



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

Washington, DC 20515

James L. Oberstar
Chairman

John L. Mica
Ranking Republican Member

David Heymsfeld, Chief of Staff
Ward W. McCarragher, Chief Counsel

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James W. Coon II, Republican Chief of Staff

SUMMARY OF SUBJECT MATTER

TO: Members of the Subcommittee on Aviation
FROM: Subcommittee on Aviation Staff
SUBJECT: Hearing on "Airline Fees"

PURPOSE OF THE HEARING

The Subcommittee on Aviation will meet on Wednesday, July 14, at 2:00 p.m., in room 2167 of the Rayburn House Office Building to receive testimony regarding airline fees. The hearing will cover a number of issues pertaining to the trend of unbundling airfares to require passengers to pay for particular services individually. The hearing will also explore requirements for disclosure of fares, taxes, and fees, options for passengers to recover the costs of some fees, and revenue potentially available to the Airport and Airway Trust Fund (Trust Fund) if certain ancillary fees were subject to the Federal tax on airline tickets.

BACKGROUND

From 2001 through 2009, the U.S. airline industry, including air cargo carriers, posted a cumulative net loss of \$58.1 billion. Yearly industry-wide net losses, which were offset by modest profits in 2006-07, were the result of many factors, including the aftermath of the September 11, 2001, terrorist attacks, the SARS epidemic, excess capacity, record oil prices of up to \$147 per barrel, and an economic recession. According to an airline association, high fuel prices, in particular, have created persistently challenging conditions. From January to April of 2010, U.S. airlines paid 26.8 percent more for jet fuel than in the same period of 2009.¹

Starting in mid 2007, in response to these economic challenges, many airlines began to unbundle services by instituting separate fees for checked baggage. Airlines next introduced "a la carte" fees for passenger services, some of which traditionally have been considered as included in

¹ Bureau of Transportation Statistics (BTS), *Airline Fuel Cost and Consumption (U.S. Carriers - Scheduled)*, <http://www.transtats.bts.gov/fuel.asp>.

the cost of a ticket. By the end of 2009, airlines charged for numerous ancillary services, including seat selection, extra leg room, beverages, meals, and more.

According to the BTS, U.S. airlines collected a total of \$7.8 billion in ancillary fees in 2009,² including \$2.7 billion in baggage fees alone. In the fourth quarter of 2009, U.S. airlines collected 18.3 percent more in ancillary revenue than in the fourth quarter of 2008. Collectively, U.S. passenger airlines incurred \$5.5 billion in operating losses in 2008, but reported operating profits of approximately \$1.2 billion in 2009.³

The proliferation of ancillary fees over a relatively short period of time has raised concerns over the costs and transparency of such fees. Often, consumers are not entirely aware of the range of fees that they may encounter in the ticket booking process, at check-in, and at the gate. A recent poll conducted by Consumer Reports of consumers on what “annoys travelers the most,” luggage charges and added fees rated the highest, at 8.4 and 8.1, respectively, based on a 10 point scale.⁴

I. Nature of Ancillary Fees

It is estimated that airlines present passengers with more than 100 ancillary fee options in the course of travel. The table below provides a description of items and services for which some airlines currently charge ancillary fees. The actual fees charged vary widely depending on each individual airline’s policies.

Ancillary Fees Charged by Airlines

| Baggage | Ticketing | In-Flight Services |
|-----------------------------|---|--|
| 1 st Checked Bag | Change or Cancellation | Food |
| 2 nd Checked Bag | Booking (phone/in person/online) | Beverage |
| Additional Bags | Unaccompanied Minors | Blankets |
| Overweight Bags | Pets | Pillows |
| Oversized Bags | Seat Selection (location, additional legroom, exit row) | Wireless Internet |
| | Early Boarding | In-flight entertainment |
| | Holiday Travel Surcharge | Misc. (e.g., antlers, firearms, extra seats for overweight passengers) |
| | Fuel Surcharge | |
| | Standby | |
| | Frequent Flyer Redemption | |
| | Club Membership | |

² BTS’ definition of ancillary fees includes: baggage fees, reservation change fees and miscellaneous operating revenue, including pet transportation, sale of frequent flyer award miles to airline business partners, and standby passenger fees. Revenue from seating assignments and on-board sales of food, drink, pillows, blankets, entertainment, or any other ancillary items are reported as Transport Related Revenue and cannot be identified separately.

