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BY FEDEX and Electronic Mail

Kevin C. Willis, Director
Office of Airport Compliance and Management Analysis
Federal Aviation Administration
U.S. Department of Transportation
800 Independence Ave., SW
Washington, DC 20591

RE: Peninsula Airport Commission Response to FAA Letter Dated September 26, 2017

Dear Mr. Willis,

The Peninsula Airport Commission (“PAC”), the operator of Newport News/Williamsburg International Airport (the “Airport”), has asked us to respond to your letter of September 26, 2017 (“FAA Letter”). The FAA Letter describes six concerns about possible illegal airport revenue diversion arising from the FAA’s review of the Special Review Report, Peninsula Airport Commission (PAC), and Report Number 2017-165 dated June 2, 2017, prepared by the Assurance and Compliance Office, Department of Transportation, Commonwealth of Virginia (“VDOT”) (the “VDOT Report”) and the associated Chronology of Events (the “VDOT Chronology”).

This letter responds to those six concerns stemming from (a) payments and expenditures made by PAC related to a line-of-credit guarantee for People Express Airlines, Inc. (“PEX”); (b) the failure of PEX to remit PFCs collected by PEX; and (c) the use of a PAC-issued credit card by PAC’s former Executive Director for expenses unrelated to the capital and operating costs of the airport.

Out of the \$4,554,361.73 identified by VDOT as being expended by PAC on the line-of-credit guarantee and related transactions, \$3,560,665 was funded with either state grant funds or funds contributed by the local community. See VDOT Report at 24 (finding that the loan guarantee was funded using \$3,510,642 in state grant funds and \$50,023 in local community or "RAISE" grant funds). Of the remainder, \$982,741.23 was funded using "airport revenue," as defined in the FAA's Policy and Procedures Concerning the Use of Airport Revenue, 64 Federal Register 7696 (February 16, 1999) (the "Revenue Use Policy"). The remaining \$10,955.50 was spent on legal fees that were either unrelated to the line-of-credit guarantee or to recover the funds expended on the guarantee.

Although the federal airport revenue use statutes and the Revenue Use Policy do not expressly bar financial guarantees by an airport sponsor of bank loans to an airline serving the airport, PAC understands that FAA has interpreted the Revenue Use Policy's bar on providing subsidies to an airline to encompass the use of airport revenue to provide or pay a financial guarantee of a loan to an airline.

PAC takes its federal grant obligations and state grant obligations very seriously. The payment of the loan guarantee that was the subject of the VDOT Report cannot be undone. Moreover, as a special purpose airport authority, PAC does not have any non-airport funds available to reimburse the airport. Thus, PAC's options to replenish the airport revenue are limited to recoveries from third parties. Fortunately, utilizing the extensive information gathered by the VDOT audit, new personnel at PAC initiated legal claims that resulted in a \$2 million settlement agreement with its former legal counsel and the bank that provided the line-of-credit. This recovery will more than fully restore the \$982,741.23 in airport revenue used to pay costs related to the line-of-credit guarantee.

Second, with respect to PFCs, no PFCs were used for any expenses related to the line-of-credit guarantee or any other expense that was not an eligible and approved PFC use. PAC took appropriate steps to recover PFCs from PEX, including reporting to FAA PEX's failure to remit certain PFCs PEX had collected.

Finally, PAC has taken appropriate corrective actions to address the misuse of airport credit cards and other airport funds by the former Executive Director, including terminating the responsible individual and recovering over \$5,000 of the improperly used funds.

FAA Concern #1: "Legal costs incurred to obtain the line-of-credit were \$43,208.73, which appears to be airline subsidization."

