



U.S. House of Representatives
Committee on Transportation and Infrastructure

Washington, DC 20515

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April 20, 2007

SUMMARY OF SUBJECT MATTER

TO: Members of the Subcommittee on Aviation

FROM: Subcommittee on Aviation Staff

SUBJECT: Hearing on Essential Air Service and Small Community Air Service Development Programs

PURPOSE OF HEARING

The Subcommittee will meet on Wednesday, April 25, 2007, at 2:00 p.m. in room 2167 of the Rayburn House Office Building to receive testimony regarding the Essential Air Service (EAS) and Small Community Air Service Development (SCASD) programs, and what changes, if any, should be made to these programs in the upcoming Federal Aviation Administration (FAA) reauthorization bill.

BACKGROUND

In 1978, believing that market competition among airlines would improve service and lower fares for the traveling public, Congress passed the Airline Deregulation Act of 1978. This landmark legislation eliminated Federal controls over domestic fares and routes served and allowed market forces to determine price, quality, and quantity of domestic commercial air service.

Since the passage of the Airline Deregulation Act, aviation has become an essential form of travel for much of the nation. The number of commercial air travelers has grown dramatically, from 312 million travelers in 1980 to 740 million in 2006, an increase of 137 percent. Overall, airline deregulation has brought better service at lower prices to the majority of communities around this country. However, many small- and medium-sized communities have struggled to obtain and retain commercial air passenger service, because they often lack the population base and economic activity to generate the passenger traffic necessary to make air service consistently profitable. Even if a community is large enough to

sustain a basic level of service, it may still have difficulty attracting enough air carriers to provide consumer choice or low fare competition.

The two main programs that seek to address these problems are the EAS program, which was established as part of deregulation, and the SCASD program, which was established more recently, in the Aviation Investment and Reform Act for the 21st Century (AIR 21) (P.L. 106-181).

I. Essential Air Service (EAS) Program

At the time the Airline Deregulation Act was enacted, 746 communities in the United States and its territories were listed on air carrier operating certificates as receiving scheduled air service. Prior to deregulation, air carriers' certificates generally required carriers to schedule and provide two daily round trips at each point on their certificates. The prospect of allowing carriers to terminate scheduled service without prior government approval raised concern that communities with lower traffic levels would lose service entirely, as carriers shifted their operations to larger, potentially more lucrative markets.

Congress addressed this concern by establishing the EAS program as part of the Airline Deregulation Act. The EAS program guaranteed that communities served by air carriers prior to deregulation would continue to receive a certain level of scheduled air service, thereby retaining a link to the national air transportation system. The program was initially authorized for a ten-year period, from 1978 to 1988, with funding provided by the general fund of the Treasury.

In general, the Airline Deregulation Act ensured continued service by authorizing the Civil Aeronautics Board (CAB), whose duties were later transferred to the Department of Transportation (DOT), to require carriers to continue providing service at these communities. If an air carrier could not continue that service without incurring a loss, DOT could then use EAS funds to award that carrier, or another carrier, a subsidy. These subsidies are intended to cover the difference between a carrier's projected revenues and expenditures and provide a minimum amount of profit.

Under the EAS program, DOT determines the minimum level of service required at each eligible community by specifying a hub through which the community is linked to the national network; a minimum number of round trips that must be provided to that hub (typically two daily round-trip flights, six days per week); certain characteristics of the aircraft to be used; and the maximum permissible number of intermediate stops to the hub. Where necessary, the Department pays a subsidy to a carrier to ensure that the specified level of service is provided. Most certificated points do not require subsidized service. The highest number of communities subsidized during the program's history was 405 in 1980. As of April 1, 2007, DOT was subsidizing service at 145 communities (41 in Alaska and 104 elsewhere in the U.S.).

Air carriers, not the communities themselves, apply directly to DOT for EAS subsidies. Air carriers set the subsidy application process in motion when they file a 90-day notice of intent to suspend or terminate service. If no air carrier is willing to provide replacement air service without a subsidy, DOT solicits proposals from carriers that are

willing to provide service with a subsidy. Carriers requesting a subsidy must document that they cannot profitably serve the community by submitting financial data, including projected operating expenses and operating revenues that would result from serving the community. DOT then reviews these data, selects a carrier based on statutory selection criteria, and sets a subsidy amount to cover the difference between the carrier's projected cost of operation and its expected passenger revenues, while providing the carrier with a profit margin equal to five percent of total operating expenses, as required by statute.