³ Source: BTS and the Government Accountability Office (GAO). Calculated based on operating losses for passenger airlines with revenues over \$20 million, excluding cargo carriers.

⁴ ConsumerReports.org, *Things That Annoy Travelers Most: Consumer Reports Survey Results*, www.consumerreports.org/cro/magazine-archive/2010/june/money/top-travel-gripes/overview/index.htm.

Although critics have suggested that ancillary fees are merely a means for airlines to “nickel-and-dime” passengers, the Air Transport Association (ATA) maintains that ancillary fee policies are beneficial to passengers because such policies allow passengers to pay only for services that they use. In addition, the ATA states that many airlines offer “restricted” tickets, which are less expensive but carry greater fees and penalties for changes to itineraries, as opposed to “full-fare” tickets, which allow changes free of additional charge. ATA argues that this price difference allows the cost of air travel to remain much lower for consumers who do not make changes to their itineraries.⁵

In addition to ancillary fees levied by airlines, the Federal Government imposes direct taxes and fees on passengers for their ticket purchase. Some of these fees vary according to each traveler’s itinerary.

Government-Imposed Taxes on Passengers⁶

| Government Tax or Fee | Amount and Description |
|---|---|
| Passenger Ticket Tax | 7.5 percent: A tax levied as a percentage of the fare that the passenger pays for a domestic airline ticket. |
| Flight Segment Tax | \$3.70 per flight segment: Paid by the passenger based on the number of segments in the passenger’s itinerary for domestic travel. A segment is single flight from a takeoff to landing. This tax is not applicable to passengers departing from rural airports. ⁷ |
| Alaska/Hawaii Ticket Tax and Facilities Tax | 7.5 percent: A tax imposed on passengers on domestic flights to or from Alaska or Hawaii. \$8.10 is also charged for any ticket not subject to the ticket tax. |
| Frequent Flyer Award Tax | 7.5 percent: A tax on amounts paid by companies with frequent flyer marketing arrangements with airlines (including credit card companies). |
| International Departure/Arrival Tax | \$16.10: Imposed on passengers on international flights departing or arriving in the United States. |
| September 11 Security Fee | \$2.50: Funds the Transportation Security Administration at up to \$5 per one-way trip and \$10 per round trip |
| U.S. Customs Fee | \$5.50: Funds inspections by U.S. Customs. Assessed for travel on tickets issued to passengers arriving from outside the U.S. Customs territory. |
| Immigration Fee | \$7.00: Assessed for travel from any international point into the United States. |
| Agricultural Inspection Fee | \$5.00: Assessed for travel from any international point into the United States and Puerto Rico. Funds agricultural quarantine and inspection. |

In addition, airports may also impose a passenger facility charge (PFC) of up to \$4.50 per flight segment.

For nonrefundable tickets that are unused by the passenger, the question has been raised as to whether government taxes and fees can be refunded to the passenger. According to the GAO, the 7.5 percent passenger ticket tax is generally not refundable. In addition, it is not always clear to

⁵ ATA, *Airline Ancillary Revenues*, <http://www.airlines.org/PublicPolicy/IssueBriefs/Pages/AirlineAncillaryRevenues.aspx>.

⁶ See Airlines Reporting Corporation, *Industry Agents’ Handbook, Taxes Fees and Charges*.

⁷ A rural airport tax is levied at 7.5 percent on passengers whose flights depart or arrive at rural airports. This is assessed in lieu of the general passenger ticket tax. When the rural airport tax applies, there no segment fee is assessed.

the passenger whether other government taxes and fees are refundable and, if they are, how the passenger can obtain a refund.