49 U.S.C. § 47107(b) generally requires that "revenues generated by a public airport will be expended for the capital or operating costs of—(A) the airport; (B) the local airport system; or (C) other local facilities owned or operated by the airport owner or operator and directly and substantially related to the air transportation of passengers or property." Virtually identical requirements are included in 49 U.S.C. § 47133(a), and apply directly to all airport sponsors such as PAC that have received federal financial assistance. These statutory restrictions on airport revenue are reflected in the standard form of FAA Grant Assurance No. 25. 49 U.S.C. § 47107(k) directs the Secretary of Transportation to establish policies and procedures to prohibit, among other things, the diversion of airport revenue through "(A) direct payments or

indirect payments, other than payments reflecting the value of services and facilities provided to the airport; or (B) use of airport revenues for general economic development, marketing, and promotional activities unrelated to airports or airport systems.” The FAA has interpreted these statutory requirements as prohibiting the use of airport revenue for the direct subsidy of an air carrier. Revenue Use Policy, Section VI.B.12. The FAA has further interpreted Section VI.B.12 as barring the provision of or payment on loan guarantees by an airport sponsor to an individual airline. *See e.g.* “Loan Default Could Result in Misuse of Funds at Tulsa International Airport,” FAA Report No. AV-2004-058 (May 6, 2004).¹

In 2011, AirTran Airlines announced plans to cease service to the Airport. PAC’s then-Executive Director explored options to replace AirTran’s service, and began working with a start-up airline, PEX. *See* VDOT Chronology at 18-19, 27; Exhibit 1, SCASDP Reports at January 15, 2013 Report.

On June 18, 2014, PEX, PAC and TowneBank entered into a series of agreements to secure PEX a \$5 million line-of-credit issued by TowneBank and guaranteed by PAC. *See* Exhibit 1, VDOT Chronology at 120-121. Between May 2014 and June 2015, PAC paid its former attorneys, Jones, Blechman, Woltz & Kelly, P.C. (“JBWK”), to facilitate the line-of-credit guarantee and then, when TowneBank called on the guarantee, to facilitate its payment. *See* Exhibit 2, Attorney Fees. The purpose of the line-of-credit, and the guarantee provided by PAC to secure it, was to provide PEX with the capital it needed to initiate air service at the Airport. Under the FAA’s interpretation of Section VI.B.12 of the Revenue Use Policy, airport revenue should not have been used to pay for any costs, including the legal transaction costs incurred by JBWK, associated with PAC’s guarantee of the line-of-credit. Such payments by PAC would, according to FAA, constitute a subsidy of PEX. However, not all of the \$43,208.73 incurred over that time period was for legal services related to the line-of-credit guarantee. For example, the legal services from August 2014 through October 2014 were related to air services agreements, air service grants and PEX’s failure to remit PFCs, all issues discussed below and all appropriate uses of airport revenue. The legal services in April and May of 2015 were aimed at recovering funds, which is also an appropriate use of airport revenue. However, invoices from May 2014 through June 2014 and November 2014 through January 2015 appear to be for legal services related to the line-of-credit guarantee. **The total amount paid on these invoices was \$32,253.23.**

FAA Concern #2: “Peoples Express Airlines (PEX) was forced to vacate their offices at the airport due to non-payment of PFCs collected for July and August 2014. It appears PEX kept the PFCs funds collected, which could be a misuse of restricted PFC funds.”

PAC fully complied with its obligations under federal law and took all reasonable steps to seek remittance of the PFCs from PEX. Under 49 U.S.C. § 40117 and 14 C.F.R. Part 158, PEX was obligated to collect and hold PFCs in trust and timely remit PFC revenue to PAC. The Space/Use Permit, by which PEX rented space in the terminal, required PEX to charge \$4.50 per

¹ At this time PAC is not challenging the FAA’s interpretation that the federal revenue use statutes prohibit air carrier subsidies or that Section VI.B.12 necessarily bars an airport sponsor from offering financial guarantees, but PAC reserves the right to do so.

enplaned passenger. *See* Exhibit 3, Space/Use Permit at Exhibit B. As stated in the PFC regulations, issuing carriers (*i.e.* PEX), not the public agency (*i.e.* PAC) “shall be responsible for all funds from time of collection to remittance.” 14 C.F.R. § 158.45.

