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NEWSLETTER

DOT Seeks to Protect Air Charter Customers

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The U.S. Department of Transportation (DOT) is proposing new disclosure requirements for the protection of private jet charter customers. In a Notice of Proposed Rulemaking (NPRM) published September 30, 2013, DOT is proposing three regulatory changes likely to generate significant debate and some resistance.

1. Charter Carriers Behaving as Charter Brokers

First, and perhaps most controversial, is DOT's proposal to require air charter carriers to provide their customers with prior notice and disclosure if the transportation service will be provided by another charter carrier (sub-service operator). It is not unusual–bordering on routine–for charter carrier to wear a broker's hat. This occurs when the customer has an aircraft need (size/range/schedule) that the charter carrier cannot meet with its fleet; or when the intended fleet aircraft becomes unavailable due to mechanical or scheduling issues. The operator typically uses the open market to procure sub-service for its customer. The operator receives a broker-like commission for arranging the transportation.

In such cases, DOT wants the charter carrier to give its customer:

(a) the name of the sub-service operator;

(b) the "capacity" in which the charter company is acting in relation to this sub-service operator;

(c) the relationship between the charter company and the sub-service operator;

(d) the make and model of the aircraft to be used; and

(e) a statement of the total cost of the air transportation, including all fees and taxes, and all third-party charges that the customer will need to pay directly.

The NPRM states that the customer must receive "reasonable" notice of an equipment change to permit the customer to reconsider its options. Cynically, this would include the customer's right to cancel its contract with the original charter company to arrange transportation directly with the sub-service operator.

Anticipate resistance to this proposal (particularly as to disclosing financial terms) because it is a significant infringement on a very common practice in the industry. DOT is obviously trying to bring airline-level disclosure to the charter market. However, when American Airlines discloses that you will be flying on an American Eagle aircraft, there is no risk that you will cancel your American ticket and deal directly with American Eagle. The same is true with airline code-share alliance bookings. The charter industry is likely to argue that the detailed financial disclosures are not necessary given the sophistication of the charter consumer, and that the disclosures present a substantial risk to the industry because any on-demand operation can be replaced with an identical on-demand operation, and the cost information is highly proprietary. Oddly, the disclosure requirements above do not appear to apply to a non-operator charter broker as long as that charter broker is acting as agent to the customer.

2. Brokers as Indirect Air Carriers

DOT wants to create a new category of indirect air carriers called air charter brokers. An indirect air carrier is granted the ability to enter into contracts with operators and with passengers as principal (meaning that it is not require to act as agent to an operator or passenger). As with the DOT proposal on operators-acting-as-brokers, DOT requires that an air charter broker that chooses to be an indirect air carrier needs to provide the same five-point disclosures that are listed above, plus a disclosure as to whether the charter broker is providing liability insurance. In the proposal, DOT expects brokers to voluntarily opt into the regulatory requirements rather than requiring them to register or report in some formal manner.

Although DOT characterizes this proposal as an operating opportunity for air charter brokers, a deeper reading suggests otherwise. First, DOT acknowledges that an air charter broker can remain unregulated as long as it is a "bona fide" agent of the passenger. DOT's current views on charter brokerage are in the October 2004 DOT Notice, "The Role of Air Charter Brokers in Arranging Air Transportation," which allows a charter broker to act as agent to either the passenger or to the carrier. Most air charter brokers today are (or should be) acting as a bona fide agent to the passenger, and establishing that agency is a matter of basic contract.

In effect, the only mode of operation that DOT has forced into the regulatory regime is charter brokers acting as agent to the charter carrier. Arguably, any air charter broker could voluntarily opt into the regulatory status, but there is no apparent upside for doing so. The ability of a broker to hold out as providing air transportation as principal is undermined by the broker's obligation to disclose that it is not a carrier, and is not operating the flight. The NPRM compares charter brokerage to the public charter rules (Part 380) where a non-carrier is able to sell transportation as principal, provided that specific consumer protection rules are followed, including detailed disclosure and escrow of passenger funds. Yet, DOT does not propose an escrow arrangement to protect charter customers, most likely due to the high volume of charter transactions and DOT's practical inability to police such a volume of transactions. Perhaps there is a role here for one of the major trade associations to develop a trusted escrow program.

So, why would DOT pass a regulation that may apply to nobody? Three possible reasons. First, it may be a way for an air charter broker to participate in U.S. government procurements (in light of DOT's actions in Section 3, below). Second, if DOT is going to limit an air charter carrier's ability to sub-service, then perhaps it is fair and necessary to apply the same restrictions to an air charter broker acting as agent to an air charter carrier. Third, DOT will decide when the regulations apply to a broker based on its activities, and the new regulations will create a clearer roadmap for DOT to pursue enforcement actions against air charter brokers.