II. Revenue

According to the GAO, airlines have reported a four-fold increase from 2008 to 2009 in revenue from ancillary fees. However, the GAO notes that precise comparisons are difficult, because airlines report ancillary revenue from fees other than baggage fees differently. In 2008, checked baggage revenue was reported to be \$1.1 billion. For 2009, airlines collected \$2.7 billion from baggage fees, \$2.4 billion from reservation change fees, and \$2.7 billion from other ancillary fees. The table below shows ancillary revenues by airline, ranked by the total amount collected in 2009.

Airlines' Ancillary Fee Revenue (in millions of dollars)

| Airline | 4th Quarter 2008 | 4th Quarter 2009 | Percent Change 4Q 2008-4Q 2009 (%) | Total 2009 Ancillary Fee Revenue |
|-----------------------|-------------------------|-------------------------|---|---|
| Delta | 289.0 | 425.7 | 47.3 | 1,647.6 |
| American | 246.2 | 253.3 | 2.9 | 1,002.4 |
| US Airways | 227.0 | 231.8 | 2.1 | 912.1 |
| Northwest | 185.2 | 156.7 | -15.4 | 718.7 |
| United | 151.3 | 146.2 | -3.4 | 619.5 |
| Southwest | 140.6 | 157.2 | 11.8 | 617.1 |
| Continental | 77.5 | 129.1 | 66.6 | 539.7 |
| AirTran | 36.2 | 61.2 | 69.1 | 249.7 |
| JetBlue | 49.5 | 48.1 | -2.8 | 193.1 |
| Alaska | 30.2 | 42.2 | 39.7 | 147.0 |
| Industry Total | 1,615.1 | 1,911.1 | 18.3 | 7,825.7 |

Source: BTS, Form 41; Schedule P1.2.

In terms of ancillary fee revenue as a percentage of total operating revenue for 2009, Spirit reported the highest with 20 percent of operating revenue from fees, followed by AirTran at 10.7 percent, Allegiant at 10 percent, Delta at 9.1 percent, and US Airways at 8.5 percent.⁸

Ancillary fees and the associated revenues they generate have prompted some policymakers to question whether such fees should be subject to the 7.5 percent tax on airline tickets, especially if the services provided for such fees were traditionally included in base ticket prices. The Internal Revenue Code imposes a 7.5 percent excise tax on the amount a passenger pays for “taxable transportation”⁹ – essentially, the passenger’s airline ticket. Certain airline charges, however, are not taxable; Federal regulations (last amended in 1962) exclude, from the excise tax, fees for “transportation of baggage” as well as fees for “nontransportation services,” among others.¹⁰

⁸ Press Release, BTS, *4th-Quarter 2009 Airline Financial Data: Low-Cost and Regional Airlines Report Profits, Network Carriers Report Loss* (May 3, 2010), http://www.bts.gov/press_releases/2010/bts021_10/html/bts021_10.html.

⁹ 26 U.S.C. § 4261(a) (2010).

¹⁰ 26 C.F.R. §§ 49.4261-8(f)(1), (4) (2010).

Last year, the Internal Revenue Service (IRS) issued a private letter ruling,¹¹ which stated that an ancillary fee is subject to the excise tax only if it is “paid as a condition to receiving air transportation” and is not paid for an “optional” service that is “not reasonably necessary to the air transportation itself.”¹² The IRS concluded that fees for the following services are not subject to the excise tax: checked baggage, headsets for use with in-flight entertainment systems, food and alcoholic beverages in flight, and ticket changes.

The Trust Fund – the source of money for the Federal Aviation Administration’s (FAA) capital programs to maintain and improve airports and facilities, and for some FAA operations – draws revenue from excise taxes such as the tax on passenger tickets.¹³ At a time when the FAA’s primary fund for capital programs is in decline, a hypothetical application of the 7.5 percent tax to ancillary fees could generate additional revenue for necessary aviation programs. In 2009, the GAO found that, if the Trust Fund’s uncommitted cash balance fell below \$752 million (its then-forecast balance), the “decline . . . could pose budgetary challenges for FAA.”¹⁴ At the end of calendar year 2009, however, the Trust Fund’s uncommitted cash balance had fallen to \$299 million, according to information provided by FAA officials to staff.