PEX missed the July payment of PFCs, due at the end of August 2014, and then missed the August payment due at the end of September. *See* 14 C.F.R. 158.51 (providing that PFCs must be remitted no later than the last day of the calendar month following collection). PAC’s former Executive Director orally notified the PEX Chief Financial Officer that its PFC payments were overdue. *See* VDOT Chronology at 161. On October 2, PAC’s former Executive Director followed up with an e-mail to the PEX Chief Executive Officer, Jeffrey Erickson, notifying him that PAC would issue a default notice if payment was not made. *Id.* Mr. Erickson replied that PEX had “[n]o cash to pay” the PFCs, but that the payment would be made “when air service restarted.” *Id.* PAC’s former Executive Director responded that “PFCs are not revenue to [PEX]. Those funds are [PAC’s] and should not be used as cash flow.” *Id.*

On October 10, 2014, PAC sent PEX a formal written notice that it had defaulted on its obligations under the Space/Use Permit to make July and August payments of PFCs. *See* Exhibit 4, October Notice of Default. The notification stated that if PEX failed to remit the payments within thirty days of the date of the letter, PAC would terminate PEX’s right to occupy the terminal space. *Id.*

PEX missed the September payment of PFCs, due at the end of October. On November 1, 2014, PAC sent PEX a second notice of default concerning the missed September PFC payment. *See* Exhibit 5, November Notice of Default. The notice stated that PEX owed PAC approximately \$115,211 in PFCs. *Id.* Again, it threatened to terminate PEX’s right to occupy the terminal space if payment was not forthcoming. *Id.*

PAC also notified Jeffrey Breeden of FAA that PEX had failed to remit PFCs. *See* Exhibit 6, Nov. 7 FAA E-Mail. On November 7, 2014, PAC sent an e-mail to Mr. Breeden stating that PAC “has not received [PFCs] from [PEX] for the months of July, August, and September. The approximate collections for the three months is \$115,211.”² *Id.* Mr. Breeden responded that he alerted the headquarters of the PFC branch of FAA “to the nonpayment by [PEX] and they are keeping an eye on this issue.” *Id.* He went on to say, “we don’t have a lot of leverage on this end and would encourage the PAC to continue their efforts in the collection of this PFC revenue.” *Id.*

PEX failed to remit the PFCs within the 30-day deadline provided by the October notice of default. On November 10, PEX was ejected from the airport. *See* VDOT Chronology at 176 (PEX reports that it had been given 24-hours notice to vacate the terminal and that the “locks were changed on our office space”).

² Flight logs indicate that PAC initially underestimated the amount of PFCs that PEX illegally retained. In July, August, and September, PEX flew a total of 51,754 passengers, and should have remitted \$4.39 per passenger. *See* Exhibit 7, Passenger Number Station Reports; *see also* 14 C.F.R. 158.53 (permitting a collecting air carrier to retain \$0.11 of each PFC collected). Therefore, PEX failed to remit a total of \$227,200.06 in PFCs.

Federal law empowers the Secretary of Transportation and the FAA “to enforce PFC and other aviation regulations, through various administrative, civil, and criminal sanctions.” Express One International, Inc., 1996 WL 276785, at *2. For example, the Secretary of Transportation may bring a civil action to enforce the PFC regulations, 49 U.S.C. § 46106; may investigate whether an air carrier has engaged in an unfair or deceptive practice, 49 U.S.C. § 41712(a); and may impose criminal penalties against individuals that knowingly and willfully violate the PFC statute, 49 U.S.C. § 46316(a).

Federal law does not provide for a private right of action for airport operators to enforce the PFC statute or regulations. It does, however, permit an airport operator to submit a complaint in writing to the FAA concerning alleged violations of the PFC statute or regulations. *See* 49 U.S.C. § 46101(a).