A. Program Reauthorized in 1987, and Minimum Level of Service Increased

The EAS program was reauthorized by the Airport and Airway Safety and Capacity Expansion Act of 1987 (P.L. 100-223), which expanded the EAS program and extended it for ten more years, through fiscal year 1998.

The 1987 reauthorization act specified an increased minimum level of service -- termed "basic" essential air service -- for any community that was eligible for service under the earlier program and was actually receiving service during any part of FY 1998. "Basic" essential air service required the following:

- 1) service to a medium- or large-hub airport¹;
- 2) service with no more than one intermediate stop to the hub;
- 3) service with aircraft having at least 15 passenger seats at communities that averaged more than 11 passenger enplanements a day in any year from 1976-1986;
- 4) under certain circumstances, service with pressurized aircraft; and
- 5) flights at reasonable times taking into account the needs of passengers with connecting flights.

In addition, the 1987 reauthorization act provided for a higher level of service -- termed "enhanced" essential air service -- which communities could obtain either by agreeing to a subsidy-sharing commitment or by agreeing to risk the loss of basic service if the DOT-funded enhanced service failed to meet agreed levels of passenger use. Finally, the 1987 reauthorization contained provisions by which certain new communities could participate in the program if they were willing to pay part of the total subsidy.

At the time the 1987 reauthorization act was enacted, EAS program funding was insufficient to implement the service upgrades to meet the new standards for "basic" essential air service, or support enhanced service or service at new points.

B. Initial Efforts to Establish Eligibility Criteria

In June of 1989, the Dire Emergency Supplemental Appropriations Act of 1989 (P.L. 101-45) was enacted, providing additional funds for EAS, but also requiring that no subsidy paid for any service to or from an EAS point in the contiguous United States could exceed \$300 per passenger.

¹ The nation's commercial airports are categorized into four groups based on the annual number of passenger enplanements -- large hubs, medium hubs, small hubs, and nonhubs. A large hub enplanes at least one percent of all passengers, a medium hub 0.25 to 0.99 percent, a small hub 0.05 to 0.249 percent, and a nonhub less than 0.05 percent. The 30 large hubs and 37 medium hubs together enplane about 89 percent of all passengers.

On December 19, 1989, DOT further modified the EAS program, establishing by regulation (14 CFR 398.11) more stringent eligibility criteria, which became effective January 1, 1990. These criteria were established in response to funding shortfalls in the EAS program. The regulation provided that if, in any fiscal year, appropriations for EAS were insufficient to maintain essential air service at the places receiving such service, and Congress provides no statutory direction to the contrary, appropriations shall not be available for EAS to otherwise eligible places that have a rate of subsidy per passenger in excess of \$200 or are located less than 70 highway miles or more from the nearest medium or large hub airport, 55 highway miles or more from the nearest small hub airport, or 45 highway miles or more from the nearest non-hub airport that enplanes 100 passengers or more per day. An exception to these criteria was made for some state capitals, and points in Alaska, Hawaii, and the Pacific.

C. 1990 Reauthorization Increased Funding and Rejected DOT's Eligibility Criteria

In the Aviation Safety and Capacity Expansion Act of 1990, which was enacted as part of the Omnibus Budget Reconciliation Act of 1990 (P.L. 101-508), Congress provided \$38.6 million for the EAS program each year from FY 1992 through FY 1998, from the Airport and Airway Trust Fund, to allow DOT to implement the upgraded "basic" essential air service authorized by the 1987 reauthorization act. As shown in Table 1 below, this \$38.6 million funding level was actually provided for two years (FYs 1992 and 1993) before it became the target of budget cuts in annual appropriations acts.

In addition, the 1990 reauthorization act prohibited DOT from declaring any existing EAS point ineligible for federal subsidy on the basis of the amount of per-passenger subsidy or any other basis not specifically set forth in statute. This trumped the regulation issued by DOT in December 1989.

Table 1. EAS Program Funding and Communities Served, FYs 1992 - 2007

Fiscal Year	Number of Communities	EAS Funding (in millions)
1992	130	\$38.6
1993	126	38.6
1994	112	33.4
1995	107	33.4
1996	97	22.6
1997	95	25.9
1998	101	50.0
1999	100	50.0
2000	106	50.0
2001	115	50.0
2002	123	113.0
2003	126	101.8
2004	140	101.7
2005	146	101.6
2006	151	109.4
2007	145*	109.4

*As of 4/1/07.

