to be *sui generis*, given the special needs of a small number of residents, it should consider whether other EAS markets include a similar if not greater number of residents with special needs. Communities may read this Order as opening the door to claims of excessive *subsidized* as well as unsubsidized fares.

The Department is charged with the responsibility to administer the Essential Air Service program with due regard to the limited funding available for the program.⁸ Over the years, Pacific Wings has saved the Government millions of dollars by operating fuel-efficient 9-seat Cessna Caravan aircraft at a fraction of the cost of other EAS carriers operating 19-seat or

⁶ Pacific Wings sent this fare information to the EAS program office via e-mail on March 28, 2011.

⁷ While Pacific Wings neither needs nor wants a subsidy to continue to operate sustainable service at Kalaupapa, there is another avenue the Department could have pursued to assist the community in providing residents with fare relief. In enacting the Small Community Air Service Development Program ("SCASD"), 49 U.S.C. §41713, Congress addressed the challenges faced by airports in small or remote locations, including "insufficient air carrier service" and "unreasonably high air fares." Under the SCASD, an eligible airport "presents characteristics, such as geographic diversity or unique circumstances, that will demonstrate the need for, and feasibility of [a SCASD grant]." 49 U.S.C. §41733(c)(2). Kalaupapa plainly presents these characteristics. We recognize that the Department, as a matter of discretion, limits grant awards to EAS-*subsidized* communities to marketing and promotion projects that support existing or newly subsidized EAS. See Order 2011-7-1 ("Order Soliciting Small Community Grant Proposals"), at 6, but Pacific Wings has provided EAS service at Kalaupapa without a subsidy. Accordingly, a SCASD grant could have been requested to give the Kalaupapa residents subsidized fares, for a period not to exceed three years, as opposed to engaging in fare regulation and subsidizing a competing carrier.

⁸ While the EAS statute does not explicitly charge the Department with this responsibility, it is inherent in any Government agency's responsibility to dispense finite Federal funds to competing private entities.

larger aircraft in similar markets. In several markets, including Kalaupapa, Pacific Wings has saved the Government even more money by providing service without any EAS subsidy. It comes as a surprise, therefore, for the Department to insist on providing a subsidy of close to one million dollars each year simply because a small number of residents object to an increase in fares. Before its Order, the Department had never informed Pacific Wings that its fares were of concern, much less that they were so high as to be deemed "excessive," thereby terminating Pacific Wings' Essential Air Service eligibility for this market and foregoing millions of dollars of the savings to the Government.

What is worse, by this Order the Department is subsidizing a competitor in this market, at a rate that was incorrectly calculated and excessive. By subsidizing a competing carrier in this market, whether Pacific Wings can afford to continue service is seriously in doubt.

For the foregoing reasons, the Department should grant this petition and, upon reconsideration, re-select Pacific Wings to provide the EAS service without subsidy. In the alternative, the Department should re-open the proceeding and solicit bids with guidance as to what fares the Department considers not to be "excessive" under the EAS statute.

Respectfully submitted,

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