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file for Cam Findlay :

Privatization



EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

DEPUTY DIRECTOR
FOR MANAGEMENT

March 23, 1992

NOTE FOR: AL DELLIBOVI
NANCY DORN
HANK HABICHT
ARTHUR ROTHKOPF
ROCKWELL SCHNABEL
LINDA STUNTZ

FROM: Frank Hodsoll *Frank (H)*

SUBJECT: Meeting on Tuesday, March 23 at 4:00 p.m.
in Room 248 OEOB: Potential Privatization
Initiatives

Attached for the above captioned meeting is a revised draft paper that identifies the remaining issues and attempts to flesh out specific initiatives.

It is my hope that we can bring unresolved issues to closure in order to schedule announcements, beginning in April.

Attachments

cc: David MacIntosh
Bill Burrows
Gene Schaerr
Dianna Furchtgott-Roth

DRAFT
March 23, 1992

POTENTIAL PRIVATIZATION INITIATIVES

This paper revises the March 12 draft. It contains (A) proposed Government-wide policies and issues with respect to user fees and Federal recoupment upon asset disposition and (B) proposed agency-specific initiatives.

The overall goal is several infrastructure privatization initiatives by April 28, 1992 (as part of the President's initiative to promote economic growth and reduce regulatory burden).

This paper suggests initiatives in the areas of mass transit, highways, airports, air traffic control, wastewater treatment, home ownership, community development, ports, uranium enrichment, non-nuclear parts facilities, and Army Corps of Engineers' projects.

Privatization is specifically authorized (or there are no barriers) in the cases of mass transit, highways, home ownership, community development, non-nuclear parts facilities, and Army Corps of Engineers projects. Problems do exist, however, with respect to airports, waste water treatment plants, ports, and uranium enrichment facilities. The only place where OMB Circular A-102 and the Common Rule appear to pose problems involves airports (and perhaps waste water treatment plants).

OBJECTIVES AND BENEFITS

- Financing Expansion. Support infrastructure expansion and modernization by leveraging Federal funds and by providing State and local governments and other users/beneficiaries greater freedom to sell or lease real property (and related assets) acquired with Federal assistance. In this manner, private parties could be encouraged to provide required expansion or repair activities, and State and local governments and others could have additional funds to address local needs.
- Contracting-out. Reduce operational costs and improve service by transferring day-to-day operational decisions to private sector management.

POLICY CONSIDERATIONS

- Protect Public Interest. In working toward these objectives, Federal policy must ensure that the public interest is protected. Privatization transactions must meet several criteria:

- Increase efficiency, effectiveness, or serve an unsatisfied need.
- Ensure reasonable recoupment of Federal costs (see "Protect Federal Interests" below).
- Avoid providing undue enrichment to private parties.
- Serve an underlying need, and not merely be a financial "gimmick".
- Assure private "monopolies" do not inappropriately reduce service or increase charges (see "Protect User Interests" below).

- Protect User Interests. An advantage to privatization by State or local owners of public infrastructure (e.g., airports) is realization in cash of their assets' appreciated value. Users (e.g., airlines) worry that they will then have to pay increased user fees to meet the private owners' need for a return on investment in an asset that already has been fully capitalized with taxpayer funds.

- This is not a problem for unappreciated or rapidly depreciating assets (e.g., waste water treatment plants, vehicles, etc.).
- These additional user costs must be balanced against operational/efficiency improvements and facility expansion.

- Protect Federal Interests. Current Federal policy is contained in program authorizing statutes, the Common Rule, and OMB Circular A-102. The Common Rule provides for pro rata reimbursement to the Federal government for its original share of project costs.

State and local governments (grantees) believe that they should be permitted to retain the proceeds from the sale of appreciated assets that were financed, in part, with Federal grants. Because the funds were provided as a grant, rather than as a loan or equity investment, the States claim repayment (or at a minimum "full" repayment) is unreasonable. However, most grant agreements provide (by incorporating the Common Rule by reference) that the Federal Government has a reversionary interest in assets funded with Federal grants in the event that ownership of the asset changes to a non-eligible owner (even where the original use is retained).

Potential private purchasers of appreciated assets claim pro rata Federal reimbursement discourages State and local governments from privatizing since a large percentage of the proceeds would go the Federal Government (and access to some

No recoupment when public transfers have taken place

Federal grants would also be lost). So far as we know, this has been a problem only in the case of airports. Mass transit privatization moves forward notwithstanding the Common Rule. This means that, in the case of airports, a cash infusion for appreciated value may be a precondition of their willingness to privatize (e.g., the Cuomo proposal).

- Support Federalism. Federal policy should leave specific asset privatization decisions to State and local entities. Because many State and local governments are currently experiencing budget shortfalls, they are seeking to improve the utilization and operation of their assets.

INITIATIVES

A. Government-wide

(1) Issue Government-wide Executive Order or Other Policy Document

Exceptions to the Common Rule may be provided by agencies on a "case-by-case" basis and by OMB on a "class" basis. It is suggested that the Reagan Administration's policies discouraged such exceptions. (N.B. So far as we know, the only place where it is now claimed that the Common Rule poses a problem involves airports.)

RECOMMENDATION. Issue an Executive Order or other policy document that:

- (a) articulates Administration policy in favor of infrastructure privatization where it increases local flexibility or efficiency and serves the public interest;
- (b) asks agencies to review their grant programs and real property holdings for asset disposition considerations;
- (c) asks agencies to develop conforming policy statements; and
- (d) asks agencies to provide case-by-case exceptions to the Common Rule's asset disposition requirements for real property and related equipment if certain conditions are met. These conditions would require a contract or regulatory mechanism between the grantee and the new owner which provides appropriate controls on (i) subsequent sale, (ii) limitations of price and service changes for the primary revenue streams, (iii) covenants concerning capital investments, and (iv) a reversionary interest in the event of insolvency or other failure to perform.

(2) Change Government-wide Policies on User Fees and Federal Recoupment

Administration policies with regard to the following issues can be incorporated now in the policy document described in "(1)" above, and agencies could then except transactions on a case-by-case basis from the Common Rule. Changing the Common Rule would require a full rulemaking process.

ISSUE (a): User Fees Related to Appreciated Assets

- **How should user fee increases be constrained in relation to private purchases/leases at appreciated levels?**

Background. This issue is particularly difficult in the case of airports which have appreciated with the escalation of air traffic utilization (including especially the appreciation of the value of surrounding land for airport related development). The Administration should seek to avoid financial transactions which would cause existing users (e.g., airlines and their passengers) to pay additional amounts to help a private investor recoup its financing costs and local taxes for non-air traffic related development.

 Possible Solution. A contractual or regulatory mechanism to ensure that such costs are not borne by existing airport users is needed. Limits should be placed on increases in price or reductions in the availability of certain services for existing users: landing fees, terminal/hanger rent and space, and gate charges for commercial airlines; passenger drop-off/pick-up charges; rental counter rent/space for ground transportation companies; and passenger facility charges and parking fees for travellers). These limits should be related to that portion of the investment attributable to the airport as such.

The owner would remain free to develop additional services and expand airport utilization to obtain a return on investment. That portion of the appreciated price related to ancillary development (e.g., hotels, shopping centers, commercial office space) should be recouped through returns from those developments.

ISSUE (b): Federal Recoupment

- **What compensation should the Federal government receive upon asset sale/lease?**

Options

- a. Pro-rata (i.e., If the Federal matching share was 70%, then the Federal government receives 70% of the

proceeds). This is the policy in the current Common Rule. However, this option substantially reduces the incentive for State and local governments and others to privatize where the assets in question have appreciated and were built with a high Federal matching contribution (e.g., airports).

- b. Original grant. By not requiring an inflation adjusted repayment or interest, this option provides a limited incentive for privatization, especially for older and depreciated projects. It relates Federal recoupment to the length of time the Federally funded real property had in fact been in use under public ownership. It also provides for repayment of Federal "book value." However, this would prevent privatization of depreciated assets because the asset's fair market value is less than the original grant amount.
- c. No Compensation. The Federal Government could treat society's benefit from the infrastructure expansion as its equitable consideration. By avoiding repayment, the State and local government or private entity could use/reinvest the funds as it chooses. It is disputable whether or not "society's benefit" provides (legally) sufficient equitable consideration for the Federal government.

-- If there is no Federal recoupment, should timing restrictions should be placed on the grantees ability to sell/lease the asset?
(Options: (1) No timing restrictions, (2) 5 years, or (3) 80% of useful life).

Should the choice of one of the options above be linked to whether the initial Federal investment in the assets assumed revenue generation for the Federal Government or obligations to repay the Federal Government?

Should the choice of one of the options above be linked to whether the grantee's use of the proceeds is restricted to the original purpose of the grant or infrastructure generally?

B. Agency Specific Initiatives.
(Attachment)

B. Agency Specific Initiatives.

Agency/Area	Discussion	Initiative Actions
DOT/FTA: Mass Transit	<u>Objectives:</u> Leverage Federal funds to support the expansion and efficient operation of mass transit. <u>Background:</u> • <u>Contracting-out.</u> FTA presently supports competitive contracting of public transit services and development of independent free market services (10-50% savings). For example, San Diego saved 43 percent by competitively contracting their bus and van services. • <u>Expansion/Modernization:</u> FTA promotes private sector involvement in transit infrastructure financing through joint development and other private sector tools. Initiatives include joint development (Metro), turnkey projects (Hawaii light rail), cross-border leasing (BART), and Certificates of Participation (Los Angeles buses). <u>Legal Framework:</u> The Urban Mass Transit Act of 1964 (as amended) establishes (1) a formula assistance program that provides capital (80:20 match) and operating (50:50 match) assistance, (2) a major investment grant program (80:20 match), and (3) a requirement that Federally assisted local mass transit include private enterprise to the maximum extent possible. <u>Issue:</u> Contracting-out to reduce operating costs needs to be emphasized. A mechanism needs to be developed to utilize privatization lessons learned here for other applications.	<u>Proposal:</u> • Highlight the Administration's support for competitive contracting for the operation of transit services. -- Announcement of Federal Capital bus grant for newest privatization project -- suburb to suburb service (\$5 million); Los Angeles, CA. <i>March/April 1992</i> -- Selection of private contractor for service expansion; Las Vegas, NV. <i>April 1992</i> -- Announcement of Mayor's privatization plan (preliminary); Indianapolis, IN. <i>TBD/April/May 1992</i> • Make grant awards for entrepreneurial ventures. -- Joint Venture for traveler centers (\$500K). <i>April 1992</i> -- Combined courier and transit services (market research, \$80K); Tysons Corner, VA. <i>April 1992</i> -- Metro transit company serving 5 black colleges; Orangeburg, SC. Ribbon-cutting scheduled. <i>April 23, 1992</i> -- Reverse commute service (planning, \$50K); Baltimore, MD. Service to begin within 4 months of grant. <i>April 1992</i> • Highlight the Administration's support for private sector ventures. -- Purchase of buses, communications system and etc. for \$30 million (\$22 million is FTA share); Sacramento, CA. Closing ceremony. <i>Early April 1992</i>

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DOT/FHA Highways	<u>Objective:</u> Leverage Federal funds to implement needed highway improvement (and expansion) projects. <u>Description:</u> • <u>Matching Grants.</u> The Federal matching share is normally between 50 percent and 80 percent. • <u>State Action:</u> Many States will need to enact conforming legislation to take advantage of the public-private toll funding provisions. • <u>FHA Guidance.</u> FHA guidance explaining the process for private sector involvement was issued on March 12, 1992 to its field offices. It leaves important decisions concerning "reasonable rates of return" to State discretion. <u>Legal Framework:</u> • <u>Historical.</u> Traditionally, Federal highway matching funds could only be used for publicly owned toll-free projects (except bridges and tunnels). • <u>Present.</u> The Intermodal Surface Transportation Efficiency Act of 1991 allows (1) public and private funds to be commingled for new and reconstruction highway projects (including bridges, ramps, etc.), (2) tolls both at the outset and to remain after the original costs have been recouped, (3) conversion to tolls of existing bridges and tunnels upon reconstruction or replacement, and (4) Federal assistance through State loans to privately-owned tolled projects. <u>Issue:</u> Since the FHA guidance was just issued, States and interested parties need to be made aware of the process.	<u>Proposal:</u> • FTA issued guidance to field on private/public highway funding earlier this month. It allows for substantial State flexibility. <i>March 23, 1992</i> • Educate States through an informational campaign about FHA's new policy guidance, requirements, and its implication for State action (to create conforming legislation). <i>April/May 1992</i> • Send out "action" teams to work with ___ States in developing private/public projects during FY 1992. <i>1992</i> • Highlight the private sector plan to build a private toll road (without Federal assistance). Financing for Dulles toll road extension should be completed soon. <i>May 1992</i> • A major milestone is scheduled for May in one of four planned private toll roads to be built in California. This road (SR91) is to be a 10 mile toll highway located in Orange County, CA. There may be an opportunity for a joint State-Federal announcement. <i>last week of May 1992</i>
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DOT/FAA: Airports	<u>Objectives:</u> (1) Support airport expansion/modernization and (2) improve operational efficiency. <u>Background:</u> • <u>Contracting-out:</u> Under present policy, contracting-out of airport operations/management is permissible and occurs at several airports (e.g., Burbank). • <u>Expansion/Modernization:</u> Airport expansion is supported by (1) Federal "Airport Improvement Program (AIP)" matching grants (75 to 90% Federal share) with financing through a 10 percent ticket tax, and (2) local passenger facility charges (\$3 maximum per person). • <u>Current Interest:</u> Local officials in Los Angeles (LAX), West Palm Beach, New York City, BWI, and Santa Clara County have recently expressed an interest in exploring airport privatization.	<u>Proposal:</u> • Provide Secretary with an options paper on airport privatization. <i>[First week of April 1992]</i> • Receive Secretarial decision. <i>[April 15, 1992]</i>
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- Albany Case: The only serious airport privatization proposal this decade was Lockheed/BA's proposal (in 1989) to obtain a 40 year lease of the Albany County airport. Due to concern over the legality of a proposed upfront payment of \$30 million generated from prior airport operations from the airport to Albany County (to be reimbursed by Lockheed), FAA withheld approval. Subsequently, OLC determined that the payment represented repayment of Albany County's unreimbursed costs and was therefore legal. However, questions remain regarding the ownership of equity appreciation in airports and the application of user fees. OLC also said that FAA could regulate the level of user fees that could be charged (including whether those fees might include reimbursement and a return on equity investment).

Legal Framework: The grant programs' authorizing legislation (49 USC 2210) contains covenants for grantees:

- (1) *"All revenues generated by the airport, if it is a public airport [defined in Section 2202], and any local taxes on aviation fuel.... will be expended for the capital or operating costs of the airport...."*
- (2) *"The airport to which the project relates will be available for public use on fair and reasonable terms and without unjust discrimination [with respect to fees and usage]...."*

Interpretation of these clauses has been in dispute in the past. Transactions could be structured to include the sale of terminals or land, or the long term lease of terminals or land.

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Issues:

1. FAA traditionally has been reluctant to approve airport privatization transactions due to concerns for airport users. The concern is that airport users would have to pay fees in excess of any benefits derived from operational efficiencies. Should airport privatization be permitted from a policy perspective?
2. FAA Chief Counsel's position on whether there can be returns on private investment equity is today unclear. OLC says FAA has discretion to provide for such returns even if the airport remains a "public airport" (i.e., eligible for continuing Federal grants). N.B. A private party can under the law purchase a currently "public airport" and operate it privately (for public use), but in that event, the private party (under the Common Rule) may have to repay the pro rata Federal share of the airport's fair market value (as well as be ineligible for future AIP grants). Do we need legislation to allow appropriate airport privatization, or can this be done administratively?

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DOT/FAA: Air Traffic Control	<u>Objective:</u> Without reducing passenger or aviation safety, increase the efficiency and cost effectiveness of air traffic control (ATC) tower operations. <u>Background:</u> • <u>Benefit.</u> The Inspector General estimates a two to three year payback by converting existing low level (i.e., level 1 and 2) VFR towers from public employees to private controllers. • <u>One-time costs.</u> FAA estimates that conversion costs are approximately \$400 thousand per tower, primarily for providing permanent changes of station to the active FAA controllers (5 to 10 controllers per tower). • <u>Turnover/training.</u> Air traffic controller turnover is already high in these facilities. The FAA does not need to use these towers as training stages for Federal controllers on their way to bigger facilities. • <u>Progress.</u> To date, FAA has contracted-out operations for its 26 new VFR towers, but has converted only 1 part-time tower (Martha's Vineyard). FAA states that the lack of progress is due to insufficient funds for conversion. <u>Legal Framework:</u> There are no legal constraints to contracting-out. <u>Issue:</u> Conversions of existing low level towers are not occurring although the cost is minimal.	<u>Proposal:</u> • Support legislation to make contracting-out easier for State owned low activity air traffic control towers. <i>Legislation Pending</i> • Begin cost comparison study required by Circular A-87 for ___ towers. <i>April 1992</i> • Complete contracting-out of ___, ___, and ___ towers during fiscal years 1992, 1993 and 1994, respectively. <i>1992-94</i>
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EPA: Wastewater Treatment Plants	<u>Objectives:</u> (1) Support the expansion and replacement of aging wastewater treatment plants, and bring these facilities up to current EPA standards. (2) Increase the operating efficiency of plants. <u>Background:</u> • <u>Expansion/modernization.</u> Throughout the 1970s and 1980s, local governments received matching grants (55 percent Federal share) to support wastewater construction needs. Beginning in 1990, these grants were replaced completely by State revolving funds (with Federal contributions until 1994). • <u>Contracting-out:</u> Contracting-out the operation of plants to increase efficiency is currently permissible and occurs in several communities. • <u>1983 Case:</u> EPA requested approval for a sale-leaseback arrangement for Suffolk County in 1983 which OMB rejected (based on the former Circular A-102) because the asset had not reached its useful life. This type of financial arrangement was subsequently made unprofitable by the 1986 tax code's elimination of applicable depreciation credits. <u>Legal Framework:</u> (1) Authorizing legislation states: "The Administrator is authorized to make grants... for the construction of publicly owned treatment works" (33 USC 1281(g)) and "a grant may be made ... to construct a privately owned treatment works... [that meets different conditions.]" (33 USC 1281(h)). <u>Issue:</u> The authorizing legislation provides grants for "publicly owned treatment works." Most grant agreements provide for the common rule by reference. EPA believes current law will not permit outright sale or capital lease. Does the law permit partial public ownership and public-private partnerships?	<u>Proposal:</u> <u>A. Rulemaking</u> • Publish in the Federal Register proposed rulemaking that provides for less than 100 percent public ownership. [by March 31, 1992] • Issue final rule to enable disposition of wastewater treatment plants. [July 1, 1992] • Be prepared to approve ___ private-public transactions over the next three years. 1992-94 -- OR -- <u>B. Legislation</u> • Seek legislation to increase the private sector's role in wastewater treatment plants. [July 1, 1992] • Be prepared to approve ___ private-public transactions over the next three years. 1992-94
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HUD: Home Ownership	<u>Objective:</u> Improve living conditions for low income families by offering equity participation in homeownership. <u>Background:</u> • <u>5(h) Program.</u> The existing Section 5(h) program permits public housing authorities (grantees) to sell their properties (and obtain voucher replacements). • <u>HOPE Initiative.</u> The HOPE initiative incorporates the activities in the 5(h) program, and includes other measures. The HOPE initiative is being phased-in (\$351 million enacted in FY 1992; \$1 billion proposed for FY 1993) and the first grants should be issued in several months. <u>Legal Framework:</u> HUD has substantial discretion under a variety of programs (including Section 5(h) and HOPE) to approve property sales. There are no legal impediments; however, HUD must provide replacement units (through vouchers) for units sold. <u>Issue:</u> None.	<u>Proposal:</u> • Transmit Administration's proposed legislation, "Perestroika for Troubled Housing Act of 1992," that will assist 23 troubled PHAs in disposing of properties. <i>March 24, 1992</i> • Support HOPE program during appropriations process as proposed in the President's Budget. <i>April-Sep. 1992</i> • Award \$10 million in HOPE-3 (single family) homeownership planning grants and \$85 million in HOPE-3 implementation grants. <i>1st week of August 1992</i> • Hold selected ceremonies around the following closing, approval, and occupancy actions: <i>March/April/May 1992</i> -- Patterson, NJ. Brooke-Sloate Development. 242 units; occupied. -- New York, NY. Project Home. 430 units. Families ready to purchase. -- Delaware. 15 tenants ready to purchase. -- High Point, NC. 27 units. All sold. -- Louisville, KY. Low income conversion. -- Grand Rapids, MI. 50 units. 2 units to be occupied soon. -- Edinburg, TX. Up and out program. First resident, Mr. Jose Garcia, selected. -- Dallas, TX. Seven homebuyers close to acquiring title. -- New Orleans, Louisiana. Two residents to take at any time. -- Fresno, CA. 30 units. Families in occupancy; several are close to taking title. -- Pierce County, WA. 15 units. Closing ceremony for one resident planned (for early May).
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HUD: Community Development Block Grants	<u>Objective:</u> Provide Federal support (operating or infrastructure) for local projects that support certain low income populations. <u>Background:</u> This program already indirectly supports privatization of construction projects. Local governments are permitted to sell assets constructed with Federal support without requesting Federal approval. Sales proceeds are about \$400 million to \$500 million annually. <u>Legal Framework:</u> There are no legal barriers; however, the proceeds must be reinvested in additional applicable projects. <u>Issue:</u> None.	<u>Proposal:</u> • Notify grantees that Federally supported infrastructure may be sold if the proceeds are reinvested in other applicable projects. <i>April 1992</i>
Commerce: Ports	<u>Objective:</u> Support local economic development. <u>Background:</u> Ports are usually operated and owned by public entities although the majority of terminals are privately owned. The Economic Development Administration has supported the development of some ports. Local governments sometimes have operated ports at a loss due to their positive effects elsewhere on the local economy. <u>Legal Framework:</u> Commerce's regulations go beyond the Common Rule in ensuring that the Federal government receives pro-rata compensation in the event of privatization. <u>Issue:</u> Should we seek legislative or regulatory changes to provide for public asset privatization?	<u>Proposal:</u> • Issue policy statement reminding grantees that present policy permits publicly owned ports and related facilities to be privatized (subject to local laws). (The only Federal requirement is pro-rata repayment of the Federal share of project costs (which is typically very small).) <i>April/May 1992</i>

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DOE: Uranium Enrichment	<u>Objective:</u> Increase profitability of uranium enrichment operations by transitioning operations to the private sector. <u>Background:</u> • The Administration has proposed legislation to achieve this objective. • The Senate passed the "Energy Security Act of 1992" (S2241). It creates a government corporation for all enrichment operations but does not provide for privatization (no objection was made in the last S.A.P.). • The House Energy Committee has reported out "The Comprehensive National Energy Policy Act of 1992." It provides for (1) privatization of new technology and marketing services for uranium enrichment activities, and (2) leasing existing enrichment plants while maintaining Federal ownership. House action by the full Space, Science and Technology (SST) and Interior Committees is expected on March 31 and April 1, respectively. Final action is expected in May 1992. • The House Energy Committee and SST Subcommittee's Bills require a \$500 million and \$300 million annual deposit, respectively, into a decontamination and decommissioning fund based on collections from the corporation and domestic nuclear utilities. <u>Legal Framework:</u> Legislation required. The government corporation is viewed as a necessary interim step before privatization to enable the corporation to develop a financial history. <u>Issue:</u> How can we ensure that eventual legislation provides (as in the Administration's proposal) for transition (after 5 years as a government corporation) to a private entity.	<u>Proposal:</u> • Administration will work with the Congress to obtain the Administration's position. <i>Legislation pending</i>
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DOE/DP: Non-nuclear facilities	<u>Objective:</u> Maximize privatization and consolidate manufacturing operations for the Nuclear Weapons Complex's (NWC) non-nuclear activities to improve operational efficiency and cost effectiveness. <u>Background:</u> A Privatization Planning Panel was launched in January 1992. The panel examined 120 NWC manufacturing activities and nominated 33 for privatization during the 1992-95 period. Sandia National Laboratory is developing detailed plans for transferring activities into the private sector in conjunction with the NWC reconfiguration. In addition, the study concluded that consolidation of manufacturing operations is needed. <u>Legal Framework:</u> No barriers, but environmental impact study required for plant consolidation activities. <u>Issue:</u> How quickly can privatization occur?	<u>Proposal:</u> • Complete NEPA study for plant consolidation. <i>December 1992</i> • Consolidate the activities in DOE's three current facilities into one or two locations. <i>FY 1995</i>
Army Corps of Engineers: Transfer of Federal Facilities to State/local Governments	<u>Objective:</u> Devolve responsibility to State agencies for land and related recreation facilities at Corps projects. <u>Background:</u> When building a dam or other major project, the Corps also constructs recreation facilities (picnic area, boat launching) at the site. The Corps spends \$140 annually to operate these unrelated recreation facilities. <u>Legal Framework:</u> No specific legislative barrier exists. However, the Corps must declare the properties excess; then GSA with Interior's approval may transfer them to the States pursuant to the Federal Property and Administrative Services Act of 1949. <u>Issue:</u> Will progress in this area create Congressional backlash?	<u>Proposal:</u> • Complete environmental assessment and hold public meeting necessary for transfer of Wynoochee multiple-use reservoir project to Aberddden, WA. <i>April 1992</i> • Complete Memorandum of Agreement between the Corps, GSA, and Interior to expedite transfer of Federal recreation areas to State and local governments where requested (no change in land use is permitted). <i>April 1992</i> • [Transfer ___ of the 1900 Federal recreation sites to State governments during FY 1992 and 1993.] <i>1992-93</i>

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2300 N STREET, N. W.
WASHINGTON, D. C. 20037

TELEX/CABLE
89-2693 (SHAWLAW WSH)

TELEPHONE
(202) 663-8000

VIRGINIA OFFICE
1501 FARM CREDIT DRIVE
MCLEAN, VIRGINIA 22102
(703) 790-7900

FACSIMILE
(202) 663-8007

March 20, 1992

WRITER'S DIRECT DIAL NUMBER

Cameron Findlay, Esq.
Deputy Assistant to the President
and Counselor to the Chief of Staff
The White House
Washington, D. C. 20500

Dear Cam:

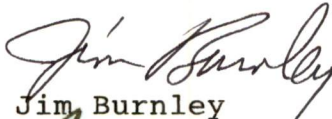
As several Department of Transportation officials requested, we have prepared a memorandum on legal and policy issues related to airport privatization. A copy is enclosed for your review.

Our client, Lockheed Air Terminal, Inc. is seeking guidance on federal policy on airport privatization. As our memorandum discusses, no statutory changes are needed; and there are only a handful of policy or regulatory revisions needed to assure both public owners and companies such as Lockheed that the full range of privatization options may be considered for use and the most appropriate alternative chosen in a particular case.

The memorandum also addresses the mechanisms readily available to guard against a number of potential problems that have been alleged might result from privatization of an airport.

We and Lockheed Air Terminal, Inc. both welcome the opportunity to discuss these issues with you and to answer any questions you may have. We appreciate your interest in this important subject.

Sincerely,


Jim Burnley

Robert Cohn

Enclosure

*Bussey
Shade
Rothkopf
Murray
Klapp
Harris
Sel Burke
M. Felt
C. Quinn*

LEGAL ANALYSIS AND POLICY RECOMMENDATIONS PERTAINING TO
PRIVATIZATION OF PUBLICLY-OWNED, PUBLIC-USE AIRPORTS

PREPARED BY:

JIM BURNLEY
ROBERT E. COHN
SHAW PITTMAN POTTS & TROWBRIDGE

March 20, 1992

I. INTRODUCTION AND OBJECTIVES

"There are many areas where increased private sector participation in transportation offers significant benefits, for example, in public transit, passenger rail service, airports, air traffic control towers at low-activity airports, toll roads and bridges, and intermodal facilities. The Federal Government encourages such involvement." U.S. Department of Transportation, "Moving America - New Directions, New Opportunities: A Statement of National Transportation Policy Strategies for Action", at 58 (1990) (emphasis added).

* * *

"Our companies can't compete if the government chokes them off in red tape. We've got to stop counterproductive regulations that cripple your freedom of action and cost this country jobs." President George Bush, Speech to Economic Club of Detroit, March 13, 1992.

This memorandum has been prepared on behalf of our client, Lockheed Air Terminal, Inc., to assist Department of Transportation officials and others as they consider issues relevant to airport privatization.

It is our conclusion, as discussed in detail below, that existing law permits privatization of airports and gives the Secretary wide discretionary latitude to adopt policies permitting the full range of privatization options. Thus, we submit there are no statutory impediments under current law to the sale or lease of a publicly-owned airport to a private entity.

The Department of Transportation can and should take the initiative to permit state and local governments to privatize their airports, should they choose to do so. Through the exercise of the Department's existing discretionary authority it can remove the few impediments remaining on the federal level, while continuing to assure that federally-subsidized facilities are fully available to the public for aviation uses.

Although the primary purpose of this memorandum is to offer legal and policy analyses of airport privatization issues, as a preliminary matter, we believe it is important to give a brief overview of the national public interest benefits of permitting the privatization of airports. To many people, these benefits are quite evident; yet there are others who argue, much along the same lines as those who opposed airline deregulation, that the private sector cannot be trusted with such responsibilities.

Every component of the aviation industry shares a common goal: to maintain a safe, efficient nationwide system of

airports that has the flexibility to handle the growing service, capacity and financial needs of civil aeronautics. While the U.S. aviation system has grown rapidly since deregulation, continuing growth in airport capacity is threatened in many areas by financial and environmental problems.^{1/} Privatization can be a partial remedy in particular instances to the need for accommodating such growth, by permitting the use of private capital to meet needs for which public funds are not readily available. The Department of Transportation need not conclude that privatization is a panacea; but it should recognize the value to the national aviation system of policies that permit, or even encourage, innovative approaches to investment in and efficient operation of airports.

Private ownership and reliance on the marketplace are fundamental precepts of this nation's economic policies. Privatization is not a new concept, but one that has been ingrained in this country's economic philosophy since its founding. There is nothing sinister or radical about private ownership of airports. Many smaller airports are owned and operated by private companies

^{1/} The 1990-91 recession has caused a pause in growth in passengers and air traffic, but there is no evidence that this is a permanent change in the long-term pattern of continuing growth. In fact, the FAA projects growth in air carrier operations from 1991-2003 at an annual rate of 2.3%. Domestic RPM's are forecast to increase by 4.1% annually and international RPM's are forecast to increase by 7% annually from 1991-2003. FAA Aviation Forecasts, February 1992, Chapter 1, at 6, 7 and 9.

today. In fact, the FAA has made grants totalling over \$40 million to over 30 privately-owned reliever airports between 1982 and March 1991, in recognition of the critical role such facilities play in the national system. The FAA already has policies presently in force expressly contemplating that a public owner may wish to lease an entire airport to a private entity, and setting out conditions to govern such an arrangement. See FAA Order 5190.6A, Airport Compliance Requirements, Section 6-5, Use Agreements Involving an Entire Airport at 43 (copy attached as Appendix A).

The Department has recently reaffirmed in its National Transportation Policy the wisdom of encouraging full participation by the private sector. That policy stated:

"Continuing and substantial infusions of private capital will be required to sustain the performance of the transportation system and accommodate increasing traffic. While government bodies at all levels must encourage and welcome private investment in transportation, many laws and policies deter such participation. Future policy must minimize barriers to private participation in the ownership, planning, financing, construction, maintenance and management of transportation facilities and services, while encouraging state and local governments to do the same."^{2/}

^{2/} U.S. Department of Transportation, "Moving America - New Directions, New Opportunities: A Statement of National Transportation Policy, Strategies for Action", at 5 (1990).

Privatization as a matter of broad federal policy achieved landmark status in the Intermodal Surface Transportation Efficiency Act of 1991 where, for the first time in the history of the federal-aid highway program, state grant recipients were authorized to loan federal grants to private companies for use in privately-owned highway, tunnel and bridge projects. Following the lead of Virginia and California, almost a dozen states have passed legislation providing for private toll roads and/or high speed rail facilities.

The list of benefits that may flow in particular instances from privatizing airports is substantial, including: (1) improved efficiency, reduced costs and increased revenues; (2) accelerated airport development of new capacity through more flexible, streamlined procurement procedures, bringing new infrastructure online more rapidly than is typically possible for the public sector; (3) ability to attract large new sources of private capital not previously available for airport investment; (4) substantial reduction in government costs and financial risk; (5) potential for increased revenues to state and local governments by enhancing the tax base, as well as by obtaining value for embedded equity in the airport; and (6) freeing the former public owner's bonding capacity to be used for other infrastructure needs.

The case for permitting privatization is clear, and the Department has recognized its value in its 1990 National

Transportation Policy. The only question is to what extent and how privatization should be further applied to the nation's airport system. The Department is not being asked to coerce public owners to privatize, or even to provide incentives for privatization. Rather, a few modest revisions of existing policies should be made to give public owners an opportunity to privatize their facilities, should they choose to do so. All constituencies of the nation's air transportation system can derive substantial benefits from a policy that permits public airport owners to sell or lease, as well as contract out their facilities. Accordingly, Lockheed Air Terminal, Inc. urges the Department to adopt a policy utilizing its substantial existing authority to permit the full range of airport privatization options.

II. LEGAL AND POLICY ANALYSIS OF ISSUES AFFECTING PRIVATIZATION

A. Statutory And Regulatory Framework.

The primary statute that governs issues with respect to airport privatization is the Airport and Airway Improvement Act of 1982, as amended ("AAIA"), 49 U.S.C. App. 2201 et seq. That statute provides for federal grants to fund airport development projects for publicly-owned, public-use airports, as well as for privately-owned public-use airports. A condition to approval of

any airport grant under the AAIA requires that the sponsor^{3/} provide in writing certain assurances relating to the manner in which the airport will be operated including, for example, assurances with respect to safety, civil rights obligations, prohibitions against granting exclusive rights, protections relating to airspace and hazards, reporting and inspection provisions, availability of the airport for public use on fair and reasonable terms, and assurances relating to certain aspects of disposition of revenue and fee and rental structures.

Privately-owned public-use airports are authorized under the AAIA to receive discretionary grants. Section 508(b). Section 505(b)(2) of the AAIA provides that a privately-owned public-use airport which receives federal airport grants must give written assurances that the airport "will continue to function as a public-use airport during the economic life (which in no case shall be less than ten years) of any facility at such airport that was developed with federal financial assistance under this Title." Publicly-owned public-use airports must abide by the written assurances throughout the useful life of the facilities developed, not to exceed twenty years from the date of acceptance

^{3/} A "sponsor" is defined in the AAIA to include a private owner of a public-use airport or a public agency (i.e., a state or local government or political sub-division thereof). Section 503(a)(22) of the AAIA.

of the grant offer.^{4/} These assurances are contained in all grant agreements and are therefore binding contractual obligations.

One of the assurances to which an airport sponsor must agree requires that it not sell, lease, encumber or otherwise transfer or dispose of any part of the property upon which federal funds have been expended without approval by the Secretary. FAA Order 5100.38A, Appendix 1, p.3 of 9; Assurance 5.b. That assurance provides that if the Secretary finds the proposed transferee "to be eligible under the Airport and Airway Improvement Act of 1982 to assume the obligations of the grant agreement and to have the power, authority, and financial resources to carry out all such obligations, the sponsor shall insert in the contract or document transferring or disposing of the sponsor's interest, and make binding upon the transferee, all of the terms, conditions and assurances contained" in the grant agreement. Id. (emphasis added).

In addition to the AAIA, some may argue that other statutory provisions may potentially bear on the issue of privatization,

^{4/} There does not appear to be an explicit statutory provision for this duration provision. It is set forth in FAA Order 5100.38A, Airport Improvement Program (AIP) Handbook, October 1989. We note that this FAA Order serves only as guidance with respect to FAA's policy and procedures under the AAIA. It was not issued pursuant to rulemaking procedures provided for under the Administrative Procedure Act.

including Section 308 of the Federal Aviation Act of 1958, as amended, ("FAAct"), prohibiting the grant of an "exclusive right" for the use of any landing area or air navigation facility upon which federal funds have been expended, and Section 1113 of the FAAct relating to "head taxes". These provisions have only remote applicability to the issue of privatization and cannot be considered potential legal obstacles to such transactions.^{5/}

^{5/} The non-exclusive right provision in Section 308 of the FAAct is also contained in Section 511(a)(1) of the AAIA and in the grant assurances. The FAA has recognized that airport proprietors may exercise but cannot grant the exclusive right to engage in an aeronautical activity. FAA Order 5190.6A, Par. 3-9d. See also, FAA Order 5190.6A, Par. 6-5(c), (attached hereto as Appendix A), which permits leasing an entire airport subject to conditions which, inter alia, ensure that the airport will be available for use by all qualified persons desiring to conduct operations at the airport.

The Anti-Head Tax provision applies only to Governmental authorities and prohibits the imposition of a tax, head charge, levy or other charge, directly or indirectly, on persons traveling in air commerce or on the sale of air transportation or on gross receipts therefrom; except that Governmental authorities owning or operating an airport can levy and collect reasonable rental charges, landing fees, or other service charges from aircraft operators for the use of airport facilities. 49 U.S.C. App. 1513(a) and (b).

B. Analysis Of Key Issues Involving The Consistency Of Privatization Transactions With Existing Law.

There have been a number of statutory and regulatory provisions that opponents of privatization (sale and/or lease)^{6/} transactions have suggested constitute legal impediments to those transactions. These so-called legal obstacles fall within the following general areas:

1. The qualification of the transferee to run an airport.
2. The retention of grant assurances.
3. Concerns relating to (a) public agencies' "cashing in" on taxpayer money invested in airport development under grant programs and related issue of (b) the extent to which previous grants must be paid back to the federal government.

^{6/} There is no dispute that contract management arrangements with private airport operators are wholly consistent with the law. Such arrangements exist throughout the country including Burbank-Glendale-Pasadena Airport, Stewart International Airport, Westchester County/White Plains Airport, Albany Airport, Republic Airport, Rickenbacker Airport, and Atlanta's International Terminal facility. Moreover, airports are also operated pursuant to long-term leases; e.g., Morristown Airport (which is owned by the municipality and leased for a 99 year term), and Teterboro Airport (owned by the Port Authority of New York and New Jersey and operated under a 30-year lease/management arrangement), as well as three public-use heliports in New York City.

4. The public agency's ability to utilize the purchase price and/or lease payments for non-aviation expenditures.
5. The debt burden imposed on the airport by the transaction.
6. The seller's ability to obtain the appreciated value of airport property.
7. The transferee's ability to recover a profit (an essential requirement for any private enterprise).
8. The transferee's financial condition as it relates to continued provision of the airport for public use.

We submit that none of the foregoing issues limit, restrict, impair or otherwise prohibit as a matter of law privatization transactions involving a sale, lease or other disposition of publicly-owned airports.^{7/} Rather, the law gives the Secretary wide latitude to deal with these issues as matters of policy,

^{7/} The FAA has recognized the existing legality of leasing an entire airport. FAA Order 5190.6A, par. 6-5 contemplates a lease of an entire airport subject to certain conditions to preserve the owner's rights and obligations under any applicable grant agreement, including the prohibition against granting an exclusive use, and the availability of the airport for use by any qualified person. Many of the conditions contained in that FAA provision involve issues of policy, which can be modified if necessary to assist privatization.

including the extent to which the Department should intervene, through regulatory oversight or otherwise, in these matters.

Lockheed believes, as discussed below, that each of these areas are susceptible to resolution through the marketplace, and none will require active regulatory intervention by the Department through public-utility type procedures. The following sections discuss each of these general areas of concern. Because each concern is implicated differently if the transaction is a sale or a lease, the discussion will, as applicable, analyze the issues with respect to both a sale and a lease transaction.

1. Qualification of Transferee to Operate An Airport.

The qualification of the transferee to run an airport is an appropriate area of concern to the Secretary. Current policy and standards provide that the Secretary must determine that a sponsor of a grant application, whether it is publicly-owned or privately-owned, establish that it possesses requisite financial and managerial qualifications. These same standards and practices should be applied in connection with reviewing a particular transferee's qualifications. In lease situations, there is less concern, because the public agency will still own and have substantial control (through the lease document) of the airport.

2. Retention of Grant Assurances.

The issue of retaining all grant assurances is not an obstacle as a matter of law. The AAIA already contemplates private ownership of public-use airports and entitles privately-owned airports to receive federal grants. Thus, Section 509(a) authorizes "any sponsor of a public-use airport" to submit an application for federal grants under the AAIA. The term "sponsor" is defined in Section 503(a)(22) of the AAIA to include "any private owner of a public-use airport who submits to the Secretary, in accordance with this Title, an application for financial assistance for such airport." Private owners of public-use airports are required, as a condition to approval, to submit to the Secretary the assurances set forth in Section 511(a) of the AAIA. Clearly, there is no legal impediment to the award of federal grants to a privately-owned public-use airport, or to a private owner complying with the assurance requirements of the AAIA.^{8/}

^{8/} Privately-owned airports are eligible for discretionary grants. Certain privately-owned airports can receive entitlement grants. Between 1982 and March 1991, 13 privately-owned reliever airports received entitlement grants. There is nothing in the AAIA that requires a private purchaser that acquires from a public agency an airport that received entitlement grants to repay such grants as a condition to the transfer. This is an issue left by the AAIA to the Department as a matter of policy.

Grant Assurance No. 5(b), by its terms, provides that if the Secretary finds the transferee to be eligible under the AAIA to assume the obligations of the grant agreement, the

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Moreover, Lockheed submits that privatization of airports as a means to achieve greater reliance on the marketplace is expressly contemplated by the Declaration of Policy of the AAIA. Section 502(a)(5) provides that:

"All airport and airway programs should be administered in a manner consistent with the provisions of Sections 102 and 103 of the Federal Aviation Act of 1958, with due regard for the goals expressed therein of fostering competition. . ."

Section 102 of the FAAct was the keystone provision of the Airline Deregulation Act through which Congress freed the airline industry from the yoke of forty years of economic regulation. It requires the Department to place "maximum reliance on competitive market forces" to provide efficiency and innovation. Section 102(a)(4) and (9) of the FAAct (emphasis added).

In a sale transaction, concerns relating to grant assurances can be dealt with as a matter of policy in the context of the

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sponsor "shall" require the transferee to assume all grant assurances and conditions. This does not mean that the Secretary is required to disapprove a transfer to a private investor of an airport on which entitlement grants were previously made. The Secretary could approve such a transfer and require the seller and the transferee both to comply with all assurances (a position we recommend that the Department adopt). Post-transfer, the privately-owned airport would not, however, be eligible for future entitlement grants. See also discussion relating to grant paybacks on pp. 18-22, infra.

Secretary's contract authority^{9/} to approve any such sale or transfer transaction. Thus, as a condition to approval, the Secretary can require that both the seller and the transferee be jointly and severally obligated to abide by all of the terms, conditions and assurances contained in the grant agreement. (It should be noted that since Grant Assurance No. 25,^{10/} by its terms, is only applicable to a public agency, a private owner would not be required to comply with that assurance.)

The underlying contractual documentation would reflect the continuation of the assumed assurance liabilities on behalf of both parties.^{11/} Thus, in a sale transaction, the deed of transfer and contract of purchase would contain provisions relating to the grant assurances by both parties. Similarly, the lease

^{9/} It is noteworthy that Section 511(a) does not by its express terms require prior approval by the Secretary of a sale transaction (or for that matter a lease transaction). However, the grant agreements contain a provision that the sponsor "will not sell, lease, encumber or otherwise transfer or dispose of any part of its title or other interests in the property. . .for the duration of the terms, conditions, and assurances in the grant agreement without approval by the Secretary." Order 5100.38A, Appendix 1, p.3 of 9, Assurance 5.b. See also Section 519 of the AAIA granting the Secretary general powers to act.