Today (prior to the effectiveness of these propose rules) DOT can pursue and penalize an air charter broker for behaving like an indirect carrier (or for behaving like a direct carrier). These enforcement actions commonly hinge on a broker claiming to have a fleet or referring to its aircraft, or its safety record–all things that imply carrier status. In short, DOT has jurisdiction over carriers, and as long as a charter broker does not act like a carrier, it will not be subject to DOT jurisdiction. To avoid DOT enforcement today, a broker needs to refrain from acting like a carrier and must contractually establish itself as agent to the passenger. The changes proposed to the NPRM simply codify the existing basis for DOT enforcement, without giving the charter broker any upside. As such, DOT will continue to identify questionable broker behavior, but will be bolster its case by: (i) asserting that the broker was acting in a manner that made it an indirect carrier under the new regulations, and (ii) deeming the broker to be in violation of the specific elements of the regulation. Enforcement is easier and penalties may be greater.

3. The Government as Charter Customer

The last controversial point in the NPRM is a piece of self-serving housekeeping by DOT. In 2011, DOT was chastised by the U.S. Court of Appeals for the D.C. Circuit for concluding, without any articulated basis, that offering and selling air transportation service to the U.S. government was engaging in common carriage by holding out air transportation to the public (*CSI Aviation Services, Inc. v. U.S. Department of Transportation*, 637 F.3d 408). At the time, DOT made the regulatory determination, the industry was dumbfounded that DOT would equate the U.S. government with the general public. At that time the U.S. government (specifically the U.S. General Services Administration (GSA)) actively invited brokers to bid as principal on transportation contracts, and unlike a consumer, the U.S. government had virtually no financial exposure to fraudulent or misbehaving brokers. Upon review, the court concluded that,

... it appears that CSI has performed under its contract with the GSA as a dedicated service provider, not as a common carrier. Under the GSA contract, CSI provides charter service to government agencies only, not to all comers. Thus, within the scope of the contract, CSI does not appear to provide "transportation of passengers or property by aircraft as a common carrier." Id. § 40102(a)(25). (637 F.3d at 415).

The court went further, stating that, "It appears to us that the law cannot support DOT's interpretation, but we leave open the possibility that the government may reasonably conclude otherwise in the future, after demonstrating a more adequate understanding of the [Federal Aviation Act]." (Id. at 416) (emphasis added). In short, the Judge Griffith for the D.C. Circuit shared the industry's view that engaging in the charter business

with the U.S. government is not common carriage and is not holding out to the public, but mused that perhaps DOT could find a basis to find otherwise.

It took two years and five months, but DOT has identified further authority to back this assertion, and it is using the NPRM to codify that assertion in the Federal Aviation Regulations. DOT cites two federal court cases, one of which could not be legitimately used as precedent for DOT's position. DOT cites its prior actions as well, but that authority simply affirms DOT's position. The first case cited is a 1925 U.S. Supreme Court decision, involving a contractor's claim for compensation for railroad transportation (*St. Louis, B.&M. RY.Co. v. United States*, 268 U.S. 169, 173), the railroad presented a bill for transportation based on its public tariffs, and the government unilaterally deducted amounts. On appeal, the Supreme Court decided that the railroad had a right to seek payment for the deduction stating that "the railroad ordinarily bears to the government the same relation that it does to a private person using its facilities" meaning that it can pursue unpaid amounts as if it was dealing with the public. This case had nothing to do with the definition of common carriage and is a far cry from a determination that common carriage includes transportation for the U.S. government.

The second case, *USAC Transport, Inc. v. United States*, 203 F.2d 878 (10th Cir 1953), is of less precedential force, but factually more applicable. In that case, a trucking company (a common carrier holding federal authority to transport goods interstate) was found to have violated the Interstate Commerce Act by failing to have an appropriate certificate of public convenience to cover the point-to-point service that the trucking company provided to the U.S. government. The court concluded that, "A common carrier transporting goods for the United States Government for hire from one state to another is still a common carrier, engaged in interstate transportation, to the same extent as when thus transporting goods for a private individual." (Id. at 879).

It would be interesting to see what the D.C. Circuit would say about the *USAC* case as it bears upon the *CSI* decision (and perhaps we will get that chance). On its face, it appears to support DOT's position, but there are factual distinctions. In *USAC*, the court did not delve into the common law definitions of "common carrier" and instead began with the view that USAC was a common carrier by virtue of its common carrier status under Interstate Commerce Act. Similarly, the *USAC* court relied on Section 306 of the Interstate Commerce Act which provides that "it is a violation for a common carrier to engage in interstate commerce on the public highways without possessing a certificate of public convenience and necessity from the commission." (Id. at 878-879). In effect, the court skipped over, or assumed, that USAC was a common carrier–because by statutory license it was–just not for the specific service provided. And, of course, the statute being construed is a statutory codification of the common law on common carriers developed for the trucking industry. While instructive, it is not necessary instructive to the same question when raised in the air transportation industry where there is no similar codification of common carrier status.