Adding ancillary fees to the taxable charges that arise as part of air transportation could increase the Trust Fund’s balance.¹⁵ Based on BTS data, if all baggage fees charged in 2009¹⁶ had been subject to the tax, Trust Fund revenue would have increased by approximately \$202.5 million, assuming all other factors (including demand) remained constant. That revenue would have represented a roughly 1.1 percent increase in Trust Fund income from excise taxes in 2009, according to FAA-provided data.

III. Legal Requirements for Disclosures of Fees: Current and Proposed

As the number of fees charged by airlines grows increasingly complex, with requirements for disclosure not yet updated to reflect the pricing changes, consumers are oftentimes left confused about what they will really pay for the total cost of their travel itinerary. The Department of Transportation’s (DOT) Office of Aviation Enforcement and Proceedings is responsible for economic regulation of airlines and for protecting consumers.

¹¹ A private letter ruling is directed solely to the taxpayer who requests it and is limited to the facts as presented by that particular taxpayer; the ruling is not binding on other taxpayers and holds no precedential value. Whether or not the IRS would rule that ancillary fees are not taxable in all cases remains an unsettled question.

¹² IRS, Private Letter Ruling 118216-09 (Jan. 15, 2010), at 8.

¹³ 26 U.S.C. § 9502(b) (2010).

¹⁴ GAO, *Airline Industry Contraction Due to Volatile Fuel Prices and Falling Demand Affects Airports, Passengers, and Federal Government Revenues*, GAO-09-393 (April 2009), at 38.

¹⁵ Unless otherwise indicated, all estimates discussed in this summary are based on data reported by the BTS. Estimates of tax revenue are the product of total reported fees multiplied by the 7.5 percent excise tax and do not account for variables such as changes in demand.

¹⁶ Figures reported by the BTS. See BTS, *1st-Quarter 2010 Airline Financial Data: Low-Cost and Regional Airlines Report Profits, Network Carriers Report Loss*, Table 1A: “Baggage Fee Collections” (June 28, 2010), http://www.bts.gov/press_releases/2010/bts031_10/html/bts031_10.html.

A. Current Law

1. Full Fare Advertising Rule

By statute, airlines may not engage in unfair or deceptive practices when advertising airfares.¹⁷ In 1984, the DOT adopted the “full fare advertising rule.” Under the rule, an advertisement that states an airfare advertisement is “an unfair or deceptive practice, unless the price stated is the entire price to be paid by the customer to the air carrier, or agent, for such air transportation.”¹⁸ The Secretary of Transportation has authority to investigate violations of these requirements and to assess a civil penalty of up to \$2,500 for each violation.¹⁹

The DOT interprets the rule to permit an airline to disclose government taxes and fees separately from the base fare quoted in an advertisement, but only if, among other things, the taxes and fees are levied or approved by a government agency and the advertisement, on its face, clearly indicates the amounts of such taxes and fees, so that the prospective passenger can calculate the total cost of travel.²⁰ An Internet advertisement that, on the customer’s first encounter, merely displays a certain fare “plus taxes/fees,” without specifying the amounts of those taxes and fees or directing the customer to another page that lists their amounts, does not comply with these requirements.²¹

Through various rulings and guidance, the DOT has required that airlines and ticket agents disclose the following fees in airfare advertisements: fuel surcharges, peak travel and holiday surcharges, and government fees, among others.

2. Baggage and Change Fees

In May 2008, in response to the growing trend of airlines levying fees for checked baggage (which traditionally were not levied for up to two bags of up to 50-70 pounds), the DOT issued guidance on disclosure of policies and charges associated with checked baggage, by stating:

The [DOT’s] long-standing policy has been to require carriers to clearly disclose significant conditions applicable to air fares. Failure to disclose such conditions has been considered an unfair and deceptive practice and unfair method of competition. . . . [and DOT] considers such significant conditions to include limiting passengers to fewer than two free checked bags of the size and weight that have generally been free on the carrier in the past and to assessing passengers a charge in addition to the air fare for such checked baggage.²²

¹⁷ 49 U.S.C. § 41712(a) (2010).