^{10/} Grant Assurance No. 25 includes the so-called Revenue Retention clause, discussed infra at pp. 25-36.

^{11/} The seller and buyer would both covenant that the airport would continue to operate as a public-use airport and the seller would have the right to take back the airport (by sale or lease through a reverter provision) in the event of a material default.

agreement would reflect the ratification by lessor and assumption by lessee of the grant assurances. Hence, the Department will have the power to seek redress from either the seller or the buyer in the event of any default in the assurances, with the ultimate remedy (subject to the applicable provisions of the Act and due process) of seeking recovery of the federal grant in the event of a material, continuing failure to comply.

Enforcement of the grant assurances is no more of a problem in connection with a privatized airport than with other public and private airport grant transactions. The FAA can rely on both its contract remedies or on its statutory remedies in the event of a default to enforce compliance. FAA Order No. 5100.38A provides that ". . . recoveries of payments by FAA under the grant shall be in accordance with the legal rights and liabilities of the parties."^{12/} In addition, Section 519 of the AAIA authorizes FAA to withhold approval of grants or withhold payments of grants. It is worth emphasizing that just because an airport is a publicly-owned airport provides no guarantee that grant assurances will be complied with, as the Department well knows. There have been numerous instances in which publicly-owned airports have violated grant assurances and in which the FAA has pursued enforcement remedies, (e.g., San Francisco International Airport). For its part, Lockheed will assume the requirements that

^{12/} FAA Order 5100.38A, Chapter 11, Par. 1142d.

exist today with respect to any public airport it acquires and will agree to be subject to applicable penalties that may apply to the publicly-owned airport seller or lessor. Lockheed would be willing to accept a condition that requires both the buyer/lessee and a seller/lessor to accept applicable grant assurances.

By imposing a condition that obligates the seller to continue to be bound by the grant assurances, concerns relating to such issues as exercise of governmental powers that only a public agency can perform (e.g., eminent domain, zoning, etc.) evaporate. To the extent that public agency action may be considered necessary under a grant assurance, the state or local government would still have the ability through the exercise of governmental police power, to take appropriate action to meet a public purpose.^{13/}

^{13/} In this connection, it should be noted that privately-owned public-use airports are eligible for grants for airport noise compatibility planning and programs pursuant to Sections 505(a) and (c) of the AAIA for purposes of the Aviation Safety And Noise Abatement Act of 1979. Pursuant to that Act, grants "may be made to operators of airports . . . and to units of local government in the areas surrounding such airports if the Secretary determines such units have the capability to carry out projects for which grant applications are made. . . . Such airport operator may in turn agree to make the grant available to public agencies in the areas surrounding such airports. . . ." Section 104(c)(1) of the Aviation Safety and Noise Abatement Act of 1979.

In a lease transaction, the public agency will continue to own and control (through the lease provisions) the facility and, as a result, will continue to be obligated to ensure full compliance with grant agreement conditions. Significantly, the Department of Justice concluded in a Memorandum to the Department: "Even if the proposed lease is executed, the county would remain subject to the assurance requirements in Section 511(a)."^{14/} Moreover, the Department has the authority, see supra, n.8, to require the lessee to agree to be bound by the applicable grant assurance provisions.

3. Recovery Of Prior Federal Grants.

As a matter of law, there is no requirement that grants must be paid back to the federal government. The issue of recovery of grants is a policy question, not an issue of law. And, as a matter of policy, Lockheed submits that the Department should not require that grants be paid back. Such a requirement would be impossible to reconcile with a statutory scheme which explicitly permits discretionary grants to privately-owned public-use airports and discretionary and entitlement grants to privately-owned reliever airports.

^{14/} Office of Legal Counsel (hereinafter referred to as "OLC"), U.S. Department of Justice, Memorandum dated February 13, 1991 to C. Dean McGrath, Jr., Acting General Counsel, Department of Transportation ("OLC Memorandum").

The issue of grant recovery is one that is implicated only in a sale transaction. In a lease transaction, the public agency continues to own the property and therefore remains fully obligated thereunder to comply with and maintain all assurances.

The AAIA is silent on the question of recovering grant funds in the context of a sale or lease. The AAIA does address the issue of return of grant funds, but only in the context of a grant "for the purpose of land for airport development purposes . . . when the land is no longer needed for airport purposes." Section 511(a)(14) (emphasis added). In that circumstance, the airport operator or owner is required to dispose of the land "at fair market value" or make available to DOT an amount equal to the U.S. share of the fair market value. Id.

Moreover, in other statutes involving federal grants, Congress explicitly provided for the recovery of prior grants when a public facility is sold to a private enterprise. See, e.g., Community Mental Health Centers Act, 48 U.S.C. 2689(m) and the Hospital and Medical Facilities Amendments of 1964 (Hill-Burton Act), 42 U.S.C. 291i. Obviously Congress could have included a similar provision in the AAIA, but it did not do so. To the contrary, the AAIA expressly contemplates that grants can and will be made to privately-owned public-use airports. Section 505(a) and (b)(2) of the AAIA. Given that express recognition, there is no basis on which to conclude that federal law requires repayment

of prior grants when an airport changes from public to private ownership.

By OMB Circular A-102 (Revised), the Office of Management and Budget directed federal agencies to follow consistent policies for administering grants to state and local governments. These requirements, as they pertain to the Department of Transportation, are set forth in 49 CFR Part 18 of the Department's Regulations. The OMB Circular does not require recovery of grants. The Department's Regulations, however, provide for pro rata recovery of grants by the U.S. Government when real property or equipment acquired with federal grants is no longer needed for the originally authorized purpose. See 49 CFR §§ 18.31, 18.32. These provisions would not be triggered in the event of a sale of a public airport, because the new owner would continue to use the real estate and equipment purchased with federal grants for their originally authorized purposes -- i.e., the operation of a public access airport. To the extent that it could be argued that the sale would trigger the recovery provisions, both the OMB Circular (Par. 5) and the Department's Regulations (49 CFR § 18.6) authorize OMB or the Department to grant exceptions or deviations from the requirements.^{15/}

^{15/} There is no valid legal theory on which the United States could rely to recover federal grants to an airport sponsor if the airport continues to operate as a public-use airport.

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An argument raised by proponents of requiring grants to be paid back is that it is unfair for the seller to "cash in" on taxpayers dollars used to fund federally sponsored projects. This of course is not a legal issue but one of policy. We submit that the contention is completely unfounded.

First, the grant monies are still embedded in the airport infrastructure for the benefit of all of the users of the airport. Airlines, passengers, the federal government and the airport operator continue to derive the benefits from those grants for which they were made, and the airport remains an important part of the national system.^{16/}

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There would be no basis on the grounds of a diversion of grant money to recover the payments unless the recipient did not properly use the funds at the time granted. See United States v. Lutheran Medical Center, 680 F.2d 1211 (8th Cir. 1982), citing United States v. City of Palm Beach Gardens, 635 F.2d 337 (5th Cir. 1981), which held that sale of a "special purpose" facility constructed with federal grant money to a profit-making enterprise does not constitute a "diversion of grant money under a federal grant program" which would give rise to an action for the Government to recoup the grants pursuant to 28 U.S.C. 2415(b), so long as the recipient of the grant "properly employed the money paid under the grant program for the construction" of a facility that at the time met the requirements of the statute providing for the grant.

^{16/} By analogy, the Department has authorized airlines to buy and sell high density airport slots for any consideration. 14 CFR 221. That provision was designed to provide a vehicle by which the marketplace would inject a competitive

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Second, the users of the airport (who are the ultimate beneficiaries of the federal grants) remain protected by virtue of the continued assurances that the prior owner and the new owner have provided as a condition to the transaction.

A lease transaction is even less a matter of concern, because the public-owner will still maintain ownership of the property. To the extent that a lease involves an up-front payment (equivalent to accelerated lease payments), as a matter of law, the Department of Justice has advised the Department that such payments are valid under the AAIA.^{17/} OLC determined that receipt of an initial lease payment by a public agency, for use in connection with general expenditures unrelated to airport activity, does not violate Section 511(a)(12), to the extent that such payment involves a recoupment of capital and operating costs that the owner had incurred.

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discipline to allocate more efficiently scarce resources, despite the fact that airlines can reap substantial monetary benefits. Similarly, here, the policy of authorizing privatization of airports will inject a greater level of marketplace activity within the airport system, resulting in improved efficiencies, innovation, and enhanced competition among airports throughout the nation.

^{17/} OLC Memorandum at 10, n.14.

4. Airport Debt Burden.

An argument against privatization is that the privatized airport and its users will be "burdened" with new debt to underwrite the acquisition cost. There is no basis to conclude that the forces of the marketplace will not exercise appropriate discipline in this area. Airports compete with one another for airline service and air traffic. Hub airports, in particular, compete with one another for flow traffic; passengers have a variety of choices for their routings between city-pairs. The competition among airports takes many forms and includes airport amenities, facilities, on time performance, lack of congestion, and, of course, costs. Any private owner of an airport will necessarily be cognizant of the impact of airport user charges on air service and air traffic -- the growth of both factors is essential to long-term economic viability of the airport. It is not in the best interest of either the private owner or the airline user for there to be unnecessary or unproductive costs. Privatization may redound to the significant benefit of airport users in particular instances through the ability of private investors to tap new sources of investment for airport development and to bring online needed airport and capacity improvements much more quickly than is often the case with a publicly-owned airport. In any event, as the Department of Justice OLC Memorandum concludes, the question of rates and charges imposed by an

airport owner falls entirely within the "fair and reasonable" clause of Section 511(a)(1) of the AAIA under which the FAA retains review authority. See OLC Memorandum at 12.

It is somewhat ironic that this supposed "weakness" in private ownership would become an issue simultaneously with the uproar in the airline industry over various proposals by publicly-owned airports to use Passenger Facility Charges ("PFCs") to fund the debt service on new capital projects. As a senior official of Northwest Airlines, Inc. said recently, the competition among major airlines and their respective hubs makes it impossible for a carrier to pass through PFCs to passengers if its competitors' hubs do not also charge PFCs.^{18/} In other words, the capital-related costs of an airport are what worries the airlines most, not the identity of the owner.

For a private buyer, bank lending policies will dictate a cap on purchase-related debt. Many factors will discipline the debt formation decision including the number of users serving the airport and the term of their existing agreements. Should major airline tenants be near the end of the term of existing

^{18/} Airlines have recently expressed concern about the effects of PFCs proposed to be imposed by some airports on the airlines' competitive positions vis-a-vis airports that do not impose such charges. See, e.g., Aviation Daily, March 18, 1992, at 477.

agreements, or hold short-term leases, they will have substantial influence over the transaction and debt related thereto.

5. Revenue Retention Requirement.

Section 511(a)(12) provides in pertinent part as follows:

"All revenues generated by the airport, if it is a public airport, . . . will be expended for the capital or operating costs of the airport, the local airport 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."^{19/}

This provision is commonly referred to as the Revenue Retention requirement. The requirement has implications for sale and/or lease transactions.

It has been argued by opponents of privatization that (a) a public-owner as seller or lessor cannot use the acquisition payment from a sale or lease for general purposes; (b) a seller cannot receive (and use for general purposes) the appreciated equity value of the airport; and (c) an owner or operator cannot retain a profit on the basis of the Revenue Retention provision.

^{19/} There is an exception to this provision if covenants or assurances in debt obligations that were issued prior to September 3, 1982 by the owner/operator or contained in provisions enacted before that date in governing statutes controlling the owner/operator's financing, provide for the use of airport revenues to support general debt obligations or other facilities. Section 511(a)(12).

Lockheed disagrees with these arguments and submits that, as a matter of law, the foregoing are not prohibited under the AAIA.

(i) Purchase price and lease acquisition costs.

We understand that FAA has argued in the past that the entire transaction cost (either the purchase price for the sale of an airport or a lease acquisition cost) constitute "airport revenues" pursuant to the Revenue Retention provision which cannot be used by the seller for nonairport purposes.

This interpretation has been rejected by the Department of Justice in connection with the acquisition costs of a leasehold interest. OLC determined that a proposed \$30 million lease payment to a municipality constitutes "revenues generated by the airport" within the meaning of Section 511(a)(12). OLC Memorandum at 4. Nevertheless, OLC correctly concluded that the same section of the AAIA "permits an airport owner or operator to recoup airport-related capital and operating costs through airport revenues." The OLC also determined that there was no "temporal limitation on the recovery of such costs." Accordingly, OLC determined that the municipality would be able to use the proceeds of the lease transaction for general purposes.

Significantly, OLC also concluded that the extent to which the lessee could recoup its acquisition costs from the airport users depends solely on whether including the acquisition costs

in the lessee's charges to users is consistent with the municipality's continuing obligation under the AAIA to make the airport available for public-use on "fair and reasonable" terms. OLC Memorandum at 5. Consequently, the lessee's ability to recoup its payment depends on policy (not law) as to whether its rates and charges are "fair and reasonable". OLC Memorandum at 12-13.

As a matter of policy, it would seem entirely appropriate for the private investor lessee to be able to recoup its acquisition costs from airport users, since it would, in effect, take the place of the municipality with respect to the municipality's prior capital or operating expenditures which have been paid for by the private investor through the lease acquisition cost. Accordingly, there is every basis to conclude that recoupment of the acquisition costs through user charges would be fair and reasonable. Significantly, OLC concluded that with respect to this issue it does not make any legal difference if the lessee is a public rather than a private entity. OLC Memorandum at 3, n.3.

In a sale transaction, the purchase price received by the municipality does not constitute airport revenue that would be subject to the Revenue Retention clause.

The AAIA does not define the term "revenues" as used in Section 511(a)(12). Although Section 511(a)(12) uses the phrase "all revenues generated by the airport", as a practical matter

not all revenues are or have ever been considered to fall within the Revenue Retention clause. For example, revenues received by airlines and concession services from other users, which are clearly generated by the airport, are not covered. In this connection, airlines control substantial portions of terminal facilities and sublease those facilities to other airlines earning revenues (and profits). Similarly, concession operators (some of them operating as master concession managers) earn revenues (and profits) from facilities at the airport. "Revenues" earned by tenants have never been considered subject to the Revenue Retention provision of the AAIA.

The legislative history of the provision further indicates that not all monies received are intended by Congress to be included within the scope of this clause. For example, the Conference Report to the AAIA states:

"This provision is not intended to apply to revenue generated by facilities which are located on airport property but are unrelated to air operations or services ~~which support or facilitate air transportation~~. It would accordingly not apply to revenue generated by such facilities as a water reservoir or a convention center which happen to be located on airport property, but which serve neither the airport nor any air transportation purpose. It would apply to such facilities as terminal concessions and parking lots serving the terminal or other air transportation purposes." 1982 U.S. Code Congressional and Administrative News, 1474.

The legislative history shows that the intent behind the term "revenues" was to include operating revenues "generated by facilities and activities" relating to the airport. See, FAA Order 5100.38A, at 73.^{20/} In short, the legislative history demonstrates that the term "revenues" refers to income generated by airport and airport-related facilities activities. A purchase price reflecting the inherent equity value of the airport was not intended by Congress to constitute "airport revenues."^{21/}

Finally, for accounting purposes "revenues" are distinguished from "gains" on the sale of real estate. Revenues are generally defined as "inflows or other enhancements of assets of an entity. . .from delivering or producing goods, rendering services or other activities that constitute the entity's ongoing major or central operations."^{22/} Thus, in the accounting sense,

^{20/} The FAA Order states "examples of airport revenue include revenue from service fees, landing fees, lease or rental fees, usage fees, sale of commodities such as agricultural or forest products, proceeds from mineral sales or other net revenue produced from real property."

^{21/} Further indication that Congress did not intend the term "all revenues" to include all revenues at the airport is reflected in Section 511(g)(2)(B) relating to the so-called Hawaiian Exception. That section references other types of funds generated at the airport other than revenue such as unrestricted cash on hand, and federal funds. In short, the intent was not to have the term revenues to be as all encompassing as some might suggest.

^{22/} Statement of Financial Accounting Concepts, No. 6, Elements of Financial Statements, ¶ 79 (Financial Accounting Standards Board of the Financial Accounting Foundation 1985).

revenues are derived from the main activity of the enterprise. Gain, however, is defined as "an increase in the equity derived from peripheral or incidental transactions of an entity and from all other transactions and other events and circumstances affecting the entity during a period except those that result from revenues or the investments of owners." Id. at ¶ 82 (emphasis added). In fact, FAA Order 5100.38A at 73 states that "airport revenue does not include proceeds from the sale of real property owned by the sponsor."^{23/}

In any event, the scope of the term "revenues" has been left to the Department to determine as a matter of policy. The Department has the legal authority to conclude that a purchase price does not constitute "revenues" under the Revenue Retention clause.

(ii) Private Owner/Lessor Profit.

Profits derived from the operation of airports are not per se prohibited under the AAIA. Indeed, it has been recognized

^{23/} Furthermore, the Revenue Retention clause in Section 511(a)(12) applies only with respect to "a public airport". A "public airport" is defined in Section 503(a)(17) as an airport "under the control of a public agency" (i.e., a state, municipality or political subdivision thereof; Section 503(a)(16)). Upon consummation of the sale and delivery of the purchase price, the airport would no longer be "a public airport" and therefore, under the AAIA the revenue retention requirement would not be applicable to the privately-owned public-use airport.

that airports make substantial profits.^{24/} Moreover, Section 511(a)(12) requires the airport operator/owner to "maintain a fee and rental structure for the facilities and services being provided the airport users which will make the airport as self-sustaining as possible under the circumstances." The term "self-sustaining" does not imply "break-even". A self-sustaining operation certainly contemplates an operation that has a reasonable profit.

Consequently, as a matter of law, profits by an owner/lessor are permissible under the AAIA. Lockheed submits that the issue of profitability relates to the "fair and reasonable" requirement in Section 511(a)(1) of the AAIA. The OLC Memorandum clearly supports this position. Thus, OLC concluded that issues relating to the Lessee's charges to users depends on whether the "rates is [sic] consistent with the County's continuing obligation under the AAIA to make the airport available for public-use on fair and reasonable terms." OLC Memorandum at 5, n.8.

Lockheed further submits that the question of what procedures DOT may wish as a policy matter to employ concerning "fair and reasonable" rates should have no bearing on whether the entity is a public or private enterprise. The fact that a public

^{24/} See Raleigh-Durham Airport Authority v. Delta, 429 F. Supp. 1069 (1976), at 1076 ("Raleigh-Durham has been consistently profitable").

entity may reap profits and reinvest those profits in unnecessary "field of dreams" airport improvements is no less a burden on users than allowing a private operator to earn a fair and reasonable return on investment.

Lockheed submits that public policy does not warrant a detailed public-utility ratemaking type procedure in which the FAA or DOT become a mini-CAB ratemaking agency. Instead, we believe that the DOT should continue the case-by-case approach it now uses to deal with these issues. The Department should rely first and foremost on the marketplace (i.e., on operator-user negotiations) and not attempt to apply a general ratemaking policy applicable to all airports. Every airport has different financial structures, demands, and characteristics. A system good for one airport is not necessarily good for another.

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The entities involved are sophisticated, knowledgeable enterprises which have the resources and capability to protect their interests in the marketplace. Moreover, it is in the best interest of the private owner to reach resolution on its charges to users.^{25/} Indeed, the number of ratemaking disputes over the years involving airports and users has been extremely limited. In a deregulated environment, there is no more need to regulate

^{25/} There is substantial competition among airports which disciplines pricing behavior. See Aviation Daily, March 18, 1992, at 477 and n.18.

airport charges than to regulate the fares airlines charge to the traveling public.

In the unusual event, however, that disputes cannot be resolved through the commercial marketplace, there are existing remedies available to airports and users. See, e.g., Indianapolis Airport Authority v. American Airlines, 733 F.2d 1262 (7th Cir. 1984); Denver v. Continental, 712 F. Supp. 834 (D. Colo. 1989); New England Legal Foundation v. Massachusetts Port Authority, 883 F.2d 157 (1st Cir. 1989). There is no reason for the Department to assume that these historically used and well accepted vehicles for resolving issues are not workable in the context of private ownership.

What
are
they?

It may be argued by opponents of privatization that owner/lessee profits from users cannot be removed and used for general purposes, based on the Revenue Retention requirement of Section 511(a)(12). We submit that the law does not so provide.

To the extent that profits are considered to be "revenues" within the context of Section 511(a)(12), that provision requires such revenues to be expended "for the capital or operating costs of the airport." As the OLC Memorandum states:

"The phrase 'capital or operating costs' in Section 511(a)(12) is not defined. The Supreme Court has stated, however, that 'it should be generally assumed that Congress expresses its purposes through the ordinary meaning of the words it uses.' Escondido

Mut. Water Co. v. LaJolla Band of Mission Indians, 466 U.S. 755, 772 (1984). 'Capital costs' and 'operating costs' are generally understood as referring, collectively, to all of the costs incurred by a business. [cite omitted] Consistent with this common meaning, section 511(g) of the AAIA, which permits the use of certain airport-generated revenues in the State of Hawaii for highway construction projects, broadly defines the phrase 'airport capital and operating costs' as 'costs incurred. . .for operation of all airports. . .and costs for debt service incurred. . .in connection with capital projects for such airports, including interest and amortization of principal costs.' 49 U.S.C. App. § 2210(g)(4)(A). The FAA does not suggest that a different meaning should be ascribed to the phrase 'capital or operating costs' in section 511(a)(12)." OLC Memorandum at 7, n.12.

Since there is no statutory definition of these terms, the Department has the discretion to establish its own policies with respect to the definition of these provisions. We submit that under ordinary, accepted regulatory concepts, profits should be considered an integral component of the cost of capital related to the airport, since it reflects a return on the capital investment. Section 511(a)(12) of the AAIA would not by its terms

prohibit such an interpretation.^{26/27/} It is illustrative to compare the general language in the AAIA with the language in the Intermodal Surface Transportation Efficiency Act of 1991, which also contains a revenue limitation provision. Whereas the AAIA limits revenues to "capital and operating costs", the Intermodal Surface Transportation Efficiency Act states as follows:

"All toll revenues received from operation of the toll facility will be used first for debt service, for reasonable return on investment of a private person financing the project, and for the costs necessary for the proper operation and maintenance of the toll facility. . ." Section 1012 of the Act (22 U.S.C. 129(a)(3)).

We submit that this strongly suggests the rate of return on investment can reasonably be considered as falling within the more general concept of "capital costs", consistent with the spirit of the legislative history of the AAIA.

^{26/} It is significant that Section 511(a)(12) contained an express exception to the Revenue Retention requirement for certain nonairport related debt obligations incurred prior to the effective date of the AAIA. See, OLC Memorandum at 8. This certainly demonstrates that when Congress intended to limit costs (or in case of the exception to permit costs unrelated to the airport) it did so expressly.

^{27/} Nor can it be argued that the 1987 amendments to this section of the AAIA changing the phrase "directly related" to "directly and substantially related" to air transportation, suggests that profits cannot be removed. To the extent that profits reflect a return on capital investment, which investment was "directly and substantially related to the actual air transportation of passengers or property" (i.e., airport related), that return on investment would be legitimate under the revenue retention clause.

Furthermore, this interpretation is consistent with the OLC's interpretation of the legislative history of the AAIA, which is that "the plain purpose of Section 511(a)(12) is simply to prevent an airport owner or operator who received federal assistance from using airport revenues for expenditures unrelated to the airport." OLC Memorandum at 10. The legislative history of the AAIA makes clear that the purpose behind the Revenue Retention clause was to ensure that airport users "not be burdened with 'hidden taxation' for unrelated municipal services." H.R. Conf. Rep. No. 760, 97th Cong. 2d Sess. 712 (1982). In this case, the recovery of a reasonable return on investment would not violate the policy behind the Revenue Retention clause, because the taking of a reasonable profit cannot be properly characterized as an "expenditure unrelated to the airport" or as a "hidden taxation" on airport users.

Accordingly, the only "regulatory" question relating to profits involves the extent to which profits are "fair and reasonable" under the provisions of Section 511(a)(1). The Department has ample authority to control that matter pursuant to its contractual powers under the grant assurances with the Owner, and a history of addressing specific problems, in particular cases, as they arise.

6. Private Owner/Lessee Financial Condition And Related Concern About Closure Of Airport.

Opponents to privatization express concern about the potential financial distress or collapse of a private owner/lessee and its impact on the airport's availability for public-use. This is not a legal issue; it is a policy issue. As a legal matter, the AAIA already allows private ownership of public-use airports and the making of grants to such owners. The AAIA contains all of the provisions Congress deemed necessary to protect its investment in federal grants to private owners.

As a matter of policy, we do not see a basis for treating privately-owned airports any differently from publicly-owned airports. Municipalities are just as susceptible to financial distress, insolvency, and bankruptcy as private enterprises. There are a multitude of communities throughout the country that are currently experiencing substantial financial distress, and many are even considered to be insolvent. In fact, such problems are driving much of the recent interest among many state and local governments in a long list of privatization opportunities. In such situations, these communities may not have the wherewithal to continue to fund necessary airport expenditures. If such cities went bankrupt, and they are eligible for relief under Chapter 9 of the Bankruptcy Code, the results would not be significantly different than if a private operator were to experience financial

problems. The private operator will be subject to the same statutory and contractual assurances as the public operator, and those assurances will necessarily bind its actions, even in a bankruptcy context.

Second, the fact that a private owner seeks bankruptcy protection does not mean that the enterprise will not continue to operate the airport. The reorganization provisions of the federal bankruptcy law expressly contemplate companies operating in bankruptcy. Since the 1930's there have been only two investor-owned utility bankruptcy filings, those of Public Service of New Hampshire ("PSNH") and most recently, El Paso Electric. Those private-investor owned entities provide a service to the public that is arguably more important than the operation of airports. Under Chapter 11 of the Bankruptcy Code, both PSNH and El Paso Electric continued to operate during reorganization with no interruption of service to customers.

Although it may be argued by some that a state or municipality has a greater incentive to prop up a public utility in difficult economic circumstances, thus averting a disruption of service, in light of the significant economic contributions the airport makes to the community, a state or municipality would also have strong incentives to aid a privately-owned airport facility. For example, in the PSNH case, the New Hampshire Senate

considered a bill that would have allowed the State of New Hampshire to purchase PSNH with funds from an issue of state bonds.

Furthermore, if the transaction is structured as a lease, the lessor could impose conditions on the lessee to ensure continued operation of the airport. If the lessee were to seek bankruptcy protection, the lessor has some flexibility under the bankruptcy code to terminate or modify the lease based on the insolvency or financial condition of the lessee or the commencement of a case, particularly if applicable nonbankruptcy law excuses the lessor from accepting performance under the lease from the bankruptcy trustee or its assignee. 11 U.S.C. 365(e).^{28/}

Finally, the Secretary has the authority under existing law to take appropriate action, if necessary, to protect the public interest. The DOT/FAA have a jurisdictional basis to impose conditions on approval of the transfer to ensure continued operation of the airport. The AAIA gives the Secretary authority to impose appropriate protections on the basis of his general powers to approve transfers. Section 519(a) of the AAIA. For example, the Secretary, as a condition to approval of the transfer, could require that the former owner continue to be bound by the grant

^{28/} The Bankruptcy code also provides lessors of non-residential property protections by requiring that if the trustee does not assume or reject the lease within 60 days, the lease is deemed rejected. 11 U.S.C. 365(d)(4).

assurances. That would give the federal government two entities from which to seek redress, the seller and the buyer. A key grant assurance requires that the airport "be available for public-use." These assurances must be observed "for the useful life of the facility. . .but not to exceed twenty (20) years." In addition, the exclusive rights assurance and assurances with respect to real property acquired with federal funds have no duration limits. This should provide a sufficient "safety-net" to ensure continued operation of the airport.

There are a variety of additional protections the Secretary could consider on a case-by-case basis. For example, the Secretary could, as a condition to the approval, impose reporting requirements on the private owner to the previous owner. He could insist on the establishment of pre-bankruptcy financial conditions which would trigger certain action. For example, the Secretary could provide that upon the occurrence of a triggering event, title to the property would revert to the prior public owner (with an appropriate reversion payment from the public entity to the prior owner). Alternatively, the Secretary could require that before any airport is closed, the operation of the airport must first be offered to the previous public owner (essentially a right of first refusal) and if that is not exercised to any other public or private interest. Or, the Secretary could require that the previous public owner obligate itself to

assume control of the airport in the event of a voluntary or involuntary cessation of service. These are simply illustrations of the variety of mechanisms the Secretary could develop on a case-by-case basis to deal with concerns in this area.

In a lease situation, there would be ample control by the lessor to ensure continued operation of the airport. Given the economic importance to the community of the continued operation of the airport, the state or municipality has every incentive in either a sale or lease situation to take action to ensure that the airport remains open and available for use. The underlying transfer documents would obviously empower the owner to take action to preserve its interest in maintaining the operation of the airport.

Lockheed understands the FAA's concerns, but does not believe that detailed regulatory oversight is needed or should be imposed in all cases. These issues should be dealt with on a case-by-case basis, depending on the circumstances of the particular transaction. The Act currently contemplates private ownership of public-use airports and federal grants to private owners of public-use airports. Congress and the Department did not see fit to impose a special detailed regulatory framework to deal with these private owners.

III. CONCLUSION.

Lockheed submits that permitting airport privatization represents sound public policy and should be pursued with vigor by the U.S. Government and the Department of Transportation. It is clear that the Department has broad discretionary authority under existing law to authorize the full range of privatization options, including the sale of public airports to private enterprises, the long-term lease of public airports to private lessees, as well as management contract arrangements. Privatization has become an accepted method for enhancing public-use infrastructure throughout the United States, and it is the policy of the Department and the Bush Administration to encourage its use. Airport privatization projects throughout the world are becoming increasingly popular. Permitting airport privatization in the U.S. will permit private capital to be used to meet important public needs, thereby freeing scarce public capital for other equally important uses.

Attachment

10/2/89

Order 5190.6A

sion) The failure to include the language required by the sponsor's assurances—when the agreement grants the right to offer services and commodities essential to flight operations—is a violation of the grant agreement. In the review of leases and agreements at airports subject to surplus airport property deeds or Section 16 and 23 deeds, the standard contractual language must be included.

6-5. USE AGREEMENTS INVOLVING AN ENTIRE AIRPORT.

a. **Contracts to Perform Airport Maintenance or Administrative Functions.** The conditions under which an airport owner may transfer compliance obligations to another qualified party are covered in paragraph 4-2c. The delegation of maintenance and management responsibility is discussed in paragraphs 4-2c and 6-2c. The important point in such arrangements is that the airport owner may delegate or contract with an agent of its choice to perform any element of maintenance or operating supervision but—the owner—is in no way relieved of its own obligations to the Government. When the owner elects to rely upon one of the commercial operators or tenants of airport to carry out the maintenance and operating responsibilities it assumed from the Government, there is a potential conflict of interest. Any agreement conferring such responsibilities on a tenant must contain adequate safeguards to preserve the owner's control over the actions of its agent. It should preferably be in a contract separate from that which leases property or grants airfield use privileges.

b. **Total Delegation of Airport Administration.** In certain cases consideration may be given to entrusting the administration of a publicly-owned airport to a management corporation. Whether the document establishing this kind of a relationship is identified as a lease, concession agreement, management contract, or otherwise, it has the effect of placing a third party in a position of substantial control over a public airport that may be the subject of a grant agreement or other source of obligation. These agreements should be reviewed carefully to ensure that the owners' rights are protected.

c. **Restrictions on Lease of Entire Airport.** If it is contemplated that the management corporation may itself engage in one or more aeronautical activities such an arrangement must be carefully evaluated. The leasing of all available land or improvements suitable for aeronautical activity to one person will, under certain conditions, be construed as evidence of an intent to exclude others (Order 5190.1). Such evidence may be overcome—in a lease to a management corporation—if the substance of the following provisions is included:

(1) The lessee (second party, manager, etc.) agrees to operate the airport in accordance with the obligations of the lessor (owner) to the Federal Government under (insert here any existing grant agreements or Surplus Property Deeds outstanding at the time of the execution of the lease; or any outstanding Section 23 or Section 16 deeds, if the airport is not also subject to either a grant agreement or surplus property deed). In furtherance of this general covenant, but without limiting its general applicability, the lessee (second party, manager, etc.) specifically agrees to operate the airport for the use and benefit of the public; to make available all airport facilities and services to the public on fair and reasonable terms and without discrimination; to provide space on the airport, to the extent available; and to grant rights and privileges for use of the landing area facilities of the airport to all qualified persons, firms and corporations desiring to conduct aeronautical operations on the airport.

(2) It is specifically understood and agreed that nothing herein contained shall be construed as granting or authorizing the granting of an exclusive right within the meaning of Section 308a of the Federal Aviation Act.

(3) The lessor (owner) reserves the right to take any action it considers necessary to protect the aerial approaches of the airport against obstruction, together with the right to prevent the lessee from erecting, or permitting to be erected, any building or other structures on the airport which, in the opinion of the lessor, would limit the usefulness of the airport or constitute a hazard to aircraft.

(4) The lessor (owner) reserves the right to develop or improve the airport (landing area of the airport) as it sees fit, regardless of the desires or views of the lessee (second party, manager, etc.), and without interference or hindrance on the part of the lessee (second party, manager, etc.).

(5) This lease (agreement) shall be subordinate to the provisions of any existing or future agreement entered into between the lessor (owner) and the United States to obtain Federal aid for the improvement or operation and maintenance of the airport.

d. It should be made clear to all concerned that the FAA will at all times look to the airport owner for effecting such actions as may be required to conform to the owner's compliance obligations. A management corporation with a lease of the entire airport, or a tenant operator authorized to perform any of the owner's management responsibilities, shall be considered as resident agents of the airport owner and not as responsible principals.

Document Originally
Attached to
Following Page

3/26/92

Please file for Cam Findlay:

1992 Rail Strike

TRANSMITTAL SLIP

TO: D. Cameron Findlay

FROM: **WILLIAM J CURTIN** DATE: 3/25/92

☒ FOR YOUR INFORMATION

☐ FOR YOUR COMMENTS

☐ FOR YOUR APPROVAL

☐ FOR YOUR SIGNATURE

☐ SEE/PHONE ME

☐ PLEASE HANDLE

☐ PER YOUR REQUEST

☐ PLEASE NOTE & FILE

☐ PLEASE NOTE & RETURN

☐ PLEASE NOTE & DISCARD

REMARKS: In case Sam and you haven't
seen this, Cam.

file
1992
sa. file
Sam

"An Injury to One is an Injury to All"

JED DODD
General Chairman



R. L. CALDWELL, SR.
Vice Chairman - Sec'y - Treas.

Pennsylvania Federation

BROTHERHOOD OF MAINTENANCE OF WAY EMPLOYEES

Affiliated with AFL - CIO AND CLC

1930 Chestnut Street, Suite 807 • 808, Philadelphia, PA 19103 / (215) 699-1283 • 86 / FAX (215) 546-0870

Overnight Mail

March 13, 1992

Mr. George Bush
President of the United States
White House
1600 Pennsylvania Avenue
Washington, DC

Re: Conrail-BMWE Dispute and Amtrak-BMWE Dispute

Dear President Bush:

My name is Jed Dodd and I am General Chairman of the Pennsylvania Federation of the Brotherhood of Maintenance of Way Employees, a railroad union. My members construct and maintain the bridges, building, and rights of way (track) on Conrail, Amtrak and six smaller roads in the Northeast and Midwest. We also construct and maintain the electric catenary systems between New York, Washington, D.C. and Harrisburg Pennsylvania on Amtrak and repair all track equipment on Conrail and Amtrak. After three and three quarters years, the National Mediation Board, the government agency created pursuant to the Railway Labor Act to administer collective bargaining in the railroad and airline industries, proffered arbitration in our cases on March 2, 1992, freeing the parties to exercise self help within 30 days of a rejection of the proffer by either party. On March 5, 1992 Conrail and Amtrak rejected arbitration. This means that the parties may exercise self help as of April 4, 1992. Under the Railway Labor Act, you are able to stop self help from being exercised by appointing a Presidential Emergency Board. I am requesting that you refrain from making such appointments on the BMWE-Conrail dispute and the BMWE-Amtrak dispute.

In order for me to continue, I must be honest with you. I am a lifelong Democrat and have never voted for a Republican. I did not vote for you in your Presidential election, nor did I vote for President Reagan. I chose to vote against the Republican Party because I considered (and consider) its policies to be anti-Labor, meaning anti-worker. Railway Labor Act administration under successive Republican Presidencies has



permitted a decline in the real wages and labor protections MMWR workers have enjoyed in the past and also caused a geometric cut in railroad worker employment on Conrail, and, to a lesser extent, Amtrak.

Although I have been attracted by certain rhetoric from the Republican Party -- the rhetoric of getting government off of our backs -- the facts are that when railroad workers attempt to compete in the market place by exercising self help, we are stonevalled by railroad managements and the National Mediation Board. The Board sits on disputes for three years at a time, and then erupts releases so that a national emergency can be created which Congress ends with legislation. The legislation usually imposes harsh recommendations that come from Presidential Emergency Boards appointed by the President. In April, 1991, our members on the national level struck rather than accept the onerous, anti-family, recession prolonging recommendations of your P.E.B. 219 Board only to be ordered back to work by Congress within 24 hours.

These policies benefit rail management and they are aware of it. I have enclosed a copy of a letter sent from the C.E.O. of the Chicago & Northwestern Railroad, Robert Schmiede, to the C.E.O.s of all of the other class 1 railroads in the country, including, but not limited to James Hagen of Conrail and Graham Clayton of Amtrak, in which he states that the railroads should endeavor to stay in national handling rather than engage in local handling because the railroads are able to use the process to injure labor. It is my profound belief that in railroad disputes in the 1990s, as opposed to the 1970s when the Railway Labor Act was passed, the Republican Party's stated policies of staying off of the backs of the people should be respected. If the Party believes in deregulation of business, why does it regulate business's relations with its employees with harsh, anti-worker policies? It appears from the record that successive Republican administrations have mouthed the rhetoric of deregulation and less government while acting like Soviet commissars when they wanted to exercise government influence over the lives of the railroad workers in the country.

I am not saying that the Democrats are much better. While publicly bemoaning your treatment of workers, the Democratic (check kiting) Congress joins together and passes anti-worker legislation ending our right to strike and imposing harsh Presidential Emergency Board recommendations on us in order to end our strikes. They accept the absurd arguments of economic paralysis, even if we strike only one railroad at a time, such as Amtrak or Conrail.

The remainder of my letter includes my reasons why there should be no Presidential Emergency Board created on Amtrak on Conrail in the event that my members strike one of these carriers

at a time. I am asking that you demonstrate fairness and commitment to the principles the Republican Party espouses -- non interference by government permitting market forces to determine the ultimate collective bargaining agreements which result. If I am able to see that type of fairness and consistency applied, I would be much more likely to reconsider my attitudes regarding the Republican Party, especially in light of the record of many Democrats in Congress.

I. WHY A PRESIDENTIAL EMERGENCY BOARD SHOULD NOT BE APPOINTED FOR THE CONRAIL-AMWA AND/OR THE AMTRAK-AMWA DISPUTES

When the Railway Labor Act was passed in the mid 1920s, the railroad industry held a wholly different position in the U.S. economy than it does at present. On the national level, 80-85% of all intercity freight moved by rail. There was no great interstate highway system. The trucking and auto industries were fledgling, and trucks did not have the huge freight hauling capacity they have today. Air transports also had limited freight hauling capacity. Large numbers of passengers moved by rail. A national disruption of rail service, freight or passenger, would have crippled the economy. As a result of the position of the rail industry within the economy, the Railway Labor Act created a labor-management mechanism to resolve disputes that included in its design an attempt to stimulate settlement and deter disruptions of service. However, even at the end of this process, the parties were given the right to strike. This means that Congress, even though it was fully aware of the incredible disruption a rail strike would have to the national economy, did not consider it so significant that it simply outlawed railroad strikes altogether.

In America of the 1990s, the rail industry holds a much less significant position within the U.S. economy than it did in the 1920s. The percentage of intercity freight that moves by rail has declined from 80-85% in 1926 to approximately 33% in 1991. The rails are engaged in a fierce competition with an aggressive trucking industry, whose truck move on a sophisticated and intensive combine of interstate highways and well developed state and local highway systems. Air freight transportation has increased geometrically since the mid 1920s. Similarly, our waterways are also able to service markets which are served by railroads. The growth of the automobile and air passenger industries since the mid 1920s have resulted in an intercity rail passenger system that is merely a skeleton of its former prominence.

To be sure, the rail industry still plays an important role within the economy of the United States. The fact that Congress provided approximately \$7 billion to rebuild and streamline freight transport in the Northeast between 1976 and 1983

demonstrates this, as does the yearly operational and capital subsidies it provides for Amtrak. However there can be little doubt that the railroad industry is presently a shell of its former self and, as a result, critical analysis must be made prior to determining how substantial a disruption will occur in the event of a railroad strike and/or lookout.

A. CONRAIL

Conrail, as we all know, is a major rail freight carrier in the Northeast and mid West. It is not, however, the only major rail freight carrier in the Northeast and mid West. Markets served by Conrail are also served by the CSX, Norfolk Southern, C & NW, Canadian Pacific and numerous short lines that have either been spun off from Conrail or have emerged over the past decade. In addition, the trucking industry serves virtually every market that Conrail serves. Indeed, the possibility of a calamity occurring in the event Conrail is struck appears overstated, given the fact that Conrail has shed approximately one third of its lines since it commenced operations in 1976 with little disruption. We are not attempting to act as if a strike against Conrail will have no economic impact -- it will. However the days when cities would go without milk within days and communities would go hungry have long since passed. Indeed, when Conrail's intermodal facilities were struck in February, 1992, there was little impact to the economy of the Northeast. In addition, the Union is well aware that if we spread picket lines to other railroads, there may well be a Congressional imposition. The RMWE intends to choose its strategy well, so that the impact of a strike against Conrail will be to challenge it economically with as little disruption to Conrail's shippers as is possible. In addition, the Union will contact Conrail shippers to inform as many as possible that: (a) Conrail will be struck; and (b) other carriers exist in the Region and who those carriers are. There is little doubt that a strike against Conrail will not be so harmful to Northeast Region that a P.E.B. should be created. The march of time has changed all of the reasons for creating a P.E.B. on Conrail.

B. AMTRAK

There is even less reason for a P.E.B. to be created on Amtrak. Amtrak only moves approximately 1.5% of the commuters in the country. Most of its routes outside of the Northeast Corridor are actually unprofitable. It provides a valuable service as part of the overall traffic pattern in the Northeast by reducing congestion on the highway system and being an environmentally sound means of transport. However a strike against Amtrak has only minimal effect on the economy in the Northeast. The RMWE has been in contact with some of the commuter agencies in the Northeast and has agreed to permit whatever arrangements will be necessary in order that they should

run without interruption, so long as they do not assist Amtrak in running its trains. Again, there is no legitimate reason for there to be a P.E.B. created in the event of a strike against Amtrak.

**II. IF AMTRAK AND/OR CONRAIL P.E.Bs. ARE CREATED,
THEY SHOULD BE CRAFT, RAILROAD AND SPECIFIC**

The history of railroad work is a history of strict craft divisions regarding the manner and kind of work performed. Our members on Conrail and Amtrak construct and maintain the bridges, buildings and rights of way on those carriers. In addition, on Amtrak, our members construct and maintain the electric catenary system between New York, Washington, D.C. and Harrisburg, Pennsylvania. And on Conrail and Amtrak our members repair the on track machinery and some of the trucks. This work is wholly different from the operating side of rail labor and is substantially different from the non operating side as well, with the possible exception of the work performed by the Brotherhood of Railroad Signalmen. Our work, more than any of the other non operating crafts, has seen the greatest growth in the technology areas, converting much of our work from laboring type work to skilled teams employing the most sophisticated technology that exists on the non operating side of the railroad.