D. Eligibility Criteria Established in Annual Transportation Appropriations Acts

The FY 1994 Transportation Appropriations Act (P.L. 103-122) imposed a limitation of \$33.4 million on the EAS program, and established new criteria limiting eligibility for the program. These criteria provided that a community is ineligible to receive subsidized essential air service if it is within 70 miles of a medium or large hub, or if its subsidy exceeds \$200 per passenger (unless it is more than 210 miles from a medium or large hub). Under these criteria, DOT was required to discontinue subsidy support for essential air service at 12 communities in FY 1994.

These criteria were repeated in each annual appropriations act from FY 1994 through FY 1999, before being enacted as permanent law in the FY 2000 DOT Appropriations Act (sec. 332 of P.L. 106-69). These eligibility criteria continue in effect today, but have never been codified in Title 49 of the United States Code.

In addition, as shown in Table 1 above, the annual appropriations acts from FY 1994 through FY 1997 continued to limit EAS funding, and the number of communities served continued to decline.

E. 1996 Reauthorization Provided Dedicated Funding Stream for EAS

The Federal Aviation Administration Reauthorization Act of 1996 (P.L. 104-264) provided a dedicated funding stream of \$50 million per year for EAS, to be derived from FAA's overflight fee² collections or any amounts otherwise provided to the FAA. This provision was effective in increasing the funding level for the program to at least \$50 million annually beginning in FY 1998. DOT used these funds to restore compliance with the "minimum level of service" requirements established in the 1987 reauthorization act.

The 1996 reauthorization act also removed the September 30, 1998, sunset date by which the program would otherwise have ended, thereby permanently authorizing the EAS program.

F. 2001 To Present: Effect of Airlines' Weak Financial Condition on EAS Program

For a variety of reasons, including a slowing economy and the terrorist attacks of September 11, 2001, the airline industry suffered staggering financial losses from 2001 through 2005. According to the Air Transport Association, U.S. passenger and cargo airlines sustained \$35 billion in net losses during this period, before earning what is expected to be a \$2 - \$3 billion profit for 2006. In response to these significant losses, the airlines took drastic steps to cut costs and reduce capacity, which often included reducing or eliminating service to small- and medium-sized communities.

As shown in Table 1 above, a total of 106 communities required EAS subsidy in 2000 (32 in Alaska and 74 elsewhere in the U.S.). The number of subsidized communities subsequently increased each year before reaching 154 subsidized communities in 2006. The

² Overflight fees are charged by FAA to cover the cost of air traffic control and related services provided to aircraft that neither take off from, nor land in, the United States.

situation now appears to be improving somewhat. Within the last eight months, 11 communities have come off subsidy. At seven of these communities, the carriers are continuing to serve, but on a subsidy-free basis; at four, they exceeded the statutory \$200 subsidy-per-passenger cap.

EAS program costs increased substantially after 2001. An emergency supplemental appropriation of \$50 million was provided for EAS in the FY 2002 Department of Defense Appropriations Act (P.L. 107-117, signed into law 1/10/2002) for emergency expenses to respond to the September 11, 2001, terrorist attacks. This increased EAS funding to a total of \$113 million for FY 2002. In February 2002, DOT increased the subsidies paid to EAS air carriers by an amount equal to 30 percent of the carriers' forecast revenue on an interim basis (DOT Order 2002-2-13). DOT adjusted the subsidies in recognition of the EAS carriers' "precipitous rise in costs" accompanied by a "substantial drop in revenue" that followed the events of September 11, 2001. The order expressed a concern that, absent some acknowledgment of the carriers' financial position, some carriers could be forced to cease operations. Although the financial condition of the airline industry has now stabilized, the cost of the EAS program has not returned to pre-2002 levels.

G. 2003 Reauthorization Contained Several EAS Reforms

The Vision 100 - Century of Aviation Reauthorization Act (Vision 100) (P.L. 108-176) included several provisions aimed at increasing the effectiveness of the EAS program, including the Alternate Essential Air Service Pilot Program, the Community Flexibility Pilot Program, the Code-Sharing Pilot Program, the EAS Local Participation Program, and the Marketing Incentive Program.