¹⁸ 14 C.F.R. § 399.84 (2010).

¹⁹ See 49 U.S.C. §§ 41712, 46301 (2010).

²⁰ See *United Air Lines, Inc., Violations of 49 U.S.C. § 41712 and 14 C.F.R. § 399.84*, DOT Dkt. No. DOT-OST-2009-0001, Order No. 2009-8-17 (Aug. 25, 2009).

²¹ *Id.*; *Spirit Airlines, Inc., Violations of 49 U.S.C. § 41712 and 14 C.F.R. § 399.84*, DOT Dkt. No. DOT-OST-2008-0031, Order No. 2008-12-14 (Dec. 23, 2008).

²² DOT, *Guidance on Disclosure of Policies and Charges Associated with Checked Baggage*, 73 Fed. Reg. 28854 (May 19, 2008).

The guidance requires that airlines disclose baggage fees and baggage policies in Internet advertising “on the first screen in which the carrier offers a fare quotation of a specific itinerary selected by the customer,” and it requires disclosure of the baggage fee in close proximity to the fare for print advertising. Similarly, airline reservation agents must disclose fees during telephone and counter sales.

B. Proposed Rulemaking

The DOT recently issued a notice of proposed rulemaking (NPRM) that includes both a number of proposed enhancements to existing consumer protections and poses a number of questions for comment. The NPRM expresses the DOT’s conclusion that “there is a need to enhance protections for air travelers by establishing rules to ensure adequate notice of such fees for optional services to consumers Consumers are not always made aware of the extra charges that a carrier may impose . . . [including] services that traditionally been included in the ticket price.”²³

To address these issues and to help passengers determine the full price of air travel (the airfare, which includes government taxes and fees, plus ancillary fees for services), the NPRM solicits public comments on whether *two prices* should be provided with respect to an advertised airfare: (1) full fare, including all mandatory charges (i.e., anything the passenger must pay to fly); and (2) “full fare-plus,” which DOT tentatively proposes to mean the full fare plus baggage fees and fees for carry-on items (the costs of which were traditionally included in ticket prices).

The DOT is seeking comment on whether the second price – the “full fare-plus” – should include all services that traditionally have been included in the prices of the ticket, as opposed to just those services relating to the transport of baggage, and what exactly such services would include. In the alternative, the DOT is seeking comment on whether sellers of air transportation should be required to display on their Web sites information regarding optional fees selected by the passenger when conducting a query and information on the passenger’s “full price,” which would be tailored based each passenger’s indication of his or her needs.

The DOT further proposes to amend its current price advertising rule to prohibit carriers and ticket agents from automatically including “opt-out” provisions in price advertising. According to the NPRM, the DOT has found that some sellers of airline tickets add, into the total price of air transportation, fees for ancillary services, which the consumer “is deemed to have accepted unless he or she affirmatively opts out of the service and related charges.”²⁴ These optional fees, for items such as seat selection, are preselected for the passenger and added to the total fare, without the passenger affirmatively selecting the add-on.

Additionally, the DOT’s NPRM proposes to require carriers to disclose all applicable fees, including those for ancillary services, through a prominent link on each carrier’s Web site that leads to a listing of all fees for optional services.

The NPRM also indicates the DOT may require carriers to provide up-to-date, comprehensive fee information to the operators of Internet Web sites that sell airline tickets and to travel and ticket agents. It is estimated that at least half of all airline tickets in the United States are

²³ Enhancing Airline Passenger Protections, 75 Fed. Reg. 32329 (June 8, 2010) (to be codified at 49 C.F.R. Part 399).

²⁴ *Id.* at 32328.

sold by travel agencies. In a recent letter to the DOT, two organizations that represent ticket agents and global distribution systems (GDSs)²⁵ stated, “The critical problem that remains is the practical inability of travel agencies to obtain from each airline on whose behalf they sell tickets the needed baggage and other ancillary fee information in a usable, reliable and efficient manner.”²⁶ In response to this issue, the DOT has indicated that it is considering whether to require carriers to make ancillary fee information available to GDSs. The current system through which airlines provide fare information to ticket agents and GDSs is administered by the Airline Tariff Publishing Company (ATPCO), which has developed a new database system for ancillary fees with more than 100 unique fields for airlines to input information on their specific fees.