Maintenance of Way work also has other features which really require that it be handled by a separate P.E.B. Virtually all of our members work directly on the right of way, directly adjacent to or on tracks where freight trains whiz by at over 60 m.p.h. and passenger trains pass at up to 125 m.p.h. Our production units have special work rules which permit the carriers to house the men in campcars, on track, vehicles approximately the size of a railroad car in which 8 to 10 men per campcar live during the work week or longer. They have no privacy in these cars and less room than most jails provide inmates. Many of these gangs work over huge geographical areas and require the men to live hundreds of miles away from home during the work week. No other craft of which I am aware has agreements permitting the railroads to house employees in campcars. On both railroads BWZ members can be furloughed permanently with only five (5) days notice.

A. CONRAIL

In 1982 Conrail and the BWZ reduced seniority districts from approximately 50 to 17. In addition, the Union agreed to the creation of Interregional Units which permitted production work to be performed over entire regions of Conrail. These Units are campcar units as described above. As a result of these agreements, Conrail used rail and tie units to work over hundreds of miles of railroad without having to change employees. The seniority districts became irrelevant for members of these interregional units, as they were permitted to work anywhere

within a region without regard to seniority districts. No other non operating craft of which I am aware of or deal with requires that employees work in this manner. We believe that given the critical importance that work rules played in P.E.B. 219, we wish to be able to have a P.E.B. that deal solely with BMWE issues on Conrail.

B. AMTRAK

In 1981 rail labor agreed that Amtrak employees would forego 12¢ of the raises provided to railroad workers in the rest of the country. As a result, Amtrak employees have been earning 12¢ less than their counterparts on the freight roads and between 20-30¢ less than their counterparts on many of the state and federally funded commuter systems in the Northeast. In the BMWE, the most sophisticated technology used by BMWE employees anywhere in the world is the norm on all production units. It is on Amtrak where our members work with 125 m.p.h. trains going over adjacent track. BMWE members work all shifts with no differential. Production units can work anywhere between Washington, Harrisburg and New York. Amtrak has the right to change shifts with as little as 16 hours notice. No other group of non operating craft employees in the country are subject to these conditions. We are desirous of having these issues evaluated separately from other crafts and other railroads.

There are two agreements on Amtrak. One covers the Northeast Corridor and the other covers off corridor BMWE members. Historically these contracts have been handled separately because conditions are substantially different for the two groups of employees. We feel that in the event there is a P.E.B., there should be two on Amtrak, one which deals with the Northeast Corridor agreement and one which deals with the off corridor agreement. While the Northeast Corridor agreement includes two General Chairmen who have jurisdiction over the Northeast Corridor, the off Corridor agreement includes five General Chairmen who are located all over the country and handle Amtrak BMWE members all over the United States.

III.

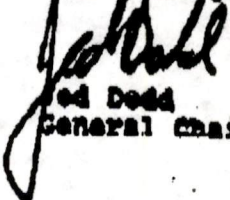
WE WILL NOT HAVE HAD OUR ISSUES HEARD PROPERLY IF THERE ARE NOT SEPARATE BOARDS

The BMWE was fully aware of the above problems when it decided that it did not wish to engage in national handling. The Union's objective was to have our disputes handled separately from the rest of the country. Despite the fact that Conrail agreed to local handling, it did everything possible to see that we were forced into national handling. We were forced to sue Conrail before it finally agreed to engage in local handling and it agreed only because it realized that a Federal judge was going to order local handling anyway. The National Mediation Board

simply placed our dispute with Conrail on hold until the recommendations of P.E.B. 219 were issued and put into effect. Between May, 1989 and August, 1991, the Mediation Board only scheduled two Mediation sessions. Only after P.E.B. 219 recommendations were imposed on July 29, 1991 did the Mediation Board begin to seriously conduct Mediation sessions. Then, when it did declare impasse, it erupted impasses in order to create a national emergency. In that way, the Department of Transportation and Congress are faced with several potential rail strikes at once, including a potential national strike by the International Association of Machinists. The purpose the National Mediation Board had in erupting impasses was to see that local issues were not handled individually, but would be handled concurrently with the problems other non settling crafts had. As a result, less time would be expended on each craft's specific problems and all of the disputes would be handled at once. In short, the Union is having its negotiating strategy dictated to it with the conscious complicity of the NMB. We informed the NMB of this letter in July, 1991 and provided them with a copy of it.

We thank you for your consideration and implore you not to even appoint P.E.B.s on Conrail or Amtrak. But, if you see fit to do so, please appoint them so that they are craft, railroad and agreement specific.

Yours truly,


Ted Dodd
General Chairman

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3/27/92

Please file for Cam Findlay

Wetlands

file →

Wetlands

Soil/Cons
Fish/Wild
EPA
Army Corps

1. 89 manual caused
firestorm — 1st interagency
manual
— no problem some places
(e.g. SE)
— big problem in SE

2. Army Corps dropped 20-40
million acres
— in line w/ Soilbusters
program w/ Ag.
— excluded em
"prior converted wetlands"
(1985)

3. 91 manual
Started out interagency
technical center
— filtered up to 4 Asst
Secy level types
— then ce to Vee's office
— no-one ever could tell
how many acres would
be covered

91 manual - draft - went out
for comment ~~the~~ August - Jan
60,000 comments
— lots mass mailings
— but there is real solid info
as well

Sept - Oct - agencies put together
joint teams — 500 sites
— extrapolated
— that's where big estimates f

losses came from (25-75%)
- state reviews & others
(incl. fed agencies) - also
came out around 50%

- also said it'll take longer &
more \$ to delineate a site

In both cases we were surprised

CEO saying give us a
decision matrix

1. ~~NAS~~ - yr to 18 mo.

2. Internal process +
outside consultants

Chmn - NAS

EPA - NAS

Commerce - NAS

Veep's-CC - need external panel

Falw - ? Review comments

Rg - ?

→ Mtg is next step. Not in any
formal process now. (PCB)

Carp's approp. bill - Congress said
don't use '87 - using Carp's
'87 manual + exemption
[Robin says that's dealt w/ problem
reasonably well]
EPA still using '87 manual

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3/30/92

Please file for Cam Findlay :

Resumes

LESLIE H. SOUTHWICK

823 Empress Court, Alexandria, Virginia 22308-2037
Phone: 202-514-5421 (O); 703-780-9453 (H)

Personal

Home: Jackson, Mississippi. Born: February 10, 1950, in Edinburg, Texas. Wife: Sharon; elementary school teacher. Children: Philip (13 years old), Catherine (7).

Education

University of Texas (J.D. 1975). Rice University (B.A. cum laude 1972). Edinburg, Texas public schools (graduated high school 3rd of 360 students; Texas All-State Band, 3 years).

Legal Career

Admitted to bar: Texas 1975 (no longer a member); Mississippi 1977. Briefing Attorney for Presiding Judge John F. Onion, 1975-76, Texas [Supreme] Court of Criminal Appeals. Law Clerk, Judge Charles Clark, U.S. Court of Appeals, Fifth Circuit 1976-77, in Jackson, MS. Associate, then partner, Brunini, Grantham, Grower & Hewes (Jackson, Mississippi) 1977-1989. Specialized in energy, real property, and public school law.

Government

Recommended for Fifth Circuit Court of Appeals by Mississippi's two U.S. Senators, October, 1991, but not appointed. Principal Deputy Assistant Attorney General, Civil Division, United States Department of Justice, August 1, 1989-, supervise Federal Programs Branch (defends all suits brought against the government and its officers) and Consumer Litigation Branch (all consumer matters). Member of Mississippi Constitution Study Commission, appointed by Governor (1985-86).

Justice Department Responsibilities

The following are examples of matters I have personally handled at DOJ. Defended against the first suit attacking the Financial Institution Reform, Recovery and Enforcement Act ("FIRREA"); spoken at numerous conferences on different aspects of the subject. Manage, because of the recusal of the Assistant Attorney General, the Civil Division component of all Iran-Contra matters; was the lead Justice Department attorney at the deposition of former President Ronald Reagan. During the Persian Gulf crisis, worked on several cases disputing Presidential authority. Second-chaired the suit brought by 54 Congressmen to prevent use of military force, an argument personally handled by the Assistant Attorney General. Prepared and won the next significant war powers case, which permitted the Army to issue its troops anti-chemical and biological warfare drugs, despite a shortened FDA approval process. Defended case in which a self-styled public interest group attempted to get the secret diplomatic cables sent by April Glaspie to the State Department outlining her meeting with Saddam Hussein. Lead trial counsel in O.T.S. action against Kaye Scholer law firm, in connection with Lincoln S&L scandal.

file:
resumes

Examples of my supervisory tasks include all census litigation, affirmative civil suits against financial institutions, defense of federal employee drug testing, and F.D.A. criminal cases (e.g., generic drugs, steroids).

Teaching

Adjunct Professor, Mississippi College School of Law, Jackson, teaching oil and gas, and general real property courses, 1985-1989. Speaker at civil rules, financial fraud, school law and energy seminars. Teaching Quizmaster (instructor of legal writing and research), University of Texas School of Law, 1974-75. Grader, Political Science Department, Rice University, 1971-72.

Civic

Member, president (1981-82), volunteer of year (1981 and 1985), Hinds County Mental Health Association. Tutor, Religious Education for the Community Handicapped. Mississippi Recruiter, Rice University, 1985-89.

Religion

Member, St. Richard's Catholic Church, Jackson, Mississippi.

Military

Commissioned Officer, United States Army Reserves, Judge Advocate General Corps, enlisted January 1991.

Publications

"State Constitution Revision: Mississippi and the South," in November-December 1985 Mississippi Lawyer. "Methods of Constitutional Revision: Which Way, Mississippi?," Mississippi Law Journal, July, 1986. Also wrote several articles for newspapers and other periodicals on Mississippi constitutional revision. Presidential Also-Rans and Running Mates, 1788-1988, (1984, rev. 1989) which won an American Library Association "Best Reference Work of Year" award. "Spare Tires of Past Got Kicked as Much as Quayle," Wall Street Journal, November 1, 1988, p. A30. Five other articles in Houston Review, East Texas Historical Journal, and Mississippi College Law Review.

Hobbies

Reading, writing about American history. Jogging, including one (slow) Marathon.

Family

Father, Lloyd, practiced medicine in south Texas for 35 years; now deceased. Mother, Ruth Tarpley, is retired college biology professor.

Politics

Member, state and Hinds County Republican Executive Committees, (1988-89). Hinds County Chairman, Jack Reed for Governor (1987). Member, Republican Commission on Mississippi's Future (1986-87). Chairman, Republican Constitutional Task Force (1985-86). Chairman, state convention nominating committee (1988). Republican National Convention: alternate delegate (1984); delegate and Bush floor whip (1988). Member, state steering committees: Haley Barbour for U.S. Senate (1982); Reagan-Bush (1984). Volunteer, Doug Shanks for Mayor (1977, 1981); Thad Cochran for Senate (1978, 1984); Charles Pickering for Attorney Gen. (1979).

George Bush Campaigns

My first involvement in a Bush campaign was in 1970, when I was a student at Rice University in Houston and did volunteer work at the Bush for Senate state headquarters. In 1979 I became Mississippi campaign manager of Bush for President, and continued in that role until he withdrew. In 1985 I became a member of the Fund for America's Future, and in 1987 joined the Bush for President national steering committee. In 1987 the Mississippi Bush campaign was organized and I became one of the three chairmen: chairman of the state committee, in charge of organizational work for the campaign.

In summary, I was the first Bush leader in Mississippi, headed the 1980 campaign, and remained in a major leadership role throughout the 1988 campaign.



U.S. Department of Justice

Civil Division
Room 3143
(202)-514-5421

March 18, 1992

Office of the Assistant Attorney General

Washington, D.C. 20530

D. Cameron Findlay
Deputy Assistant to the President and
Counselor to the Chief of Staff
White House
Washington, D.C. 20500

Dear Cam:

Thank you for your openness to a meeting regarding future White House opportunities. Attached is a sanitized version of my life story.

I would not initially foreclose considering any significant position. My experience at the Justice Department should be extremely useful in several areas -- the litigation I see every day involves defenses of every conceivable government program. I am overly familiar with a range of them, from a misguided one such as the National Endowment of the Arts, to airport noise legislation, civil rights issues, financial institution fraud and the bailout, through everything else that federal agencies have done and been sued about over the last two and a half years.

However, my particular interests are in two positions that are not presently vacant. My lead role at DOJ not only in defense of suits challenging federal employee drug testing, but in various interdepartmental drug coordinating groups, gives me expertise and experience that would be a good foundation for becoming Director of the Office of National Drug Control Policy. In a totally different vein, separate experiences and interests would make me a zealous director of the Office of National Service. Should Governor Martinez or Gregg Petersmeyer decide to advance out of either position, I would be extremely interested in being considered as a successor.

I look forward to seeing you and discussing the general question of a White House position. Thanks again.

Sincerely,

Leslie H. Southwick

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3/17/92

Pls. file for Cam Findlay:

IRS Issues

INSERT AT END OF FOURTH PARAGRAPH:

We continue to believe that over-reporting of charitable contributions is a serious problem that must be addressed.

Although the original Treasury reporting proposal was never intended to require churches to report contributions to the Internal Revenue Service, some have expressed the concern that it could be construed to require such reporting. In response to those concerns, the Administration has announced its intention not to pursue the original reporting proposal any further. The Treasury Department is also willing to explore other, less burdensome, ways to address the problem of over-reporting of contributions to other charitable organizations.

Therefore, let me reiterate what we said last week:

file:
IRS issues



DEPARTMENT OF THE TREASURY
WASHINGTON

ASSISTANT SECRETARY

March 16, 1992

MEMORANDUM FOR SECRETARY BRADY

THE HONORABLE SAMUEL K. SKINNER
CHIEF OF STAFF TO THE PRESIDENT

FROM: FRED T. GOLDBERG, JR.
ASSISTANT SECRETARY (TAX POLICY)

SUBJECT: Charitable Contributions Reporting Requirement as
Applied to Churches

I continue to receive inquiries regarding the status of our charitable contributions reporting proposal as it applies to churches and other religious organizations. In order to put this issue to bed, I recommend sending the attached letter over my signature to Oliver Thomas, General Counsel to the Baptist Joint Committee. Oliver is the attorney who is taking the lead in representing various religious organizations on this issue.

The draft letter reflects the results of a Treasury Department meeting with Oliver and representatives of various denominations on March 5, 1992. Based on my follow-up conversations with him, I believe that the letter would be well received and would achieve its intended purpose.

____ Agree, transmit letter as is
____ ☒ Agree, transmit letter with suggested changes
____ Disagree, do not send letter
____ Other

cc: Ede Holiday
Bill Burrow

Hollis McLoughlin
Mary Sophos
Desiree Tucker-Sorini

Dear Oliver:

I first want to thank you and your colleagues for taking the time to meet with us. Hopefully, we conveyed our sensitivity to the issues you raised regarding the charitable contributions reporting proposal, and our desire to work openly and cooperatively with you in this and other areas of mutual concern.

I also thought it might be helpful to summarize in writing how we got where we are, our current position, and where we are headed.

By way of background, as you know, the Administration is deeply committed to the view that charitable giving is fundamental to our way of life. In this regard, the President's Budget includes two proposals that are strongly supported by the charitable community: (1) excluding gifts of appreciated property from the alternative minimum tax, and (2) treating all charitable contributions as domestic sourced expenses for purposes of applicable foreign tax credit calculations.

Because these two proposals would reduce tax revenues by close to one billion dollars through 1997, it was necessary to find appropriate revenue off-sets. Our effort was to find an approach that would avoid raising others' taxes, and would not adversely affect the charitable community. The original reporting proposal was intended to provide an off-set by assuring that taxpayers claim the proper amount of charitable contribution deductions. In this regard, IRS data indicates these deductions may be overstated by as much as \$5 billion annually. *we continue to believe that over-reporting of charitable contributions is a serious problem that must be addressed.*

Since the time it was released, a number of concerns over the reporting proposal have been raised:

- > While the various reporting thresholds were intended to exclude most contributions to churches from the reporting requirements, the proposal should be modified to provide for an express exclusion.
- > The reporting requirement on other charitable organizations may be too burdensome; there may be less costly ways to address the problem of overstated charitable contributions.

In terms of where matters now stand, let me reiterate what we said last week:

(1) We remain firmly committed to the two proposals supported by the charitable community (relief from the AMT and sourcing rules).

(2) Working closely with you, your colleagues, and the charitable community, we will continue to explore measures to help

assure that taxpayers claim the proper amount of charitable contribution deductions.

(3) ~~Along these lines,~~ One approach we are continuing to explore is some form of information reporting. While this is only one of several options under consideration, we want to make clear that churches and other religious organizations (as defined in Internal Revenue Code Section 7611) would be expressly excluded from any such requirement.

Above all, we want to emphasize our commitment to working with you and your colleagues, as well as other representatives of the charitable community, as we go down the road. Government is doomed to fail if it invents "solutions" behind closed doors and ignores the public it serves.

Once again, thanks for your time and support. I look forward to working with you in the months ahead.

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4/6/92

Please file for
Cam Findlay :

Airport Privatization

file :
airport privatization

An Airport Executive's Guide To Privatization

A Privatization Study by
the American Association of Airport Executives
and the
Airport Research and Development Foundation

TABLE OF CONTENTS

Preface

- A. Purpose of the Study
- B. Development of the Study
- C. Recognition of Contributors

Executive Summary

Chapter I: Why Privatization?

- A. The Growing Popularity of Privatization
- B. A New Precedent in Federal Transportation Law
- C. The Case for Airports

Chapter II: Applications of Privatization

- A. Overview
- B. Airport Privatization is a Spectrum of Relationships
 - 1. Full Government Ownership and Operation
 - 2. Government Ownership with Privatization of Selected Services
 - 3. Government Ownership, Private Management
 - 4. Private Ownership and Operation
 - a. Perpetual Franchise
 - b. Build-Buy-Operate (BBO)
 - c. Build-Operate-Transfer (BOT)
 - d. Build-Transfer-Operate (BTO)
 - e. Wraparound Addition
 - f. Lease-Develop-Operate (LDO)

Chapter III: Analysis of Airport Privatization

- A. Problems Proponents Argue Privatization Can Address
 - 1. Improved Financial Performance
 - 2. Infusion of Capital
 - 3. Government Costs and Revenues
 - 4. Congestion
 - 5. Politicizing of Airport Operations
- B. Public Policy Issues in Airport Privatization
 - 1. The Economics of Airport Privatization
 - a. Market Value and the Government's Perspective
 - b. The Potential for New Revenue to Local Government
 - 1) Overview
 - 2) Factors Affecting Revenue
 - c. Potential Increases in Costs
 - 1) Replacing AIP Grants
 - 2) Tax-exempt Bond Availability
 - 3) Investment Recapture
 - 4) Taxes

- d. Valuation
 - 1) Basic Principles
 - 2) Dividend-Discount Growth Model
 - 3) Pro forma Financial Analysis
- 2. Legal Considerations
 - a. Overview
 - b. Federal Aviation Act of 1958 (as amended)
 - 1) Section 308 (a)
 - 2) Section 1113
 - c. The Airport and Airways Improvement Act of 1982
 - 1) Section 511 Project Partnership
 - 2) Section 515 Performance of Construction Work
 - d. Antitrust Considerations
 - e. Sovereign Immunity
 - f. Other Legal Issues
 - g. Safety
 - h. Noise
 - i. Liability and Insurance
 - j. Citizen Participation
 - k. Dispute Resolution
 - l. Economic Regulation of the Private Owner/Operator
 - m. Bankruptcy
- 3. Impact on Parties of Interest
 - a. Effect on Airlines
 - b. Effect on Service Area
 - c. Effect on General Aviation Users
 - d. Effect on Concessionaires

Chapter IV: Alternative Approaches

- A. Overview
- B. Lessons from Other Hybrid Management Structures
- C. Goals of a Hybrid Management Structure
- D. Current Airport Authority Models
- E. How Alternative Management Models Address These Goals
 - 1. Lease-Operate
 - 2. Commercialization of Landside Operations
 - 3. Full Private Ownership
- F. Blending the Alternatives
- G. Observations about this Structure
- H. Critique of the Alternatives

Appendix

- A. Bibliography
- B. Response of the Air Transport Association

PREFACE

A. Purpose of the Study

The national aviation system has grown consistently since deregulation, producing numerous problems and opportunities for passengers, shippers and providers of aviation services. A fundamental reason the system has prospered is that the people and institutions that comprise it have not been content with the status quo. Rather, they have addressed problems and pursued new opportunities with common sense, creativity and a willingness to try innovative approaches to advance the frontiers. Today, in some locales, the hurdles of restricted airside and groundside capacity, rapidly escalating costs and severe governmental fiscal distress are preventing the aviation system from obtaining the goals of increased operating efficiency, reasonable profits for service providers, quality service and enhanced benefits to local communities. It is incumbent on each component organization and profession in the system to explore options that might develop new opportunities or reduce existing problems. This perpetual examination is part of the process for public entities to implement sound public policy and for private corporations to maximize their return on investment.

The pursuit of progress requires that innovative concepts and ideas be explored to determine if they could benefit the national air system. A number of these concepts and ideas might prove to be productive tools for some local governments if properly applied. No tool, however, is a panacea. Sometimes a tool fits a problem and is useful, sometimes a tool does not fit the problem at hand and is not useful, and sometimes no problem exists and a tool is not necessary. It is in this context that the American Association of Airport Executives (AAAE) and the Airport Research and Development Foundation (ARDF) Boards of Directors decided that airport privatization should be explored, and consequently that this analysis was undertaken.

Much has been said and written about airport privatization in recent years. However, little of it has applied specifically to airport executives or other local decisionmakers who now or might in the future confront the question, "Would it be prudent to privatize or enhance the privatization level of our local airport?" The central goal of this analysis is to provide a practical guide for these local decisionmakers. It is not the intent of this study to argue for or against privatization, but rather to address many of the issues that local decisionmakers will confront in assessing privatization.

This study is not an academic treatise. It is neither inclusive of all issues or points of view, nor does it intend to answer the question of whether an individual airport should be privatized. It is intended to provide some insights on the pertinent issues. One should also note that this study is written from the perspective of primarily air carrier airports.

All facets and implications of airport ownership and management obviously cannot be adequately addressed in a brief study. If time and resources were available now, or perhaps in subsequent AAAE and ARDF efforts, several issues have surfaced that contributors to this study believe would be prime items for further analysis. They include the following:

- Pro forma financial analyses for actual airports of varying size and structure
- Application of the legal issues to an actual airport seeking to enhance its level of privatization

- Detailed description of impact on employees
- Analysis of several hybrid management structures to determine if they are relevant to airports
- Analysis of whether privatization can improve the credit value/worthiness of airports
- Definition of the type and value of subsidies presently existent among cities/counties/states to airports, airports to airlines/shippers/passengers, government to airlines or passenger and concessionaires to airlines through airports.

B. Development of the Study

Since much has already been written about privatization in general and somewhat less but still a significant amount about airport privatization in particular, the first step in our analysis was to review existing material on airport privatization and to distill out those concerns that seemed particularly relevant and useful for airport executives and local government officials. From that review, a series of questions was developed that addresses those issues about which local decisionmakers might have the greatest concern. AAAE communicated with numerous individuals who had expressed interest in privatization in the past, and asked these individuals if they would like to participate in the preparation of this analysis. In several instances, these individuals had developed considerable expertise and a reputation for understanding the field. Many of these individuals were willing to help and took it upon themselves to organize an outline for this study and make assignments among themselves for the research and writing of its individual sections. This group of contributing analysts submitted their work to team leaders who then endeavored to synthesize the different pieces into one document. It was the clear and understood responsibility of each analyst to address the important issues within his or her topical area but not to advocate a particular point of view to advance or detract from privatization; rather, the goal was to provide information and points of view to facilitate the evaluation process engaged in by the readers of this analysis.

C. Recognition of Contributors

Chapters I and II

Ted David served as team leader working with Len Wilson and Wayne Lindquist combining significant quantities of material dealing with privatization in general and specific application of the concept at airports around the world. Their task included defining and evaluating the problems encountered at non-privatized airports that proponents argue would be alleviated if the airport were privatized.

Chapter III

Frank Berardino led the difficult effort of defining and analyzing the economic issues that are critically important for airport executives in considering privatization. Barbara Fallon, Cy Smith and Ed Merlis contributed different points of view and in the process these analysts present an insightful overview of the major economic influences.

Sandy Murdock capitalized on the work he had previously done on privatization, as a part of a Federal Aviation Administration (FAA) task force, and worked as team leader for the legal considerations section. John Giraudo, John Meenan, Ray Rasenberger and John Henderson, each with considerable experience in the field, contributed valuable input to this section, which covers a wide array of matters relevant to the question of privatization.

Chapter IV

Tom O'Leary and Steve Williams contributed their practical views regarding the management of airport operations today by private corporations. Together with this practical experience, numerous contributors, including Spencer Dickerson concerning airport authorities, provided grist for the mill looking to the future and offering ideas about how the best ownership/management techniques from several methods might be combined into a hybrid.

The study managers are particularly grateful to Steve Steckler and his cadre of experts in Price Waterhouse's Transportation Finance Group. Steve Steckler, William Payson, Avi Berg and George Casey not only wrote portions of each chapter but also by synthesized input from team leaders, challenged and questioned assumptions and forged language that clearly defines the key issues and different points of view. Each chapter bears the imprint of their professional input.

As the study team managers, we hope this product is useful to the AAAE and ARDF membership.

Charles Barclay
Executive Vice President
AAAE

Bill Diefenderfer
Wunder, Diefenderfer, Ryan,
Cannon & Thelen

Bill Burhop
Wunder, Diefenderfer,
Ryan, Cannon & Thelen

List of Contributors

Mr. Frank Berardino
Gellman Research Associates
One Jenkintown Station
115 West Avenue
Jenkintown, PA 19046

Mr. Avi Berg
Price Waterhouse
1801 K Street, N.W.
Washington, DC 20006

Mr. George Casey
Price Waterhouse
1801 K Street, N.W.
Washington, DC 20006

Mr. Ted David
APOGEE Research
4350 East West Highway
Bethesda, MD 20814

Mr. Spencer Dickerson
American Association of
Airport Executives
4212 King Street
Alexandria, VA 22302

Ms. Barbara Fallon
Smith Barney
1345 Avenue of the Americas
New York, NY 10105

Mr. John Giraudo
Skadden, Arps
1440 New York Avenue N.W.
Washington, DC 20005

Mr. John Henderson
Katten, Muchin
1025 Thomas Jefferson Street, N.W.
Washington, DC 20007-5201

Mr. Wayne Lindquist
Federal Express Corporation
P.O. Box 727
Memphis, TN 38194-9842

Mr. John Meenan
Air Transport Association
1709 New York Avenue, N.W.
Washington, DC 20036

Mr. Ed Merlis
Air Transport Association
1709 New York Avenue, N.W.
Washington, DC 20036

Mr. Sandy Murdock
Baker, Worthington
801 Pennsylvania Avenue, N.W.
Washington, DC 20004

Mr. Tom O'Leary
Lockheed Air Terminal
1735 Jefferson Davis Highway
Arlington, VA 22202

Mr. William Payson
Price Waterhouse
1801 K Street, N.W.
Washington, DC 20006

Mr. Ray Rasenberger
Mr. Dick Mathias
Zuckert, Scoutt & Rasenberger
888 17th Street, N.W.
Suite 600
Washington, DC 20006

Mr. Cy Smith
Katten, Muchin
1025 Thomas Jefferson Street, N.W.
Washington, DC 20007-5201

Mr. Steve Steckler
Price Waterhouse
1801 K Street, N.W.
Washington, DC 20006

Mr. Steve Williams
Johnson Controls
90 Moonachie Avenue
Teterboro, NJ 07608

Ms. Len Wilson
Division of Commercial Management
P.O. Box 8766
Baltimore-Washington International Airport,
MD 21240

EXECUTIVE SUMMARY

Application of privatization to publicly owned, air carrier airports is neither a panacea nor an empty concept for addressing current-day airport problems. It is a tool to be considered and used when it fits a problem that requires fixing. The following is a list of some of the issues that should be addressed when approaching the question of privatization:

- Privatization of airports is not a single theory with a single definition. The concept of privatization includes a broad spectrum of potentially useful mixes of public and private features available between the extremes of totally public and totally private enterprises;
- Converting government-owned and operated enterprises to private sector management is a trend strongly supported across the United States at all levels of government. However, when privatization includes the sale of government assets to the private sector, a number of legal, regulatory and public interest barriers are encountered. The intent of this report is to place great value on the creation of an airport environment in which prudent business decisionmaking maximizes efficiency and capitalizes on the strengths of the private sector while minimizing the influence of the unproductive elements of political control. This type of goal is often best achieved by a public-private partnership, such as an airport authority, which maximizes private investment;
- If a locale is considering selling an airport, two issues deserve scrutiny: The ultimate cost of the transaction, and the public policy issue of surrendering control of a vital public asset. The cost issue requires analysis of a pro forma operating statement in order to determine if the existing revenue streams can sustain the cost of the purchase and who will ultimately bear the burden of the sale price and any new costs, including taxes. The benefits of total sale of public assets need to be carefully examined before concluding that the inherent risks are manageable. The ability to implement the transition to private ownership should not be presumed, nor should the cost of the transition be ignored. It should also be remembered that privatization of ownership of a facility is fundamentally different from the privatization of individual services—such as trash collection or management of a facility—by management contract.
- The existing national air transportation system in the United States is undoubtedly one of the most efficient and effective in the world. The system of airports has contributed substantially to the benefits realized from this network. It would be imprudent and short-sighted to disrupt this system for the sake of expediency in dealing with the cash shortfalls of local communities during difficult economic times. The more difficult the local financial distress, the more enticing the sale of a public asset becomes. Trading future revenue streams to balance a current budget is a practice that has serious public policy ramifications.
- Fundamental aspects of privatization already exist in the management and operational structure of airports in the United States, including:
 - third party airport facility development (e.g., private cargo development);
 - airport management contracts;
 - airport concession agreements;
 - the use of private contractors for services (e.g., cleaning and janitorial contracts, parking lot management contracts), and
 - independent local authorities.

- Many of the perceived benefits of privatization can be realized without surrendering complete control of vital public use facilities. Airports, rather than be sold to private companies, might be depoliticized and deregulated. Public/private partnerships working together to leverage each other's strengths and resources provide increased cost efficiencies and financial and service benefits to the airport users and airport environs.

- By looking at other capital-intensive, essential public services—electric power, local telephone and other utilities—municipally owned airports may find models worth considering for creating new public/private mixes for airport control and operation. Considering that the continued public ownership of airports enjoys numerous legal and tax advantages in federal law, one could envision a municipal airport sale to a public authority. The authority could be constructed in statute to operate primarily as a regulatory body overseeing the return-on-investment of a private management company, which purchases the rights to its regulated control of the airport. This example is just one of many mixes of public and private control that a community might examine in seeking a recipe that best fits its own unique circumstances.

In addressing privatization, each airport must be analyzed individually, for no two airports are identical. Thus, each airport sponsor must decide on the right mix of public and private involvement for their airport, given the strengths and weaknesses of each ownership structure examined in this paper.

CHAPTER I: WHY PRIVATIZATION?

A. The Growing Popularity of Privatization

Privatization is really three distinct strategies for having private firms do what government has done before:

1. the sale or lease of existing government-owned enterprises to a private firm, usually with restrictions and obligations as to how the enterprise will be run;
2. the private development of new facilities of a type that has been traditionally provided by the government, accompanied by government oversight;
3. the contracting out by government to private firms of operations, maintenance or management of a service previously or traditionally provided by government employees.

All three strategies were employed in the wave of denationalization that swept Great Britain after Margaret Thatcher was elected prime minister. Although the British privatizations sent ripples across the oceans and through other government-dominated economies, a distinctly American privatization trend was already under way for public services and facilities. By the early 1980s, privatization had become a familiar part of American local government policy for providing everything from refuse collection to fire protection services. The 1980s saw extraordinary growth in the total net amount of privatization and in the variety of services privatized. In addition, the decade saw the emergence of full private ownership of infrastructure, especially facilities for wastewater treatment and solid and hazardous waste management.

The expansion of privatization in the United States is a testament to the steadily increasing sophistication of officials at all levels of government in understanding how to use privatization. It is also a reflection of several critical trends affecting government finance:

- the apparent shortage of public funds
- the desire of local and state governments to expand their tax base
- intergovernmental inertia in developing new facilities in the traditional manner
- a growing public support for *direct* user charges (that can help attract private capital) to pay for new infrastructure

Federal agencies have followed these trends as well and have responded with programs designed to encourage their own agencies and state and local governments to increase their use of private firms in some areas of government activity.

- In 1982, FAA developed the Low Activity Level I VFR Control Tower Program. The so-called contract tower program permits the FAA to reimburse eligible smaller communities for the full cost of the private sector operation of their Level I VFR control tower.

- In 1984, the National Aeronautics and Space Administration created its Office of Commercial Programs and the Center for the Commercial Development of Space, that were designed to promote private sector involvement in space activity.

- In 1985, the Urban Mass Transportation Administration (now the Federal Transit Administration) created a powerful Office of Private Sector Initiatives and embarked on an extensive program to encourage local governments to contract services to private firms and to assist private development of transit infrastructure.

- In 1987, the United States Environmental Protection Agency established its "P3" Public-Private Partnership Program modeled after the UMTA program. The objectives of the program are to encourage the private development, ownership and operation of environmental facilities.

- In 1988, the United States Department of Energy began its Private Sector Participation Initiative program for nuclear waste management.

- In 1990, the Federal Highway Administration embarked on an extensive grantee education program to encourage state governments to make use of public-private partnerships in freeways, bridges and toll facilities.

Public-use transportation infrastructure projects in that the private sector was at least a partial owner lagged far behind services contracting in the United States for most of the 1980s. Tax law changes begun in the early 1980s, federal grants policy (and other forms of intergovernmental subsidies) and the collective attitudes of government transportation policymakers discouraged private sector operation, management and especially ownership. However, the National Transportation Policy announced in early 1990 trumpeted a change in attitude that had been building during the previous decade. The policy states:

"Future [Federal] policy must minimize barriers to private participation in the ownership, planning, financing, construction, maintenance, and management of transportation facilities and services, while encouraging state and local governments to do the same."

The new federal policy followed the actions of several states, including California and Virginia, that had already enacted laws authorizing the construction of private toll roads. An even greater number of states had enacted laws encouraging the private development of high-speed rail facilities. The California and Virginia laws quickly spawned five new private toll road projects worth nearly \$3 billion. In the past two years, Florida, Arizona, Missouri, Texas, Ohio, Pennsylvania, New York and several other states have passed similar legislation for private toll roads and/or high-speed rail.

B. A New Precedent In Federal Transportation Law

The message of the National Transportation Policy and the language of the state laws was reflected in several landmark privatization provisions that were included in the Intermodal Surface Transportation Efficiency Act of 1991, the \$151 billion federal highway bill signed by President Bush in December. For the first time in federal legislative history, state grant recipients were authorized to invest and/or lend their highway grants to privately developed and owned toll highway, tunnel and bridge projects. The amount granted or loaned could constitute up to 50 percent of the

project's cost. Specifically, the statute states:

"Each highway, tunnel, bridge or approach thereto constructed under this subsection [pertaining to toll facilities] must:

(A) be publicly owned, or

(B) be privately owned if the public authority having jurisdiction over the highway, bridge, tunnel or approach has entered into a contract with a private person or persons to design, construct, and operate the facility and the public authority will be responsible for complying with all applicable requirements of this title with respect to the facility."

The law also includes several other key provisions affecting how the private firm may use the federal funds:

- if the funds are loaned, the loan is subordinated to all other debt financing on the project, except for loans made by a state agency;
- the rate of interest on loans is set at the rate of return on the state's own investment funds; payments on the loan can be delayed for up to five years after opening of the facility;
- the private firm is allowed to collect tolls sufficient to recover its nominal investment, operating costs and a "reasonable rate of return."
- the bill also authorizes the private takeover (but apparently not outright sale), expansion, repair and tolling of existing federally assisted roads without repayment of federal grants;
- in a different section of the same bill, Congress authorized nearly \$1 billion in federal funds for the development of pilot magnetic levitation train projects, which would largely be developed by private firms.

The bill passed Congress by a wide margin, with the privatization provisions enjoying bipartisan support. Upon passage of the bill, the Privatization Council—the national trade association of companies and government agencies involved in privatization—declared the law to be "the most significant federal support ever given to privatization." As of this report's publication date, the Federal Highway Administration was beginning to write detailed rules to carry out the legislative provisions.

C. The Case for Airports

The question now being posed around the country is: If state governments and Congress believe that private capital and financially motivated management can help solve congestion on the ground, can the private sector be used to help solve congestion in the air? With privatization sweeping the economies of Eastern Europe, the former Soviet Union and Asia and with private companies taking new leadership and supporting roles in developing transportation infrastructure around the world, privatization advocates argue that there is little justification for airports to be excluded. They

point to a list of benefits that are frequently used to support privatization of other types of government-owned enterprises, arguing that private capital and financially motivated management can provide:

- **A Catalyst for New Airport Development:**
The burst of new investment in the British airport system following the public sale of the British Airport Authority is one often-cited example of the catalytic effect that private involvement can have on investment in infrastructure. A private airport firm clearly would have a powerful financial interest in helping a new project or expansion go forward. Moreover, many self-financing projects proposed by private firms (e.g., in Virginia and California) had not been previously identified by state transportation officials.
- **New Sources of Capital:**
Some Wall Street experts argue that new private capital would come from a large and previously untapped (at least for infrastructure) pool of equity investors who are interested in somewhat higher-risk projects than the buyers of municipal bonds. This equity would play a similar (but more expansive) role to the debt service coverage required on revenue bond offerings. Investors would require the opportunity — not the guarantee—to earn a return commensurate with their risk.
- **New Tax Revenue:**
Privately developed transportation projects are usually expected to pay well over \$2.00 in direct new corporate tax revenue over their tax life for every \$1.00 of project cost. Placing an existing airport into the federal, state, and local tax base would have roughly the same effect. This has been used as an additional argument for limited government financial input for privately developed projects that are not quite able to be self-supporting from user fees.
- **Rapid Construction:**
Rapid project development can often be achieved because private firms do not have to rely on many of the government procurement requirements that stretch out planning and construction schedules, including detailed contracting procedures, extensive paperwork and inter-office/inter-agency coordination (fair labor standards and Equal Employment Opportunity Commission requirements, on the other hand, are expected to be part of any partnership project). In addition, use of design-build concepts (starting construction immediately after initial design approvals) can substantially reduce time and cost. The design-build concept has been used by a few airports but is often precluded by local government procedures.
- **Special Emphasis on Cost-Effective Design and Operation:**
Privatization proponents consider cost-effective design and operation to be a direct consequence of the investor's drive for a return on investment. Cost-effective facility design is a product of the drive to ensure that fixed capital costs do not exceed what the public is willing to pay. Cost-effective operation means that more public service is provided for each dollar spent on labor, equipment, and supplies.

- **Direct Financial Interest in Attracting and Serving Citizen-Customers:**
Privatization proponents argue that improved consumer satisfaction is a product of personalized, economically driven efforts of private management to provide for what the public will pay.

It is important to stress that privatization is not the only means of pursuing these goals. Existing public airport authorities currently pursue these goals, many quite successfully. Thus, airport authorities that are currently operated in a business-like manner with minimal political interference, high productivity, lean staffing and aggressive use of competitive bidding may have little to gain from privatization.¹

¹ This is particularly true with regard to operating efficiency. Because of restrictions on the use of airport revenues, even in the cases of an efficient public authority, privatization might offer the local community additional revenues. If privatization did not lead to improved operating efficiency, however, this would come at the expense of increased rates and charges.

CHAPTER II: APPLICATIONS OF PRIVATIZATION

A. Overview

During the advent of aviation, when aircraft first emerged as a major means of transporting people and cargo, airports were predominantly owned and operated by the private sector. For many reasons, however, the ownership and management of commercial airports became a governmental responsibility. The owning governments vary, from the federal government (that until recently owned and operated National and Dulles airports), to separate authorities established to own and operate airports to state, county and local governments.

Until recently, the pattern of public ownership and operation was prevalent throughout the world. For various reasons, the private sector has become more involved in airport operations, and, in some parts of the world, in airport ownership. This increased involvement of the private sector has had many forms and conditions with varying degrees of success. The purpose of this chapter is to examine the origin of the privatization concept, to describe the continuum of airport privatization options, and to briefly touch on some of the issues raised by privatization that must be evaluated by any airport executive or local government official considering privatization.

B. Airport Privatization: A Spectrum of Relationships

The objective of airport management is to provide a variety of goods and services to the traveling public, to the air carriers and to other users. Thus, commercial airports provide the facilities for passenger and cargo handling, including passenger and cargo terminals, fuel farms, repair and maintenance facilities and airplane services. In addition, airports provide services directly for the passengers, including parking, retail establishments, auto rentals, hotels, recreational facilities and connections with other forms of transportation.

These services provide the airport's revenue sources and generate the airport's costs of operating the airport. The objective of airport management is to provide the services as effectively and efficiently as possible, so as to fulfill the airport's objectives relating to service, economic development and safety, and to operate with no cost to the sponsoring government. In fact, in some cases, airports generate excess revenue that is typically used for airport or other transportation purposes. In other cases, however, the airport may have to be subsidized by the owning government. In addition, most commercial service airports in the United States receive grants from the federal government.

Privatization may not yield efficiency gains if it is not accompanied by some form of competition, either at the selection of the franchise holder or intermittently thereafter. Therefore, it should be emphasized that government-owned airports that regularly bid out management or operations may be closer to the model of an "entrepreneurial" airport than a BAA-style monopoly.

While most airports around the world are owned by a government entity, many have turned to the private sector in an effort to increase revenues or reduce costs. Either way, such private sector involvement has the potential to increase airport "profits." There are many models and degrees of

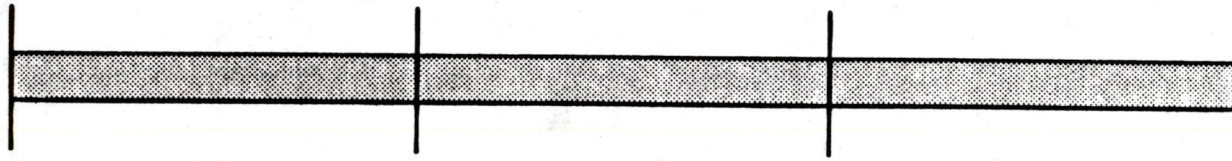
A Spectrum of Policy Options

**Full Government
Ownership and
Operation**

**Government Ownership
with Privatization of
Selected Services**

**Government
Ownership, Private
Management**

**Private Ownership
and Operation**



private involvement in airports, ranging from no involvement to ownership by the private sector. The range includes:²

- No involvement by the private sector
- Contracting portions of airport operations to the private sector
- Contracting overall management to the private sector while continuing government ownership and
- Private sector ownership and management.³

1. Full Government Ownership and Operation

At one end of the spectrum is the case in that the airport is entirely owned and operated by the sponsoring government. In this case, the government assumes all responsibilities and all economic risks. In addition, the government performs all managerial and operational duties. As a result, airport or government employees are performing tasks for that they may not be well suited,⁴ such as selling retail merchandise, catering meals and providing other services that compete with for-profit service providers.