PAC complied with its obligations under federal law and took all reasonable steps to seek the remittance of PFCs. PAC repeatedly notified PEX about its obligations to remit PFCs. It sent multiple e-mails to PEX officers informing them of the company’s obligation to remit the funds. PAC notified FAA and sought assistance in compelling PEX to comply with federal law. It sent two formal notices of default informing PEX that failure to remit PFCs would result in PEX’s eviction from PHF. Ultimately, it evicted PEX for failing to comply with that obligation.³

FAA Concern #3: “PAC appears to have made interest payments on the line-of-credit guaranty in the amounts of \$13,996, \$11,917, and \$12,972 (totaling \$38,885). It appears that airport revenues were used to pay these interest payments as no other source of revenue was identified by the review. If this is the case, airport expenditures may not have been used for capital or operating costs for the airport, and there could be airline subsidization.”

PAC made three interest payments on the PEX line-of-credit, totaling \$38,885. As explained in the response to FAA Concern #1, FAA has interpreted the Revenue Use Policy to prohibit the use of airport revenue to provide a direct subsidy to an airline. However, PAC used state grant funds, not airport revenue, to make the interest payments. The definition of “airport revenue” in the Revenue Use Policy includes “all fees, charges, rents or other payments received by or accruing to the sponsor” for a specified list of reasons. Revenue Use Policy, Section II.B. State grant funds are not included within that definition. **Since state grant funds were used to make the line-of-credit interest payments, there was no improper use of airport revenues.**

On December 8, 2014, PAC made a payment from the State Entitlement Collateral Account (ending 6589) to TowneBank in the amount of \$13,993.06, for an interest payment due on the PEX line-of-credit on November 15, 2014.⁴ *See* Exhibit 8, Dec. 2014 and Jan. 2015 6589

³ PAC explored the option of bringing a civil action against PEX to seek remittance of the PFCs. Ultimately it was determined that PEX had no assets from which a judgment could be satisfied. *See, e.g.*, VDOT Chronology at 200 (e-mail from K. Spirito to J. Bourey stating that the “State issued a levy on Pex property today. Pex owes state \$28k); *id.* at 199 (e-mail from K. Spirito responding to inquiry asking for assistance in collecting on a debt owed by PEX, stating “they owe[] lots of people money”).

⁴ PAC maintains a number of bank accounts dedicated to particular purposes or funding sources. The Operating Account is used for daily operations of the airport. VDOT Report at 25. The Capital Account is used for capital project payments. *Id.* The PFC Account holds restricted PFC revenue that has been remitted by airlines. In

Account Statements; VDOT Report at 13. PAC made a second payment of \$11,918.71 to TowneBank from the State Entitlement Collateral Account (ending 6589) account on December 17, 2014, for an interest payment due on December 15, 2014. *See* Exhibit 8, Dec. 2014 and Jan. 2015 6589 Account Statements; VDOT Report at 13. It made a third payment of \$12,971.73 to TowneBank from the State Entitlement Collateral Account (ending 6589) on January 20, 2015, for an interest payment due on January 20, 2015. *See* Exhibit 8, Dec. 2014 and Jan. 2015 6589 Account Statements; VDOT Report at 13. In total, \$38,885 was paid to TowneBank for interest on the PEX loan from the State Entitlement Collateral Account.

PFC revenue may only be used for FAA-approved airport-related projects. 49 U.S.C. § 40117; 14 C.F.R. § 158.13. Under the Virginia Department of Aviation (“DOAV”) Manual, PAC is directed that if it “uses state entitlement funds for a project and later receives reimbursement for the project from passenger facility charges, [it] must credit its state entitlement balance with the reimbursement amount.” *See* Exhibit 9, DOAV Manual at § 3.1.1.3. In accordance with that guidance, it is PAC’s practice to reimburse state entitlement funds applied to a particular PFC-eligible project with PFC revenue as it is received.