Many airlines oppose a mandate to provide GDS companies with access to information on optional services and pricing because they believe it would place airlines at a competitive disadvantage in the marketplace, further strengthen GDS market power, thwart the entry of new competitors in the GDS market, and expose consumers to higher prices necessary to recoup GDSs’ fees.

The proposal also seeks to require each carrier that issues electronic ticket confirmations to passengers to include information on the carrier’s baggage fee policies. The DOT believes these requirements will ensure that passengers avoid unexpected baggage charges at the airport and will save time for airline personnel and passengers at the airport.

IV. The Future of Ancillary Fees

Ancillary fees – a newfound source of significant revenue for airlines in a challenging marketplace – are still a fairly new concept for the airline industry and are constantly evolving. The DOT, consumer groups, GDSs, airlines themselves, and industry stakeholders are working to make fees more transparent for consumers. For example, the Institute of Travel and Meetings recently announced the formation of a group to set standards and policies for airlines regarding product unbundling.²⁷ An airline consulting firm recently proposed a “passenger bill of rights” on a la carte fees to provide passengers with greater transparency.²⁸ On June 8, 2010, the International Air Transport Association (IATA) announced a new database called Automated Carrier Baggage Rules (ACBR) that will contain airlines’ varying rules on baggage. IATA hopes the ACBR will enable airlines, travel agents, and passengers to better understand what baggage rules apply to any given itinerary, given that baggage rules have become “increasingly complex and confusing.”²⁹

Most industry analysts suggest that the nature and scope of airline fees may continue to expand. Airlines are still testing fees and consumer reactions to them. For example, US Airways instituted a fee for nonalcoholic beverages, but withdrew it after negative passenger reaction.

²⁵ A GDS generally refers to a computer reservation system that includes reservation databases of airlines. This term has largely replaced the term “computerized reservation system” (CRS).

²⁶ Letter from Paul M. Ruden, Senior Vice President, Legal and Industry Affairs, American Society of Travel Agents and Arthur B. Sackler, Executive Director, Interactive Travel Services Association to Sam Podberesky, Assistant General Counsel for Aviation Enforcement and Proceedings, DOT (Mar. 10, 2010).

²⁷ Jennifer Michels, “Industry Solutions Group Aims to Set Airline Unbundling Standards,” *Aviation Daily* (Nov. 12, 2009).

²⁸ Andrew Compart, “Ancillary Revenue Conference Host Pushes for ‘Bill of Rights’ on Fees,” *Aviation Daily* (Nov. 24, 2009).

²⁹ IATA Press Release, *LATA Brings Transparency to Baggage Rules – New Simplifying the Business Project* (June 8, 2010).

Industry analysts suggest that the next chapter of the story on ancillary fees will involve “rebundling” the fees into packages of options that the passenger can purchase in advance. There has also been discussion as to whether airlines will make the fees easier to refund when services are not actually delivered, and whether “elite” frequent flyers will be subjected to fewer ancillary fees. In addition, there is discussion about options available to passengers in purchasing ancillary fees. Under some concepts, for example, passengers may be able to pay for checked baggage in advance using GDSs. What is clear is that ancillary fees have generated revenue for the airline industry and will likely be the subject of regulation and continuing scrutiny.

WITNESSES

Dr. Gerald Dillingham
Director of Civil Aviation Issues
U.S. Government Accountability Office

Mr. Robert S. Rivkin
General Counsel
U.S. Department of Transportation

Mr. Ben Baldanza
President and CEO
Spirit Airlines, Inc.

Mr. Dave Ridley
Senior Vice President
Marketing and Revenue Management
Southwest Airlines

Mr. Kevin Mitchell
Chairman
Business Travel Coalition

Mr. Kyle Moore
Vice President, Product Marketing
Sabre Travel Industry Group
and on behalf of
Interactive Travel Services Association
American Society of Travel Agents
Consumer Travel Alliance