Airports that are entirely owned and operated by the government are typically those that are viewed as important by the sponsoring government but that do not generate enough revenue to attract interest by the private sector. In these cases, the airport may represent a vital form of transportation that requires subsidies from the government. In these cases there may not be alternative means of transportation so that the airport and air service take the place of the local highway system. Examples include general aviation facilities serving remote rural communities and the airport system in Alaska.

The advantage of government ownership and operation is that all revenues flow to the government and all operating decisions are the responsibility of the government. The disadvantage is that this type of airport may require government subsidy and that the private sector's capabilities are not utilized.

2. Government Ownership With Privatization of Selected Services

Most airports in the United States have recognized that the private sector can perform some services more effectively and efficiently than can the government. Thus, most airports privatize at least some of the services required to operate a modern airport. By retaining ownership, the government retains its rights to set direction for the airport and to assure that other community needs are fulfilled, while the partial privatization may increase revenues, reduce costs or both. Further, to the

² Although the range used may be viewed as having generally increasing privatization (moving from no involvement by the private sector to private sector ownership and management), because of the range of services and products offered by commercial airports, direct comparison between airports may be inappropriate.

³ See Exhibit 1.

⁴ This could take the form of over (or under) qualification, or wages and benefits that are out of line with comparable private sector jobs.

extent that the private contractor is successful, the owning government, or some other level of government, receives income and other tax revenues.

In this scenario, the airport leases revenue-generating facilities to the private sector or contracts with the private sector to operate such facilities. The theory is that because of efficiency advantages the private sector has in many cases, the private operator can generate more net return than can the airport and thus create a "win-win" situation for both the public and private sectors. The airport receives its revenues through lease or other payments and does not incur the costs of operations of the particular facility.

The opportunities to contract with the private sector for revenue producing activities are significant. Such opportunities include whole terminal buildings, parking lots, retail establishments, fuel farms and cargo handling. In addition, airports often lease space for auto rentals and lease land for hotels and other real estate development. Some airports are entering ventures such as office space and facilities, recreational facilities (golf courses) and other activities.

At the extreme, a few airports have sold specific facilities to the private sector or allowed the private sector to build a transportation-related facility on the airport. One example of this form of partial privatization is at Hartsfield International Airport in Atlanta, where some cargo facilities are privately owned.

The issues with such rentals and leases are to assure that the traveling public is provided with a range of reasonably priced services, to provide opportunities for private contractors to rent or lease facilities and to avoid the potential for a private monopoly. Airports throughout the country have developed a number of methods for leasing and contracting with the private sector.

The other form of contracting is to contract some of the operating responsibilities to the private sector. The theory is that the private sector can perform some activities at less cost than the public operator. Examples of such contracting include vehicle maintenance, snow removal, custodial services, parking lot management and similar services. Generally, the private sector bids for the right to perform the services for a fee (sometimes the fee is incentive based).

3. Government Ownership, Private Management

Most United States airports have achieved some degree of privatization. Even partial privatization is subject to the restrictions in the government's purchasing and procurement requirements. Thus, some governments have taken the next step: contracting with a private company for overall management of the facility.

In this case, the private company has full responsibility for the operation of the airport, within the guidelines of the owning government. Such private management can often utilize a broad range of profit-making techniques and react quickly to changes in the marketplace, such as changes in traffic patterns and pricing structures. The risks with allowing a private company to manage an airport relate to the ability of the government to assure that its other, non-profit related goals are achieved, and to the risks of monopoly pricing and control. In addition, the extent of, and responsibility for, capital improvements must be determined.

There are many possible arrangements between the public owner and the private operator. There are relatively few examples of the public ownership, private management option in the United States.

4. Private Ownership and Operation

The other end of the spectrum is the ownership and operation of commercial airports by the private sector. Other than small general aviation airports, such a privatization model does not exist in the United States at present. Perhaps the best example of this "complete" privatization is in the United Kingdom.

Within the framework of private ownership, there are several models for privatization that have been implemented, both in the United States and abroad. The definitive element in a privatization project is the manner in that the public and private sectors share risks, responsibilities and rewards. The models are listed in descending order according to the amount of private sector responsibility.

a. Perpetual Franchise

Title, financing and operation are permanent responsibilities of the private firm developing the airport. Any type of transportation project, except perhaps mass transit (that is usually subsidized by the government), can be accommodated under this model. Ferries and their port facilities are good existing examples of the Perpetual Franchise model. The government usually regulates safety, quality of service and sometimes prices or profits.

b. Buy-Build-Operate (BBO)

A private firm buys an existing airport from the local government (taking title), expands it and operates it as a profit-making private (but public-use and regulated) facility. Underdeveloped, deteriorating or congested facilities are usually good candidates for the Buy-Build-Operate model. Albany County originally proposed to sell its underdeveloped airport to Lockheed Air Terminal under this model but later switched to a Lease-Develop-Operate model (*see below*). The key in the Albany project and most others is the amount of money the buyer/operator must pay the government (to repay federal grants or provide cash for the local treasury).

c. Build-Operate-Transfer (BOT)

A private company receives a franchise to finance, build and operate the facility for 20 to 40 years, after that the facility is given to the government free of charge. The Dulles Toll Road Extension in Loudon County, Virginia, is one non-airport example of the Build-Operate-Transfer model. The certainty of eventual government ownership makes the BOT model appealing to many government officials. Around the world, BOT is becoming the most common model for private financing of transportation infrastructure, as well as for energy and environmental facilities.

d. Build-Transfer-Operate (BTO)

The private firm designs, finances and builds the facility but transfers title to the government immediately after construction is finished. The private firm then leases the facility from the government, operates it *and collects revenues* for 20 to 40 years afterwards. All project financial obligations are responsibilities of the private firm. The sponsoring government usually has no financial responsibility for the project, although lower levels of government may contribute funds through a separate agreement with the private firm.

The California AB-680 private toll road projects are the only United States examples of the Build-Transfer-Operate model. Title is held to ensure government control and (especially applicable in California) to help protect the private firm from excessive tort claims.

e. Wraparound Addition

An existing government-owned core facility is expanded by a private firm, that holds title to the addition only; the private firm operates the entire facility, including contract operation of the government-owned core.

The SR91 project in California, in that private toll lanes are being added to a congested freeway, is the one major transportation project that most closely (but not perfectly) emulates the Wraparound Addition model. The model has been applied in wastewater treatment systems. For airports, this model approximates private ownership of a terminal or parking facility in an existing public airport. The most important advantage of this model is that both parties have an ownership stake in the final product and the financing/grants in the core do not necessarily have to be repaid.

f. Lease-Develop-Operate (LDO)

A private firm leases an existing facility and surrounding land from the government and expands, develops and operates the facility under a revenue-sharing contract with the government for 20-40 years or more. The government holds the title.

This model was proposed by the respective governments in Albany, New York, and Peoria, Illinois, for expanding the Albany County Airport and the Peoria Airport. The key advantage of the LDO model is that private entrepreneurial expansion can be unleashed without transferring ownership or repaying debt and grants.

Using a combination of the Buy-Build-Operate and the Perpetual Franchise models, the British government sold the British Airports Authority in 1987 to private interests. It now operates as a private stock company, with its airside activities price-regulated according to a fixed formula. The private BAA operates the largest airports in Britain, including Heathrow and Gatwick. Since it became private, BAA has increased profits, employment and capital investment. The British government is encouraging the shift of municipal airports into the private sector and other transactions are underway.

Others argue that the continued use of the British Airports Authority as the prime example for the sale of an airport is a disservice to the privatization argument in the United States. BAA, it can be argued, was developed and controlled as an instrument of the national government and, despite its "refinancing," is one of the least privatized airports to the extent that term denotes a lack of government control. BAA's circumstances, some would argue, are very much different than those for United States airports. Further, with 25 percent of the revenue stream coming from duty-free shop operation, BAA's financial base is atypical of airports in the United States, according to many experienced observers.

In Canada, a private consortium built, owns and is operating Terminal 3 at Pearson International Airport in Toronto. This is a combination of the Build-Transfer-Operate and Wraparound Addition models. It appears to be a success for the traveling public, the government, the airlines and the private operator. In fact, the Canadian government has developed and is implementing a strategy to move all municipal airports out of direct federal government ownership, although they have not gone entirely for privatization. Under the Canadian government's policy, airports at major municipalities are to be leased by the national government to local airport authorities that include representatives of local business and governments. Smaller airports may be leased to LAAs or sold to the private sector. In addition, further privatization is being considered for Toronto's airport.

Other countries outside the United States are also considering private ownership of new or existing major airport facilities. In addition to the U.K. and Canadian examples above:

- London City Airport on the docks of downtown London is privately owned and operated. Opened only a few years ago, the facility limits operations due to noise and runway length.
- Aircraft manufacturer British Aerospace is the majority shareholder of Liverpool Airport in England. The firm intends to develop this regional airport into a major transatlantic gateway. The airport enplanes 500,000 passengers annually.
- The airport authority employees have been negotiating for the purchase of East Midlands Airport in central England.
- In many countries, government agencies are not allowed to borrow private development funds. The Copenhagen Airports Authority was formed to allow for bank financing. The government still owns 75 percent of the authority.
- Many French airports, including Toulouse, Marseille and Lyon, are operated by the local Chamber of Commerce. In most cases, the land is owned by a governmental agency. In Chateauroux, a little over two hours driving time south of Paris, the land is also privately held. In most cases, the airport director is a Chamber of Commerce employee.
- Birmingham International Airport in the United Kingdom boasts the first "integrated domestic and international airline hub terminal." The 250,000-square-foot terminal building is operated by British Airways, which owns 21 percent of the consortium. Other partners include a major hotel and the airport authority.
- Foreign investors are reported to have made proposals to upgrade Ivanka Airport in Bratislava, Czechoslovakia. The Vienna Airport Authority in Austria, is one of the investors.

- The Greek government will be receiving proposals for consortia regarding the new Athens International Airport at Spata. This major international facility is expected to be fully privatized. The winning consortium will have the right to operate the airport or to license all concessions. The airport should be operational in late 1996. Several airlines are considering a consortium to build and operate new cargo facilities at Hellenikon, the current Athens airport.

- The new Chinese airport at Shenzhen, next to Hong Kong, is looking for foreign partners. British Petroleum has a one-third interest in a joint venture with the airport administration. Constructed at a cost of \$2 billion, the airport opened late 1991.

- Consultants are studying the potential for privatizing Changi Airport, Singapore. Singapore's Minister of Communication stated that he feels privatization would increase the efficiency of operations.

EXAMPLES OF PRIVATE PARTICIPATION AT SELECTED AIRPORT FACILITIES

Airport Facility	Degree of Private Investment/Participation	Basic Financial Arrangement
Alliance Airport	The Airport is owned and operated by a public entity of the City of Fort Worth. However, the Perot Group owns 4800 acres around the airport, and is developing an industrial park with access to the Airport on this land.	The Perot Group donated the land for the airport. AIP grants financed the construction. The Perot Group controls the surrounding land which has benefited from access to the airport.
Burbank-Glendale Pasadena Airport	The Airport is owned by the Burbank-Glendale-Pasadena Airport Authority, and is managed under contract by Lockheed Air Terminal.	Lockheed Air Terminal receives a fixed management fee plus expenses. The Burbank-Glendale-Pasadena Airport Authority is responsible for capital improvements.
Morristown Airport	The Airport is owned by the municipality, which has leased the airport to D.M. Airport developers, Inc. for a 99 year term. The Airport is managed under contract by Avco Services.	D.M. Airport Developers assumed the airport's debt, contracted to pay rent, and agreed to provide professional airport management. In exchange D.M. Developers received operating rights to the airport and the right to develop office facilities on the property for a 99 year term. D.M. has filed for and received AIP grants for the airside facilities.
Atlantic City International Airport	The Airport landside facilities are owned by the City of Atlantic City, and operated by Johnson Controls under a lease-management contract. Johnson Controls is responsible for the development and operation of the landside facilities. The FAA owns and operates the airside facilities.	Johnson Controls pays Atlantic City either a base rent, or a percentage of gross receipts, whichever is greater. Johnson Controls operates the airport under a ten year lease on the terminal, commercial aircraft apron, parking lots, and other civilian activities. Johnson Controls is applying for a 15 year extension and if approved will improve the terminal.

EXAMPLES OF PRIVATE PARTICIPATION AT SELECTED AIRPORT FACILITIES

Airport Facility	Degree of Privatization	Basic Financial Arrangement
Teterboro Airport	The airport is owned by the Port Authority of New York and New Jersey, and is operated by Johnson Controls under a 30 year lease-management contract.	Johnson Controls pays the Port Authority of New York and New Jersey an annual fixed fee plus a percentage of revenues. Johnson Controls operates the airport, is responsible for capital development, and has filed for and received AIP grants for the airside facility.
Albany Airport	A long term lease-management contract with Lockheed Air Terminal and British American Ltd. was proposed. Under the November 13, 1990 proposal, Lockheed and British American Ltd. would have operated and maintained landside facilities. Airside facilities would have remained under public ownership.	The proposed lease-management contract would be for a period of 40 years, with a 40 year option. Under the proposed lease Lockheed and British American would develop the Airport, constructing a 27 gate addition, a new parking facility and a 250 room hotel. However, there were difficulties obtaining FAA approval. The Airport is now operated under contract by Lockheed.
Peoria Airport	Proposed long term lease of landside facilities. Under the proposal airside facilities would continue to be owned and maintained by the public authority to maintain eligibility for federal grants.	The proposed lease is for a period of 99 years. Under the proposal all landside facilities would be leased to a private firm. The public authority would then use the proceeds from the lease to acquire additional lands for airside expansion.
British Airports Authority; owns and operates multiple airports including Heathrow, Gatwick and Stansted	BAA owns and operates the airports, subject to periodic regulatory review of its aeronautical charges. Commercial charges are unregulated.	BAA is responsible for all capital improvements and operating expenses, and receives any profit.

EXAMPLES OF PRIVATE PARTICIPATION AT SELECTED AIRPORT FACILITIES

Airport Facility	Degree of Privatization	Basic Financial Arrangement
Lester B. Pearson Airport	A consortium of Huang & Danczkay and Lockheed Air Terminal was selected to finance, design, build, and operate a 29 gate terminal facility under a long term lease. The terminal is owned by Transport Canada.	The consortium built and financed the facility. Upon completion title was transferred to Transport Canada. The facility was then leased back to the consortium, which is operating the terminal.
Ataturk International Airport in Istanbul	A consortium which included Fluor, Lockheed Air Terminal, Lewis Enterprises, and three Turkish firms has been selected to develop a \$200 million, 18 gate terminal. The franchise agreement is under negotiation. Under the rough outlines of the agreement the terminal will be operated by Lockheed Air Terminal for a period of 10-12 years, after which title will be transferred to the Turkish Government.	The consortium will operate the terminal for the franchise period. During this time the consortium will recover its initial investment plus a reasonable rate of return defined in the franchise agreement.

- Spain has had a centralized system where all airports in the country were under a single federal agency. The Council of Ministers recently announced that airports will be permitted to function with financial autonomy and private capital. The state, however, will retain majority interest.

In the United States, there is a blurring of financial responsibilities between private and public, but actual ownership remains almost entirely in government hands. Exhibit 2 summarizes some additional examples of airport projects in that the private sector acts as a manager, operator or developer.

CHAPTER III: OBJECTIVES OF AIRPORT PRIVATIZATION

Chapters I and II of this study reviewed the concepts underlying airport privatization and the spectrum of applications currently in use. The first section of this chapter will examine the problems that proponents argue privatization can alleviate. The second section will review the other side of the coin, addressing the issues that an airport executive or public official needs to consider before recommending an enhanced form of privatization. The issues and opportunities surrounding privatization of a commercial airport often will hinge on local circumstances. To aid the assessment of privatization from a local perspective, this section will also examine potential changes in operations, sources of funds and sources of finance that will not only determine the economic viability of a private facility but also may affect the community's public interest. In the end, the attractiveness of privatization from the community's standpoint will depend on the impact of these factors.

A. Problems Proponents Argue Privatization Can Address

1. Improved Financial Performance

An important component of privatization is the potential for increased revenues and decreased costs. At some airports, the private sector may have enough opportunities to reduce costs and increase revenues, not only to improve the efficiency of the airport but also to make airport privatization an attractive option.

According to proponents of privatization, there are a number of possibilities, depending upon the specific circumstances, for the private sector to lower the costs of running an airport:

- Private firms may have a more flexible procurement process. Streamlining procurement can save both time and money.

- Private investors may be more aggressive about the schedules for finishing projects since they have a direct personal stake in the quick completion of a project. The private sector may also demonstrate innovative solutions to problems. For example, in order to expedite the environmental permitting process for wetlands development, the Toll Road Corporation of Virginia offered up front to preserve twice the amount of wetlands required under federal statute. This was a factor in reducing the environmental approval time for the Dulles Toll Road project, saving the corporation time and money.⁵ In addition, Terminal 3 at Toronto Pearson International Airport was built in half the

⁵ Environmental approval for this project was approximately 1.5 years. The average time it takes to acquire a permit for such a project is approximately three years.

time estimated by the Canadian government.

- Once a project is finished, the private sector may have higher performance ratios than an equivalent public sector project.

- Private owners may be able to adapt more readily to changing needs. This is especially true in staffing, where the private sector can alter its personnel structure more easily.

- The private sector may be able to take advantage of economies of scale in airport operation. Theoretically, owners of multiple airports would be able to cross-utilize their operations experience among all facilities.

- The private sector might be more likely to use innovative (and more efficient) cost allocations, such as peak-hour pricing. Although airports need not be private in order to institute a more elastic price structure, publicly owned airports have come under heavy political pressure not to do so.

Some airports also may offer opportunities for private firms to increase revenues.

- The private sector might be able to profit from airport-related real estate development as a result of increased flexibility in deal-making (real estate development has been a major component of many private sector airport proposals).

- Direct incentives may act as a stimulus or catalyst for the private sector to identify new projects and revenue opportunities. For example, two of the four projects proposed by private firms and approved under the California AB680 legislation had not been previously identified by the state DOT.

In conclusion, proponents argue that private firms can lower costs and raise revenues. If this is the case at a particular airport, then private firms may be able to not only improve efficiency but also increase the level of development above current levels.

2. Infusion of capital

In the previous section, it was stated that the private sector may be able to lower costs and increase revenues. Vital to the success of a private venture, however, is the ability of the firm to attract private capital. If investors are convinced that private airports can be run for an acceptable profit (allowing for risk), then they will be inclined to invest equity in the project.

The creation of an independent pool of equity could have two positive effects:

- First, equity allows the airport operator to have increased financial flexibility, including the ability to engage in high-risk/high-return projects. If the potential profits are large enough, some investors will be willing to finance high-risk projects. Public projects, however, that tend to have limited discretionary capital, have a reduced ability to attract high-risk investors and are therefore constrained to low-risk projects, regardless of the potential benefits of the high-risk projects.

- Second, the existence of an outside pool of equity may place the airport in a better position to negotiate airline leases. In order to provide a measure of security to debt holders, government operators often need to obtain a long-term financial commitment from the airlines. In exchange, however, the government often must grant the airlines veto power over major capital improvements at the airport, in effect giving the airlines a dominant position over some airports. Although private investors would also want the security of an anchor airline(s), the existence of outside equity could reduce the importance of the security the airline offers.

In addition, if airport operators could manage airports with reduced restrictions such as majority in interest provisions, airports ultimately may be able to generate more airline competition and, consequently, reduced fares.

3. Government Costs and Revenues

While it may be true that privatization potentially holds substantial benefits for the private investor, we have not discussed the benefits to the public sector. Equally important to the successful establishment of privatization are the benefits to the public sector.

Privatization has the potential to reduce government costs and increase government revenues. Privatization implies that government outlays and subsidies will not be required. This reduces government costs and removes the government's exposure to financial risk.⁶ In addition to the potential for immediate cost savings in airport operations, there are other potential cost savings as well. By reducing the government payroll, the government's employee pension payments are reduced, as is the long-term cost exposure from fewer pension liabilities.⁷

Privatization's main benefit for the government, however, is the potential for increased revenues. The three major ways that the government might increase its revenues are:

- First, a February 1991 Justice Department memorandum⁸ appears to allow the local government to recover its aggregate historical investment (plus reasonable interest) if it decided to privatize the airport. Thus, should a government decide to sell or lease an airport to a private operator, the government might be able to recover its prior investment.

- Second, government-owned airport land is free from property taxes. On the other hand, if a private entity owns an airport, the airport's land could be taxable. Therefore, if the local government would sell the airport, it could increase its property tax base. If the government allows a private firm

⁶ The risk may not fall to zero if the public sector takes ultimate responsibility for the success of the venture. If the government plans to bail out a failed venture, then the government retains some risk. For government risk to fall to zero, the government must allow a bankrupt venture to fail.

⁷ This will depend on the nature of pension funding and the airport's financial health

⁸ Office of Legal Counsel for C. Dean McGraff, Acting General Counsel, February 12, 1991.

to build a new airport, it might or might not increase its tax base, depending on the agreed nature of the development on airport lands. Regardless of what is developed, however, the local government could capture more property taxes than if a new airport were publicly owned and operated.

- Third, by making the airport private, the local, state and federal governments are enabling themselves to capture corporate income taxes from the airport. Publicly owned airports do not pay corporate income taxes.

4. Congestion

Insufficient airport capacity is the result of increased demand and under investment. Between 1980 and 1988, domestic passenger enplanements increased from 191.1 million to 444.7 million, and FAA is currently predicting 761.4 million passenger enplanements by 2000. Correspondingly, aircraft operations have increased from 14.7 million to 21 million and are forecast to reach 29.7 million in 2000. Despite the rapid growth in air travel, there has been minimal new airport construction. The last major airport to be built, Dallas/Fort Worth, was constructed in 1974. The only major passenger airport currently under construction is intended to replace Denver's Stapleton.

Inadequate airport facilities are forecast to cause increasing delays in both aircraft operations and in the movement of airline passengers. For example, in 1988, 21 major airports were listed by the FAA as "seriously congested" (over 20,000 annual air carrier flight delay hours). Forty-one airports are predicted to be seriously congested by 1998, with the most congested airports exceeding 100,000 hours of air carrier delays.⁹ In addition to delays, several recent studies have shown that inadequate airport facilities reduce airline competition by limiting both the number of landing slots and the available terminal space (primarily aircraft gates), thereby restricting the entrance of new carriers in certain markets.¹⁰ In other cases, entrants have been forced to pay a substantial premium to gain access to new markets.¹¹

It is clear that something must be done to alleviate the constraints on our nation's airports. Proponents of privatization argue that privatized airports have three major advantages in dealing with congestion compared to public ones:

- First, private owners may be more aggressive in identifying opportunities to increase efficiency and more innovative in their solutions to problems. Thus, privatization may be able to reduce congestion by increasing the effective capacity of the airport.
- Second, private investors may be more aggressive in project scheduling. Plans for airport

⁹ 1990-91 Aviation System Capacity Plan, Federal Aviation Administration, System Capacity and Requirements Office, 1990, pp. 1, 13.

¹⁰ "Airline Competition: Industry Operating and Marketing Practices Limit Market Entry," United States General Accounting Office, GAO/RCED-90-147.

¹¹ "Airline Competition: Higher Fares and Reduced Competition at Concentrated Airports," United States General Accounting Office, GAO/RCED-90-102.

improvements might be implemented faster by the private sector in comparison to the public sector.

- Third, private owners may be able to more readily adapt to changing needs than government agencies. Government agencies are bound by restrictive regulations and agreements, particularly in relation to personnel structure.

5. Politicizing of Airport Operations

An airport with enhanced privatization should be designed to avoid the intrusive and non-productive inclination for excessive oversight by political bodies that exist at some of the airports owned and operated by municipalities and other forms of local government. A private corporation could make procurement decisions, set employee policies and determine all other normal business transactions based on the economic forces of the marketplace.¹²

B. Public Policy Issues in Airport Privatization

1. The Economics of Airport Privatization

a. Market Value and the Government's Perspective

The economic perspective on airport privatization can vary depending upon what level of government is the viewer. From a city's perspective, the main reason for privatizing an existing government-owned airport would be if the city (defined as either the government or its citizens) would be better off economically after privatization. This will be mostly, but not entirely, reflected in the sale price of the airport. From a state's perspective, an airport should be privatized if the state will be economically better off with a private airport. From the national perspective, an airport should be privatized if, all other things being equal (that may not be the case), the nation would be economically better off after privatization and the air transportation system would enjoy enhanced efficiency and a growth in capacity.

Full privatization, as in the sale of the airport, has several economic consequences for governments:

- the local government owner would receive a cash payment at the time of sale and might also receive a share of airport profits;
- the local government (and the state as well) would benefit economically if privatization also means growth in air travel to the city and new commercial development at the airport;
- the local government would receive new tax revenue after the airport goes into the local tax base;
- the state and federal government would also receive tax revenue from corporate income taxes (and any other taxes to that a public airport is not currently subject).

¹² Private airports, however, may still be constrained to act within broad parameters set by public policy.

To achieve these benefits, the private owner would have to increase revenues and reduce costs compared to government ownership and operation. These changes in the stream of costs and revenues—including their magnitude, predictability and vulnerability—would determine the sale price of the airport. The following sections discuss how these changes might occur and what factors influence their magnitude, predictability and vulnerability. Afterwards, the discussion will shift to how these factors influence both the market value (sale price) and the value to the government.

b. The Potential for New Revenue to Local Government

1) Overview

This section discusses the potential for revenue enhancement from an existing municipally owned airport as a result of privatization. In summary, although it may be possible to enhance municipal revenue through the sale of an airport to private enterprise, substantial barriers are present in a number of federal laws and policies that either favor municipal ownership or directly restrict private ownership. Not only would many of the benefits available to the public sector not be available to a private enterprise, but federal aid reimbursement also might be required as a cost of conversion. Airport revenue enhancement through efficiencies of operation and enhancement of airport user fees through more limited forms of privatization such as management contracts would not necessarily result in municipal revenue enhancement, because existing contractual arrangements and federal policies may require the bulk of increased revenues to be dedicated to the airport.

There are two primary sources of airport revenues. The first is revenues collected from the airlines, businesses and general aviation users in the form of rates and charges, including landing fees, space rentals, ground rentals, equipment rentals and other charges for services. These revenues are based upon an airline's utilization of the airport (for example, landing fees are based upon an airline's landed weight while space rentals are based upon the square footage leased). Secondly, the airport collects revenues from its concession operations, including parking, food and beverage, gift shops, rental cars and, in some cases, commercial development of hotels and industrial parks. Revenues from concessions can be collected as a flat fee or as a percentage of gross or net revenues of the concession operation. In addition, there is a wide variation as to the extent of airport involvement in the management of the concessions — some airports manage the concession operations themselves while others contract out to private corporations for these services.

Some privatization proponents argue that there is one area for potentially major gains that could also have a material and beneficial effect on the long-term investment needs of the airports. Perhaps the scarcest asset on the landside at major airports in the United States today is curbside capacity. As airline passenger demand continues to grow, airports are experiencing growing congestion at the curbside, that spills over onto the roadway system. The traditional solution has been to expand the curbside and roadway system to accommodate demand and to develop curbside management policies that favor certain on and off airport service providers as well as public transportation vehicles. None of these policies, however, directly affects the demand by the most significant user group on the curbside—the general public. Faced with the substantial costs of expanding such facilities, and having already put in place curbside management systems, many private airports might be relieved of the local political pressures that work against considering the use of tolls as a

means of controlling demand for curbside access.¹³

Airport revenues are first used to pay operating and maintenance expenses of the airport. The remaining net revenues are applied to debt service, replenishment of funds required under the bond resolution, renewal and replacement projects and capital projects funded on a pay-as-you-go basis. The valuation of an airport will reflect the strength and magnitude of these net revenues, in combination with the case-specific opportunities for cost savings.

2) Factors Affecting Revenues

The factors that affect the strength of revenues of an airport are primarily the demand for air traffic, the nature of the traffic and the type of airline use agreement, if any. These factors are described below:

Air Traffic Demand. One of the most important components in evaluating the strength of the revenue stream at a particular airport is determining the region's demand for air services. This is typically demonstrated by certain demographic characteristics of the airport's air trade area. For example, strong historical and projected population growth in the air trade area indicates a population base that is likely to require additional air service in the future. Similarly, employment growth and the diversity of the air service area's industrial base are important factors because a growing employment base and an economy that is not dependent on a single industry is more likely to be able to generate air traffic revenues in a recessionary environment. The wealth of the population base is also an indication of strength as an affluent population typically generates more air traffic. Finally, a high percentage of business travel relative to discretionary travel is an indication of the strength of an airport as business travel is less likely to be affected by negative economic environments.

Nature of the Traffic. The type of traffic generated at an airport is also important in evaluating the strength of the revenue stream at an airport. The level of traffic at an origin and destination (O&D) airport (in that passengers are traveling to and from that airport and not connecting to another destination) will be largely dependent upon the strength of the local air trade area. Conversely, an airport with a high percentage of connecting traffic will be less dependent on the air trade area and more dependent upon the financial strength and scheduling decisions of the hubbing carrier(s). The strength of an airport can typically be demonstrated by the percentage of O&D traffic, the growth in enplanements (particularly during recessionary periods) and the diversity of the carriers serving the airport.

Use Agreements. The presence of an airline use agreement and the methodology used to calculate airline rates and charges are also important when evaluating the strength of the revenue stream at a particular airport. There are two basic approaches to calculating airline rates and charges:

- **Compensatory Approach.** Under this approach, an airport operator assumes the financial risk of running the airport. Airline fees and charges are set to recover the actual costs of the facilities and services the airlines use. To the extent that non-airline revenues exceed the cost of the non-

¹³ It is important to note that public airports are not precluded from assessing tolls. In fact, some airports currently assess commercial vehicle access fees.

airline facilities, the airport operators may generate "surplus" revenues. These surplus revenues can be used for discretionary airport development (not under airline purview).

- **Residual Approach.** Under a residual cost approach, the airlines collectively assume the financial risk at the airport by agreeing to pay the costs of operating the airport that are not recovered through non-airline revenue sources. Thus, a shortfall in non-airline cost centers would be paid by the airlines. Although this reduces the financial risk on the airport authority, it may also limit the amount and use of an airport's discretionary revenues.¹⁴

In actual practice, many airlines use a hybrid of the residual and compensatory approaches, with certain facilities and activities allocated on a residual basis, and others allocated on a compensatory basis (e.g., parking facilities might be excluded from a residual agreement). The importance of a use agreement as a means of assuring financial stability to the airport varies with the nature of the facility and the characteristics of the market. For example, airports with a strong local origin and destination traffic level may be more assured of covering costs, and so may have a reduced need for the financial security of a residual agreement. At an airport with a more volatile market, however, a residual agreement may be more desirable.

Airline use agreements are particularly important in considering privatization as they represent a pre-existing legal contract between the airport authority and the airlines. As a result, it could be necessary either to "privatize" the airport in sections as existing use agreements expire, or to limit privatization efforts within the bounds of the use agreements. Because the expiration of major use agreements can provide increased flexibility, the impending expiration of an agreement can make the assessment of the privatization option more relevant.

Federal Grants. Municipalities that have received capital improvement grants pursuant to the Federal Airport and Airway Improvement Act of 1982, as amended, are bound to comply with statutorily required assurances given in connection with these grants. The grant program provides 75 percent to 90 percent of the cost of airside facilities. Section 511(a)(12) of the act requires assurances that, with limited exceptions, all airport-generated revenue be expended only for aviation-related operations and facilities. Thus, current federal law applicable as a result of receipt of airport improvement grants requires that all revenues generated by an airport be expended for the capital or operating costs of the airport or other local facilities owned or operated by the municipality and directly and substantially related to air transportation of passengers or property. Virtually all air carrier airports are eligible for the federal grant program and have received grants thereunder. Many states administer similar, more limited programs.

Passenger Facility Charges. Passenger facility charges (PFCs) could have significant ramifications for airports and their financial structures, now that airports are allowed to receive them.

¹⁴ In return for accepting the financial risk under a residual approach, airlines may require some form of majority-in-interest control over future capital improvements. It is believed by the Financial Accounting Standards Board that for an airline lease to be considered an "operating lease," the airport must be owned by a governmental unit or authority. If privately owned, the lease will in most cases be capitalized and shown on the airline's balance sheet—something most corporations seek to avoid.

Because cash flow is an important ingredient in the private valuation of airports, PFCs may influence the attractiveness of private ownership/management. As stated in Chapter III.B.2.b.2 of this analysis, until the FAA implementing regulations are applied, the role of PFCs in privatization is unclear.

c. Potential Increases in Costs

Despite the proper incentives, privatization is not a panacea on the cost side. A private company will be exposed to other potential cost increases that could easily eclipse any cost reductions or increased revenue generation. Among the key areas of concern are:

1) Replacing AIP Grants

A private entrepreneur may not want to be subject to AIP sponsor assurances or may be found ineligible for them and therefore will have to find alternative sources for a significant amount of investment funds, especially related to projects on the airside of the airport. In exchange for the significant operating constraints imposed by the federal government that come with these grants, the investment funds that they represent are in effect free to the airport operator. The cost of replacing them, therefore, is not only the funds themselves, but also the opportunity cost of the money. Moreover, the absolute size of the cost increase will be significant at most airports because AIP funds can provide 75 percent to 90 percent of airside capital project costs. Small and medium-sized airports, given their relative dependence on these funds, may be more vulnerable than large airports.

2) Tax-Exempt Bond Availability

A private entrepreneur may not be able to use municipal bonding. The interest rates for privately placed bonds could be significantly higher than those for equivalent municipal bonds that they replace. The market may also assign an additional risk premium to the bonds because of the higher costs of raising capital experienced by the private entrepreneur. In fact, the creditworthiness of a private operator could affect the ability of the airport to raise funds; if an operator has other businesses besides the airport under a single holding company, the performance of those other businesses could affect the creditworthiness and hence the interest costs of the private airport.

3) Investment Recapture

Depending upon the federal policy on airport privatization, and upon the proposed privatization mechanism, it may be necessary for the private entrepreneur to buy out the embedded investment of the federal government.¹⁵ In addition, the bond covenants in existing municipal debt may call for the early redemption of bonds if contingencies, including

¹⁵ There is additional uncertainty on what method would be used to value the embedded federal investment (e.g., with interest, original value, depreciated value) if repayment were required. Note, however, that in the recent Intermodal Surface Transportation Act, repayment of federal investment was not required in a private takeover.

privatization, were to take place. Both of these events could increase the debt-carrying costs of the privatized facility and could reduce the funds that the locality would receive for the privatized airport.

4) Taxes

Depending on the contract between the proposed private operator and the airport authority or controlling government, the airport may be subject to property taxes. This would result in increased revenues for the local community but could also be reflected (negatively) in the value the private sector places on the airport. In addition, a private company would have to pay all applicable local, state and federal income taxes.¹⁶

d. Valuation

1) Basic Principles

Valuation is a somewhat ambiguous concept and can be estimated in a wide variety of ways, that may give different answers. Although alternative definitions and methodologies for valuation could have been used, for clarity and simplicity a limited number of definitions and models will be used in this report. The definitions and models used are explicitly defined and the specific definition intended is referenced for each use. The three definitions of valuation used in this section are:¹⁷

o Market Value

This is the value the "market" places on the airport. The market value of the airport is primarily based on the cash flow of the airport and on its ability to service debt and equity. The market value will reflect outstanding debt and encumbrances and restrictions on airport operations.

o Value to Local Government

This is defined here as the cash value that the local government receives from the airport. If the airport were privatized this would include the transfer payment (that would be based on the market value), and any tax receipts. For public airports,¹⁸ this includes any revenues derived from airport-related facilities, and any revenues that are available for use outside the

¹⁶ Although taxable debt, if used, would result in increased state and federal tax revenues, the taxes would not be a direct cost to the private operator but would result in increased financing costs.

¹⁷ Additional definitions of valuation include book value (that is based on the accounting balance sheet), and the replacement value (based on what it would cost to construct a comparable facility under current prices).

¹⁸ If any of these revenue sources were to remain under a privatized airport, they must also be factored into the valuation of the privatized airport.

airport.¹⁹

o Societal Value

This is the overall value of the airport to society. Of particular importance is the value of the airport to the local community.²⁰ This is largely based on the quality and extent of services rendered by the airport, less the fees charged for those services. The societal value for the local community includes the value to the local government, but excludes the value of the airport itself. Thus, if a private airport would charge higher fees but would not provide higher quality service, or a greater quantity of service, then the private airport would have a lower societal value based on those criteria (a sufficiently high value to the local government could compensate).

These definitions of valuation have clear differences. The most encompassing definition is the societal value, while the least encompassing is the market value. Proponents of privatization have focused heavily on market value and the value to the local government. Because of restrictions placed by the FAA on airport operations, proponents of privatization argue that private operation would increase these values. The impact on the societal value, however, is largely ignored in these arguments.²¹

For example, all other things being the same, a community could in some cases maximize the amount of revenues it receives upon the sale of an airport by providing the operator with an unlimited monopoly right to operate the airport property in whatever manner he or she sees fit, including closing the facility in order to redevelop it to its highest and best use (thus maximizing the value to the government). However, granting such an unlimited right would probably not be consistent with preserving the community's access to the national air transportation system, and could reduce the societal value of the airport to the local community.²² Or, the community might be uncomfortable with the higher prices and required returns of a privately owned monopoly. On the other hand, these interests need not be in conflict. Granting unlimited rights could in some circumstances be consistent with preserving the community's access to air transportation if the community itself is unable to operate and invest in the facility adequately. It is important to note in assessing privatization that there are different levels of privatization, ranging from contracting out airport operating functions, to

¹⁹ These revenues are only available from airports grandfathered under the Section 511 (a)(12) restrictions, and even in these cases there are restrictions on the use of these revenues.

² ^oThus, although a privatized airport would pay taxes to the federal government, that a public airport does not, these taxes are not relevant to the local decision on whether to privatize an airport.

²¹ For example, the British Airports Authority may have a higher market value and a higher value to the government. Complaints about excessive increases in non-aeronautical rates, however, raise concerns about the overall effect on the societal value.

²² This illustration obviously ignores existing and potential federal prohibitions against closure of commercial airport facilities that have received grants from the federal government.

privatizing individual airport activities such as terminal buildings, to complete privatization of an entire commercial airport facility.

2) Dividend-Discount-Growth Model

The dividend-discount-growth model is one of the popular models for conceptualizing valuation.²³ The dividend discount growth model determines value based on three factors: dividend (returns from the asset), discount rate (based on cost-of-capital) and growth rate (the rate at that the dividend increases). The formula is:

$$\text{Valuation} = D_0 + (D_0 * (1 + G) / (R - G))$$

Where D_0 is the dividend at time 0 (the current dividend), G is the growth rate of the dividend, and R is the discount rate. Influences that alter these factors will affect the valuation. Because the "dividend" is largely based on the difference between revenues and operating costs, changes in either of these factors will also influence valuation.

The dividend-discount-growth model may be conceptually applied to the three models as follows:

Market Value. Market value will be based on the cost of capital, the cash flow available to pay debt and service equity and the projected growth rate of cash flow to service debt and pay equity.

Value to Government. The value to the government would be based on the government revenue streams generated by the airport, the government's cost of capital and the projected revenue growth rate.

Value to Society. The total value to society cannot be readily modeled. To some extent, however, the difference in the value to society between two alternatives can be assessed. If, for example, there is a clear difference in rates, then the difference in rates between the alternatives could be compared and discounted. But, in general, the overall societal value must be assessed on a more qualitative basis. It is only possible to assess changes in the value to society on a quantitative basis if qualitative factors are held constant—for example, if both the public and private alternatives would have comparable quality and production of service, comparable noise impacts, etc.

Regardless of the form of privatization, it is convenient to think of the process as a negotiation between the public sector and the entrepreneur. In a negotiation, the entrepreneur will seek to pay something close to the going concern value of the airport under the current operating rules. Such a price would reflect a going concern value today minus a factor for all the restrictions and benefits of public sector ownership, including restrictions against earning significant profits and lower cost of capital. The public sector, on the other hand, would seek, subject to protecting its future interests, an amount close to the going concern value of the privatized airport. The entrepreneur would argue that he or she would create the marginal value associated with the higher going concern value in the private sector, and public sector operator would counter that it had created the vehicle that permitted these premiums to take place.

²³ The dividend-discount-growth model was originally developed to estimate the cash price of equity and not the overall valuation of an asset.

3) Pro Forma Financial Analysis

When evaluating the potential for increased private involvement in airports, a *pro forma* analysis can provide useful quantitative information. *Pro forma* analyses are important in evaluating both the sale of airports to the private sector and a combined public-private partnership structure. It has been suggested that this paper recommend a framework for developing a *pro forma*. The following (see next page) is a first draft of a proposal for assembling financial data for a *pro forma* analysis. Many other issues, however, must be considered. A brief discussion of some of these issues follows the *pro forma*.

The following issues would be raised by a *pro forma* airport financial analysis, comparing public and private sponsorship:

- The comparison would only be useful if the public and private sponsorship scenarios were carefully structured and independently feasible. For example:
 - if the primary goal of the project were the development or expansion of airport facilities, and if the public sector would be unlikely to pursue the project through traditional mechanisms, then public sponsorship would not be a helpful benchmark for private sponsorship options. In this case, a test of the private option's stand-alone feasibility would be more useful;
 - if a particular private sponsorship scenario were unlikely to overcome regulatory or other barriers, the comparison to a feasible public scenario would be meaningless.
- The purpose of the analysis would not be a line-by-line comparison but a test of the impact of private investment on each of the interested parties.
 - the parties include the private entity; federal, state and local governments; passengers; cargo shippers; airfield users; aviation-related service providers; tenants; passenger service providers; airport employees or potential employees, and, perhaps most importantly, the people and economy of the region served by the airport;
 - the impact on government would include federal, state and local taxes and fees paid (including taxes paid or foregone on bond interest payments) and other funds moved off-airport, as well as government grants and services received by the public or private sponsor.
- The comparison of public or private sponsorship would not be exclusively financial. For example:
 - developing or expanding airport facilities and services could be a higher priority for users or government (due to competitive, economic or transportation concerns) than maintaining the lowest possible cost to users or maximizing financial benefits to the government;

Outline of Financial Pro Forma

	Existing Public Operator	Pro-Forma Private Operator	
Revenues			
Airline (Cost Recovery)	\$	\$	
Flight fees			
Rentals			
Utilities			
Fuel Fees			
Passenger (Market-Based)			(1)
Parking			
Concessions			
Service Providers (Market-Based)			(1)
Ground Handling			
In-Flight Catering			
Other (Market-Based)			
Private Property Development			
Gross Revenues	\$	\$	
Expenses			
Operating Expenses			
Materials and Services	\$	\$	
Payroll			
General and Administrative			
Payments to Municipalities			
Airport Site Lease Payments			
Payment in Lieu of Taxes			
Municipal Service Payments			
Property Taxes			
Sales Taxes			
Income Taxes			
Amortization and Interest Payments			(2)
Debt Service			
Debt Service Coverage Factor			
Expenses	\$	\$	
Net Revenues Available for Airport Acquisition	\$	\$	(3)
Cost of Capital	%	%	(4)

Notes to the Financial Pro Forma Outline:

(1) Revenues from passengers (parking and consumer services) and airport service providers are market-priced and should be the same under both public and private airport operation. Any enhancement to the airport revenues must come from:

- Increased airport fees and charges to the airlines
- Greater private development of commercial enterprises

(2) It is assumed that existing airport debt (non-taxable) would be repaid with private capital (taxable debt and equity).