On December 8, 2014, shortly before PAC made the first interest payment on the line-of-credit, it transferred \$26,000 from the PFC Account (ending 7219) to the State Entitlement Collateral Account (ending 6589), to cover the first two interest payments totaling \$25,911.77. *See* Exhibit 8, Dec. 2014 and Jan. 2015 6589 Account Statements. On January 20, 2015, shortly before the third interest payment was made, PAC transferred \$13,000 from the PFC Account (ending 7219) to the State Entitlement Collateral Account (ending 6589) to cover the final interest payment of \$12,971.73. *See id.*

The transfers of \$39,000 from the PFC Account (ending 7219) to the State Entitlement Collateral Account (ending 6589) account constituted reimbursement of state entitlement funds that had been used to pay for the rehabilitation of a runway, called the “Runway 7/25 Rehabilitation” project (PWE 2.1) and were recorded as such. Exhibit 10, Dec. 2014 Transaction Journal (recording a \$26,000 reimbursement of state entitlements with PFCs on December 8, 2014); Exhibit 11, Jan. 2015 Transaction Journal (recording a \$13,000 reimbursement of state entitlements with PFCs on December 8, 2014); Exhibit 12, FAA Approval of PAC PFC Projects (listing the PWE 2.1 project as a project approved for the use of PFC revenue).

in addition, PAC established three new bank accounts to underwrite the line-of-credit guarantee: the State Entitlement Collateral Account, the USDOT SCASD Collateral Account, and the RAISE Funds Collateral Account. *Id.* at 12-13. Each account is associated with both a general ledger account number and a bank account number. For reference, the table below provides both the bank account and general ledger account number for each account.

Account Name	Ledger Account No.	Bank Account No.
Operating Account	10200	8024280957
Capital Account	10300	8024296551
PFC Account	11200	0243017219
State Entitlement Collateral Account	11400	0243066589
USDOT SCASDP Collateral Account	11500	0243066597
RAISE Funds Collateral Account	11600	0243066619

The full \$39,000 transferred from the PFC Account to the State Entitlement Collateral Account properly reimbursed state entitlement funds that had been expended on an approved PFC-eligible capital project. Because state entitlement funds—rather than PFCs or airport revenue—were used to make the interest payments, there was no improper use of airport revenue.

FAA Concern #4: “PAC Account #10200 Operating Cash and PAC Account #10300 Capital Cash contained cash that PAC appears to have determined was available and used to underwrite the \$5M line-of-credit guaranty to PEX. The amounts were \$565,311 and \$385,177, respectively, or a total of \$950,488. These accounts are generally observed by VDOT to be an account consisting of airport revenues. It appears that there was airline subsidization and the expenditures may not have been used for capital or operating costs for the airport.”

a. The \$385,177 from Capital Account

On July 31, 2014, PAC transferred \$385,000 from the Capital Account (ending 6551) to the RAISE Funds Collateral Account (ending 6619). See Exhibit 13, Jul. 2014 6551 Account Statement; VDOT Report at 25. The \$385,000, plus \$177 in interest, was ultimately used to pay the line-of-credit guarantee. VDOT Report at 26. Those funds were airport revenue as defined by the Revenue Use Policy.

b. The \$565,311 Payment from Operating Account

In 2012, PAC received a federal Small Community Air Service Development Program grant (“SCASDP Grant”) up to a maximum amount of \$950,000. See Exhibit 14, SCASDP Grant. Under the terms of the SCASDP Grant, the federal government would reimburse PAC for eligible projects at a rate of 57.55%, with local grant funds making up the remainder. See *id.* at § C.3.e.

On or about June 27, 2013, it is alleged that PAC and TEM Enterprises, a Nevada corporation, entered into an air service agreement, which provided for a revenue guarantee to be reimbursed by the SCASDP grant. See VDOT Chronology at 72-73. That day, at the direction of its former Executive Director, PAC transferred \$565,000 from PAC’s Operating Account to PEX, which PEX cashed. See Exhibit 15, Transfer of 565,000 to PEX (e-mail from the former Executive Director directing that the \$565,000 check be payable to People Express Airlines, Inc.). The money was spent by PEX and was not returned to PAC’s Operating Account.

