

## **Grandfathered Revenue Diversion**

(December 3, 2018 by Dafang Wu; [PDF Version](#))

With the recent FAA determination on [Port Authority of New York and New Jersey \(PANYNJ\) vs. United Airlines](#) regarding operations at Newark International Airport, the issue of grandfathered revenue diversion has begun to attract attention. In April 2018, the U.S. DOT Office of Inspector General issued a report ([“FAA Needs To More Accurately Account for Airport Sponsor’s Grandfathered Payments”](#)) but didn’t research detailed calculation methodologies. Some ambiguities, as discussed below, must be further explored by each related airport.

### **Statutory Requirements**

[The 1999 Revenue Use Policy](#) prohibits unlawful revenue diversion (which is “the use of airport revenue for purposes other than the capital or operating costs of the airport”) at airports that receive federal assistance. The definition of airport revenue covers virtually all types of revenue, including aviation fuel taxes. With the Airport Improvement Program funded at over \$3.2 billion annually, most, if not all, commercial airports have received federal assistance and are therefore subject to this policy.

Section IV.B lists exceptions for certain preexisting arrangements (grandfather provisions) which permit certain arrangements prior to the adoption of the Airport and Airway Improvement Act of 1982 (AAIA), re-codified as 49 U.S. Code 47101 on July 5, 1994. 49 U.S. Code 47107(b)(2) states,

*“Paragraph (1) of this subsection [The revenue restriction] does not apply if a provision enacted not later than September 2, 1982, in a law controlling financing by the airport owner or operator, or a covenant or assurance in a debt obligation issued not later than September 2, 1982, by the owner or operator, provides that the revenues, including local taxes on aviation fuel at public airports, from any of the facilities of the owner or operator, including the airport, be used to support not only the airport but also the general debt obligation.”*

Section 47115(f) further provides:

*“Subject to paragraph (2), in deciding whether or not to distribute funds to an airport from the discretionary funds established by subsection (a) of this section and section 47116 of this title, the Secretary shall consider as a factor militating against the distribution of such funds to the airport the fact that the airport is using revenues generated by the airport or by local taxes on aviation fuel for purposes other than capital or operating costs of the airport or the local airports system or other local facilities which are owned or operated by the owner or operator of the airport and directly and substantially related to the actual air transportation of passengers or property.*

*(2)Required finding.—*

*Paragraph (1) shall apply only when the Secretary finds that the amount of revenues used by the airport for purposes other than capital or operating costs in the airport’s fiscal year preceding the date of the application for discretionary funds exceeds the amount of such revenues in the airport’s first fiscal year ending after August 23, 1994, adjusted by the Secretary for changes in the Consumer Price Index of All Urban Consumers published by the Bureau of Labor Statistics of the Department of Labor.”*

The message in Section 47107 is loud and clear – there will be no new lawful revenue diversion after 1982. The language in 47115(f)(2) is quite vague and did not provide clear guidance on the calculation methodology.

## Calculation of Grandfathered Revenue Diversion

The 1999 Revenue Use Policy listed six examples of grandfathered revenue diversion. In addition, on its [Compliance Activity Tracking System \(CATS\)](#) site, the FAA provides a [document about the grandfathered airport](#) with a list of nine grandfathered airports. It is uncertain why only nine airports are listed.

To determine whether Section 47115(f) affects an airport, that airport must identify three items: (a) related payment in the current year; (b) related payment in the first fiscal year ending after August 23, 1994 (the Base Year); and (c) the escalation factor using CPI-U:

- The base year should be "... the airport's first fiscal year ending after August 23, 1994." For airports with fiscal years (FYs) ending June 30, the base year is FY 1995 ending June 30, 1995. For airports with fiscal years (FYs) ending December 31, the base year is FY 2014 ending December 31, 1994.
- The FAA tracks the base year amount and provides annual updates in an internal report. The OIG report quoted the base year amount for PANYNJ but not for other airports.
- CPI-U has two series: not seasonally adjusted and seasonally adjusted. Both are provided monthly by the Bureau of Labor Statistics. The former [Series CUUR0000SA0](#) seems to be the default used in this calculation. However, it seems that some airports will use the average CPI-U for the entire base year, and compare it to the average number for the current year. Other airports may choose a monthly data point. For an airport with a fiscal year ending June 30, the CPI-U for June 1995 was 152.5 and the CPI-U for June 2018 was 251.989. Therefore, the escalation factor could be  $251.989/152.5 = 165.24\%$ .
- The current year amount should be reported on FAA Form 5100-126.

The grandfathered amount seems to include two types:

1. A defined payment from an airport to another governmental agency that is not based on cost reimbursement (the Payment Diversion), such as 5% of gross receipt
2. An implicit payment when a consolidated port authority uses authority-wide revenues for authority-wide obligations (the Commingled Diversion)

For any airport with the Payment Diversion, the payment amounts for the base year and the current year can easily be identified from the internal accounting record. The annual amounts since FY 1996 are also reported on Form 5100-126 in CATS, as the FAA instructed in the document on the grandfathered airport.

For any airport with the Commingled Diversion, the calculation of "... revenues used by the airport for purposes other than capital or operating costs" is difficult to determine. Intuitively, one airport may allocate revenues, operating expenses, debt service, certain reserves, and capital expenditure by business line, and use the deficit of non-aviation operations as the grandfathered revenue diversion. However, the term "revenues" may refer to both current-year operating revenues and cash balance/bond proceeds. There is no reporting of the base-year cash balance. It is possible that a combined authority may have accumulated a healthy cash balance from non-aviation operations prior to 1994 and that the proper use of those cash balances is mistaken as a grandfathered revenue diversion.

PANYNJ uses a different method that the FAA seems to find acceptable – calculating the amount of aviation-related surplus and treating the entire surplus as the grandfathered revenue diversion. This calculation is shown in attachment 5 of [the FAA contractor's report](#). The FAA contractor did an excellent job discussing the base year, and re-calculated the amount under both approaches in attachment 7a and 7b. The aviation surplus approach seems more favorable to PANYNJ because all prior-year surpluses can then be moved to a reserve fund and used freely afterward.

## Conclusion

Because 49 U.S. Code Section 47115 is not going away any time soon, the FAA may come back over and over requiring each grandfathered airport to validate the calculation of grandfathered amounts, including the supporting documents to calculate the original 1994/1995 base amount. If the supporting documents are no longer available, an airport should act now to reverse-engineer the 1994/1995 calculation before all organization knowledge and documents are lost.

One potential approach to avoid an overage is to use bond proceeds for non-aviation purposes. In that case, the calculation of the grandfathered revenue diversion may exclude the debt service payment instead of the cash used for non-aviation purposes, resulting in a much smaller amount. This approach must be compatible with the 1994/1995 calculation and is subject to each airport's discussion with the FAA.

It is worth noting that exceeding the inflation-adjusted amount does not necessarily lead to a reduction in discretionary grants; it is only one factor out of many that the Secretary shall consider. This issue does not affect the entitlement portion. There is no requirement to return the overage, although an airport may choose to do so.