(3) The majority of large public airports in the U.S. operate under a net cost recovery basis that does not allow for excess revenues beyond payment of debt service and cover.

(4) The cost of capital for public and private operators should be compared and the private operator's cost of capital should be used to evaluate the net revenues available for airport acquisition.

- the feasibility of private involvement rests in part on the underlying strength of the revenue base. Revenue streams from airports with a high percentage of origin and destination traffic are more predictable and potentially less volatile than revenue streams from airports with a high percentage of transfer traffic;
 - the reallocation of risk could be a significant benefit of private investment that would not appear in a simple financial *pro forma* analysis;
 - the speed with which new facilities or services would be developed by a public or private sponsor could also be an important factor;
 - the comparison would take into account the differing powers, capabilities and needs (e.g., for regulatory approval) of public and private sponsors.
- The financial comparison would be conducted by the airport cost center (rather than object type); would take into account different cost recovery mechanisms (compensatory versus residual), and would calculate rates and charges for users and tenants.
 - The *pro forma* analysis would include a complete assessment of capital needs and funding, as well as operating results, for reasons that include:
 - the potential development or expansion of airport facilities could be a critical factor in deciding on public or private sponsorship;
 - external governmental financial support for airports has traditionally been concentrated on the capital side;
 - airport rates and charges, which would be one of the impacts on users, could be based in part on capital charges;
 - a sponsor could choose capital-intensive solutions that would reduce operating costs while increasing capital costs.
 - If the private sponsorship option includes a build-operate-transfer mechanism, the *pro forma* analysis would need to reflect the value of the facilities ultimately transferred to the government;
 - The airport's financial results could be affected by the different motivations available to public and private sponsors, particularly if rates and charges were determined on compensatory or market bases;
 - The revenue streams could be augmented by expanding existing services to existing customers, by increasing the number of customers for existing services, by adding new services in conjunction with existing services, or by developing ancillary facilities or services;

- Operating costs would be affected by facility size and service levels (which could be revenue-driven), economies of scale in ownership, productivity factors and unit costs.

These factors must be addressed in any detailed study of expanded private involvement in airport management and ownership. Further analysis is required for the development of a more refined *pro forma*.

2. Legal Considerations

a. Overview

It is important to analyze the relevant legal considerations when assessing the privatization decision. Therefore, this section reviews some of the major legal issues in privatization. It is not within the scope of this study, however, to provide a comprehensive legal overview, and a detailed legal review would be required as part of a serious assessment of privatization. In addition to the legal issues that directly affect privatization, it is also necessary to consider the general legal issues in airport development and operation. Areas discussed in this section include:

- Federal Aviation Act of 1958
 - No exclusive use of airport facilities
 - Passenger Facility Charges
- Airport and Airway Improvement Act of 1982
 - Use of airport revenues
 - Equal access
 - Consultation
 - Construction
- Antitrust Considerations
- Access to Tax-Exempt Financing
- Sovereign Immunity
- Other Legal Issues

b. Federal Aviation Act of 1958 (as amended)

1) Section 308

(a) ...There shall be no exclusive right for the use of any landing area or air navigation facility upon that Federal funds have been expended. ...The providing of services at an airport by a single fixed-based operator shall not be construed as an exclusive right if it would be unreasonably costly, burdensome or impractical for more than one fixed-base operator to provide such services...

This statutory language has been primarily construed in terms of the use of the airport by air carriers, fixed base operators and other actual or constructive tenants of the facility. Theoretically, every airport in the United States is subject to the exclusive ownership by a single sponsor/proprietor. At a number of airports today third-party contractors are given the exclusive rights to manage the facility. None of these arrangements has been successfully attacked under the section. Some cases have involved the exclusive use by FBOs or the operators of fuel farms.

The sale or lease of an airport to a third party in all probability will not create a problem under Section 308. There is an element of a locational monopoly inherent in the management of any airport. The proprietor considering "privatization," however, should be very careful in considering such a transfer to an entity that has or could be competitive with other users. Attention must be given to ensure that the privatization transaction does not create—or, stated differently, that it "protects against"—an exclusive right at the airport with an airline, fixed base operator or other tenant.

2) Section 1113

(3) (e) AUTHORITY FOR IMPOSITION OF PASSENGER FACILITY CHARGES. (1) IN GENERAL—Subject to the provisions of this subsection, the Secretary may grant a public agency that controls a commercial service airport authority to impose a fee... to finance airport-related projects...

The PFC enabling legislation clearly specifies that public authorities may impose such a charge. The legality of a PFC imposed by a private operator is uncertain.²⁴ It might be possible, however, to use some form of cooperative arrangement between a public authority and a private developer.

c. Airport and Airway Improvement Act of 1982

The Airport and Airway Improvement Act contains a range of clauses and grant assurances that would affect airport privatization. The sections discussed here would affect airports that have received AIP grants. A new airport, if developed without AIP grants, would not have to meet these requirements. An existing airport might be able to repay the AIP grant to avoid the AIP requirements.²⁵

²⁴ Although Section 1113 explicitly pertains to state taxation of air commerce, the clause is expanded to include subdivisions of a state, or authorities acting for a state or subdivision of a state. This might be applied to a private operator serving as an agent for the state.

²⁵ It is unclear what basis would be used to determine the AIP grant repayment. Conceivably, the grant repayment could be based on either (1) the original grant, (2) the original grant plus interest, or (3) the depreciated value of facilities constructed with the grant, times the ratio of the grant to total project costs. The valuation method used could have a considerable impact on the feasibility of privatization.

1) Section 511 Project Sponsorship

(a)(1) The airport to that the project relates will be available for public use on fair and reasonable terms and without unjust discrimination, including the requirement that (A) each air carrier using such airport shall be subject to such non-discriminatory and substantially comparable rates, fees, rentals and other charges... as are applicable to all such air carriers...

The requirement that airport facilities be available for public use on a fair and reasonable basis is intended to ensure equal access to airport facilities by all competing airlines. Such "fair and reasonable" provisions are typical of federal grant capital assistance programs, and they ensure that federal funds are used for the broader public benefit. Although Section 511(a)(1) does make allowance for different classifications, such as tenant and non-tenant, it limits contractual flexibility and may prevent mutually beneficial arrangements between the private developer and air carriers, particularly if the air carrier is a direct (not leasehold) investor in the airport. This could expose the airport developer and investors to a confusing and economically damaging review of the rates and charges structure.

These provisions establish many of the economic criteria for managing an airport. These existing statutory standards can be enforced against an airport proprietor only if the FAA staff agrees that some aggrieved party has a valid complaint and if the FAA receives permission from DOT and/or Justice Department to take enforcement, funds-withholding or court action against the offending proprietor. Since these decisions to act are subject to extraneous considerations such as FAA staffing shortages, DOT policy and/or political oversight and similar DOJ considerations, the idea that an aggrieved party can bring a direct cause of action in federal district court will be appealing to airport users and neighbors.

(a)(2) there will be no exclusive right for the use of the airport by any person providing, or intending to provide, aeronautical services to the public...

This clause is similar to Section 308 of the Federal Aviation Act of 1958.

(a)(5) appropriate action, including the adoption of zoning laws, has been, or will be taken, to the extent reasonable, to restrict the use of land adjacent to or in the immediate vicinity of the airport to activities and purposes compatible with normal aircraft operations, including the landing and takeoff of aircraft;

To satisfy this assurance, the airport operator would either need to control the land within the immediate vicinity of the airport, or have the cooperation of the local government.

²⁶ "Airport" means any area of land or water that is used, or intended for use, for landing and takeoff of aircraft, and any appurtenant areas that are used, or intended for use, for airport buildings or other airport facilities or rights-of-way, together with all airport buildings and facilities located thereon. "Public airport" means any airport that is used or to be used for public purposes, under the control of a public agency, the landing area of that is publicly owned.

(a)(12) all revenues generated by the airport, if it is a public airport,²⁶ and any local taxes on aviation fuel... will be expended for the capital and operating costs of the airport, the local airport system or other local facilities that 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...

This clause is currently somewhat controversial, and the final interpretation will have a major impact on the feasibility of privatization. Commercial and general aviators have interpreted this clause to minimize airport costs by keeping return on investment (ROI) calculations out of the rate-making base, and by attempting to channel airport-related revenues into the airport. These users have also argued that selling an airport to a private entity is a "decapitalization" of the airport and should be prohibited under this (a)(12). One of these users' primary concerns is that the costs associated with transferring the airport would not be offset by any added efficiency brought by a private owner and could possibly lead to higher fees.

In contrast, some communities and private airport managers have taken a more liberal interpretation of the clause, arguing that, in cases where the communities or private operators have made an investment in the airport, this investment carried a certain cost, which should be allowable under (a)(12).²⁷ Similarly, repayment of this investment (plus a reasonable return) could be viewed as repayment of an airport's cost.

In some respects, the language of Section 511(a)(12) is fairly clear. It would not apply to constrain the profits of a private airport owner because by its terms it only applies to "public airports," i.e., airports "under the control of a public agency." Section 511(a)(12) is directed exclusively at municipal airport owners. Hence, the FAA has allowed private contract operators to earn a reasonable profit under long-term lease-management contracts at a number of publicly owned airports. In a recent legal opinion to the FAA, the Department of Justice has further sanctioned the recovery of lease payments by municipalities out of airport revenue. Moreover, private operation of these airports has not prevented the airports from receiving federal AIP grants for airport improvement. The legislative history to Section 511(a)(12) suggests that the section would not prohibit an airport sale.²⁸

It is unclear what the FAA's position would be on airport privatization. If the airport were developed without the assistance of AIP funds, FAA would have no control over the financial aspects of landside development, although punitive delays in permitting and regulatory clearances would still be possible if the agency were hostile to privatization. There is no reason, however, to think it would be. In the past, FAA has publicly supported private development (or at least "significant" private involvement) in the development of new airport facilities.

²⁷ For example, funds invested in the airport could have been used to amortize existing debt.

²⁸ A recent opinion of the Office of Legal Council at the Department of Justice provided to the DOT General Counsel does not dispute Albany County's right to use the proceeds from the proposed sale of their airport off airport. FAA, however, has not responded to Albany County.

(c) CONSULTATION—In making a decision to undertake any airport development project under this title, each sponsor of an airport shall undertake reasonable consultations with affected parties using the airport at that such project is proposed.

2) Section 515 — Performance of Construction Work

(a) REGULATIONS—The construction work on any project for airport development contained in an approved project grant application submitted in accordance with this title shall be subject to inspection and approval...

(b) MINIMUM RATES OF WAGE—All contracts in excess of \$2,000 for work on projects for airport development approved under this title that involve labor shall contain provisions establishing minimum rates of wages, to be predetermined by the Secretary of Labor, in accordance with the Davis-Bacon Act...

d. Antitrust Considerations

Airports today are subject to the controls of the United States antitrust laws, but those limitations are usually somewhat muted because the airport proprietor/sponsor is usually an entity that qualifies for the more limited exposure of the Local Government Antitrust Act, 15 United States Code §35. While anti-competitive practices are still subject to substantial civil and criminal risks, a proprietor that acts reasonably is not likely to be the subject of such litigation.

Under a *purely* privatized regime, the non-governmental entity will have to be more careful of the requirements of the Sherman Act, for the exceptions of the Local Government Antitrust Act will probably not apply. Under such additional scrutiny, the private proprietor will have to be more careful about issues of access, rates and charges and other practical terms that affect competition at the airport. For example, the private proprietor will have to develop significant financial and economic rationale in order to grant one tenant a better deal than another.

There may be options that will shelter the private proprietor from the full impact of the Sherman Act. The success of such options will clearly depend upon the degree of review that the government can and does exercise over decisions concerning the airport.

e. Sovereign Immunity

A potential concern in airport privatization is the possible loss of "sovereign immunity." In many jurisdictions, the airport is considered to be a governmental unit and is not liable for actions deemed to be governmental functions. This results in reduced liability exposure. A possible consequence of privatization, however, will likely be the loss of sovereign immunity protection where it now exists. It is possible, however, that through legislative action or the careful combination of privatization and citizen participation, the airport may be able to maintain the sovereign immunity shield.

f. Other Legal Issues

Due to limitations on the scope and scale of this paper, all of the relevant legal issues and legislation could not be examined. Additional issues that could influence privatization include:

- Local Approval
- Good Title
- Preserving Rights and Powers
- Responsibility and Authority of Sponsor
- Consistency with Local Plans
- Consideration of Local Interest
- Public Hearings
- Air and Water Quality Standards
- Consultation with Users
- Terminal Development Prerequisites
- Civil Rights
- Audit and Recordkeeping Requirements
- Planning Projects
- Accounting System
- Operations and Maintenance
- Hazard Removal and Mitigation
- Compatible Land Use
- Land for Federal Facilities
- Airport Layout Plan
- Reports and Inspections
- Use by Government Aircraft

Some of the additional laws and regulations that could influence airport privatization include:

- Federal Fair Labor Standards Act of 1938
- National Historic Preservation Act of 1968
- Archeological and Historic Preservation Act of 1974
- Flood Disaster Protection Act of 1973
- Aviation Safety and Noise Abatement Act of 1979
- Age Discrimination Act of 1975
- Architectural Barriers Act of 1968
- Powerplant and Industrial Fund Use Act of 1978
- Contract Work Hours and Safety Standards Act
- Copeland Anti-Kick Back Act National Environmental Policy Act of 1969
- Endangered Species Act of 1973
- Single Audit Act of 1989
- OMB Circulars

g. Safety

Aviation safety has numerous components, including safe operation of aircraft in the airways and on the ground, safe movement of passengers and workers in the several airport environments, secure processing and passage of people and things through the aviation network and coordination of these systems to assure the highest possible degree of safety. Because the national aviation system, from its inception, has highlighted this goal as paramount, and passengers and shippers have responded with their trust and patronage, any airport ownership/management arrangement must be held to the same stringent standard as are today's airports. This would require the FAA to clearly define the relationship and responsibilities that would exist among the parties, including the federal and local governments, airport authorities, contractors and private corporations. To the extent that some airports and towers are owned and operated by private entities and that they function safely today as a part of the national airport system, these parties already have experience to draw from. Of course, there are numerous examples, some explored in Chapter II, of airports where some or all operations are managed by a corporation under contract to the airport. In addition, it will not be in anyone's interest to diminish the standards of safe operation. To be sure, the local decisionmakers must recognize FAA's continuing preeminent authority in safety/security matters. Also, the federal government must use its authority to provide clear and prompt direction to all parties as airport ownership/management evolves.

h. Noise

Airport noise creates one of the greatest barriers to airport development, public or private. Although a public airport presents more opportunities for an opposition group to voice its opinion and to erect legal roadblocks, a privately developed airport would also be subject to environmental and land use permits that are subject to hearing processes and legal challenges.

There is reason to believe that a public-private airport could handle noise mitigation as effectively as a public airport. In England, BAA has implemented a system of noise-related surcharges and rebates. Despite sharp increases in traffic, the size of the area that is adversely impacted by noise has substantially decreased. At Burbank Airport, operated under contract by Lockheed Air Terminal, noise mitigation programs have also been successfully advanced. Moreover, future public-private airports should be eligible for AIP noise mitigation grants.

An additional factor that could further minimize the risks of a hostile community reaction is that a new, privately developed airport, particularly a wayport or cargo facility, could be developed in a remote or economically depressed area. In such a case, land condemnation and relocation issues would be less pressing than in a facility located close to an urban center. Finally, if other options are insufficient to obtain public support, there is apparently nothing to prevent a private airport developer from directly compensating existing residents for noise impacts.²⁹

i. Liability and Insurance

Whether the airport is owned and operated publicly or privately will not change the airport operator's attention to the effective management of the liability and insurance issues. The potential

²⁹ The economics of this idea, however, may make it impractical in many instances.

liability for catastrophic accidents, environmental clean-up and numerous small accidents, as well as the cost of managing and avoiding these risks, is obviously substantial. A number of issues, however, may factor into the decision to embrace privatization.

In many jurisdictions, the municipal owner and operator of an airport enjoys immunity from lawsuits based on allegations of an airport operator's negligence. The immunity is generally provided for governmental functions by the public airport owner-operator. Privatization of the airport operations will eliminate this immunity from liability.

Moreover, the cost of liability insurance may change with the change in ownership and control over certain parts of the operation. For example, insurance rates for a municipality's ownership and operation of an airport may be lower, simply because a greater volume of coverage is being purchased for all the municipality's risks.

j. Citizen Participation

One of the most difficult privatization concepts for many of the current public owners and operators of airports to accept is loss of control by the public. Citizen participation in the decision to privatize the airport as well as institutionalizing citizen participation in future decisions by the airport will minimize the perception that the public is losing control.³⁰ Even more significantly, providing citizens an opportunity to participate in decisions affecting the airport will enhance the airport's ability to work with local governments, which in turn make decisions affecting the airport. There are numerous examples of local citizens organizations and local governments taking action, which creates obstacles to the airport and that cost the airport money. The most prominent examples relate to expansion and noise. There are a number of ways in that to provide for citizen participation, including the formation of a citizens advisory board, naming activist citizens or elected officials to the board of directors and holding regular meetings with local civic or government organizations and committees. Each community is different and the form of citizen participation will be a reflection of each community. However, the key in every instance is formal access and genuine attention to the issues raised by the public.

A deliberate effort should be made to provide for citizen participation, both in the debate about the decision to privatize and future decisions affecting the community. A reasonable amount of time invested on this issue in the beginning will pay large dividends when problems arise—and there will be problems.

k. Dispute Resolution

³⁰ Privatized airports may also be less subject to input from concessionaires and airline tenants. To the extent that this results in more autocratic, less equitable decisionmaking, this may be seen as a "cost" of privatization. Some level of public/tenant participation may be required in the terms of transfer.

Corporations traditionally have found that forms of dispute resolution other than the courts are more efficient. Alternative dispute resolution programs are well established. However, since each jurisdiction has had different experiences with and opportunities for alternative dispute resolution methods, addressing this matter with appropriate representatives of the local bar should provide additional guidance.

Construction contracts typically contain arbitration provisions prescribing a method for resolving disputes arising under the contract. Contracts with vendors or other entities may also contain similar provisions providing the opportunity for or even requiring a system for resolving disputes other than the courts. Reference should be made to the type of contract language establishing alternative dispute resolution methods that the courts have approved in each particular jurisdiction.

1. Economic Regulation of the Private Owner/Operator

One of the concerns about the private development or operation of an airport is that the private operator might abuse its position by setting excessive rates and charges. Public airport authorities generally lack incentives for monopoly pricing and are subject to several factors that limit pricing flexibility. These include:

- AIP grant assurances that all revenues generated by an airport must be used for improvements or operations of the airport³¹
- AIP grant assurances that prohibit discriminatory charges
- Long-term agreements with airlines that limit (in a variety of ways) the airport's flexibility in setting rates and charges
- Competition with other airports for airline traffic

Private airport development without AIP funding would face only the last two limitations on rates and charges and would have a direct incentive to maximize profits. Therefore, a legitimate risk exists for monopoly pricing by an unregulated developer, and it is important that the need for regulation, and possible types of regulation, be considered during the assessment process.

Factors that influence the need for regulation include:

- and
- Traffic composition (O&D traffic faces lower levels of competition than hubbing traffic)
 - Level of competition from existing airports

Airports can be economically regulated in two basic ways: through limitations on rates and charges, or through limitations on profits (returns to equity or returns to total employed capital, that

³¹ Several airports are exempt from the prohibition of using airport revenues off-airport. These airports include facilities that are part of multi-modal transportation authorities with consolidated bonds.

includes debt and equity). Limiting rates is intended to protect users from discriminatory or monopolistic price-gouging. Limiting profits is often seen as the *quid pro quo* for governmental protection of an enterprise's monopoly status. However, both types of regulation are related, since limiting rates and charges puts an indirect limit on profits, while limiting profits or returns to capital places an indirect limit on rates.

Both types of regulation have advantages and disadvantages. Limiting rates encourages aggressive cost controls and marketing but provides the airport developer with little recourse if demand falls. It also requires adjustment as costs and market conditions change, and rate hearings can be costly and adversarial.

Limiting profits, on the other hand, gives the airport developer the freedom to set rates and adjust service levels to provide the best protection for lenders and equity investors, but it also provides far less incentive to reduce costs and attract business once the facility has reached the profitability limit. In addition, it creates difficulty finding the right limit on profits to attract investors while preventing public outcry over government protection of a private profit.

In developing a regulatory mechanism for private development/operation of an airport, it is important to work closely with the private sector to ensure that the regulatory mechanism meets the private sector's needs and concerns while protecting the public welfare. Ideally, the regulatory framework will provide:

- A predictable operating environment for the private operator and investors
- Economic incentives to the private developer for efficient operation of the facility
- Sufficient flexibility to respond to changes in market demand or economic conditions
- Effective limits on monopoly pricing.

In addition to decisions on these aspects of regulation, it is also necessary to decide how the private sector will be regulated (either through ongoing regulation by a commission, or an "autopilot" mechanism in the franchise agreement). Most investor-owned utilities are considered natural monopolies (because they face decreasing marginal costs) and are regulated by state public utility commissions (PUCs). These commissions are charged with ensuring that investor-owned utilities provide adequate service at the lowest price that compensates them for the direct cost of operations and capital. Most PUCs use rate of return regulation (limits on profits), while a few have begun to use "price cap" regulation, that places few limits on profitability but does put a ceiling on rates. PUCs usually have an appointed commission and permanent staff who are responsible for monitoring the profitability and pricing of the utility and a commission membership that approves all rates and service changes.

For example, at the British Airports Authority (BAA), airside charges are regulated under a Rate Plus Inflation system (RPI). Under RPI, BAA is allowed to increase its aeronautical charges in proportion to inflation. Although the original rate setting was based on the inflation rate minus 1 percent, recent rate hearings have proposed to adjust this to RPI minus 4 or even 8 percent. Although the RPI scheme is applying downward pressures to aeronautical rates, many airport users charge that BAA's flexibility in setting non-aeronautical rates has been abused, leading to monopolistic groundside prices.

In newly emerging transportation projects, such as the private toll roads in California, continuous PUC oversight is being replaced by a long-term franchise agreement. Because the franchise agreement contains all of the financial and economic contract provisions under that the franchise will operate, little or no need exists for regular revisiting of rates or profits. In the California case, the agreement includes a limit on returns to total employed capital (equity and debt), plus efficiency incentives, but no limit on toll rates. With the economic regulation running on autopilot, the agreement can be managed on the public side by a state department of transportation without the involvement of a PUC.

m. Bankruptcy

Another concern that arises from turning over all or part of the operation of an airport to a private operator is the danger that the operator may encounter financial difficulties and seek bankruptcy protection. A bankruptcy filing triggers provisions of the Bankruptcy Code that may or may not be applied in a manner that is consistent with the interests of the community served by the airport.

Under the code, the bankruptcy court will assume supervisory jurisdiction over all but the most routine activities of the debtor operator and has broad powers to take such actions as are "necessary and appropriate" to carry out the provisions of the code. In taking those actions, the court will weigh input from a variety of interests—the debtor itself, unsecured creditors, secured creditors, employees, commercial partners and others. Those interests are invariably in conflict to some degree. There is certainly no assurance that they are parallel with the interests of the community.

Take, for example, a case where the private operator in a "government ownership, private management" situation files under Chapter 11 (reorganization) of the code. The filing triggers the "automatic stay" under Section 362 of the code that, essentially, prevents parties (unless they obtain court approval) from taking most actions that would be adverse to the interests of the debtor, such as perfecting liens, terminating contracts, enforcing judgments or taking possession of property. This protection is not necessarily bad for the community, as the continued viability of the operator is, presumably, consistent with the community's interests. If, however, the quality of the operator's performance under an agreement with the community were to deteriorate—as can occur following a bankruptcy filing—the community's ability to substitute a new operator could be severely restricted by Section 362.

The filing also triggers the applicability of Section 365 of the code, which allows the debtor (subject to court approval) to "assume" (i.e., to elect to continue in effect) or "reject" (i.e., to terminate) any "executory contract or unexpired lease" to which the debtor is a party. Under this section, therefore, the debtor operator could, conceivably, decide to reject its lease from the owner of the airport or its management agreement, or its agreements with other parties, such as suppliers and subcontractors, that are integral to the operation of a full service airport.

As a practical matter, the debtor is generally unlikely to reject a contract, such as a management agreement, that brings it substantial revenues. However, it may seek to use the leverage provided by Section 365 to negotiate more attractive terms for those contracts and leases under which it is the payor. Even if the operator wanted to "assume" all of its agreement, the operator's creditors

could object to the costs involved in doing so ("assuming" an executory contract or unexpired lease requires curing the related defaults and providing assurances of future performance). Or, the creditors might decide that they are better served by an outright liquidation of the operator's assets than by attempting a risky reorganization. Suffice it to say, when an operator goes into bankruptcy, the community must be prepared to devote substantial time and close attention (not to mention legal expenses) to ensure that the disruption of airport activities and the airport budget is kept to a minimum.

3. Impact on Parties of Interest

a. Effect on Airlines

Airlines are capital-intensive ventures that operate on extremely thin margins. But, unlike most other capital-intensive businesses, the majority of the airlines' assets are relatively portable. Thus, airlines have some degree of latitude in redeploying assets in order to garner return on investment.

It is also important to understand that half of all airline passengers are leisure travelers, not business travelers. Thus, there is a significant degree of elasticity in the demand for air travel. Airlines have found that for every 1 percent increase in price, there is a 0.5 percent to 0.7 percent decrease in traffic. Airline understanding of this elasticity is used in virtually every aspect of ticket pricing.

In a privatized environment that results in revenue diversion from the airport, any increased costs for airlines operating to a particular destination will be reflected by the carriers in different ways. Major cost increases at a connecting airport might be passed on only to travelers beginning or ending their trips at the hub. Cost increases at an origin and destination airport with relatively high yields might result in reduced flight frequencies. In this case, the airline would effectively increase its load factor and yield by serving the community with fewer flights to minimize the impact of the cost increases.

While airlines and their passengers would respond in many ways, it is important to bear in mind that the elasticity of demand applicable to air transportation also will be reflected in concession and parking revenues, airport-based employment, and local tax collections. Thus, the cost impact of a privatization or revenue diversion proposal will be borne by a large number of citizens who derive income from airport-related activities. Another impact on airlines, and a crucial consideration for local government authorities in analyzing privatization proposals, is the inherent conflict of interest between airport users and shareholders as far as investment in new capacity and efficiency is concerned. At a private airport, shareholders might benefit more through the use of the facility for non-aviation ventures that have a greater return on investment. Airlines, on the other hand, benefit most from the use of the facility for air transportation. For example, the use of capital for the construction of a shopping mall on airport premises might generate greater revenues for shareholders than the construction of an additional runway. The installation of high-speed moving sidewalks improves airline efficiency at the expense of the concession revenues generated by delays in passengers moving through retail concourses.

b. Effect on the Service Area

In addition to the impact privatization would have on the air carriers is the impact on the air service area. Besides the sale price itself, one of the primary benefits that would accrue to the air service area from a private ownership structure is the fact that a private owner would be required to pay taxes on the airport franchise. As a result, both the state and local community would benefit from the fact that the private owner would be paying property taxes and corporate income taxes on the airport's operations.

Residents of the air service area that utilize the airport would also likely be affected. The nature and magnitude of this impact would be a function of how the private airport operator is able to offset the additional costs associated with private ownership relative to public ownership. To the extent that the additional capital costs inherent to privatization can be offset by operating efficiencies, the impact on the air service area may be minimal. Passengers would not experience additional costs as a result of private ownership and may even receive some positive benefits as a result of a more efficient airport operation, improved concession operations and other amenities.

On the other hand, if the costs associated with the private capital structure are paid for through revenue enhancement measures, these increases would ultimately be born by the users of the airport facility—the passengers. This could take the form of increases in air fare costs (as the airlines pass through their increased costs of operating at the airport) or as increases in other costs, such as parking fees, ground access fees, etc. To the extent that the majority of an airport's traffic is O&D and not connecting traffic, these cost increases would be borne by the local community. In addition, a community could also experience a reduction of air service at the airport if airline yields decline. This would have negative repercussions throughout the community and would act as a disincentive for corporations looking to locate in the community.

As a result, it is important to note that while the decision to sell an airport to a private owner may provide some near-term financial benefit to the municipal owner, certain policy issues must also be considered, including the impact on the local community and who would bear the brunt of a potentially increased cost structure.

c. Impact on General Aviation

The effect of privatization on general aviation will depend on a variety of factors peculiar to each airport. Among these are the relative size of the air carrier and GA operations; the amount of airside congestion; the adequacy of pre-existing GA facilities, and the contractual arrangement with FBOs and others that govern GA operations. An airport that is privately managed will tend to see GA users from the same perspective as it looks at other aspects of the operation—profit maximization. This can mean either a better or worse environment for GA, depending on how much the policies or the public operator departed from marketplace considerations.

For example:

- If the airport is a large, congested air carrier facility, the private operator may want to give preference to air carrier operations because they create a higher level of facility utilization and generate greater concession revenues. This could be reflected in higher landing fees and other

charges to GA users. DOT made clear in the Massport case that there are limits to how far the airport can go without unlawfully discriminating against small users, but this still leaves room for the private operator to create an environment that discourages GA usage.

- A private operator may not want to discourage GA operations but may conclude that higher revenues can be extracted from GA. Fuel charges and other concession prices to GA might be forced up through pressure on FBOs, corporate facilities and concessionaires, pressure that was not practical in a more public environment. Here, also, there are limits to what a private operator can do. Pre-existing contracts with the airport may give some protection to FBOs and other leaseholders, depending on contract duration and other terms. Competition from other GA airports in the vicinity may also provide a measure of protection to GA operators against excessive charges. However, when a single entity controls all the airports in a region, strong economic pressure can be applied, requiring GA operators to either pay higher charges or use secondary airports.

- A private operator that wants to develop GA business has a greater incentive to attract GA operations by upgrading the quality of facilities and services offered to GA users. This may include financing better facilities for the FBOs and other GA concessionaires and attracting newer, more aggressive GA service providers to the airport.

d. Impact on Concessionaires

Landside concessions at a public airport (e.g., food, beverage and other retail establishments, ground transportation, car rentals and parking) are among the most likely initial prospects for privatization. The new Pittsburgh terminal, for example, has contracted out its retail concession package to the British Airports Authority, which will operate and manage that package much as a private shopping center. From the standpoint of the individual retailer, it will be the BAA and not the airport proprietor in control. The airport receives a guaranteed return and a percentage of profits, if any. The BAA takes the risk of the private marketplace but will also be in a position to reap substantial rewards, provided that the underlying retail concessions succeed.

From the standpoint of the landside concessionaires, privatization creates a situation similar—if not identical—to a typical shopping center development. The benefits and disadvantages of the private shopping center model vis-a-vis the public facility model are difficult to predict, given the many variables, but the areas of concern can be isolated.

Access to the facility by concessionaires is, and undoubtedly will remain, a primary area of contention. A public facility arguably has greater leeway in denying or limiting access by concessionaires. With a fair degree of immunity from the antitrust laws, and given the limited scope of the equal access and related provisions of other federal laws, the public airport proprietor, at the very least, has less explaining to do with regard to the concessions it grants or denies on the airport property. At the same time, however, the political process at a public facility generally gives concessionaires more input than they would have in the shopping center model.

The rentals, fees and other charges paid by concessionaires under either model may also be a concern. A business-oriented public airport will approach concessionaires in about the same way as a private business. However, if arrangements with concessionaires do not reflect market conditions, existing concessionaires may face "sticker shock" when the private owner proposes a new contract.

On the other hand, private ownership may be more aggressive in finding ways to draw potential customers through the airport, creating a more profitable environment for all concessionaires.

IV. ALTERNATIVE APPROACHES

A. Overview

In previous sections of this study, we have described several forms of airport privatization that exist today. After that, we discussed a number of issues, primarily economic and legal, that need to be explored by any airport executive or other local leader if they are considering privatization or a move toward greater private involvement in airport operations. This section of the study does not endorse privatization nor does it prescribe an ideal airport management structure. It does look at the varieties of airport ownership-management arrangements and asks what are the best aspects of each that could be used to improve upon where we are today.

B. Lessons from Other Hybrid Management Structures

Several economic and organizational structures might provide insight and edification for airport executives interested in how other industries deal with questions similar to those this study addresses. They include: Fannie Mae, SR91 Tollway in California, Joint Development Transit Station and Spaceport Florida. As indicated in the preface, it might be worthwhile to explore these in a subsequent study.

C. Goals of a Hybrid Management Structure

There is a prevailing sense among a segment of airport executives that they are limited in carrying out their duties by a variety of political influences and governmental procedures that have little to do with the efficient functioning of an airport. Similarly, many local officials view their airports as great fiscal resources kept purposely from their grasp by federal restrictions. Listed below are some of the objectives that these two groups might share in developing a hybrid management structure.

1. Improve efficiency of operations to enhance service to users and the community.

Airport executives frequently cite three factors that affect their efficiency of operations and customer service: government procurement rules, government employment rules, and a lack of direct financial incentive for improving efficiency. Private operation could overcome these difficulties in some circumstances by eliminating the need to use cumbersome procurement rules, by giving greater freedom to hire and fire and by giving greater freedom to set salaries and pay high rewards for superior performances.

2. Strike a proper balance between local oversight and professional management.

The business-government relationship in a privatized airport is defined by the written contract, franchise or lease agreements entered into as a part of the privatization process. The presumption is that by limiting local government involvement to the receipt of lease payments or other financial participation prescribed in the public-

private agreement, airport executives would enjoy enhanced freedom to develop and operate the airport in the most economical fashion.

3. Contribute to the relief of local government fiscal distress.

An airport is often the largest single enterprise (in terms of book value, employment and revenues) in a local government jurisdiction. Its absence from the tax base or lack of any other means of contributing directly to the local treasury (notwithstanding general support of the local economy) is often viewed as unfair by local officials. If all or part of the facility and operations were genuinely in private hands, the city or county could expect much-needed tax payments and perhaps an up-front payment and a share of future revenues, paid for by airport users.

4. Maintain availability of federal funds and tax-exempt financing for airport use.

Federal grants and tax-exemption of interest payments on debt are federal subsidies that either reduce the cost to users or give more room for payments to local government. While they come with significant strings attached and limits on private ownership, they are the lifeblood of small, medium-sized and many large airports. Keeping them means a good deal more financial breathing room for airport management, while their loss may mean a net loss to the local economy from privatization (vis-a-vis government ownership).

5. Introduce equity financing to airport capital projects.

Equity financing could give some airports more flexibility in developing new projects and commercializing their operations. With enough "upside" potential, equity financing can be much more patient than debt, perhaps giving some airport managers the leeway they need to develop and operate some airports in an entrepreneurial fashion.

6. Structure ownership and management to reduce risks and thereby minimize any differences between debt and equity financing.

It is hard to argue for privatization if there is a genuine loss in financial risk efficiency (in terms of placing different types of risks on those who are most efficient at bearing them). Such loss would be reflected in a higher cost of equity relative to debt financing (tax consequences aside). An ideal public-private structure would carefully and efficiently allocate these risks.

7. Maintain a motivated management team and labor force.

Motivation is a product of pride in operation and financial incentives. To the extent that government ownership somehow interferes with a "can-do" attitude among the workforce or limits management in its ability to reward (or be rewarded for) superior performance, privatization may have something to offer.

8. Provide opportunity for local citizens to be equity partners.

Local citizens may be owners of an airport, but not directly. However, privatization could conceivably take "investing in the community" to the literal extreme by allowing citizens to buy (perhaps at a discount) shares in the local airport.

9. Assure adequate but not excessive rate of return for lenders and stockholders.

Investors need to be compensated for the risks they take in financing a project. In many government-owned airport projects, taxpayers take these same risks without being conscious of them, but they still have a cost. Shifting to privatization means that the risks are now exposed and valued, but the government should see that the accompanying compensation is reasonable. Specifically, the private investor must be allowed enough "upside" potential to offset the possible negative outcomes for the investment, with the actual return expected to fall somewhere in between.

D. Current Airport Authority Models

Public use airports in the United States are owned and operated under a variety of organizational and jurisdictional arrangements. Commercial service airports may be owned and operated by a city, county or state, or by more than one jurisdiction (e.g., a joint city and county operation). In some cases, a commercial airport is owned by one or more of these governmental entities but operated by a separate public body, such as an airport authority specifically created for the purpose of managing the airport. Regardless of ownership, legal responsibility for day-to-day operation and management can be vested in any of three kinds of governmental or public entities: (1) a municipal, county or state government; (2) a multi-purpose port authority, or (3) an independent airport authority.

A typical municipally operated airport is city owned and run as a department of the city with policy direction by the city council and, in some cases, by a separate airport commission or advisory board. Under this type of public operation, airport policy decisions are generally made in the broader context of city or countywide public investment needs, budgetary constraints and development goals.

Port authorities are legally chartered institutions with the status of public corporations that operate a variety of publicly owned facilities, such as airports, harbors, toll roads and bridges. In managing the properties under their jurisdiction, port authorities have extensive independence from state and local governments. Their financial independence rests largely on the power to issue their own debt, in the form of revenue bonds, and on the breadth of their revenue bases. In addition, some port authorities have the power to tax within their port jurisdiction.

Similar in structure and in legal charter to port authorities, single purpose airport authorities also have considerable independence from state or local governments. Like multi-purpose port authorities, airport authorities have the power to issue their own debt for financing capital development. Airport authorities, however, must rely on a much narrower base of revenue than port authorities to run a financially self-sustaining operation.

Since the 1950s, there has been a gradual and steady transition from city- and county-controlled airports to the independent single or multi-purpose authorities even though the predominant form of operation is still municipal, particularly for the smaller commercial and general aviation airports. The reasons for this evolution are:

- Many airport service areas have outgrown the political jurisdiction responsible for the airport. In some of these cases, the tax liability of the airport is limited to a rather specific area, so the creation of an authority to spread the economic support for the airport over the entire service area may be recommended. By distributing the financial base of support for the airport, more equitable treatment of individual taxpayers can occur and the taxpayers supporting the airport are more often the actual users of the facility.
- Independent airport authorities allow the governing board to concentrate resources and specialize in airport matters. This in turn allows local governments to focus their energies and increasingly limited resources on more traditional government services.
- Airport authorities may provide greater efficiency of operation and economies of scale, particularly when several political jurisdictions choose to combine airport responsibilities under one board.
- Authorities permit management to assess rates and charges to users that are generally unclouded by non-airport costs. Moreover, there usually is less political impact on the business of running the airport under an independent authority.³²

While not the model for every community, the creation of a quasi-governmental authority for the management of airports is one potential solution to the problems identified within this report. Airport authorities have been viewed favorably by airlines and communities when the existing management has difficulties developing capital for airport expansion and modernization (the Washington, D.C.-area airports), or when the community has severe fiscal problems and would like to capitalize on the airport's wealth (Philadelphia).

In the case of Washington National and Dulles airports, the federal government owned and operated the airports but was consistently unable to finance the necessary improvements that would keep the airports competitive. After much deliberation, Congress turned the airports over to the Metropolitan Washington Airports Authority, which represents and interests of the states of Virginia and Maryland and the District of Columbia, while also retaining a congressional voice in the management of the airports. The desired effect—large-scale investment in the airports—has started to become reality.

Philadelphia International Airport is faced with a double-barreled problem: The city, which owns and operates the airport, is in such dire financial straits that the airport's credit rating is suffering. Added to that are the desires of the city management to remove money from the airport in order

³² Authorities are usually designed to minimize parochial political influences that can interfere with sound business operations. Many authorities, however, like other forms of government ownership, experience fluctuations in political influence depending on changes in leadership and community attitudes.

to partially relieve the city budgetary pressures. The airport management, airlines and city fathers are working together to resolve these problems by creating an authority which, as one of its first acts, will transfer a payment to the city representing its unreimbursed investment in the facility over its history.

E. How Alternative Management Structures Address These Goals

The idea of a hybrid structure is to blend together those parts of the traditional and privatization structures in a way that best achieves the objectives listed above. Listed below are alternative ways of writing the recipe.

1. Lease-Operate

In this structure, public ownership of all assets is maintained, but most operating control and development authority is effectively relinquished to a private entity via a lease with the airport authority board. The leases can be unified or separated for major portions of the airport, with more flexible leases governing the portions of the airport with the greatest commercial potential or revenues that can be sent downtown in lieu of taxes.

This model has been proposed for at least two medium-sized American airports: Albany, New York, and Peoria, Illinois. It is the least disruptive of the three models discussed here as applied to existing airports. It preserves a high degree of public control, reduces or eliminates employment and procurement restrictions, financially encourages operating efficiencies and should preserve access to AIP grants, although the long-term nature of the lease could conceivably jeopardize tax exemption of the interest on debt.

It fails to achieve all the objectives by making it somewhat more difficult (but not impossible) to infuse equity into facility financing and by continuing to keep all of the airport out of the local tax base (aside from privately owned facilities built on leased airport land), and does not readily lend itself to citizen investment.

2. Commercialization of Landside Operations

Under this model, the airport is divided into physical portions roughly corresponding to landside and airside operations. The objective is to privatize (sell) those facilities and operations with the greatest commercial potential and/or those that would suffer the least from loss of federal grants or tax-exempt debt availability.

The airside remains strictly in public hands and (presumably, but not indisputably) eligible for federal grants and tax-exempt financing. The landside is established as a separate private corporation geographically located next to the airside. Overall policy is set by a combined public and private board, governed by a public-private franchise agreement. Depending upon how tax law restricts contract management of the airside, the landside owner may be given a long-term or short-term management contract of the airside. Only the landside is included in the tax base. Developable land around the airport is either sold or leased to the private firm, depending on how it was acquired.

This model meets many of the objectives listed above by focusing privatization on those operations that are both relatively labor-intensive (where management, employment, and procurement efficiencies are likely to show the greatest impact) and have the highest potential for commercialization. Tax-exempt debt and access to AIP grants are presumably maintained for the most capital-intensive and least commercializeable portions of the airport, although the uncertainty of this point is the primary drawback to this divided-facility model.

3. Full Private Ownership

Full private ownership of land and facilities is the simplest of the privatization structures and is most easily accomplished for a new airport, where any efficiencies in land acquisition (e.g., donations), land use synergies with surrounding development opportunities, design and construction may be able to offset at least part of the grants and tax-exemption of debt foregone by private ownership. (Although it is not entirely clear that a privately developed airport would not be eligible for AIP grants, a public authority would be required to receive the grants and ensure that the private entity adhered to the grant strictures.) Debt financing could be done via taxable municipal securities, unless this interfered with the depreciation of the asset for tax purposes. All assets would be included in the tax base.

Full private ownership achieves complete freedom in procurement, employment and compensation practices, and commercialization. It gives nearly complete freedom (within the limits of safety and local land-use planning) in facility design and construction. It also allows clear access to accelerated depreciation for tax purposes and avoids (to the extent that it does not receive AIP grants) federal regulations restricting use of airport funds. Finally, the internal operations of the airport are free from political interference except to the extent that all businesses perceived as "public utilities" are subject to political intrusions.

The primary downside of the full privatization model is that—because of the complete loss of access to tax-exempt debt—its average cost of capital is likely to be significantly higher than under any of the other models listed above, perhaps enough to drive airline user costs beyond the competitive range, despite other efficiencies.

F. Blending the Alternatives

A state statute could be adopted that would authorize a local airport authority to exercise the following powers:

- The authority would be comprised of several members, similar to authorities existing today, but this new authority membership would emphasize business/management skills.
- The authority would serve as airport sponsor for all federal grants, PFCs and other purposes.
- The airport authority would act as the financially responsible party for all debt instruments, thereby maintaining currently available tax exempt status.
- The authority would purchase from the local government or current owner all airport land and improvements.