Under the Alternate Essential Air Service Pilot Program, instead of paying compensation to an air carrier to provide essential air service to an eligible place, DOT is authorized to provide assistance directly to a unit of local government or a State having jurisdiction over the eligible place. The grant assistance may be used by the local government or State for any of the following purposes: (1) to pay an air carrier that will use smaller aircraft to provide the air service, possibly at increased frequencies; (2) to pay an air carrier to provide on-demand air taxi service to and from the eligible place; (3) to provide scheduled or on-demand surface transportation to and from the eligible place and an airport in another place; (4) to provide regionalized transportation services to and from all the eligible places in a region; and (5) to purchase aircraft to provide transportation to and from the eligible place, including the purchase of a fractional share in an aircraft. This authority has never been used because no community has applied to participate in this pilot program. The Administration's draft FAA reauthorization bill would repeal this pilot program.

Under the Community Flexibility Pilot Program, at up to ten eligible places, instead of paying compensation to an air carrier to provide essential air service, DOT is authorized to provide a grant to the airport sponsor. The grant would be equal in value to twice the compensation paid to provide EAS at that place in the most recent 12-month period. The grant may be used for any project that is eligible for assistance under the Airport Improvement Program, is located on the airport property, or will improve airport facilities in a way that would make such facilities more usable for general aviation. In return for such a grant, the eligible place must elect to forego any essential air service for a ten-year period.

This authority has never been used because no community has applied to participate in this pilot program. The Administration's draft FAA reauthorization bill would repeal this pilot program.

Under the Code-Sharing Pilot Program, DOT is authorized to require major air carriers serving large hub airports to participate in multiple code-sharing arrangements with EAS carriers when DOT determines that such multiple code-sharing arrangements would improve air transportation services. The lack of code-sharing arrangements between EAS carriers and the major carriers that serve the particular hubs to which EAS communities seek access continues to be identified as an impediment to effective EAS service. However, the mandatory code-sharing authority provided in Vision 100 has never been used.

Under the EAS Local Participation Program, DOT was directed to designate not more than ten EAS communities located in proximity to hub airports and require such communities to pay a ten percent local share of their EAS subsidy costs for a four-year period. Due to language subsequently included in annual appropriations acts, this program was never allowed to take effect. The Administration's draft FAA reauthorization bill would repeal this pilot program.

Under the Marketing Incentive Program, DOT is authorized to provide grants of up to \$50,000 to sponsors of airports serving an eligible EAS community to develop and implement a marketing plan to increase passenger enplanements. An additional \$12 million per year was authorized for this program, but funding was never appropriated. Therefore, this authority has never been used. The Administration's draft FAA reauthorization bill would repeal this pilot program.

H. Administration's EAS Proposal

The Administration's draft FAA reauthorization bill proposes several changes to the EAS program. According to the Administration, the EAS program has remained fundamentally unchanged since its inception with the Airline Deregulation Act of 1978, while the aviation landscape has changed dramatically with the spread of the hub-and-spoke system, regional jets, and low-fare carriers. Without fundamental change to the EAS program, the Administration argues that subsidy costs will continue to rise.

The Administration's proposal would essentially freeze the program at the status quo, i.e., if a community is receiving EAS subsidy as of the date of enactment of the FAA reauthorization bill, then it would continue to remain eligible for the program. However, no new communities could enter the program, even if they had received service prior to deregulation. Under the Administration's proposal, eligibility for EAS subsidy in the future would continue to be limited to communities that are more than 70 driving miles from the nearest large- or medium-hub airport, and at which the subsidy per passenger does not exceed \$200 if the community is less than 210 driving miles from the nearest large- or medium-hub airport.

The Administration also proposes to limit EAS funding to \$50 million per year. As \$50 million would not be sufficient to support all currently subsidized services, all communities would be ranked on the basis of isolation (i.e., driving distance to a medium- or

large-hub airport) and the most isolated would receive subsidized air service to the extent allowed by the funds available. As a result of this proposed funding cut, approximately one-half of the 145 communities that currently receive EAS funding would be dropped from the program. (The actual number could be more or less depending on the rates at which contracts are renewed.)