- The authority would contract with a private management company to manage all aspects of the airport.
- The airport authority would regulate the company's rate of return.
- The authority would provide oversight and review of complaints regarding discrimination, pricing, access and other necessary areas.
- The authority would receive and act on noise complaints and require the company to enforce noise abatement policies.
- The authority would not have authority to exercise control of the day to day management of the airport and would be required to allow the contracted company to administer all personnel and procurement policies.

The statute could also define some of the characteristics of the management company to include the following:

- The company would be a publicly traded entity that would issue equity shares and be managed by employees with officers who report to a board of directors elected by the share holders (initial management and employees to be transferred from the existing government entity).
- The company would issue stock at the outset of its organization providing a certain percent of shares to employees (and perhaps to the local government entity "selling" the airport to the authority) and the remainder would be sold to the public.
- The company would utilize the proceeds of this stock sale to capitalize its operations and to provide an amount to the airport authority to purchase the airport land and improvements from the previous owner.
- The company may sell stock to airlines and other airport users, but no user may gain control of the company.
- The company would relieve the previous employer of all salary, pension and other benefit obligations for employees transferred to the company's employment.
- The company would assume all operating debts, contractual obligations and other liabilities of the previous owner under a contractual delegation from the authority. To the extent such an obligation could not be transferred to the company, the contract would account for that financial obligation to assure proper disposition.
- The company would be required by contract to comply with all requirements imposed by the FAA and other federal, state and local authorities with jurisdiction.

Such a structure would be most similar to the structures of local power and telephone companies under the jurisdiction of public utility commissions.

G. Observations About This Structure

Valuation is critical to the transfer of ownership. Valuation assumes a formula negotiated between the parties that would find a price of the ongoing value of the airport, defined by the real economics of the asset—not, for instance, what the property could be used for in its highest and best form as a real estate asset. The value of the asset would be reduced by all existing debt, contracts, leasehold agreements, necessary repayments to any level of government and, to some extent, the influence of tax exempt financing and federal grant assurances. Clearly, this real-world valuation number will be significantly less than the theoretical numbers held out in numerous press accounts of privatization overtures at several major airports.

The authority's oversight role includes the assurance that the company does not set rates and charges at such a level that the company's profit is excessive, but that an adequate return on investment is continued. The authority must determine that type of economic regulation will be employed to accomplish this objective. The rate of return on investment methodology, as opposed to cost-type regulation, has merit and needs to be explored.

There are several existing examples of authorities purchasing airports from private or municipal owners and receiving federal approval (and in some cases funding) for such a transfer. Examples include Burbank, California, Charleston, South Carolina, and Addison, Texas.

H. Critique of the Alternatives

The lease-develop-operate model offers the simplest implementation and because of that may be an attractive way to convert existing facilities. However, new airports or those airports that are being greatly expanded might be candidates for either of the more expansive models. All three approaches will require a great deal of time and political effort to execute. The question of whether the ultimate benefits justify that effort will have to be addressed at the local level.

Each of the alternatives poses the fundamental question of whether government-employed airport managers and private airport managers will differ in their decisions and whether that difference, if it does exist, will benefit the traveling public, the city served by the airport, and/or the nation as a whole. Many airport authorities in the country, such as the Port Authority of New York and New Jersey, involve the private sector through a wide array of service contracts, concessions and leases, all overseen by public management. In such circumstances, the balance between public and private dollars might not change significantly after privatization, at least for large airports already managed as a collection of contracts. Therefore, it is probably not the volume of private involvement that is at issue but the structure of the relationship.

Despite the lingering oversight included in the three models in Section E, each relinquishes to the private sector many of the airport *development* decisions now made by a local government council or board, as well as the *operating* decisions made by airport management. Accordingly, the structure of the public-private relationship can be said to change in a way that, to some degree, reduces public oversight.

Airport executives have struggled for years with that same oversight, but it is the price paid for public involvement in what often is the largest single enterprise in a city or county. While public involvement can be assured through provisions in a transfer and sale agreement, it ceases to become a part of daily operations and a somewhat lessened part of airport development decisions.

On the positive side, other public-private institutions operate successfully in industries with a similar, capital-intensive, local monopoly nature. Electric power, water and local telephone services are all successful examples.

Local government leaders who are interested in privatizing their city's airports must ask themselves how they and their citizens value the public oversight and involvement that might be foregone by privatization, and whether that value exceeds the new tax revenue or revenue sharing that might be gained. But even these revenues have an additional price, for an airport is also an enterprise that enjoys extensive intergovernmental subsidies from outside the community, subsidies that may be lost under some forms of privatization. While airport users will be the primary bearers of such a loss, the local community will be affected as well, perhaps by diminishing rather than enhancing the price competitiveness of the airport and because many of the airport users are community residents.

Some or all of this impact might be overcome by efficiency gains in airport operations and new development under privatization, but the resounding lesson is that tampering with the current structure of the public-private relationship has a cost. Therefore, selecting among the current airport management structures and one of the alternatives discussed above should be done carefully and with full consideration of the long-term costs and benefits for the community.

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American Association of Airport Executives

4212 KING STREET • ALEXANDRIA, VIRGINIA 22302 • (703) 824-0500 • FAX (703) 820-1395

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MEMORANDUM

TO: AAAE and ARDF Boards of Directors

FROM: Chip Barclay

RE: Airport Privatization Study

DATE: March 18, 1992

At the recent Board meeting, we discussed the draft privatization study. It was decided the draft was basically acceptable, but numerous additions and changes should be made. If those changes are acceptable to you, we will proceed to final printing.

Enclosed is the proposed final version for your review. We would appreciate your comments and recommendations for further changes. Please call Bill Burhop at (202) 778-0884 or me, or send a telefax message to (703) 820-1395. Input is needed no later than Wednesday, March 25. Thank you in advance for your prompt attention.

The following is a list of the major changes to the previous version:

Pages 11 and 12

p. 23

p. 45

p. 49

p. 52

p. 54

p. 55

p. 59

pgs. 34-42

Footnote 14

Executive Summary

Bottom

Section 511(a)(12)

Liability and Insurance

Bankruptcy

Impact on General Aviation

Impact on Concessionaires

Bottom

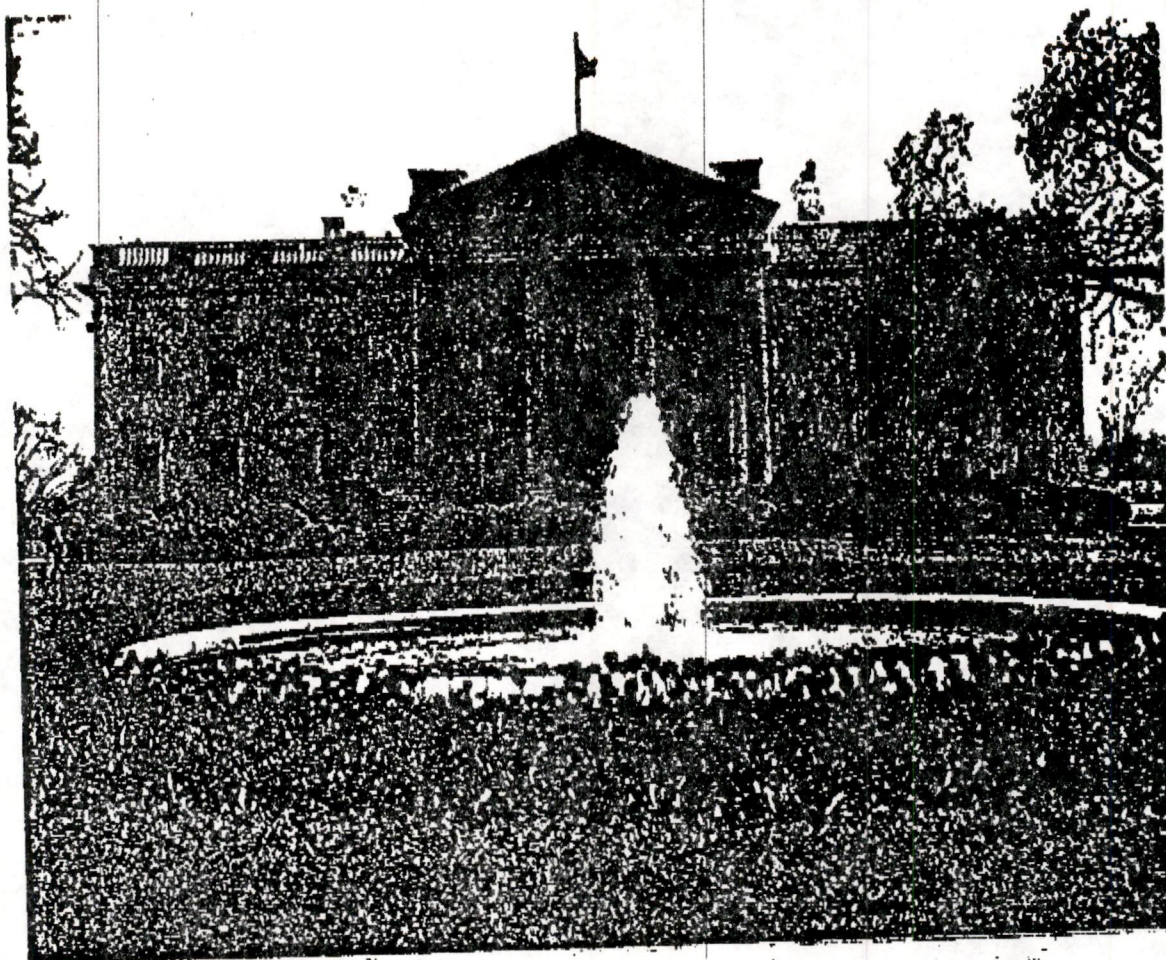
Pro forma analysis

Document Originally
Attached to
Following Page

4/8/92

Pls. file for
Cam Findlay

Voting Rights Act

THE WHITE HOUSE
WASHINGTON

FACSIMILE TRANSMISSION COVER SHEET

TO: Cam Findlay

FAX NUMBER: X1121

TELEPHONE NUMBER: X6594

FROM: Nelson Lund

TELEPHONE NUMBER: X2896

PAGES (INCLUDING COVER): 3

COMMENTS: As we discussed.

Talking Points

Meeting with Barr and Skinner on Proposals to Overrule the Supreme Court's Recent Voting Rights Act Decision

Section 5 of the Voting Rights Act requires certain jurisdictions to obtain judicial or administrative preclearance of any new "voting qualification or prerequisite to voting, or standard, practice, or procedure with respect to voting." In the recent Presley case, the Court held that this language applies to matters involving voting, including substantive changes as to which offices are elective, but that it does not extend to changes in the structure of government that alter the relative power of various officials.

The Department of Justice had advocated a reading of section 5 that would have required preclearance of any "change in the decisionmaking authority of any elected official . . . even if the officials involved are responsible to the same constituency, and even if the authority at issue may be viewed as relatively minor or inconsequential." (DOJ Brief at 10.) In the course of Justice Kennedy's opinion, the Court made some exceptionally caustic remarks about the position taken by the Justice Department. Noting that the Government's test would require preclearance "every time a covered jurisdiction passed a budget that differed from the previous year's budget," the Court observed:

"Confronting this difficulty, at oral argument the United States suggested that we draw an arbitrary line distinguishing between budget changes and other changes. There is no principled basis for the distinction, and it would be a marked departure from the statutory category of voting. . . . Even if we were willing to draw an unprincipled line excluding budgetary changes but not other changes in an elected official's decisionmaking authority, the result would expand the coverage of section 5 well beyond the statutory language and the intention of Congress." (Presley opinion at 4139.)

I gather that there are currently three options being considered:

(1) Codifying the Government's litigating position. For the reasons given by the Court, this would be arbitrary if it made an exception for budget changes and absurdly broad if it did not. It's very hard to see how the President could defend either of these approaches as sound policy.

(2) Senator Danforth is apparently considering a bill to require preclearance of any transfer of authority among officials that is taken "in response to the election of a nonwhite candidate" after the entry of a judgment or decree designed to increase minority opportunities to have representation in an elective body.

I am baffled by this proposal, despite (or perhaps because of) the fact that it picks up some language from Justice Stevens' dissent in Presley. If the "in response to" language creates a state of mind requirement, seeking preclearance might almost amount to an admission of guilt. If that is so, it is hard to see what the Danforth bill would accomplish.

(3) OLC has come up with a suggestion that starts with the Government's litigating position and adds two limitations. First, preclearance would be required only with respect to transfers of authority occurring within one year after entry of a judgment or decree designed to increase minority opportunities to have representation in an elective body and within six months after the election of a nonwhite candidate to the office from which authority is being transferred. This resembles a test proposed in one part of Stevens' dissent, although Stevens did not have any specific time limits like the one-year and six-month limits in the OLC draft. Second, the OLC draft would give the Attorney General unlimited authority to further delimit the scope of the new class of government actions covered by section 5.

In light of the Government's conduct of the Presley litigation, including its advocacy of a distinction that the Supreme Court called an "arbitrary line," people who are less charitable than I am might not take too much comfort from a proposal to confer on DOJ unfettered discretion to create exceptions from the definition proposed by the Government in the litigation. Such people might be found in some of the jurisdictions covered by section 5.

OLC's one-year/six-month rule looks more promising at first. It is objective, and it looks tight enough to keep this expansion of section 5 within reasonable bounds. The problem, however, is that it concedes the principle that the Voting Rights Act needs to be amended. Once that principle is conceded, negotiations will begin and we can be sure they will end, not with OLC's proposal but with something far less reasonable.

A better approach, in my view, would be to insist that any new preclearance requirement apply to all 50 States and that it be stated in a race-neutral form. Whatever justification there may have been for the application of section 5 to selected parts of the country in 1965, I think it's pretty hard to explain why an expansion of the Voting Rights Act in 1992 should be targeted exclusively at the South or at one race over others. Rather than have another debate that we will inevitably lose because we have conceded the core of the argument, why not force Senator Kennedy to explain why it's still appropriate to single out white Southerners and apply to them the kind of presumption of bigotry that section 5 incorporates?

§ __. Alteration of voting qualifications and procedures; authority of Attorney General to define transfers of authority considered to be a practice or procedure with respect to voting.

The Attorney General shall by regulation define those transfers of decisionmaking authority from one elective official or body to another official or body which shall be considered a practice or procedure with respect to voting for purposes of section 5[; provided that no such transfer shall be considered a practice or procedure with respect to voting for such purposes unless such transfer is effected:

(1) with one year after the entry of a litigated final judgment or consent decree designed to give nonwhite voters an opportunity or more of an opportunity to have representation; and

(2) within six months after the election of a nonwhite candidate to serve as the elective official or as a member of the body from whom or from which such decisionmaking authority is transferred].

5 “(2) that is taken—
6 “(A) soon after the election of a nonwhite
7 candidate; and
8 “(B) after the entry of a litigated judg-
9 ment or consent decree designed to give
10 nonwhite voters an opportunity or more of an
11 opportunity to have representation in an elec-
12 tive body.”.

the Act covers transfers of decisionmaking authority
from an elected official or set of officials to another
official or set of officials.

1 *Be it enacted by the Senate and House of Rep-*
2 *resentatives of the United States of America in Congress*
3 *assembled*

4 **SECTION 1. TRANSFERS OF DECISIONMAKING AUTHORITY.**

5 Section 5 of the Voting Rights Act of 1965 (42
6 U.S.C. 1973c) is amended—

7 (1) by inserting “(a)” before “Whenever”; and

8 (2) by adding at the end the following new sub-

9 section:

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S.L.C.

2

1 “(b) As used in this section, the term “vote” or “vot-
2 ing” includes a transfer of decisionmaking authority—

3 “(1) from one elected official or set of officials
4 to another official or set of officials; and

5 “(2) that is taken—

6 “(A) in response to the election of a
7 nonwhite candidate; and

8 “(B) after the entry of a litigated judg-
9 ment or consent decree designed to give
10 nonwhite voters an opportunity or more of an
11 opportunity to have representation in an elec-
12 tive body.”.



OPINIONS ANNOUNCED JANUARY 27, 1992

The Supreme Court decided:

ELECTIONS—Voting Rights Act

Changes made by the Supreme Court in its authority of the Commission on the Voting Rights Act, No. 90-711.

LABOR—Organized Labor

Section 7 of the National Labor Relations Act, No. 90-712, which gives employees of the federal government the right to join a union and to be represented by a union in their dealings with the government.

Fu

TO: CAM FINDLAY

FROM: NELSON LUND
Associate Counsel
to the President

Date 3/31/92

As promised.

enforcing any new "voting qualification or prerequisite to voting, or standard, practice, or procedure with respect to voting." In various Alabama counties, voters elect members of county commissions whose principal function is to supervise and control county road maintenance.

Howah County inter alia, its or practice of how to spend on was passed ly after appeal- were elected erms of which 2, the Russell ich abolished y for all road ntee. Neither gislation was to a consent t without any rms of which County's first , along with other things, by failing to id Resolution ert convened r was subject

1 of the Unit ered by §5. 14, and this hat changes hat the four aid that the unges in the and qualifi- at may vote ing the cre- e categories iples within as to which rocedure or he election

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that do not. Some standard is necessary, for in a real sense every decision taken by government implicates voting, yet no one would contend that Congress meant the Act to subject all or even most government decisions in covered jurisdictions to federal supervision.

(c) The Russell County Commission's adoption of the Unit System and its concomitant transfer of operations to the county engineer do not constitute a change covered by §5. There is not even an arguable basis for saying that the Unit System's adoption fits within any of the first three categories of changes in voting rules that this Court has recognized. As to the fourth category, the argument that the delegation of authority to an appointed official is similar to the replacement of an elected official with an appointed one and is therefore subject to §5 under *Bunton v. Patterson*, decided with *Allen*, *supra*, ignores the rationale for the *Bunton* holding: The practice in question changed an elective office to an appointive one. Here, the citizens of Russell County may still vote for members of the county commission. The fact that those commissioners exercise less authority than they once did is a routine matter of governmental administration that does not in itself render the Unit System a rule governing voting. Because the county commission retains substantial authority, including the power to appoint the county engineer and set his or her budget, this Court need not consider whether an otherwise uncovered enactment might under some circumstances rise to the level of a *de facto* replacement of an elected office with an appointive one, within the *Bunton* rule.

(d) Although the construction placed upon the Act by the Attorney General is ordinarily entitled to considerable deference, this Court need not defer to the United States' interpretation that the changes at issue are covered by §5, since that section is unambiguous with respect to the question whether it covers changes other than changes in rules governing voting: It does not. See, e.g., *Chevron U. S. A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U. S. 837, 842-844.

Affirmed.

KENNEDY, J., delivered the opinion of the Court, in which REHNQUIST, C. J., and O'CONNOR, SCALIA, SOUTER, and THOMAS, JJ., joined. STEVENS, J., filed a dissenting opinion, in which WHITE and BLACKMUN, JJ., joined.

JUSTICE KENNEDY delivered the opinion of the Court.

In various Alabama counties voters elect members of county commissions whose principal function is to supervise and control the maintenance, repair, and construction of the county roads. See Ala. Code §§11-3-1, 11-3-10 (1975). The consolidated appeals now before us concern certain changes in the decisionmaking authority of the elected members on two different county commissions, and the question to be decided is whether these were changes "with respect to voting" within the meaning of §5 of the Voting Rights Act of 1965, 79 Stat. 439, as amended, 42 U. S. C. §1973c. The case has significance well beyond the two county commissions; for the appellants, and the United States as *amicus curiae*, ask us to adopt a rule embracing the routine actions of state and local governments at all levels. We must interpret the provisions of §5, which require a jurisdiction covered by the Act to obtain either judicial or administrative preclearance before enforcing any new "voting qualification or prerequisite to voting, or standard, practice, or procedure with respect to voting."¹

¹ As set forth in 42 U. S. C. §1973c, §5 provides:

"Whenever a State or political subdivision with respect to which the prohibitions set forth in section 1973b(a) of this title based upon determinations made under the first sentence of section 1973b(b) of this title are in effect shall enact or seek to administer any voting qualification or prerequisite to voting, or standard, practice, or procedure with respect to voting different from that in force or effect on November 1, 1964, or whenever a State or political subdivision with respect to which the prohibitions set forth in section 1973b(a) of this title based upon determinations made under the second sentence of section 1973b(b) of this title are in effect shall enact or seek to administer any voting qualification or prerequisite to voting, or standard, practice, or procedure with respect to voting different from that in force or effect on November

I

To determine whether there have been changes with respect to voting, we must compare the challenged practices with those in existence before they were adopted. Absent relevant intervening changes, the Act requires us to use practices in existence on November 1, 1964, as our standard of comparison.

A

We consider first the Etowah County Commission. On November 1, 1964, commission members were elected at large under a "residency district" system. The entire electorate of Etowah County voted on candidates for each of the five seats. Four of the seats corresponded to the four residency districts of the county. Candidates were required to reside in the appropriate district. The fifth member, the chairman, was not subject to a district residency requirement, though residency in the county itself was a requirement.

Each of the four residency districts functioned as a road district. The commissioner residing in the district exercised control over a road shop, equipment, and road crew for that district. It was the practice of the commission to vote as a collective body on the division of funds among the road districts, but once funds were divided each commissioner exercised individual control over spending priorities within his district. The chairman was responsible for overseeing the solid waste authority, preparing the budget, and managing the courthouse building and grounds.

Under a consent decree issued in 1986, see *Dillard v. Crenshaw County*, No. 85-T-1332-N (MD Ala., Nov. 12, 1986), the commission is being restructured, so that after a transition period there will be a six-member commission, with each of the members elected by the voters of a different district. The changes required by the consent decree

1, 1968, or whenever a State or political subdivision with respect to which the prohibitions set forth in section 1973b(a) of this title based upon determinations made under the third sentence of section 1973b(b) of this title are in effect shall enact or seek to administer any voting qualification or prerequisite to voting, or standard, practice, or procedure with respect to voting different from that in force or effect on November 1, 1972, such State or subdivision may institute an action in the United States District Court for the District of Columbia for a declaratory judgment that such qualification, prerequisite, standard, practice, or procedure does not have the purpose and will not have the effect of denying or abridging the right to vote on account of race or color, or in contravention of the guarantees set forth in section 1973b(f)(2) of this title, and unless and until the court enters such judgment no person shall be denied the right to vote for failure to comply with such qualification, prerequisite, standard, practice, or procedure: *Provided*, That such qualification, prerequisite, standard, practice, or procedure may be enforced without such proceeding if the qualification, prerequisite, standard, practice, or procedure has been submitted by the chief legal officer or other appropriate official of such State or subdivision to the Attorney General and the Attorney General has not interposed an objection within sixty days after such submission, or upon good cause shown, to facilitate an expedited approval within sixty days after such submission, the Attorney General has affirmatively indicated that such objection will not be made. Neither an affirmative indication by the Attorney General that no objection will be made, nor the Attorney General's failure to object, nor a declaratory judgment entered under this section shall bar a subsequent action to enjoin enforcement of such qualification, prerequisite, standard, practice, or procedure. In the event the Attorney General affirmatively indicates that no objection will be made within the sixty-day period following receipt of a submission, the Attorney General may reserve the right to reexamine the submission if additional information comes to his attention during the remainder of the sixty-day period which would otherwise require objection in accordance with this section. Any action under this section shall be heard and determined by a court of three judges in accordance with the provisions of section 2284 of title 28 and any appeal shall lie to the Supreme Court."

were precleared by the Attorney General. For present purposes, it suffices to say that when this litigation began the commission consisted of four holdover members who had been on the commission before the entry of the consent decree and two new members elected from new districts. Commissioner Williams, who is white, was elected from new district 6, and Commissioner Presley, who is black, was elected from new district 5. Presley is the principal appellant in the Etowah County case. His complaint relates not to the elections but to actions taken by the four holdover members when he and Williams first took office.

On August 25, 1987, the commission passed the "Road Supervision Resolution." It provided that each holdover commissioner would continue to control the workers and operations assigned to his respective road shop, which, it must be remembered, accounted for all the road shops the county had. It also gave the four holdovers joint responsibility for overseeing the repair, maintenance, and improvement of all the roads of Etowah County in order to pick up the roads in the districts where the new commissioners resided. The new commissioners, now foreclosed from exercising any authority over roads, were given other functions under the resolution. Presley was to oversee maintenance of the county courthouse and Williams the operation of the engineering department. The Road Supervision Resolution was passed by a 4-2 margin, with the two new commissioners dissenting.

The same day the Road Supervision Resolution was passed, the commission passed a second, the so-called "Common Fund Resolution." It provides in part that

"all monies earmarked and budgeted for repair, maintenance and improvement of the streets, roads and public ways of Etowah County [shall] be placed and maintained in common accounts, [shall] not be allocated, budgeted or designated for use in districts, and [shall] be used county-wide in accordance with need, for the repair, maintenance and improvement of all streets, roads and public ways in Etowah County which are under the jurisdiction of the Etowah County Commission." App. to Juris. Statement in No. 90-711, p. 49a.

This had the effect of altering the prior practice of allowing each commissioner full authority to determine how to spend the funds allocated to his own district. The Etowah County Commission did not seek judicial or administrative preclearance of either the Road Supervision Resolution or the Common Fund Resolution. The District Court held that the Road Supervision Resolution was subject to preclearance but that the Common Fund Resolution was not. No appeal was taken from the first ruling, so only the Common Fund Resolution is before us in the Etowah County case.

B

We turn next to the background of the Russell County Commission. On November 1, 1964, it had three commissioners. Like the members of the Etowah County Commission before the consent decree change, Russell County Commissioners were elected at large by the entire electorate, subject to a requirement that a candidate for commissioner reside in the district corresponding to the seat he or she sought. A 1972 federal court order, see *Anthony v. Russell County*, No. 961-E (MD Ala., Nov. 21, 1972), required that the commission be expanded to include five members. The two new members were both elected at large from one newly-created residency district for Phenix City, the largest city in Russell County. Following the implementation of the court order, each of the three rural commissioners had individual authority over his own road shop,

road crew, and equipment. The three rural commissioners also had individual authority for road and bridge repair and construction within their separate residency districts. Although funding for new construction and major repair projects was subject to a vote by the entire commission, individual commissioners could authorize expenditures for routine repair and maintenance work as well as routine purchase orders without seeking approval from the entire commission.

Following the indictment of one commissioner on charges of corruption in Russell County road operations, in May 1979 the commission passed a resolution delegating control over road construction, maintenance, personnel, and inventory to the county engineer, an official appointed by the entire commission and responsible to it. The engineer's previous duties had been limited to engineering and surveying services for the separate road shops, and running a small crew devoted to pothole repair. Although the May 1979 resolution may have sufficed for the necessary delegation of authority to the county engineer, compare Ala. Code §23-1-80 (1975) with Ala. Code §11-6-3 (1975), the commission also requested the state legislature to pass implementing legislation. The Alabama Legislature did so on July 30, 1979, when it enacted Act No. 79-652, 1979 Ala. Acts 1132. It provides in pertinent part:

"Section 1. All functions, duties and responsibilities for the construction, maintenance and repair of public roads, highways, bridges and ferries in Russell County are hereby vested in the county engineer, who shall, insofar as possible, construct and maintain such roads, highways, bridges and ferries on the basis of the county as a whole or as a unit, without regard to district or beat lines."

The parties refer to abolition of the individual road districts and transfer of responsibility for all road operations to the county engineer as the adoption of a "Unit System." Neither the resolution nor the statute which authorized the Unit System was submitted for preclearance under §5.

Litigation involving the Russell County Commission led to a 1985 consent decree, see *Sumbry v. Russell County*, No. 84-T-1386-E (MD Ala., March 17, 1985), that enlarged the commission to seven members and replaced the at-large election system with elections on a district-by-district basis. Without any mention of the Unit System changes, the consent decree was precleared by the Department of Justice under §5. Following its implementation, appellants Mack and Gosha were elected in 1986. They are Russell County's first black county commissioners in modern times.

C

In May 1989, the appellants in both cases now before us filed a single complaint in the District Court for the Middle District of Alabama, alleging racial discrimination in the operation of the Etowah and Russell County Commissions in violation of prior court orders, the Constitution, Title VI of the Civil Rights Act of 1964, 42 U. S. C. §2000d, and §2 of the Voting Rights Act, 42 U. S. C. §1973. In a series of amended complaints, the appellants added claims under §5. The §5 claims alleged that Etowah County had violated the Act by failing to obtain preclearance of the 1987 Road Supervision and Common Fund Resolutions, and that Russell County had failed to preclear the 1979 change to the Unit System. Pursuant to 28 U. S. C. §2284, a three-judge District Court was convened to hear the appellants' §5 claims. The other claims still pend in the District Court.

With respect to the issues now before us, a majority of the District Court held that neither the Common Fund

Resolution of the Etowah County Commission nor the adoption of the Unit System in Russell County was subject to §5 preclearance. The court held that changes in the responsibilities of elected officials are subject to preclearance when they "effect a significant relative change in the powers exercised by governmental officials elected by, or responsible to, substantially different constituencies of voters." App. to Juris. Statement in No. 90-711, pp. 13a-14a. Applying its test, the court found that the Common Fund Resolution in Etowah County did not effect a significant change, and adoption of the Unit System in Russell County did not transfer authority among officials responsible to different constituencies. We noted probable jurisdiction. We affirm the District Court but adopt a different interpretation of §5 as the rationale for our decision.

II

We first considered the Voting Rights Act in *South Carolina v. Katzenbach*, 383 U. S. 301 (1966). Although we acknowledged that suspension of new voting regulations pending preclearance was an extraordinary departure from the traditional course of relations between the States and the Federal Government, *id.*, at 334, we held it constitutional as a permitted congressional response to the unrelenting attempts by some state and local officials to frustrate their citizens' equal enjoyment of the right to vote. See *id.*, at 308-315.

After *South Carolina v. Katzenbach* upheld the Voting Rights Act against a constitutional challenge, it was not until we heard *Allen v. State Board of Elections*, 393 U. S. 544 (1969), that we were called upon to decide whether particular changes were covered by §5. There we rejected a narrow construction, one which would have limited §5 to state rules prescribing who may register to vote. We held that the section applies also to state rules relating to the qualifications of candidates and to state decisions as to which offices shall be elective. *Id.*, at 564-565. We observed that "[t]he Voting Rights Act was aimed at the subtle, as well as the obvious, state regulations which have the effect of denying citizens their right to vote because of their race." *Id.*, at 565. Our decision, and its rationale, have proven sound, and we adhere to both.

In giving a broad construction to §5 in *Allen*, we noted that "Congress intended to reach any state enactment which altered the election law of a covered State in even a minor way." *Id.*, at 566. Relying on this language and its application in later cases, appellants and the United States now argue that because there is no *de minimis* exception to §5, the changes at issue here must be subject to preclearance. *E.g.*, Brief for United States as *Amicus Curiae* 21-22. This argument, however, assumes the answer to the principal question in the case: whether the changes at issue are changes in voting, or as we phrased it in *Allen*, "election law."

We agree that all changes in voting must be precleared and with *Allen*'s holding that the scope of §5 is expansive within its sphere of operation. That sphere comprehends all changes to rules governing voting, changes effected through any of the mechanisms described in the statute. Those mechanisms are any "qualification or prerequisite" or any "standard, practice or procedure with respect to voting."

The principle that §5 covers voting changes over a wide range is well illustrated by the separate cases we considered in the single opinion for the Court in *Allen*. *Allen* involved four cases. The eponymous *Allen v. State Board of Elections* concerned a change in the procedures for the casting of write-in ballots. 393 U. S., at 570-571. In *Whitley v. Williams*, there were changes in the require-

ments for independent candidates running in general elections. *Id.*, at 551. The challenged procedure in *Fairley v. Patterson* resulted in a change from single-district voting to at-large voting. *Id.*, at 550. The remaining case, *Bunton v. Patterson*, involved a statute which provided that officials who in previous years had been elected would be appointed. *Id.*, at 550-551. We held that the changes in each of the four cases were covered by §5.

Our cases since *Allen* reveal a consistent requirement that changes subject to §5 pertain only to voting. Without implying that the four typologies exhaust the statute's coverage, we can say these later cases fall within one of the four factual contexts presented in the *Allen* cases. First, we have held that §5 applies to cases like *Allen v. State Board of Elections* itself, in which the changes involved the manner of voting. See *Perkins v. Matthews*, 400 U. S. 379, 387 (1971) (location of polling places). Second, we have held that §5 applies to cases like *Whitley v. Williams*, which involve candidacy requirements and qualifications. See *NAACP v. Hampton County Election Comm'n*, 470 U. S. 166 (1985) (change in filing deadline); *Hadnott v. Amos*, 394 U. S. 358 (1969) (same); *Dougherty County Bd. of Educ. v. White*, 439 U. S. 32 (1978) (rule requiring board of education members to take unpaid leave of absence while campaigning for office). Third, we have applied §5 to cases like *Fairley v. Patterson*, which concerned changes in the composition of the electorate that may vote for candidates for a given office. See *Perkins v. Matthews*, 400 U. S., at 394 (change from ward to at-large elections); *id.*, at 388 (boundary lines of voting districts); *City of Richmond v. United States*, 422 U. S. 358 (1975) (same). Fourth, we have made clear that §5 applies to changes, like the one in *Bunton v. Patterson*, affecting the creation or abolition of an elective office. See *McCain v. Lybrand*, 465 U. S. 236 (1984) (appointed officials replaced by elected officials); *Lockhart v. United States*, 460 U. S. 125 (1983) (increase in number of city councilors).

The first three categories involve changes in election procedures, while all the examples within the fourth category might be termed substantive changes as to which offices are elective. But whether the changes are of procedure or substance, each has a direct relation to voting and the election process.

III

A comparison of the changes at issue here with those in our prior decisions demonstrates that the present cases do not involve changes covered by the Act.

A

The Etowah County Commission's Common Fund Resolution is not a change within any of the categories recognized in *Allen* or our later cases. It has no connection to voting procedures: It does not affect the manner of holding elections, it alters or imposes no candidacy qualifications or requirements, and it leaves undisturbed the composition of the electorate. It also has no bearing on the substance of voting power, for it does not increase or diminish the number of officials for whom the electorate may vote. Rather, the Common Fund Resolution concerns the internal operations of an elected body.

The appellants argue that the Common Fund Resolution is a covered change because after its enactment each commissioner has less individual power than before the resolution. A citizen casting a ballot for a commissioner today votes for an individual with less authority than before the resolution, and so, it is said, the value of the vote has been diminished.

Were we to accept the appellants' proffered reading of §5, we would work an unconstrained expansion of its coverage. Innumerable state and local enactments having nothing to do with voting affect the power of elected officials. When a state or local body adopts a new governmental program or modifies an existing one it will often be the case that it changes the powers of elected officials. So too, when a state or local body alters its internal operating procedures, for example by modifying its subcommittee assignment system, it "implicate[s] an elected official's decisionmaking authority." Brief for United States as *Amicus Curiae* 17-18 (emphasis in original).

Appellants and the United States fail to provide a workable standard for distinguishing between changes in rules governing voting and changes in the routine organization and functioning of government. Some standard is necessary, for in a real sense every decision taken by government implicates voting. This is but the felicitous consequence of democracy, in which power derives from the people. Yet no one would contend that when Congress enacted the Voting Rights Act it meant to subject all or even most decisions of government in covered jurisdictions to federal supervision. Rather, the Act by its terms covers any "voting qualification or prerequisite to voting, or standard, practice, or procedure with respect to voting." 42 U. S. C. §1973c. A faithful effort to implement the design of the statute must begin by drawing lines between those governmental decisions that involve voting and those that do not.

A simple example shows the inadequacy of the line proffered by the appellants and the United States. Under the appellants' view, every time a covered jurisdiction passed a budget that differed from the previous year's budget it would be required to obtain preclearance. The amount of funds available to an elected official has a profound effect on the power exercised. A vote for an ill-funded official is less valuable than a vote for a well-funded one.

No doubt in recognition of the unacceptable consequences of their views, appellants take the position that while "some budget changes may affect the right to vote and, under particular circumstances, would be subject to preclearance," most budget changes would not. Post-Argument Letter from Counsel for Appellants, Nov. 13, 1991 (available in Clerk of Court's case file). Under their interpretation of §5, however, appellants fail to give any workable standard to determine when preclearance is required. And were we to acknowledge that a budget adjustment is a voting change in even some instances, the likely consequence is that every budget change would be covered, for it is well settled that every voting change with a "potential for discrimination," must be precleared. *Dougherty County Bd. of Educ. v. White*, 439 U. S., at 42.

Confronting this difficulty, at oral argument the United States suggested that we draw an arbitrary line distinguishing between budget changes and other changes, Tr. of Oral Arg. 21-23. There is no principled basis for the distinction, and it would be a marked departure from the statutory category of voting. If a diminution or increase in an elected official's powers is a change with respect to voting, then whether it is accomplished through an enactment or a budget shift should not matter. Even if we were willing to draw an unprincipled line excluding budgetary changes but not other changes in an elected official's decisionmaking authority, the result would expand the coverage of §5 well beyond the statutory language and the intention of Congress.

Under the view advanced by appellants and the United States, every time a state legislature acts to diminish or increase the power of local officials, preclearance would be required. Governmental action decreasing the power of local officials could carry with it a potential for discrimination against those who represent racial minorities at the local level. At the same time, increasing the power of local officials will entail a relative decrease in the power of state officials, and that too could carry with it a potential for discrimination against state officials who represent racial minorities at the state level. The all but limitless minor changes in the allocation of power among officials and the constant adjustments required for the efficient governance of every covered State illustrate the necessity for us to formulate workable rules to confine the coverage of §5 to its legitimate sphere: voting.

Changes which affect only the distribution of power among officials are not subject to §5 because such changes have no direct relation to, or impact on, voting. The Etowah County Commission's Common Fund Resolution was not subject to the preclearance requirement.

B

We next consider Russell County's adoption of the Unit System and its concomitant transfer of operations to the county engineer. Of the four categories of changes in rules governing voting we have recognized to date, there is not even an arguable basis for saying that adoption of the Unit System fits within any of the first three. As to the fourth category, it might be argued that the delegation of authority to an appointed official is similar to the replacement of an elected official with an appointed one, the change we held subject to §5 in *Bunton v. Patterson*. This approach, however, would ignore the rationale for our holding: "after the change, [the citizen] is prohibited from electing an officer formerly subject to the approval of the voters." *Allen*, 393 U. S., at 569-570. In short, the change in *Bunton v. Patterson* involved a rule governing voting not because it affected a change in the relative authority of various governmental officials, but because it changed an elective office to an appointive one.

The change in *Russell County* does not prohibit voters "from electing an officer formerly subject to the[ir] approval." *Allen*, *supra*, at 570. Both before and after the change the citizens of Russell County were able to vote for the members of the Russell County Commission. To be sure, after the 1979 resolution each commissioner exercised less direct authority over road operations, that authority having been delegated to an official answerable to the commission. But as we concluded with respect to Etowah County, the fact that an enactment alters an elected official's powers does not in itself render the enactment a rule governing voting.

It is a routine part of governmental administration for appointive positions to be created or eliminated, and for their powers to be altered. Each time this occurs the relative balance of authority is altered in some way. The making or unmaking of an appointive post often will result in the erosion or accretion of the powers of some official responsible to the electorate, but it does not follow that those changes are covered by §5. By requiring preclearance of changes with respect to voting, Congress did not mean to subject such routine matters of governance to federal supervision. Were the rule otherwise, neither state nor local governments could exercise power in a responsible manner within a federal system.

The District Court, wrestling with the problem we now

face and recognizing the need to draw principled lines, held that Russell County's adoption of the Unit System is not a covered change because it did not transfer power among officials answerable to different constituencies. Even upon the assumption (the assumption we reject in this case) that some transfers of power among government officials could be changes with respect to voting as that term is used in the Act, we disagree with the District Court's test. The question whether power is shifted among officials answerable to the same or different constituencies is quite distinct from the question whether the power voters exercise over elected officials is affected. Intraconstituency changes may have a large indirect effect on the voters while interconstituency changes may have a small indirect effect, but in neither case is the effect a change in voting for purposes of the Act. The test adopted by the District Court does not provide the workable rule we seek. In any event, because it proceeds from the faulty premise that reallocations of authority within government can constitute voting changes, we cannot accept its approach.

We need not consider here whether an otherwise uncovered enactment of a jurisdiction subject to the Voting Rights Act might under some circumstances rise to the level of a *de facto* replacement of an elective office with an appointive one, within the rule of *Bunton v. Patterson*. For present purposes it suffices to note that the Russell County Commission retains substantial authority, including the power to appoint the county engineer and to set his or her budget. The change at issue in Russell County is not a covered change.

IV

The United States urges that despite our understanding of the language of §5, we should defer to its administrative construction of the provision. We have recognized that "the construction placed upon the [Voting Rights] Act by the Attorney General . . . is entitled to considerable deference." *NAACP v. Hampton County Election Comm'n*, 470 U. S. 166, 178-179 (1985). See also *United States v. Sheffield Board of Comm'rs*, 435 U. S. 110, 131 (1978). But the principle has its limits. Deference does not mean acquiescence. As in other contexts in which we defer to an administrative interpretation of a statute, we do so only if Congress has not expressed its intent with respect to the question, and then only if the administrative interpretation is reasonable. See, e.g., *Chevron U. S. A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U. S. 837, 842-844 (1984). Because the first of these conditions is not satisfied in the cases before us we do not defer to the Attorney General's interpretation of the Act.

We do not believe that in its use of the phrase "voting qualification or prerequisite to voting, or standard, practice, or procedure with respect to voting," 42 U. S. C. §1973c, the statute is ambiguous as to the question whether §5 extends beyond changes in rules governing voting. To be sure, reasonable minds may differ as to whether some particular changes in the law of a covered jurisdiction should be classified as changes in rules governing voting. In that sense §5 leaves a gap for interpretation to fill. See *Chevron*, *supra*, at 843. When the Attorney General makes a reasonable argument that a contested change should be classified as a change in a rule governing voting, we can defer to that judgment. But §5 is unambiguous with respect to the question whether it covers changes other than changes in rules governing voting: It does not. The administrative position in the present cases is not entitled to deference, for it suggests the contrary. The United States argues that the changes are covered by §5 because

they implicate the decisionmaking authority of elected officials, even though they are not changes in rules governing voting. This argument does not meet the express requirement of the statute.

V

Nothing we say implies that the conduct at issue in these cases is not actionable under a different remedial scheme. The Voting Rights Act is not an all-purpose antidiscrimination statute. The fact that the intrusive mechanisms of the Act do not apply to other forms of pernicious discrimination does not undermine its utility in combating the specific evils it was designed to address.

Our prior cases hold, and we reaffirm today, that every change in rules governing voting must be precleared. The legislative history we rehearsed in *South Carolina v. Katzenbach* was cited to demonstrate Congress' concern for the protection of voting rights. Neither the appellants nor the United States has pointed to anything we said there or in the statutes reenacting the Voting Rights Act to suggest that Congress meant other than what it said when it made §5 applicable to changes "with respect to voting" rather than, say, changes "with respect to governance."

If federalism is to operate as a practical system of governance and not a mere poetic ideal, the States must be allowed both predictability and efficiency in structuring their governments. Constant minor adjustments in the allocation of power among state and local officials serve this elemental purpose.

Covered changes must bear a direct relation to voting itself. That direct relation is absent in both cases now before us. The changes in Etowah and Russell Counties affected only the allocation of power among governmental officials. They had no impact on the substantive question whether a particular office would be elective or the procedural question how an election would be conducted. Neither change involves a new "voting qualification or prerequisite to voting, or standard, practice, or procedure with respect to voting." 42 U. S. C. §1973c.