II. Small Community Air Service Development Program (SCASD)

The SCASD program was established by AIR 21 as a pilot program to make grants to small communities to help them enhance their air service. The program was initially authorized on a pilot basis for FYs 2001 - 2003. The program was then reauthorized for an additional five years, through FY 2008, in Vision 100.

DOT is authorized to award SCASD grants to up to 40 communities each year that are served by small hub or nonhub airports³ (as classified in 1997) and have demonstrated air service deficiencies. Because the grants are provided on a one-time basis, their purpose is to create self-sustaining air service improvements. By statute, DOT must give priority consideration to communities (1) that have air fares higher than average for all communities; (2) that provide a portion of the cost of the project from local funding sources other than airport revenue; (3) that have or will establish a public-private partnership to facilitate air carrier service to the public; (4) at which service will provide material benefits to a broad segment of the public that has limited access to the national air transportation system; and (5) that will use the assistance in a timely manner. The grants may be made to a single community or to a consortium of communities. In addition, the authorizing legislation provides that no more than four grants each year may be in the same state, and that if funds are used to subsidize air service, the subsidy cannot last more than three years.

While small hubs and nonhubs are eligible to apply for SCASD grants, nonhub airports have been the main beneficiaries of the program. Only nine of the 108 grants awarded during FYs 2004 - 2006 (the non-pilot years of the program for which DOT data are readily available) were for communities served by small hub airports.

A. Demand Has Exceeded Available Funding

Demand for this program has far exceeded the funding available. When this program received its initial funding of \$20 million in FY 2002, DOT received 179 applications totaling more than \$142.5 million from communities in 47 states. The program continued to receive approximately \$20 million in each of FYs 2003 through 2005, and \$10 million in each of FYs 2006 and 2007. The number of applications has declined each year to 170 in 2003, 108 in 2004, 84 in 2005 and 75 in 2006, but total funding requested still exceeds amounts available for the program.

³ Communities that do not currently have commercial air service are also eligible, but when they seek SCASD grant funds to secure air service, they must have met, or be able to meet in a reasonable period, all necessary requirements of the FAA for the type of service involved in their grant applications.

B. Types of Projects Funded

Under the SCASD program, communities have been given a great deal of flexibility in the use of grant funds in the hope that they will develop creative solutions to their air service problems. According to the Government Accountability Office (GAO), individual project goals have included adding flights, airlines, and destinations; lowering fares; upgrading the aircraft serving the community; obtaining better data for planning and marketing air service; increasing enplanements; and curbing the leakage of passengers to other airports. According to GAO, to achieve these goals, grant sponsors used a number of strategies, most commonly including subsidies and revenue guarantees to the airlines, marketing to the public and to the airlines, hiring personnel and consultants, and establishing travel banks in which a community guarantees to buy a certain number of tickets. Less common strategies at the time of GAO's review included buying an aircraft, subsidizing the start-up of an airline, and taking over ground station operations to reduce the costs for an airline.

Program results have been mixed. Only 23 of 157 projects had been completed as of September 30, 2005 (when GAO last reviewed the program). According to GAO, while officials at 19 of those 23 airports reported improvements to air service or fares during the life of the grant, only about half said that the improvements appeared to be self-sustaining after the grant was completed. At DOT's request, the DOT Inspector General recently initiated an evaluation of the SCASD program, but information from that evaluation is not yet available.

C. Relationship to EAS

Nothing in statute prevents an EAS community from also receiving a SCASD grant. Communities receiving subsidized air service under the EAS program are eligible to apply for funds under the SCASD program. Indeed, a number of EAS-subsidized communities have applied in past years and some have received grant awards. Of the 108 grants awarded from FY 2004 - 2006, 17 were for EAS-subsidized communities. However, according to DOT's Order 2007-2-22, which solicits SCASD program grant proposals for FY 2007, grant awards to EAS-subsidized communities are limited to (1) marketing or promotion projects that support existing or newly subsidized air services; or (2) new air services, such as on-demand air taxi service. Furthermore, the DOT Order states that funds will not be authorized for EAS-subsidized communities to support either additional flights by EAS carriers or changes to those carriers' existing schedules.

D. Administration's SCASD Proposal

The Administration has requested no funds for the SCASD program in FY 2008, and its draft FAA reauthorization bill does not propose to extend the authorization for this program beyond its current sunset date of September 30, 2008.

WITNESSES

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