The judgment of the District Court is affirmed.

It is so ordered.

JUSTICE STEVENS, with whom JUSTICE WHITE and JUSTICE BLACKMUN join, dissenting.

In 1986, an important event occurred in each of two Alabama counties with long histories of white-dominated political processes. In Etowah County, a black commissioner was elected to the county commission for the first time in recent history, and in Russell County, two black commissioners were elected to the county commission for the first time in "modern times." App. to Juris. Statement of Appellant Presley 4a. Because of the three resolutions at issue in this case—two adopted in Etowah County after Commissioner Presley's election and one adopted in Russell County before the election of Commissioners Mack and Gosha—none of the three newly-elected black commissioners was able to exercise the decisionmaking authority that had been traditionally associated with his office.

As I shall explain, this is a case in which a few pages of history are far more illuminating than volumes of logic and hours of speculation about hypothetical line-drawing problems. Initially, however, it is important to note that a different decision in these cases would not impose any novel or significant burden on those jurisdictions that remain covered under §5 of the Voting Rights Act of 1965, 79 Stat.

439, as amended, 42 U. S. C. §1973c.¹

Prior to these cases, federal courts had uniformly agreed with the Attorney General's interpretation that §5 covered transfers of decisionmaking power that had a potential for discrimination against minority voters.² On at least eight occasions since 1975,³ the Department of Justice has refused to preclear changes in the power of elected officials that had a potentially discriminatory⁴ impact on black voters. The Department has routinely precleared numerous other transfers of authority after determining that they had no discriminatory purpose or effect.⁵ There is no evidence that the prevailing practice imposed any special burden on covered jurisdictions. For example, in this fiscal year the Attorney General has processed over 17,000 preclearance requests, and has approved over 99 percent of them without any undue delay.⁶ It is, therefore, simply hyperbole for the

¹ Alabama, like the other States that are covered under §5, was placed in that category because of its history of "substantial voting discrimination." *South Carolina v. Katzenbach*, 383 U. S. 301, 329 (1966).

² See *Horry County v. United States*, 449 F. Supp. 990 (D. C. 1978) (statute providing for election of public officials who were formerly appointed by Governor required preclearance under §5); *Hardy v. Wallace*, 603 F. Supp. 174 (ND Ala. 1985) (statute changing appointive power over local racing commission from local legislative delegation to Governor required preclearance under §5); *County Council of Sumter County v. United States*, 555 F. Supp. 694 (D. C. 1983) (law that eliminated legal power of Governor and General Assembly over local affairs and vested it in county council elected at large by county voters required preclearance under §5); *Robinson v. Alabama State Department of Education*, 652 F. Supp. 484 (MD Ala. 1987) (transfer of authority from Board of Education whose members were elected county-wide to one whose members were appointed by the city council required §5 preclearance).

³ The Solicitor General has advised us that the Department has objected to the following transfers of authority:

"(1) Mobile, Alabama, March 2, 1976, involving a transfer of administrative duties from the entire commission to individual commissioners; (2) Charleston, South Carolina, June 14, 1977, involving a transfer of taxing authority from the legislative delegation to the county council; (3) Edgefield County, South Carolina, February 8, 1979, involving a transfer of increased taxing power to the county council; (4) Colleton County, South Carolina, September 4, 1979, involving a transfer of authority to tax for school purposes from the legislative delegation to the county council; (5) Brunswick and Blynn County, Georgia, August 16, 1982, involving the abolition of separate city and county commissions and the transfer of their powers to a consolidated commission; (6) Hillsborough County, Florida, August 29, 1984, involving a transfer of power over municipalities from the legislative delegation to the county commission (objection was withdrawn because the county made clear that it did not intend to effect such a transfer); (7) Waycross, Georgia, February 16, 1988, involving a change in the duties of the mayor; and (8) San Patricio, Texas, May 7, 1990, involving a transfer of voter registration duties from the county clerk to the county tax assessor." Brief for the United States as *Amicus Curiae* 16, n. 6.

⁴ Whether a change in "any . . . standard, practice or procedure with respect to voting," 42 U. S. C. §1973c, must be precleared under §5 depends, not on whether the change "resulted in impairment of the right to vote, or whether [it was] intended to have that effect," but rather, on "whether the challenged alteration has the potential for discrimination." *NAACP v. Hampton County Election Comm'n*, 470 U. S. 166, 181 (1985); see *McCain v. Lybrand*, 465 U. S. 236, 250, n. 17 (1984); *Dougherty County Bd. of Education v. White*, 439 U. S. 32, 42 (1978) (issue "is not whether the provision is in fact innocuous and likely to be approved, but whether it has a potential for discrimination"); *Georgia v. United States*, 411 U. S. 526, 534 (1973); *Perkins v. Matthews*, 400 U. S. 379, 383-385 (1971); *Allen v. State Bd. of Elections*, 393 U. S. 544, 555, n. 19, 558-559 (1969).

⁵ Brief for the United States as *Amicus Curiae* 16-17.

⁶ Tr. of Oral Arg. 27. The Attorney General's percentage has undergone little change even though the number of submissions has increased over time. For example, when *Allen v. State Bd. of Elections*, 393 U. S. 544 (1969), was decided, the Department of Justice had received 251 submissions from States covered under §5 and had approved over 99 percent of the submissions. *Id.*, at 549, n. 5. Figures available in 1978 indicated that the Department processed 1800 submissions annually, and

Court to suggest that if we adopted the Attorney General's position in this case "neither state nor local governments could exercise power in a responsible manner within a federal system." *Ante*, at 15.⁷

In all of our prior cases interpreting §5 of the Voting Rights Act, the Court has agreed with the Attorney General's construction of this important statute.⁸ I share the Court's view that the "considerable deference" to which the Attorney General's construction is entitled⁹ does not mean automatic "acquiescence," *ante*, at 16; however, I strongly disagree with the Court that our task in these cases is "to formulate workable rules to confine the coverage of §5 to its legitimate sphere: voting." *Ante*, at 14. For reasons that I shall explain, even if the Attorney General, participating in these cases as *amicus curiae*, has asked the Court to adopt a broader rationale than is necessary or appropriate, a narrower basis for a decision is obviously available in the *Etowah County* case and, in my judgment, in the *Russell County* case as well.

I

The original enactment of §5, the interpretations of the Act by this Court and by the Attorney General, and the reenactment of the statute by Congress in light of those interpretations, reveal a continuous process of development in response to changing conditions in the covered jurisdictions.

The central purpose of the original Act was to eliminate the various devices, such as literacy tests, requirements of "good moral character," vouchers, and poll taxes, that had excluded black voters from the registration and voting process in the southern States for decades.¹⁰ As we ex-

had approved over 98 percent of those submissions. *Dougherty County Bd. of Education v. White*, 439 U. S., at 41.

⁷ In the past, various Members of the Court have objected to the types of changes that require preclearance under §5 in covered States, and have predicted that the Court's construction of the statute would leave it without boundaries. In *Perkins v. Matthews*, 400 U. S. 379 (1971), for example, Justice Harlan expressed the view that the Court was mistaken in holding that annexations are within the scope of §5 and that the Court had gone too far in its interpretation of "with respect to voting": "Given a change with an effect on voting, a set of circumstances may be conceived with respect to almost any situation in which the change will bear more heavily on one race than on another. In effect, therefore, the Court requires submission of any change which has an effect on voting." *Id.*, at 398 (opinion concurring in part and dissenting in part). Similarly, Justice Powell, taking the view in *Dougherty* that a "personnel rule" should not fall within the scope of §5 as the Court had held, was concerned that "if the Court truly means that any incidental impact on elections is sufficient to trigger the preclearance requirement of §5, then it is difficult to imagine what sorts of state or local enactments would not fall within the scope of that section." 439 U. S., at 54 (dissenting opinion) (footnote omitted). The fears the Court expresses today, see *ante*, at 15, are no more likely to be realized than those expressed by Justice Harlan and Justice Powell years ago.

⁸ See, e.g., *Perkins v. Matthews*, 400 U. S., at 390-391 ("Our conclusion that both the location of the polling places and municipal boundary changes come within §5 draws further support from the interpretation followed by the Attorney General in his administration of the statute"); *United States v. Sheffield Bd. of Comm'rs*, 435 U. S. 110, 131 (1978); *Dougherty County Bd. of Education v. White*, 439 U. S., at 39.

⁹ *NAACP v. Hampton County Election Comm'n*, 470 U. S., at 178-179.

¹⁰ "Tests or devices" include

"any requirement that a person as a prerequisite for voting or registration for voting (1) demonstrate the ability to read, write, understand, or interpret any matter, (2) demonstrate any educational achievement or his knowledge of any particular subject, (3) possess good moral character, or (4) prove his qualifications by the voucher of registered voters or members of any other class." 42 U. S. C. §1973b(c).

As this Court recognized in *South Carolina v. Katzenbach*, 383 U. S., at 330, "[t]ests and devices are relevant to voting discrimination because of their long history as a tool for perpetrating the evil."

plained in *McCain v. Lybrand*, 465 U. S. 236 (1984):

"The Voting Rights Act of 1965, as amended, 42 U. S. C. §1973 *et seq.* (1976 ed. and Supp. V), was enacted by Congress as a response to the 'unremitting and ingenious defiance' of the command of the Fifteenth Amendment for nearly a century by state officials in certain parts of the Nation. *South Carolina v. Katzenbach*, 383 U. S. 301, 309 (1966). Congress concluded that case-by-case litigation under previous legislation was an unsatisfactory method to uncover and remedy the systematic discriminatory election practices in certain areas: such lawsuits were too onerous and time-consuming to prepare, obstructionist tactics by those determined to perpetuate discrimination yielded unacceptable delay, and even successful lawsuits too often merely resulted in a change in methods of discrimination. *E. g.*, H. R. Rep. No. 439, 89th Cong., 1st Sess., 9-11 (1965). Congress decided 'to shift the advantage of time and inertia from the perpetrators of the evil to its victims,' 383 U. S., at 328, and enacted 'stringent new remedies' designed to 'banish the blight of racial discrimination in voting' once and for all, *id.*, at 308." *Id.*, at 243-244 (footnote omitted).

During the first few years after the enactment of §5, the federal courts gave its text a narrow literal construction that confined its coverage to the political subdivisions that registered voters and to the practices that directly concerned the registration and voting process. Prior to the Court's decision in *Allen v. State Bd. of Elections*, 393 U. S. 544 (1969), only three States submitted any changes to the Attorney General for preclearance and a total of only 323 changes were submitted during the first five years of administration.¹¹ At that time, the covered jurisdictions were able to respond to the increase in the number of black registered voters by means that prevented the newly registered minority voters from having a proportionate impact on the political process.

In *Allen* and its companion cases,¹² however, the Court held that some of these responses, even if not described in the literal text of the Act, were nevertheless included within the scope of §5. Relying heavily on the statutory definition of voting as encompassing "all action necessary to make a vote effective," 393 U. S., at 565-566, and the broad remedial purposes of the Act, the Court held that a change from district to at-large voting for county supervisors, a change that made an important county office appointive rather than elective, and a change that altered the requirements for independent candidates, were all covered voting practices. *Id.*, at 569-571. Thus, §5 was not limited to changes directly affecting the casting of a ballot. *Id.*, at 569 ("The right to vote can be affected by a dilution of voting power as well as by an absolute prohibition on casting a ballot. See *Reynolds v. Sims*, 377 U. S. 533, 555 (1964))." Nothing in *Allen* implied that the Court had defined an

exhaustive category of changes covered by the Act.¹³ On the contrary, the Court described §5 as "aimed at the subtle, as well as the obvious, state regulations which have the effect of denying citizens their right to vote because of their race," *id.*, at 565, and expressed, in no uncertain terms, that §5 should be given "the broadest possible scope." *Id.*, at 567. Aware of the consequences of its decision, the Court gave its broad reading of the Act "only prospective effect." *Id.*, at 572.

The Court's construction of the Act in *Allen*, as requiring preclearance of changes in covered jurisdictions that were responsive to the increase in the number of black registered voters,¹⁴ was consistent with the concern that justified the extraordinary remedy set forth in §5 itself, particularly the concern that recalcitrant white majorities could be expected to devise new stratagems to maintain their political power if not closely scrutinized.

"The rationale of this 'uncommon exercise' of congressional power which sustained its constitutional validity was a presumption that jurisdictions which had 'resorted to the extraordinary stratagem of contriving new rules of various kinds for the sole purpose of perpetuating voting discrimination in the face of adverse federal court decrees' would be likely to engage in 'similar maneuvers in the future in order to evade the remedies for voting discrimination contained in the Act itself.' *South Carolina v. Katzenbach*, *supra*, at 334, 335 (footnote omitted). This provision must, of course, be interpreted in light of its prophylactic purpose and the historical experience which it reflects. See, *e. g.*, *McDaniel v. Sanchez*, 452 U. S. 130, 151 (1981)." *McCain v. Lybrand*, 465 U. S., at 245-246.

Thus, §5 was understood to be "a 'vital element' of the Act," and was designed to be flexible enough to ensure that "new subterfuges will be promptly discovered and enjoined." *Id.*, at 248 (citation omitted).¹⁵ Section 5, as construed by the Court, was not limited to a "simple inventory of voting procedures," but rather, was understood to address "the reality of changed practices as they affect Negro voters." *Georgia v. United States*, 411 U. S. 526, 531 (1973).

In subsequent cases, this Court has reaffirmed the broad scope of §5 coverage, as first articulated by the Court in *Allen*.¹⁶ The Court has interpreted §5 expansively and has

¹³ Although the majority today agrees that §5 is not limited to only the changes covered in our earlier opinions, see *ante*, at 10, it nevertheless attempts to fit today's changes into one of the earlier models, see *ante*, at 11, 14. The Court's approach today marks a departure from the approach we have taken in the past. For example, in *NAACP v. Hampton County Election Comm'n*, 470 U. S. 166 (1985), even though the Court recognized that it had "never addressed itself to alterations in voting procedures that exactly parallel those at issue in this case," *id.*, at 176, it nevertheless concluded that §5 was broad enough to encompass a change in election date. *Id.*, at 182-183.

¹⁴ U.S. Commission on Civil Rights, *The Voting Rights Act: Ten Years After*, at 69 ("The end of formal barriers brought about by the Voting Rights Act resulted in an immediate increase in minority registration"; H. R. Rep. No. 94-196, p. 6 (1975) ("Prior to 1965, the black registration rate in the State of Alabama lagged behind that of whites in that state by 49.9 percentage points. In 1972, that disparity had decreased to 23.6 percentage points").

¹⁵ "[I]n modern-day voting rights cases such as this one, . . . racial discrimination will more than likely not show itself in the blatant forms of the past but instead will be subtle and sophisticated . . ." App. to Juris. Statement of Appellant Presley 37a (Thompson, J., concurring in part and dissenting in part).

¹⁶ See *Dougherty County Bd. of Education v. White*, 439 U. S., at 38 ("In subsequent cases interpreting §5, we have consistently adhered to the principles of broad construction set forth in *Allen*"); *NAACP v. Hampton County Election Comm'n*, 470 U. S., at 176 ("Our precedents recognize

¹¹ See *United States v. Sheffield Bd. of Comm'rs*, 435 U. S., at 148, n. 10 (STEVENS, J., dissenting); see also U. S. Commission on Civil Rights, *The Voting Rights Act: Ten Years After*, p. 25, n. 53 (1975) ("In the first 6 years of the act, section 5 was hardly used at all").

¹² *Allen* was argued along with *Fairley v. Patterson*, 393 U. S. 544 (1969) (§5 applied to a change from district to at-large election of county supervisors), *Bunton v. Patterson*, 393 U. S. 544 (1969) (§5 applied to change in which the position of county officer became appointive instead of elective), and *Whitley v. Williams*, 393 U. S. 544 (1969) (changes aimed at increasing the difficulty for an independent candidate to gain a position on a general election ballot were subject to §5), on appeal from the United States District Court for the Southern District of Mississippi.

said in the context of candidate qualification that a statute requiring independent candidates to declare their intention to seek office two months earlier than under the previous procedures created a barrier to candidacy and required §5 preclearance, *Hadnott v. Amos*, 394 U. S. 358 (1969), and in other contexts, that preclearance is required when there is a change in polling places, *Perkins v. Matthews*, 400 U. S. 379 (1971), an alteration in municipal boundaries, *City of Richmond v. United States*, 422 U. S. 358 (1975), reapportionment and redistricting plans, *Georgia v. United States*, 411 U. S., at 532-533, and the introduction of numbered posts and staggered terms, *Lockhart v. United States*, 460 U. S. 125, 131, 132, 134-135 (1983).

The reenactment of §5 in 1970, Pub. L. 91-285, 84 Stat. 314,¹⁷ in 1975, Pub. L. 94-73, 89 Stat. 400,¹⁸ and in 1982, Pub. L. 97-205, 96 Stat. 131,¹⁹ reflected congressional approval of *Allen's* broad interpretation of the Act. Indeed, congressional comments quoted in our opinion in *Perkins v. Matthews*, *supra*, expressly endorsed an interpretation of §5 that takes into account white resistance to progress in black registration.

"One Congressman who had supported the 1965 Act observed, 'When I voted for the Voting Rights Act of 1965, I hoped that 5 years would be ample time. But resistance to progress has been more subtle and more effective than I thought possible. A whole arsenal of racist weapons has been perfected. Boundary lines have been gerrymandered, elections have been switched to an at-large basis, counties have been consolidated, elective offices have been abolished where blacks had a chance of winning, the appointment process has been substituted for the elective process, election officials have withheld the necessary information for voting or running for office, and both physical and economic intimidation have been employed.

"Section 5 was intended to prevent the use of most of these devices.'" 400 U. S., at 389, n. 8.²⁰

that to effectuate the congressional purpose, §5 is to be given broad scope").

¹⁷ "After extensive deliberations in 1970 on bills to extend the Voting Rights Act, during which the *Allen* case was repeatedly discussed, the Act was extended for five years, without any substantive modification of §5." *Georgia v. United States*, 411 U. S., at 533 (footnote omitted); see *Dougherty County Bd. of Education v. White*, 439 U. S., at 38-39.

¹⁸ "Again in 1975, both the House and Senate Judiciary Committees, in recommending extension of the Act, noted with approval the 'broad interpretations to the scope of Section 5' in *Allen* and *Perkins v. Matthews*." *Dougherty*, 439 U. S., at 39.

¹⁹ "[T]he legislative history of the most recent extension of the Voting Rights Act in 1982 reveals that the congressional commitment to its continued enforcement is firm. The Senate Committee found 'virtual unanimity among those who [had] studied the record,' S. Rep. No. 97-417, p. 9 (1982), that §5 should be extended. And, as it had in previous extensions of the Act, Congress specifically endorsed a broad construction of the provision." *NAACP v. Hampton County Election Comm'n*, 470 U. S., at 176 (footnote omitted).

²⁰ Congress recognized that "since the adoption of the Voting Rights Act, covered jurisdictions have substantially moved from direct, overt impediments to the right to vote to more sophisticated devices that dilute minority voting strength," S. Rep. No. 97-417, p. 10 (1982), and that §5 was intended to be responsive to this shift:

"Following the dramatic rise in registration, a broad array of dilution schemes were employed to cancel the impact of the new black vote. Elective posts were made appointive; election boundaries were gerrymandered; majority runoffs were instituted to prevent victories under a prior plurality system; at-large elections were substituted for election by single-member districts, or combined with other sophisticated rules to prevent an effective minority vote. The ingenuity of such schemes seems endless. Their common purpose and effect has been to offset the gains made at the ballot box under the Act.

"Congress anticipated this response. The preclearance provisions of Section 5 were designed to halt such efforts." *Id.*, at 6.

Since the decision in *Allen*, the debate on reenactment of §5 in 1970, and the issuance of regulations by the Department of Justice,²¹ it has been recognized that the replacement of an elective office that might be won by a black candidate with an appointive office is one of the methods of maintaining a white majority's political power that §5 was designed to forestall. As a practical matter, such a change has the same effect as a change that makes an elected official a mere figurehead by transferring his decisionmaking authority to an appointed official, or to a group of elected officials controlled by the majority. Although this type of response to burgeoning black registration may not have been prevalent during the early history of the Act, it has been an active concern of the Attorney General since 1976. See *supra*, n. 3. In my judgment, such a change in the reallocation of decisionmaking authority in an elective office, at least in its most blatant form, is indistinguishable from, and just as unacceptable as, gerrymandering boundary lines or switching elections from a district to an at-large basis.

II

The two resolutions adopted by the Etowah County Commission on August 25, 1987, less than 9 months after the county's first black commissioner took office, were an obvious response to the redistricting of the county that produced a majority black district from which a black commissioner was elected. In my view, it was wrong for the District Court to divorce the two parts of this consolidated response and to analyze the two resolutions separately.²² The characterization of the Road Supervision Resolution as a change with a "potential for discrimination" that was "blatant and obvious," App. to Juris. Statement of Appellant Presley 20a, and that should be enjoined unless subjected to §5 preclearance, *id.*, at 21a, 23a, applies equally to the Common Fund Resolution. Both resolutions diminished the decisionmaking authority of the newly-elected black

²¹ On September 10, 1971, the Department of Justice first adopted regulations implementing §5's preclearance provisions. S. Rep. No. 94-295, p. 16 (1975); see 36 Fed. Reg. 18186 (Sept. 10, 1971); 28 CFR pt. 51 (1972); see also *Georgia v. United States*, 411 U. S. 526, 536-541 (1973) (approving regulations).

²² The District Court was also wrong to exempt the Common Fund Resolution from §5 preclearance on the ground that "the common fund resolution was, in practical terms, insignificant in comparison to the entire Commission's authority . . ." App. to Juris. Statement of Appellant Presley 19a. This is clearly the wrong test in light of our earlier cases, in which we have said that even "minor" changes affecting elections and voting must be precleared. *Allen v. State Bd. of Elections*, 393 U. S., at 566, 568 ("It is significant that Congress chose not to include even . . . minor exceptions in §5, thus indicating an intention that all changes, no matter how small, be subjected to §5 scrutiny"); see also *Perkins v. Matthews*, 400 U. S., at 387. For example, the Court has said that §5 preclearance applies to the transfer of a polling place, *Perkins*, 400 U. S., at 388, and the extension of city limits to include uninhabited territory, *Pleasant Grove v. United States*, 479 U. S. 462, 467 (1987), even though these changes might, at first blush, appear to be "insignificant." The District Court mistakenly blurred the distinction between whether a change is subject to preclearance, which turns on whether the change has the potential for discrimination, and whether the change should, in fact, be precleared, which turns on whether the change would have a discriminatory purpose or effect. The distinction is important because "[t]he discriminatory potential in seemingly innocent or insignificant changes can only be determined after the specific facts of the change are analyzed in context. The present coverage formula allows for such a factual analysis." Hearings on Extension of the Voting Rights Act before the Subcommittee on Civil and Constitutional Rights of the House Committee on the Judiciary, 97th Cong., 1st Sess., 2122 (1981) (testimony of Drew Days, Professor, Yale Law School and former U. S. Assistant Attorney General, Civil Rights Division, Department of Justice); see H. R. Rep. No. 97-227, p. 35 (1981); *NAACP v. Hampton County Election Comm'n*, 470 U. S., at 176, n. 21.

commissioner, and both were passed on the same day and in response to the districting changes effected by the consent decree.²³

At the very least, I would hold that the reallocation of decisionmaking authority of an elective office that is taken (1) after the victory of a black candidate, and (2) after the entry of a consent decree designed to give black voters an opportunity to have representation on an elective body, is covered by §5.

Similar considerations supported the Court's decision in *Dougherty County Bd. of Education v. White*, 439 U.S. 32 (1978). *Dougherty* involved a rule requiring an employee of the school system to take a leave of absence while running for or holding a public office. The Court recognized that the rule in question operated in effect as a filing fee, hitting hardest those who were least able to afford it, and that it implicated the political process to the same extent as had changes in the location of polling places, *Perkins v. Matthews*, 400 U.S. 379 (1971), and alterations in the procedures for casting a write-in vote, *Allen v. State Bd. of Elections*, 393 U.S. 544 (1969). The *Dougherty* Court also observed that the circumstances surrounding the Rule's adoption were "sufficiently suggestive of the potential for discrimination to demonstrate the need for preclearance." 439 U.S., at 42. The rule had been adopted by an area with a long history of racial discrimination in voting, after the first black to seek public office announced his candidacy. *Ibid.* In the *Etowah County* case, as in *Dougherty*, the circumstances surrounding the adoption of the resolutions are similarly suggestive of the potential for discrimination and should require §5 preclearance.

Although the test I propose here may not adequately implement §5, it would certainly provide a workable rule that would result in the correct disposition of this case without opening the Pandora's box that the Court seems to fear.²⁴

²³ The District Court approved a consent decree that provided, *inter alia*, for an increase in the number of Etowah County Commissioners in order to remedy the unlawful dilution of black voting strength caused by the prior at-large election system. See *Dillard v. Crenshaw County*, CA No. 85-T-1332-N (MD Ala., Nov. 12, 1986); *ante*, at 4. The decree expanded the Commission to six members, all of whom would eventually be elected from single-member districts. See App. to Juris. Statement of Appellant Presley 5a. The consent decree specified that the commissioners elected in 1986 were to have the same duties as the four holdover commissioners. *Ibid.* (decree provided that the two new commissioners "shall have all the rights, privileges, duties and immunities of the other commissioners, who have heretofore been elected at large"). In August, 1987, however, the commission passed the Road Supervision Resolution, which authorized the four holdover commissioners to continue to exercise authority over road operations in their districts, but which assigned non-road duties to the two new commissioners. *Id.*, at 6a. On the same day, the same commission adopted a second resolution, the Common Fund Resolution, which abolished the practice of allocating road funds to districts, and created a common fund, thus transferring authority for determining funding priorities from the individual commissioners to the entire commission. *Id.*, at 6a-7a. However, the Common Fund Resolution contained a grandfather clause that permitted each holdover commissioner to maintain control over unspent funds for the 1986-1987 fiscal years, and a provision that required all 1987-1988 road maintenance to be done out of the "four present road shops." *Id.*, at 29a. Thus, the Common Fund Resolution, when combined with the Road Supervision Resolution, which gave the four holdover commissioners exclusive control over the road shops, meant that the four holdover commissioners could effectively have complete control over all road and bridge funds.

²⁴ The Court is strangely silent about the first half of the Etowah County majority's response to the election of Commissioner Presley. The logic of its analysis would lead to the conclusion that even the Road Supervision Resolution is not covered by §5, but one cannot be sure because the Court recognizes that an otherwise uncovered enactment "might under some circumstances rise to the level of a *de facto* replace-

III

The record indicates that the resolution challenged in the *Russell County* case may well have had a nondiscriminatory, anticorruption purpose.²⁵ It would not be covered by the narrow standard that I have proposed as a "workable rule" for deciding the *Etowah County* case. I would, however, adopt a broader standard that would require preclearance in this case as well. The proper test, I believe, is suggested by the examples of resistance to the increase in black registration that were noted in our opinion in *Perkins v. Matthews*, *supra*.²⁶

Changes from district voting to at-large voting, the gerrymandering of district boundary lines, and the replacement of an elected official with an appointed official, all share the characteristic of enhancing the power of the majority over a segment of the political community that might otherwise be adequately represented. A resolution that reallocates decisionmaking power by transferring authority from an elected district representative to an official, or a group, controlled by the majority, has the same potential for discrimination against the constituents in the disadvantaged districts.²⁷ The Russell County Resolution satisfies that test, and therefore, like both Etowah County Resolutions, should have been precleared. To hold otherwise, as the Court does today, leaves covered States free to evade the requirements of §5, and to undermine the purpose of the Act, simply by transferring the authority of an elected official, who happens to be black, to another official or group controlled by the majority.

The Court today rejects the Attorney General's position that transfers of authority are covered under §5 when "they implicate the decisionmaking authority of elected officials." *Ante*, at 17. It does so because it fears that such a rule creates line-drawing problems and moves too far afield from "voting." Whether or not the rationale advocated by the Attorney General in this case is appropriate, his judgment

ment of an elective office with an appointive one." *Ante*, at 16. Despite the Court's overriding interest in formulating "workable rules to confine the coverage of §5 to its legitimate sphere," *ante*, at 14, the scope of that exception must await future cases.

²⁵ According to one judge on the three-judge District Court, the change "was adopted to eliminate a practice that had proved inefficient and conducive to abuses . . . [and] eventually resulted in a criminal indictment of one of the commissioners." App. to Juris. Statement of Appellant Presley 25a (Hobbs, J., concurring).

²⁶ In addition to the comment by Congressman McCulloch quoted, *supra*, at 10-11, the Court also quoted from a then recent study of the operation of the Voting Rights Act by the United States Civil Rights Commission, as follows:

"The history of white domination in the South has been one of adaptiveness, and the passage of the Voting Rights Acts and the increased black registration that followed has resulted in new methods to maintain white control of the political process.

"For example, State legislatures and political party committees in Alabama and Mississippi have adopted laws or rules since the passage of the act which have had the purpose or effect of diluting the votes of newly enfranchised Negro voters. These measures have taken the form of switching to at-large elections where Negro voting strength is concentrated in particular election districts, facilitating the consolidation of predominantly Negro and predominantly white counties, and redrawing the lines of districts to divide concentrations of Negro voting strength." *Perkins v. Matthews*, 400 U.S., at 389.

²⁷ In Russell County, the voters continue to elect county commissioners, but the most significant power previously held by those commissioners has been shifted to the county engineer, who is appointed by the Commission. The effect of this change, as in *Bunton v. Patterson*, 393 U.S., at 550-551 (change in which office is made appointive rather than elective is subject to §5 preclearance), and *McCain v. Lybrand*, 465 U.S., at 250, n. 17, was less power for the voters over local affairs.

concerning the proper disposition of these two cases is unquestionably correct.

I would therefore reverse in both cases.

EDWARD STILL, Birmingham, Ala. (JAMES U. BLACKSHER, JOHN C. FALKENBERRY, LESLIE M. PROLL, PAMELA KARAN, and LANI GUINIER, on the briefs) for appellants; ROBERT A. LONG JR., Asst. to Sol. Gen. (KENNETH W. STARR, Sol. Gen., JOHN R. DUNNE, Asst. Atty. Gen., JOHN G. ROBERTS JR., Dpty. Sol. Gen., ROGER CLEGG, Dpty. Asst. Atty. Gen., and DAVID K. FLYNN and IRVING GORNSTEIN, Dept. of Justice attys., on the briefs) as amicus curiae supporting appellants; PAUL M. SMITH, Washington, D.C. (KLEIN, FARR, SMITH & TARANTO, GEORGE HOWELL (JACK) FLOYD, MARY ANN ROSS STACKHOUSE, JAMES W. WEBB, KENDRICK E. WEBB, and WEBB, CRUMPTON, MCGREGOR, DAVIS & ALLEY, on the briefs) for appellees.

No. 90-970

LECHMERE, INC., PETITIONER v. NATIONAL LABOR RELATIONS BOARD

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

Syllabus

No. 90-970. Argued November 12, 1991—Decided January 27, 1992

The National Labor Relations Act (NLRA) guarantees employees "the right to self-organization, to form, join, or assist labor organizations," § 7, and makes it an unfair labor practice for an employer "to interfere with, restrain, or coerce employees" in the exercise of their § 7 rights, § 8(a)(1). Petitioner Lechmere, Inc., owns and operates a retail store located in a shopping plaza in a large metropolitan area. Lechmere is also part owner of the plaza's parking lot, which is separated from a public highway by a 46-foot wide grassy strip, almost all of which is public property. In a campaign to organize Lechmere employees, nonemployee union organizers placed handbills on the windshields of cars parked in the employees' part of the parking lot. After Lechmere denied the organizers access to the lot, they distributed handbills and picketed from the grassy strip. In addition, they were able to contact directly some 20% of the employees. The union filed an unfair labor practice charge with respondent National Labor Relations Board (Board), alleging that Lechmere had violated the NLRA by barring the organizers from its property. An administrative law judge ruled in the union's favor, recommending that Lechmere, *inter alia*, be ordered to cease and desist from barring the organizers from the parking lot. The Board affirmed, relying on its ruling in *Jean Country*, 291 N. L. R. B. 11, that in all access cases the Board should balance (1) the degree of impairment of the § 7 right if access is denied, against (2) the degree of impairment of the private property right if access is granted, taking into consideration (3) the availability of reasonably effective alternative means of exercising the § 7 right. *Id.*, at 14. The Court of Appeals enforced the Board's order.

Held: Lechmere did not commit an unfair labor practice by barring nonemployee union organizers from its property.

(a) By its plain terms, the NLRA confers rights only on employees, not on unions or their nonemployee organizers. Thus, as a rule, an employer cannot be compelled to allow nonemployee organizers onto his property. *NLRB v. Babcock & Wilcox Co.*, 351 U. S. 105, 113. *Babcock's* holding was neither repudiated nor modified by this Court's decisions in *Central Hardware Co. v. NLRB*, 407 U. S. 539, and *Hudgens v. NLRB*, 424 U. S. 507. See also *Sears, Roebuck & Co. v. San Diego County District Council of Carpenters*, 436 U. S. 180.

(b) At least as applied to nonemployee union organizers, *Jean Country* is inconsistent with this Court's past interpretation of § 7. *Babcock's* teaching is straightforward: § 7 simply does not protect nonemployee union organizers *except* in the rare case where "the inaccessibility of employees makes ineffective the reasonable attempts by nonemployees to communicate with them through the usual channels." 351 U. S., at 112. It is only when reasonable access to employees is infeasible that it becomes appropriate to balance § 7 and private property rights.

(c) The facts in this case do not justify application of *Babcock's* inaccessibility exception. Because Lechmere's employees do not reside on its property, they are presumptively not "beyond the reach" of the union's message. Nor does the fact that they live in a large metropolitan area render them "inaccessible." Because the union failed to

establish the existence of any "unique obstacles" that frustrated access to Lechmere's employees, the Board erred in concluding that Lechmere committed an unfair labor practice by barring the nonemployee organizers from its property.

914 F. 2d 313, reversed.

THOMAS, J., delivered the opinion of the Court, in which REHNQUIST, C. J., and O'CONNOR, SCALIA, KENNEDY, and SOUTER, JJ., joined. WHITE, J., filed a dissenting opinion, in which BLACKMUN, J., joined. STEVENS, J., filed a dissenting opinion.

JUSTICE THOMAS delivered the opinion of the Court.

This case requires us to clarify the relationship between the rights of employees under § 7 of the National Labor Relations Act, 49 Stat. 452, as amended, 29 U. S. C. § 157, and the property rights of their employers.

I

This case stems from the efforts of Local 919 of the United Food and Commercial Workers Union, AFL-CIO, to organize employees at a retail store in Newington, Connecticut, owned and operated by petitioner Lechmere, Inc. The store is located in the Lechmere Shopping Plaza, which occupies a roughly rectangular tract measuring approximately 880 feet from north to south and 740 feet from east to west. Lechmere's store is situated at the Plaza's south end, with the main parking lot to its north. A strip of 13 smaller "satellite stores" not owned by Lechmere runs along the west side of the Plaza, facing the parking lot. To the Plaza's east (where the main entrance is located) runs the Berlin Turnpike, a four-lane divided highway. The parking lot, however, does not abut the Turnpike; they are separated by a 46-foot-wide grassy strip, broken only by the Plaza's entrance. The parking lot is owned jointly by Lechmere and the developer of the satellite stores. The grassy strip is public property (except for a four-foot-wide band adjoining the parking lot, which belongs to Lechmere).

The union began its campaign to organize the store's 200 employees, none of whom was represented by a union, in June 1987. After a full-page advertisement in a local newspaper drew little response, nonemployee union organizers entered Lechmere's parking lot and began placing handbills on the windshields of cars parked in a corner of the lot used mostly by employees. Lechmere's manager immediately confronted the organizers, informed them that Lechmere prohibited solicitation or handbill distribution of any kind on its property,¹ and asked them to leave. They did so, and Lechmere personnel removed the handbills. The union organizers renewed this handbilling effort in the parking lot on several subsequent occasions; each time they were asked to leave and the handbills were removed. The organizers then relocated to the public grassy strip, from where they attempted to pass out handbills to cars entering the lot during hours (before opening and after closing) when the drivers were assumed to be primarily store employees. For one month, the union organizers returned daily to the grassy strip to picket Lechmere; after that, they picketed intermittently for

¹Lechmere had established this policy several years prior to the union's organizing efforts. The store's official policy statement provided, in relevant part:

"Non-associates [i.e., nonemployees] are prohibited from soliciting and distributing literature at all times anywhere on Company property, including parking lots. Non-associates have no right of access to the non-working areas and only to the public and selling areas of the store in connection with its public use." Brief for Petitioner 7.

On each door to the store Lechmere had posted a 6 in. by 8 in. sign reading: "TO THE PUBLIC. No Soliciting, Canvassing, Distribution of Literature or Trespassing by Non-Employees in or on Premises." App. 115-116. Lechmere consistently enforced this policy inside the store as well as on the parking lot (against, among others, the Salvation Army and the Girl Scouts).

In the Supreme Court of the United States

OCTOBER TERM, 1991

LAWRENCE C. PRESLEY, ET C., APPELLANT

v.

ETOWAH COUNTY COMMISSION, ET AL.

ED PETER MACK, ET AL., APPELLANTS

v.

RUSSELL COUNTY COMMISSION, ET AL.

**ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF ALABAMA**

**BRIEF FOR THE UNITED STATES
AS AMICUS CURIAE SUPPORTING APPELLANTS**

KENNETH W. STARR
Solicitor General

JOHN R. DUNNE
Assistant Attorney General

JOHN G. ROBERTS, JR.
Deputy Solicitor General

ROGER CLEGG
Deputy Assistant Attorney General

ROBERT A. LONG, JR.
Assistant to the Solicitor General

DAVID K. FLYNN
IRVING GORNSTEIN
Attorneys

*Department of Justice
Washington, D.C. 20530
(202) 514-2217*

QUESTIONS PRESENTED

The ultimate question presented in both cases is whether a transfer of decisionmaking authority from one elected official or set of officials to another official or set of officials is a "change with respect to voting" covered by Section 5 of the Voting Rights Act of 1965, 42 U.S.C. 1973c, regardless of whether the officials serve the same or different voting constituencies and regardless of whether the transferred authority is more or less important than other duties of the office.

1. In No. 90-711, the specific question is whether a county commission's decision to transfer authority to determine road work priorities from individual commissioners elected from single-member districts to the entire commission is a change "with respect to voting" under Section 5.

2. In No. 90-712, the specific question is whether a State's transfer of road work authority from county commissioners elected at large from residency districts to a county engineer appointed by the commission is a change "with respect to voting" under Section 5.

TABLE OF CONTENTS

	Page
Interest of the United States	1
Statement	2
Summary of argument	7
Argument:	
I. A change in the decisionmaking power of an elected official is a change with respect to voting requiring preclearance under Section 5	10
A. Section 5 applies to all changes that affect "the power of a citizen's vote"	10
B. Some reallocations of authority are covered by Section 5	13
C. Changes in the power of elected officials are subject to preclearance when the changes re- allocate decisionmaking authority	17
1. The district court's "different constitu- ency" rule is too narrow	19
2. There is no exception to Section 5 for minor changes	21
3. The district court's standard confuses the questions whether a change is subject to preclearance and whether the change should be precleared	22
II. The changes at issue here reallocated the deci- sionmaking powers of elected officials, and there- fore are subject to preclearance under Section 5..	23
Conclusion	26
Appendix	1a

TABLE OF AUTHORITIES

Cases:

<i>Allen v. State Bd. of Elections</i> , 393 U.S. 544 (1969)	8, 9, 11, 12, 13, 21, 24
<i>City of Lockhart v. United States</i> , 460 U.S. 125 (1983)	9, 12, 13, 19

IV

Cases—Continued:

Page

<i>City of Rome v. United States</i> , 446 U.S. 156 (1980)	26
<i>Clark v. Roemer</i> , No. 90-952 (June 13, 1991)	23
<i>County Council of Sumter County v. United States</i> , 555 F. Supp. 694 (D.D.C. 1983)	15
<i>Dougherty County Bd. of Educ. v. White</i> , 489 U.S. 32 (1978)	11, 12
<i>Georgia v. United States</i> , 411 U.S. 526 (1973)	12
<i>Hallstrom v. Tillamook County</i> , 493 U.S. 20 (1989)	11
<i>Hardy v. Wallace</i> , 603 F. Supp. 174 (N.D. Ala. 1985)	15
<i>Horry County v. United States</i> , 449 F. Supp. 990 (D.D.C. 1978)	14-15, 20
<i>Houston Lawyers' Ass'n v. Texas Attorney General</i> , Nos. 90-813 & 90-974 (June 20, 1991)	25
<i>McCain v. Lybrand</i> , 465 U.S. 236 (1984)	11, 14, 22
<i>Morris v. Gressette</i> , 432 U.S. 491 (1977)	22
<i>NAACP v. Hampton County Election Comm'n</i> , 470 U.S. 166 (1985)	7, 11, 16
<i>Perkins v. Matthews</i> , 400 U.S. 879 (1971)	11, 12, 22, 23
<i>Robinson v. Alabama State Dep't of Educ.</i> , 652 F. Supp. 484 (M.D. Ala. 1987)	16
<i>Rojas v. Victoria Indep. School Dist.</i> , Civ. A. No. V-87-16 (S.D. Tex. Mar. 29, 1988), aff'd, 490 U.S. 1001 (1989)	18
<i>South Carolina v. Katzenbach</i> , 383 U.S. 301 (1966)	8, 14
<i>Thornburg v. Gingles</i> , 478 U.S. 30 (1986)	19

Constitution and statutes:

U.S. Const.:

Amend. XIV	4
Amend. XV	4

Civil Rights Acts of 1964, Tit. VI, 42 U.S.C. 2000e et seq.	4
--	---

Voting Rights Act of 1965, 42 U.S.C. 1971 et seq.:	
§ 2, 42 U.S.C. 1973	2, 4
§ 4(b), 42 U.S.C. 1973b(b)	2

V

Statutes—Continued:

§ 5, 42 U.S.C. 1973c	1, 2, 5, 6, 7, 8, 9, 12, 13, 14, 15,
§ 14(c) (1), 42 U.S.C. 1973l(c) (1)	
Ala. Code § 23-1-80 (1975 & Supp. 1990)	

Miscellaneous:

S. Rep. No. 417, 97th Cong., 2d Sess. (1982)	
S. Rep. No. 295, 94th Cong., 1st Sess. (1975)	

In the Supreme Court of the United States

OCTOBER TERM, 1991

No. 90-711

LAWRENCE C. PRESLEY, ETC., APPELLANT

v.

ETOWAH COUNTY COMMISSION, ET AL.

No. 90-712

ED PETER MACK, ET AL., APPELLANTS

v.

RUSSELL COUNTY COMMISSION, ET AL.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF ALABAMA

BRIEF FOR THE UNITED STATES
AS AMICUS CURIAE SUPPORTING APPELLANTS

INTEREST OF THE UNITED STATES

These consolidated appeals present the question whether a transfer of decisionmaking authority from one elected official or set of officials to another official or set of officials is a change "with respect to voting" subject to preclearance under Section 5 of the Voting Rights Act of 1965, 42 U.S.C. 1973c. Under Section 5, the Attorney General is responsible for reviewing voting changes submitted by covered jurisdictions for administrative pre-

clearance. The Attorney General also has authority under the Act to bring actions to prevent unprecleared changes from taking effect. The Court's resolution of these cases will affect the scope of the Attorney General's duties under Section 5.

On April 11, 1991, in response to this Court's invitation, the Solicitor General submitted a brief expressing the views of the United States. The brief generally supported appellants' position and recommended that the Court note probable jurisdiction in both cases. The United States also participated as an amicus curiae in the district court.

STATEMENT

1. On November 1, 1964 (the date Section 5 of the Voting Rights Act became applicable to appellees, see 42 U.S.C. 1973b(b)), the Etowah County Commission consisted of five members: four commissioners elected at large but required to reside in separate "residency districts," and a chairman elected at large. J.S. App. A4.¹ The four commissioners each exercised complete control over a road shop, crew and equipment in their respective residency districts. *Ibid.* The commission allocated road funds to each district based on projected need. *Ibid.* The four "road commissioners" then unilaterally determined work priorities in their own districts. *Ibid.*

In 1986, the Commission entered into a consent decree resolving litigation under Section 2 of the Voting Rights Act of 1965, 42 U.S.C. 1973. J.S. App. A4-A5. The decree expanded the Commission to six members, all of whom eventually would be elected from single-member districts. *Id.* at A5. Two commissioners were elected from districts in December 1986; Appellant Presley, the

¹ The district court's opinion is reproduced in the appendices to the Jurisdictional Statements in both No. 90-711 and No. 90-712; references herein to "J.S. App." may be found in the appendix to either filing.

first black commissioner in Etowah County in recent history, is one of these two. Under the decree, two of the at-large holdovers ran from districts and were elected in 1988; the other two were to run from districts in 1990. *Ibid.*

The consent decree specified that the commissioners elected in 1986 were to have the same duties as the four holdovers. J.S. App. A5. In August 1987, however, the Commission passed a "road supervision" resolution providing that each of the four holdover commissioners would continue to exercise authority over road operations in their districts. *Ibid.* The resolution further provided that the "old four" would oversee road work throughout Etowah County. *Id.* at A5-A6. The resolution assigned non-road duties to the two new commissioners. *Id.* at A6. The effect of the resolution was to strip the two new commissioners of any supervisory authority over road operations. Not surprisingly, the road supervision resolution was passed by a vote of four to two, over the opposition of the two new commissioners. *Id.* at A5.

On the same day, the Commission adopted a second resolution by an identical vote of four to two. J.S. App. A6-A7. This resolution abolished the practice of allocating road funds to districts. Instead, the resolution provided that road funds would be retained in a common fund for use without regard to district lines. *Ibid.* The effect of this "common fund" resolution was to transfer authority to determine funding priorities from individual commissioners to the entire commission. Neither the road supervision resolution nor the common fund resolution was submitted for preclearance.

2. On November 1, 1964, the Russell County Commission consisted of three members elected at large from "residency districts." J.S. App. A2. In 1972, as a result of a court order to comply with the one-person, one-vote rule, the Commission was expanded from three to five members. Phenix City, the largest city in the county became the fourth residency district; two commissioner were required to reside there. *Ibid.*

Under the system adopted in 1972, each of the three rural commissioners exercised authority over a separate road shop. J.S. App. A2. (The two Phenix City commissioners lacked such authority, because Russell County generally does not fund or maintain city roads. See *id.* at A2 n.2). The three rural commissioners each set road work priorities, bought equipment, and hired and managed personnel within their districts. *Id.* at A2-A3. Each commissioner also approved funding for routine work. *Id.* at A3. Funding for new or major construction, however, required Commission approval. *Id.* at A3 n.3. A county engineer, appointed by the Commission, assisted the road commissioners in carrying out their responsibilities. *Id.* at A3.

In 1979, after an investigation uncovered corruption in Russell County's road operations, the Alabama legislature enacted a statute transferring all responsibility for road work to the county engineer. J.S. App. A3. The 1979 statute requires the engineer to perform road work without regard to district lines, thereby establishing what is known as a "unit system." *Ibid.* The 1979 statute was not submitted for preclearance.

In 1985, the Commission entered into a consent decree to resolve litigation under Section 2 of the Voting Rights Act. J.S. App. A4. Under this decree, the Commission was expanded from five to seven members, with each member elected from a single-member district. *Ibid.* Appellants Mack and Gosha were elected to office under this system in 1986, and became the first two black commissioners in recent history. *Ibid.*

3. In 1989, appellants filed suit in federal district court alleging that the conduct of road operations in Etowah and Russell Counties violated previous court orders, the Fourteenth and Fifteenth Amendments, Title VI of the Civil Rights Act of 1964, and Section 2 of the Voting Rights Act. J.S. App. A7. Thereafter, appellants amended their complaint to allege that Russell County's failure to preclear its transfer of road authority to the

county engineer, and Etowah's failure to preclear the road supervision and common fund resolutions, violated Section 5 of the Voting Rights Act. *Ibid.* A three-judge court was convened to consider the Section 5 claims. *Id.* at A7-A8.

The court held that transfers of authority are subject to Section 5 preclearance when they "effect a significant relative change in the powers exercised by governmental officials elected by, or responsible to, substantially different constituencies of voters." J.S. App. A13-A14. Since minority groups often have different levels of voting strength in different constituencies, the court explained, a transfer of authority from an official elected by one constituency to an official elected by another may have a potential for discrimination. *Id.* at A14. Such a potential is unlikely to exist, the court thought, when the officials are elected by the same constituency. *Ibid.* Even when officials with different constituencies are involved, the court added, "minor or inconsequential" transfers of authority do not have a "significant potential impact on voting rights." *Ibid.*

Applying these principles, the court concluded that Russell County's transfer of road supervision authority from the individual commissioners to the county engineer was not a change covered by Section 5, because both the commissioners and the engineer ultimately were answerable to the same constituency—the entire Russell County electorate. J.S. App. A16-A18. Although individual commissioners were required to reside in a particular district, the court explained, they "were elected by, and thus politically responsible to, all the voters of Russell County." *Id.* at A16. Similarly, the county engineer, although appointed, is responsible to the commission, and that body is responsible to all county voters. *Id.* at A16-A17.

The court also concluded that Etowah County's common fund resolution did not require preclearance. The court acknowledged that the common fund resolution transferred authority between officials with different con-

stituencies. Before enactment of the resolution, individual commissioners elected from, or facing election from, single-member districts could determine priorities for road repair in their own districts; afterwards, the entire commission had this authority. J.S. App. A18-A19. The court nonetheless concluded that this change did not affect voting since the power to set internal priorities was "minor and inconsequential" compared to the entire commission's authority, both before and after the resolution, to determine the amount of money to be allocated to each district. *Id.* at A19.

In contrast, the court held that Etowah County's road supervision resolution was covered by Section 5. J.S. App. A20-A21. The court concluded that "[t]he potential for discrimination posed by this change is blatant and obvious." *Id.* at A20. The court explained that "[w]hereas before 1987 all the voters of Etowah County participated in choosing the commissioners responsible for road management, the 1987 resolution stripped the voters in [two] districts * * * of any electoral influence over such commissioners." *Ibid.* Thus, "[a]uthority over the most important aspect of county governance was shifted from officials responsible to the entire county to officials (albeit the same individuals) responsible to only two thirds of the county's voters." *Id.* at A20-A21.²

Judge Thompson dissented in part. He agreed with the majority that Etowah County's road supervision resolution was subject to the preclearance requirement, but dissented from the court's conclusion that the common fund resolution did not require preclearance. J.S. App. A27-A33. In concluding that the power to set internal priorities was comparatively insignificant, Judge Thompson said, the majority ignored the realities of road operations in Etowah County. *Id.* at A32. The allocation of funds among districts "has never been a bone of con-

² Etowah County subsequently repealed the road supervision resolution, and has not cross-appealed from this portion of the district court's ruling. 90-711 Mot. to Aff. 2 n.3.

tention." *Ibid.* Instead, a "commissioner's real authority lies * * * in how those funds are used after they are allocated." *Ibid.* In Judge Thompson's view, "[t]he common fund resolution and the road supervision resolution, working together, took this authority away from the two new commissioners and gave it exclusively to the four holdover commissioners." *Ibid.*

Judge Thompson also dissented from the court's conclusion that Russell County's transfer of road authority from individual commissioners to the county engineer did not constitute a change affecting voting. J.S. App. A33-A35. According to Judge Thompson, the court's holding ignored the possibility that the commissioners might have been more accountable to voters in their residency districts than to those outside their districts. *Id.* at A34. More fundamentally, Judge Thompson disagreed with the majority's conclusion that transfers of authority are covered by Section 5 only when they occur between officials with different constituencies. Pet. App. A35-A36. The question whether there is a potential for discrimination, he thought, should not be decided on the basis of a rigid rule. *Id.* at A37-A38. If a limiting principle were required, Judge Thompson stated, he would find it sufficient for plaintiffs to show that "there has been a significant and fundamental change in the nature of the duties traditionally exercised by elected officials." *Id.* at A38.

SUMMARY OF ARGUMENT

1. A change in the decisionmaking power of an elected official is a change "with respect to voting" covered by Section 5 of the Voting Rights Act. Congress intended Section 5 to be applied broadly. In deciding whether a change is subject to preclearance, the court's inquiry is limited to whether the change has the potential for discrimination. See *NAACP v. Hampton County Election Comm'n*, 470 U.S. 166, 181 (1985). Moreover, any change with respect to voting, no matter how small or minor is

subject to preclearance. See *Allen v. State Bd. of Elections*, 393 U.S. 544, 566-568 (1969). In addition, it is now firmly established that Section 5 applies not only to practices that directly affect voter registration and balloting, but to all practices that affect "the power of a citizen's vote." *Id.* at 569.

Some reallocations of the power of elected officials plainly affect the power of a citizen's vote. For example, eliminating all the powers of an elected body would reduce citizens' votes for members of that body to a nullity. Because such changes could have a racial purpose or effect, they have the potential for discrimination and are covered by Section 5.

If all reallocations of authority were outside the scope of Section 5, a covered jurisdiction could negate the election of a candidate favored by minority voters simply by reallocating the successful candidate's authority to other elected or appointed officials. That would defeat the purpose of Section 5, which is to bar measures that would "evade the remedies for voting discrimination contained in the Act itself." *South Carolina v. Katzenbach*, 383 U.S. 301, 335 (1966). Accordingly, the lower courts and the Department of Justice consistently have recognized that some reallocations of authority are covered by Section 5.

We agree with the district court that not all changes in the powers of elected officials are subject to preclearance. But we disagree with the standard devised by the district court, which requires preclearance only if the change involves (1) officials responsible to different constituencies, and (2) relatively important duties. In our view, transfers of authority are covered by Section 5 when they implicate an elected official's *decisionmaking* authority. Such changes go to the core of a citizen's voting power, and therefore are subject to preclearance.

The district court erred in concluding that transfers between officials who serve the same constituency have no potential for discrimination. Transfers of power from

a larger to a smaller body, or from a body for which single-shot voting is permitted to one for which such voting is prohibited, for instance, obviously have the potential to be discriminatory, even though both bodies are elected by the same constituency. In fact, the Attorney General has objected to transfers of authority between officials serving the same constituency on at least three occasions. In addition, the "same constituency" rule is inconsistent with this Court's decision in *City of Lockhart v. United States*, 460 U.S. 125 (1983), which held that expansion of a body from three to five members required preclearance even though both the smaller body and the larger body were elected by the same constituency.

The district court also erred in concluding that relatively unimportant transfers of authority are not subject to preclearance. The statute plainly states that Section 5 applies to "any * * * standard, practice, or procedure with respect to voting," 42 U.S.C. 1973c (emphasis added), and it is well settled that there is no *de minimis* exception to the preclearance requirement. See *Allen*, 393 U.S. at 566. An exception for "minor" transfers of authority would be difficult to administer and would undermine the prophylactic purpose of Section 5. The district court's standard also blurs the distinction between the question whether a change is subject to preclearance (which turns on whether changes of that type have the potential for discrimination) and the question whether the change should be precleared (which turns on whether the particular change at issue would have a discriminatory purpose or effect). Because changes in the decisionmaking power of an elected official have the potential for discrimination, all such changes are subject to preclearance. Whether the purpose or effect is present, and the weight to be given the State's legitimate interests, are matters to be considered after the submission has been made.

2. The reallocations of authority at issue here must be submitted for preclearance. In *Russell County v. T. T. T.*

making authority concerning road matters was transferred from individual commissioners elected at large to a county engineer appointed by the commission. Similarly, Etowah County's common fund resolution transferred authority to decide the priority of road projects from individual commissioners elected from single-member districts to the commission as a whole.

ARGUMENT

I. A CHANGE IN THE DECISIONMAKING POWER OF AN ELECTED OFFICIAL IS A CHANGE WITH RESPECT TO VOTING REQUIRING PRECLEARANCE UNDER SECTION 5

The central question presented by these appeals is whether a change in the decisionmaking authority of an elected official is a change "with respect to voting" under Section 5 of the Voting Rights Act of 1965. The district court held that such changes are covered by Section 5, but only when they involve a "significant relative change" in power between officials who are "elected by, or responsible to, substantially different constituencies of voters." J.S. A13-A14. We agree that a change in an elected official's authority can be a change with respect to voting. In our view, however, a change in the decisionmaking authority of an elected official is covered by Section 5 even if the officials involved are responsible to the same constituency, and even if the authority at issue may be viewed as relatively minor or inconsequential. Under this standard, the changes at issue here require preclearance.

A. Section 5 Applies To All Changes That Affect "The Power Of A Citizen's Vote"

Section 5 of the Voting Rights Act provides that certain States and political subdivisions, including appellees, may not implement "any voting qualification or prerequisite to voting, or any standard, practice, or procedure

with respect to voting" without first obtaining preclearance from the United States District Court for the District of Columbia or the Attorney General. 42 U.S.C. 1973c. To receive preclearance, a covered jurisdiction must show that a proposed change "does not have the purpose and will not have the effect of denying or abridging the right to vote on account of race or color, or [membership in a language minority group]." *Ibid.*

This Court has recognized that Section 5 draws a sharp distinction between the procedural question whether a change is subject to preclearance and the substantive question whether the change should be precleared. In deciding the first question, a court may not inquire into whether the change has a discriminatory purpose or effect. See *NAACP v. Hampton County Election Comm'n*, 470 U.S. 166, 181 (1985); *McCain v. Lybrand*, 465 U.S. 236, 250 n.17 (1984); *Perkins v. Matthews*, 400 U.S. 379, 383-385 (1971). Instead, the inquiry is limited to whether the challenged alteration has the "potential for discrimination." *Hampton County*, 470 U.S. at 181; *Dougherty County Bd. of Educ. v. White*, 439 U.S. 32, 42 (1978). Moreover, a court may not exempt from preclearance changes it views as insignificant. The plain language of the statute makes the preclearance requirement applicable to *any* change with respect to voting, no matter how small or minor. See *Allen v. State Bd. of Elections*, 393 U.S. 544, 566-568 (1969) ("It is significant that Congress chose not to include even * * * minor exceptions in § 5, thus indicating an intention that all changes, no matter how small, be subjected to § 5 scrutiny."). See also *Perkins v. Matthews*, 400 U.S. at 387. See generally *Hallstrom v. Tillamook County*, 493 U.S. 20, 25 (1989) (Courts "are not at liberty to create an exception where Congress has declined to do so").

The Voting Rights Act defines "vote" and "voting" to include "all action necessary to make a vote effective." 42 U.S.C. 1973l(c)(1). Relying on this broad definition, and Congress's refusal to make any exceptions to Section 5's

preclearance requirement, this Court held in *Allen* that Section 5 is not limited to changes directly affecting the casting of a ballot. 393 U.S. at 563-569. The Court explained that "[t]he right to vote can be affected by a dilution of voting power as well as by an absolute prohibition on casting a ballot." *Id.* at 569. *Allen* held, *inter alia*, that a change from district to at-large voting, and a change from an elected county superintendent of education to a superintendent appointed by the board of education, were covered by Section 5.⁸ 393 U.S. at 569-570.

In subsequent cases, this Court has reaffirmed the broad definition of Section 5 coverage adopted in *Allen*. In *Perkins v. Matthews*, 400 U.S. 379 (1971), the Court held that annexations which enlarge the number of eligible voters are covered by Section 5 because they dilute "the weight of the votes of the voters to whom the franchise was limited before the annexation." 400 U.S. at 388. In *Georgia v. United States*, 411 U.S. 526, 532-533 (1973), the Court held that Section 5 applies to legislative reapportionments since they too can dilute minority voting power. And in *City of Lockhart v. United States*, 460 U.S. 125, 131-132, 134-135 (1983), the Court held that the preclearance requirement applies to the introduction of numbered posts and staggered terms, because such devices may frustrate the use of single-shot voting, a technique that permits minority voters to concentrate their vote behind a single candidate. *Id.* at 135.

Congress reenacted Section 5 in 1970, 1975, and 1982. With each reenactment, Congress has reaffirmed the validity of *Allen*'s interpretation of congressional intent. See S. Rep. No. 417, 97th Cong., 2d Sess. 6-7 (1982); S. Rep. No. 295, 94th Cong., 1st Sess. 16 (1975); *Dougherty County Bd. of Educ.*, 439 U.S. at 38-39; *Georgia v. United States*, 411 U.S. at 533. Thus, it is now firmly established that the preclearance requirement applies not only to prac-

⁸ In all, the Court's opinion in *Allen* decided three consolidated cases from Mississippi and one case from Virginia. See 393 U.S. at 547.

tices that directly affect the process by which voters are registered and cast their ballots, but also to all practices that affect "the power of a citizen's vote." *Allen*, 393 U.S. at 569.

B. Some Reallocations Of Authority Are Covered By Section 5

Some changes in the powers of an elected official plainly affect the power of a citizen's vote and therefore are covered by Section 5. To take an extreme example, a change eliminating all of a county commission's powers and making that body purely ceremonial would reduce the citizen's vote for county commissioners to a virtual nullity. Cf. *Allen*, 393 U.S. at 569-570 (change making an elective office appointive is covered by Section 5). Less drastic changes in the authority of an elected body can also affect the power of a citizen's vote. For example, stripping a school board of its power to set the tax rate would diminish the voting power of citizens who vote in school board elections, even if the school board were to retain other significant powers. After the change, a vote for school board members, although not meaningless, would mean less than it did before. And such a diminution in voting power could have a racial purpose or effect and thus have the potential for discrimination.

Although this Court has not yet decided whether changes in the powers of an elected official or group of officials are covered by Section 5, the Court has held that a change from a three-member elected body to a five-member elected body required preclearance, because it changed the voting power of the individual members of the three-member body. *City of Lockhart v. United States*, *supra*. As the Court explained in *Lockhart*, "[i]n moving from a three-member commission to a five-member council, [the city] has changed the nature of the seats at issue. * * * For example, [two of the old seats] now constitute only 40% of the council, rather than 67% of the commission." 460 U.S. at 131. *City of Lockhart v. United States*, 460 U.S. at 131.

ing that reducing the power of an individual member of an elected body by increasing the size of the body requires preclearance, it is difficult to see how reducing the power of the entire elected body can fall outside the scope of Section 5.⁴

A decision excluding all reallocations of authority from the scope of Section 5 would have far-reaching consequences. Since the enactment of the Voting Rights Act, minority voters in many jurisdictions have elected candidates of their choice to office for the first time in recent history. If transfers of authority were not subject to preclearance, a jurisdiction could negate the election of a minority candidate to a governing body by taking away the official's authority and reallocating it to other officials over whom minority voters have less influence. This would defeat the purpose of Section 5, which is to prevent covered jurisdictions from implementing measures that would "evade the remedies for voting discrimination contained in the Act itself." *South Carolina v. Katzenbach*, 383 U.S. 301, 335 (1966).

The Etowah County case illustrates this danger. Immediately after a minority-supported candidate was elected to office for the first time in recent memory, the commission stripped him of all authority over road work. The district court found that the potential for discrimination against minority voters posed by this change was "blatant and obvious." J.S. App. A20.

The lower courts have uniformly concluded that a change in the authority of elected officials can be a change with respect to voting. In *Horry County v. United*

⁴ In *McCain v. Lybrand*, 465 U.S. 236 (1984), state legislation changed the governing body of a county from an appointed commission to an elected council with increased legislative powers. The parties stipulated that this legislation incorporated changes with respect to voting, and the Court therefore was not required to address the issue. The Court nevertheless noted that "several changes are suggested," including "the basic reallocation of authority from the state legislative delegation to the Council." 465 U.S. at 250 n.17.

States, 449 F. Supp. 990 (D.D.C. 1978) (three-judge court), a state statute increased the powers of the county commission and provided that commissioners would be elected rather than appointed by the governor. The statute also transferred most of the duties of the county chairman to an administrator appointed by the commission. The court held that the first change "reallocate[d] governmental powers among elected officials voted upon by different constituencies," and therefore was subject to preclearance. *Id.* at 995. The court also concluded that the duties of the chairman "are sufficiently different that in this respect [the statute] constitutes a change in electoral practices requiring preclearance under Section 5 of the Voting Rights Act." *Ibid.* Similarly, in *Hardy v. Wallace*, 603 F. Supp. 174 (N.D. Ala. 1985) (three-judge court), a state statute transferred the authority to appoint the Greene County racing commission from the county's state legislative delegation to the governor. The court held that this change was subject to Section 5 preclearance because of "its effect on the power of the voters." *Id.* at 178. The court explained that "the transfer of appointment authority to the governor, over 99.7% of whose constituents are not inhabitants of Greene County, substantially dilutes the power of the voters in Greene County by effectively eliminating the power of such voters over the Commission." *Id.* at 179.⁵ See also *County Council of Sumter County v. United States*, 555 F. Supp. 694 (D.D.C. 1983) (three-judge court) (transfer

⁵ The Department of Justice originally concluded that the legislation at issue in *Hardy v. Wallace* was subject to preclearance, relying in part on *Horry County v. United States*, *supra*. See 603 F. Supp. at 179-180 (decision letter of June 18, 1984). On reconsideration, the Department concluded that while "it would be wrong to conclude that no reallocation of governmental power can ever be considered a change 'with respect to voting,'" the particular change at issue was not covered by Section 5. See 603 F. Supp. at 181-182 (decision letter of Oct. 31, 1984). Further experience with Section 5 has now led us to the view that we were right the first time, as the court in *Hardy v. Wallace* determined. See pp. 17-23, *infra*.

of legislative power formerly shared by county legislative delegation, state legislature, and governor to local governing body requires preclearance); *Robinson v. Alabama State Dep't of Educ.*, 652 F. Supp. 484 (M.D. Ala. 1987) (transfer of authority from county school board to city school board requires preclearance).

The Attorney General, whose interpretation of Section 5 is entitled to "considerable deference," *NAACP v. Hampton County Election Comm'n*, 470 U.S. at 178-179, has long treated certain changes in the power of elected officials as changes with respect to voting. The Department of Justice first focused on reallocations of authority in 1975, when South Carolina enacted "home rule" legislation authorizing its counties to adopt their own forms of local government and to assume increased powers. The Department precleared this enabling legislation, but notified the State that each implementation of it by a local government would require a separate preclearance. The State sought clarification of whether preclearance would be required in cases in which the county assumed increased powers but retained its existing form of government. In response, the Department stated that "changes in the powers and duties of the governing entity brings the transition within the purview of Section 5 even though the structure of the governing body remains the same." Letter from J. Stanley Pottinger to Daniel R. McLeod (Dec. 19, 1975) reprinted in App., *infra*, 2a. Since 1975, the Department of Justice consistently has treated home rule and other similar transfers of authority as changes with respect to voting requiring preclearance under Section 5. During this period, we have objected to transfers of authority on at least eight occasions.⁶ In addition, the

⁶ The Department has objected to the following transfers of authority: (1) Mobile, Alabama, March 2, 1976, involving a transfer of administrative duties from the entire commission to individual commissioners; (2) Charleston, South Carolina, June 14, 1977, involving a transfer of taxing authority from the legislative delegation to the county council; (3) Edgefield County, South Carolina,

Department has precleared numerous other transfers of authority submitted by jurisdictions after finding the absence of discriminatory purpose and effect.

C. Changes In The Power Of Elected Officials Are Subject To Preclearance When The Changes Reallocate Decisionmaking Authority

In our view, the hard question in this case is not whether a change in the power of an elected official can ever constitute a change with respect to voting requiring preclearance under Section 5—it plainly can—but rather whether the district court employed the correct standard to distinguish those changes that require preclearance from those that do not. The Department of Justice considered this question when it amended its Section 5 regulations in 1987, but did not attempt to provide an all-encompassing answer. At that time, we stated that "[w]hile we agree that some reallocations of authority are covered by Section 5 (e.g., * * * 'home rule'), we do not believe that a sufficiently clear principle has yet emerged distinguishing covered from noncovered reallocations." J.S. App. A15 n.13.

Since 1987, several cases, including this one, have forced us to grapple with this issue further and have led us to conclude that transfers of authority that implicate

February 8, 1979, involving a transfer of increased taxing power to the county council; (4) Colleton County, South Carolina, September 4, 1979, involving a transfer of authority to tax for school purposes from the legislative delegation to the county council; (5) Brunswick and Blynn County, Georgia, August 16, 1982, involving the abolition of separate city and county commissions and the transfer of their powers to a consolidated commission; (6) Hillsborough County, Florida, August 29, 1984, involving a transfer of power over municipalities from the legislative delegation to the county commission (objection was withdrawn because the county made clear that it did not intend to effect such a transfer); (7) Waycross, Georgia, February 16, 1988, involving a change in the duties of the mayor; and (8) San Patricio, Texas, May 7, 1990, involving a transfer of voter registration duties from the county clerk to the county tax assessor.

an elected official's *decisionmaking authority* are covered by Section 5. Changes that affect an elected official's authority to make decisions—to legislate, tax, spend, set school curricula, approve road and bridge projects, and so forth—go to the core of the citizens' voting power. Changes that do not affect an official's power to make decisions generally have no such potential to dilute the power of a citizen's vote. Although such changes may be of interest to the officeholders, officeholders are not protected by Section 5. Accordingly, such changes are outside the scope of Section 5.⁷

The district court adopted a different standard for distinguishing between covered and uncovered changes. According to the district court, transfers in authority are covered only when they (1) involve officials who are responsible to different voting constituencies, and (2) the duties transferred are not minor or inconsequential. These limitations cannot be squared with the language and purposes of Section 5.

⁷ The decision in *Rojas v. Victoria Indep. School Dist.*, Civ. A. No. V-87-16 (S.D. Tex. Mar. 29, 1988), aff'd, 490 U.S. 1001 (1989), illustrates this distinction. In *Rojas*, a school board replaced its rule that any board member could place items on the board's agenda with a rule giving the board president authority to require that items be placed on the agenda only at the request of two board members. This change did not affect the range of matters over which the school board could make decisions. Nor did it affect the power of individual members to influence those decisions, since decisions of the board required a majority vote both before and after the change. Moreover, the board's rules of procedure required a second to initiate discussion or bring a matter to a vote. Accordingly, the new agenda setting policy was not a change "with respect to voting" requiring preclearance under Section 5. For the same reason, a transfer of authority from a legislative body to a committee to make recommendations concerning proposed legislation would not be covered by Section 5, because the entire body retains the authority to decide whether to adopt the legislation. More generally, a transfer of authority to give advice or make recommendations would also be outside the reach of Section 5.

1. The District Court's "Different Constituency" Rule Is Too Narrow

The district court correctly recognized that transfers between officials with different voting constituencies can create the potential for discrimination, since "identifiable racial or ethnic groups of voters will often have different levels of voting strength in different constituencies." J.S. App. A14. The court erred, however, in concluding that transfers of authority between officials who serve the same constituency have no discriminatory potential.

To cite one example, if two elected bodies serve the same constituency, but one has many members while the other has only a few, minority voters may have a greater opportunity to elect a candidate of their choice to the larger body. See *City of Lockhart*, 460 U.S. at 136 (minority voters elected a candidate of their choice for the first time when the council expanded from three to five members). Consequently, a transfer of authority from the larger to the smaller body would have the potential to discriminate against minority voters. Similarly, if minority voters use single-shot voting to elect their preferred candidate to a county school board, and the authority to tax for school purposes is then shifted to a county commission where single-shot voting is prohibited, there is a potential for diluting minority voting strength, even if both the school board and the commission are elected at large by all residents of the county. Still again, if minority voters elect a mayor of their choice because of special circumstances (e.g., the minority candidate ran unopposed, see *Thornburg v. Gingles*, 478 U.S. 30, 51 (1986)), and authority to appoint city officials is then transferred to the city council, the change is potentially discriminatory even where both the mayor and the city council are chosen by the same electorate.

Our disagreement with the district court's "different constituency" rule is by no means academic. On at least three occasions, the Attorney General has objected to transfers of authority between officials serving the same

constituency. In one case (Mobile, Alabama, March 2, 1976), a three-member commission elected at-large sought to transfer administrative responsibilities exercised by the entire commission to individual members of the commission. Our investigation disclosed that the purpose of this reallocation was to forestall any possibility of a change to single-member districts (on the theory that it would be inappropriate to permit one area of the city to elect an official with city-wide responsibilities). In another case (Colleton County, South Carolina, September 4, 1979), the State transferred the authority to levy taxes for school purposes from the county's state legislative delegation to the county council, both of which were elected at-large by county residents. Our investigation uncovered evidence that the representatives to the legislative delegation had sought the support of black voters and had been responsive to their needs, while representatives to the county council had not. In the third case (San Patricio, Texas, May 7, 1990), the Attorney General objected when a county transferred the authority to register voters from the county clerk to the county tax assessor, both of whom are elected at-large by the entire county. Our investigation revealed that the purpose of the change was to retaliate against the county clerk for cooperating in a Section 5 review of an unrelated voting change. These objections demonstrate that the district court's "different constituency" test too narrowly defines the circumstances under which preclearance should be required.

In addition, the district court's "different constituency" rule is inconsistent with *Lockhart*. As discussed above, this Court held that the transfer of power from a three-member body to a five-member body was covered by Section 5, even though both bodies served the same voting constituency. Under the district court's "same constituency" rule, such a change would be outside the scope of Section 5. See also *Horry County*, 449 F. Supp. at 995-996 (transfer of administrative functions from chair-

man elected at-large to administrator appointed by Council elected at large is a covered change).

2. *There Is No Exception To Section 5 For Minor Changes*

The district court also erred in holding that transfers of authority that can be characterized as relatively minor or inconsequential need not be precleared under Section 5. The district court concluded that such transfers do not require preclearance because they do not have "a significant potential impact on voting rights." J.S. App. A14. But that is not the statutory test; as noted above, the preclearance requirement is not limited to changes with a "significant" impact on voting rights. On the contrary, the language of the statute makes the preclearance requirement applicable to "any * * * standard, practice, or procedure with respect to voting," no matter how small or minor. 42 U.S.C. 1973c; see *Allen*, 393 U.S. at 566. When minority voters lose the power to use their vote to affect a governmental decision, their voting power has been diminished. That they retain the power to influence what a court may regard as more important matters does not redeem that loss.

Not only does the district court's approach lack roots in the statute itself, but its standard would be difficult to administer. In many cases, the Department of Justice would find it necessary to conduct an extensive investigation simply to decide whether a change is subject to preclearance. Covered jurisdictions would face a similar burden in deciding whether they are required to submit a change. Even after investigation, it may not be clear on which side of the line a particular change falls. Matters that are very important to some voters may be of no importance at all to others. For these reasons, the district court's standard would invite litigation in every case to determine the question of coverage. That baleful result would defeat the purpose of administrative preclearance, which is "to provide a speedy alternative method of com-

pliance to covered States." *Morris v. Gressette*, 432 U.S. 491, 503 (1977). More fundamentally, the district court's standard would undermine the prophylactic purpose of Section 5 by permitting the covered jurisdiction to decide whether a transfer of authority is important enough to require preclearance. See *McCain*, 465 U.S. at 246 (Section 5 must be interpreted "in light of its prophylactic purpose and the historical experience which it reflects").

3. The District Court's Standard Confuses The Questions Whether A Change Is Subject To Preclearance And Whether The Change Should Be Precleared

The district court's standard also blurs the distinction between the procedural question whether a change must be submitted for preclearance and the substantive question whether the change should be precleared. This Court's decision in *Perkins v. Matthews*, *supra*, illustrates the difference between these two inquiries. In *Perkins*, the district court held that a jurisdiction's annexation did not have to be precleared because blacks still constituted a majority of the voters after the annexation. 400 U.S. at 385-386. Similarly, the court did not require the jurisdiction to preclear a change from single-member districts to at-large elections because blacks would still have the power to elect the candidates of their choice in at-large elections. Finally, the district court held that changes in the location of polling places did not require preclearance since the changes were dictated by necessity.

This Court reversed, holding that the district court had effectively inquired into the *merits* of whether the changes had the purpose or effect of discriminating against minority voters—a function reserved for the Attorney General and the United States District Court for the District of Columbia. 400 U.S. at 386. The Court explained that annexations that enlarge the number of eligible voters, changes to at-large election systems, and changes in polling places are practices that can, in particular cases, dis-

criminate against minority voters. Accordingly, this Court held that all such changes must be precleared. *Id.* at 387-394.

That principle applies here. A change in the decision-making power of an elected official has an effect on the voting power of those who vote for that official, and that type of change has the potential to discriminate against minority voters. Accordingly, all such changes must be submitted for preclearance, including those that appear innocuous. To be sure, a showing that the officials serve the same constituency, and that the transfer is a minor one, may be important evidence that a transfer of authority is without a discriminatory purpose or effect and should be precleared. But those factors do not eliminate the requirement that the change undergo the preclearance process.⁶

II. THE CHANGES AT ISSUE HERE REALLOCATED THE DECISIONMAKING POWERS OF ELECTED OFFICIALS, AND THEREFORE ARE SUBJECT TO PRECLEARANCE UNDER SECTION 5

For the reasons discussed above, the reallocations of authority at issue here must be submitted for preclearance under Section 5. In Russell County, decisionmaking authority over road matters was transferred from indi-

⁶ We have no quarrel with the district court's observation that Section 5 "is not to be stretched beyond the point of reason and beyond its legitimate purposes." J.S. App. A22 n.21. Congress did not intend to overwhelm the Attorney General with preclearance submissions. Cf. *Clark v. Roemer*, No. 90-952 (June 13, 1991), slip op. 11. Nor did it intend to require the States to delay implementation of any and all changes that can be linked to voting through an imaginative exercise in the conceivable. But these concerns are satisfied by limiting Section 5 coverage to changes in an elected official's decisionmaking authority. Unlike the district court's standard, this approach is consistent with the language and legislative history of Section 5, is faithful to its prophylactic purpose, and affords a reasonable degree of certainty about whether a particular change is covered.

vidual commissioners, elected at large from residency districts, to the county engineer, who is appointed by the Commission. The district court held that the change was not covered because it involved officials who serve the same constituency. For the reasons noted above, however, that is not sufficient to eliminate the potential for discrimination and therefore does not place the change outside the scope of Section 5. The public policy reasons for adopting the unit system may well support preclearance once the change is submitted. And the fact that the commissioners are answerable to all the voters of Russell County, and the county engineer is answerable to the commissioners, may also support the County's argument for preclearance.⁹ But those facts do not obviate the need to go through the process.

The Etowah common fund resolution also requires preclearance. That resolution removed the power of individual commissioners to decide which road projects in their districts would receive priority. Consequently, it involved a transfer of decisionmaking power concerning "the most important aspect of county governance" (J.S. App. 20) from one set of officials to another. See Ala. Code § 23-1-80 (1975 & Supp. 1990) (principal responsibility of county commissions is to maintain roads and bridges). The district court held that preclearance was

⁹ Although the district court concluded that the county commissioners and the county engineer answered to the same constituency, in fact appointed officials generally are not "answerable" to the electorate in the same sense as elected officials. (If they were, changes in the authority of appointed officials would be no less subject to preclearance than changes in the decisionmaking authority of elected officials.) Appointed officials may be subject to job protection of various kinds that insulates them from elected officials and voters. Even where an appointed official serves at the pleasure of an elected official, moreover, a vote against the elected official does not automatically translate into a "vote" against the appointed official. See *Allen*, 393 U.S. at 569-570 (holding that change from elected superintendent of education to superintendent appointed by the board of education is subject to preclearance).

not required because the power to set internal priorities is not as important as the power to determine overall funding. While this may be so, voters clearly have an interest in how both functions are performed. If the road to a voter's home is one the voter's commissioner would schedule for paving but the county commission as a whole would not, the transfer of authority to set road work priorities from the former to the latter may be—to that voter—an extremely important change.

The Etowah common fund resolution was passed while the Commission was undergoing a transition from an at-large system to single-member districts. Good government considerations might well call for different allocations of powers depending on whether members of an elected body serve specific districts or at large. At-large members may, for example, be expected to have the concerns of the entire county in mind in setting priorities, while members serving only a specific district might have more parochial concerns. The State's legitimate public policy reasons for a change are appropriately weighed in determining whether that change should be precleared. See *Houston Lawyers' Ass'n v. Texas Attorney General*, Nos. 90-813 & 90-974 (June 20, 1991), slip op. 6 ("State's justification for its electoral system is a proper factor for the courts to assess in a racial vote dilution inquiry."). But the facts of the Etowah County case illustrate why such justifications should be weighed during the preclearance process. As a result of the common fund resolution, individual commissioners were stripped of their power to determine district funding priorities almost immediately after minority voters were able to elect a commissioner of their choice for the first time. Such a change clearly warrants Section 5 review.¹⁰

¹⁰ In No. 90-712, appellants contend (J.S. 4-6) that a change with no potential for discrimination at the time it is implemented (and therefore not subject to preclearance), may nevertheless become subject to preclearance at a later date if subsequent changes—here, a change from at large voting to single member districts—create a

CONCLUSION

The district court's judgment should be reversed, and the case should be remanded for the entry of appropriate relief.

Respectfully submitted.

KENNETH W. STARR
Solicitor General

JOHN R. DUNNE
Assistant Attorney General

JOHN G. ROBERTS, JR.
Deputy Solicitor General

ROGER CLEGG
Deputy Assistant Attorney General

ROBERT A. LONG, JR.
Assistant to the Solicitor General

DAVID K. FLYNN
IRVING GORNSTEIN
Attorneys

JULY 1991

potential for discrimination. In our view, the changes at issue in this case were subject to the preclearance requirement at the time they were made. Accordingly, the Court need not reach this additional contention. But if the Court were to reach this question, the position of the United States is that a change not subject to preclearance at the time it is implemented may not thereafter become subject to preclearance because of subsequent, unanticipated changes. The rule appellants argue for is not derived from the language or legislative history of Section 5, and would impose an unwarranted degree of uncertainty on state and local governments. Of course, efforts to evade the preclearance requirement by implementing a covered change in two or more steps are subject to preclearance. In addition, if a covered jurisdiction fails to submit a change that is subject to preclearance, and the Department of Justice thereafter reviews it, it will consider intervening developments in determining whether to interpose an objection. See *City of Rome v. United States*, 446 U.S. 156, 186 (1980).

APPENDIX

[Dec. 19, 1975]

Honorable Daniel R. McLeod
Attorney General
State of South Carolina
P.O. Box 11549
Columbia, South Carolina 29211

Dear Mr. Attorney General:

This is in reference to your letter of September 9, 1975, concerning the adoption of a form of government by subdivisions in South Carolina under the provisions of Act R-396, the Home Rule Act. You requested clarification of a statement in my previous letter concerning the need for Section 5 preclearance of assigned forms of government which may include situations where no modification of existing government is involved. I apologize for the delay in responding.

With regard to counties, if a county is either assigned a form of government or retains a form of government which is identical in every respect to that which was in effect, without intervening change, since November 1, 1964, or has been implemented since November 1, 1964, and which has met Section 5 preclearance, then there would not be a change in a voting procedure within the meaning of the Voting Rights Act of 1965. However, Section 14-3701(b) provides that the type of government which will be assigned in the event a county does not elect to adopt another form of government will be a form "most nearly corresponding to the form in effect immediately prior to [July 1, 1976]". It thus appears that the Act anticipates that the exact form of government which is in effect on July 1, 1976, will probably not be assigned by operation of the Act and this

expectation would seem to be warranted at least in most cases in view of the broad new powers bestowed upon the governing body under the Home Rule Act.

In light of the Supreme Court's admonition in *Allen v. State Board of Elections*, 393 U.S. 544, 563 (1969), that Congress intended "that all changes, no matter how small, be subjected to Section 5 scrutiny", we believe that changes in the powers and duties of the governing entity brings the transition within the purview of Section 5 even though the structure of the governing body remains the same. However, in the event that procedures under the Home Rule Act should result in a county's retaining its previous form of government with powers and duties unchanged, then, of course, there would not be a change within the meaning of Section 5.

Likewise with regard to municipalities, if the form of government which a municipality adopts under the provision of Part II, Article 2, of the Act is identical to that which exists at the expiration of the period described in Section 6 of the Act, then, there would not be a change in voting under Section 5. However, if the new form of government which is selected by this municipality is different in any respect, including changes in the powers and duties of the affected entities, or if a municipality forfeits its articles of incorporation, then such action will constitute a change under Section 5.

I hope that we have been able to clarify this matter for you. If we may be of further assistance, please do not hesitate to contact us.

Sincerely,

J. STANLEY POTTINGER
Assistant Attorney General
Civil Rights Division

Document Originally
Attached to
Following Page

Please file for Cam Findlay

F.E.C

THE WHITE HOUSE
WASHINGTON

file

Date: 4/14/92

TO: Cam Findlay

FROM: ROBERT T. SWANSON ^{RTS}
Assistant Counsel to the President

FEC

Attached for your information is a copy of our response to the FEC complaint. I deleted the bracketed paragraph, which was for John's and Ron's information, and I also deleted the ripeness/mootness sentence, per your suggestion.

Thanks for your comments.

THE WHITE HOUSE
WASHINGTON

April 14, 1992

George F. Rishel
Assistant General Counsel
Federal Election Commission
999 E Street, N.W.
Washington, D.C. 20463

Re: MUR 3490 -- In re Arlen Specter

Dear Mr. Rishel:

This letter constitutes the Response of the White House Office ("Respondent") to the Complaint filed with the Federal Election Commission (the "FEC" or "Commission") by Eric Broadway, apparently on behalf of the Steve Freind for U.S. Senate Committee ("Complainant"). Respondent received the complaint on March 30, 1992.

The main allegations of the complaint concern the use of an auditorium in the Old Executive Office Building for a March 26 briefing, to which, the complaint apparently alleges, \$1000 contributors to Senator Specter's principal campaign committee were invited. Complainant filed the complaint with the Commission on March 24, 1992, two days before the briefing was to take place. Complainant appears to claim that the value of the use of the auditorium, as well as food and refreshments to be provided after the briefing, unless paid for by Senator Specter's campaign, would have constituted an illegal campaign contribution by the Government.

Respondent notes that the March 26 briefing was cancelled on March 25. In addition, no food or refreshments were prepared before the briefing was cancelled. Accordingly, Respondent did not provide "anything of value" to Citizens for Arlen Specter, and no campaign contribution was made within the meaning of the Federal Election Campaign Act. See 11 C.F.R. 100.7(a)(1).

Respondent therefore respectfully requests that the General Counsel recommend to the Commission that it find no reason to believe that a violation has occurred, and that this matter be promptly closed.

Respectfully submitted,



Robert T. Swanson
Assistant Counsel to the President

Verification

The undersigned swears that the facts set forth in this response are true to the best of his knowledge, information and belief.

Robert T. Swanson

Robert T. Swanson

District of Columbia ss:
Sworn and subscribed to before
me this *14th* day of April, 1992.

Chas. H. Ve

Notary Public *exp. 5/14/93*