At the June 18, 2014 closing of the PEX \$5 million line-of-credit facility, the sum of \$565,000 was, at the direction of PAC’s former Executive Director, directly set aside in the bank’s USDOT SCASD Collateral Account (ending 6597), out of the control of PAC, and for the ultimate disbursement to TowneBank. Exhibit 16, Jun. 2014 6597 Account Statement; Exhibit 1, VDOT Summary Report at 21; Exhibit 17, PAC TowneBank E-Mails. The \$565,000, plus \$311 in interest, was subsequently used to pay the TowneBank line-of-credit guarantee.

FAA Concern #5: “It appears that at least \$358,000 (and as much as \$916,516) in passenger facility charges (PFCs) may have been allocated as part of the line-of-credit guarantee, which may be a misuse of restricted PFC funds.”

The VDOT Report provides

The PAC did not list \$916,516 of PFC's on DOAV Commonwealth Airport Fund Entitlement Utilization Reports. \$358,000 of PFC's omitted in FY2015 was identified during our review of the \$5,000,000 loan guaranty. Subsequent research by the PAC Director of Finance and Administration identified another \$558,516 omitted in FY2011.

VDOT Report at 30.

The VDOT Report is correct: PAC did not list \$916,516 in PFC revenue on Commonwealth Airport Fund Entitlement Utilization Reports. *See id.* at 30. While that action may have violated DOAV reporting requirements concerning state grant funds, it does not constitute a misuse of PFCs.

The DOAV Program Manual requires that if an airport reimburses state grant funds with PFCs, the airport "must credit its state entitlement balance with the reimbursement amount" and "[t]he [PFC] reimbursement must be recorded on the annual Entitlement Utilization Report." Exhibit 9, DOAV Manual at § 3.1.1.3. PAC unintentionally failed to report the reimbursement of certain state grant funds on its annual Entitlement Utilization Report. *See VDOT Report at 30.* This has been corrected, as confirmed by the VDOT report. *See id.* However, PAC did not misuse any PFCs, and VDOT did not allege as much.

FAA Concern #6: "The Executive Director may have used his airport credit card improperly, since there were few internal controls to prevent unlawful expenditures. It appears that there may be expenditures that were not used for capital or operating costs for the airport."

The former Executive Director, improperly used airport-issued credit cards and airport funds to pay for non-airport related expenses, such as repairs to his vehicle, repairs to the vehicle of a motorist with whom he was involved in an accident, and the purchase of a vehicle protection plan. *See Exhibit 18, Termination Letter.* PAC has taken a number of steps to recover the improper expenditures and to deter future violations of airport policy. PAC has recovered \$5,808.17 from the former Executive Director. *See Exhibit 19, Reimbursement of Credit Card Expenditures.* PAC has also instituted new policies and procedures to deter misuse of funds. In addition, on January 25, 2018, PAC approved a resolution to create a governance committee that will oversee all of PAC's expenditures, financial reports, and contracts. *See Exhibit 20, Governance Committee Resolution.* In light of these remedial steps, PAC does not propose to take any additional corrective action with respect to this issue.

II. Conclusions

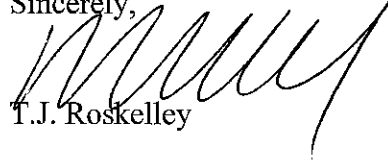
Based on the information provided above in response to FAA concerns, PAC concludes that \$982,741.23 in airport revenue, as defined in the Revenue Use Policy, was used to fund payments to TowneBank and to pay for legal costs related to the line-of-credit guarantee to PEX. PAC is committed to taking every prudent opportunity to recover from responsible parties the lost airport revenue for the Airport. PAC has entered into a \$2 million General Release and Contribution Agreement with TowneBank and JBWK to resolve claims concerning the line-of-

credit guarantee ("Settlement Agreement"). Under the terms of the Settlement Agreement, PAC received a \$1,650,000 cash payment upon execution of the Agreement on December 21, 2017. See Exhibit 21, Settlement Agreement at § 2, 4. These funds will be treated as airport revenue as defined in and restricted by the federal revenue use statutes and the Revenue Use Policy. PAC will also receive the benefit of \$350,000 in reduced interest payments on a taxable bond previously issued by TowneBank to PAC. See *id.* at § 2. Absent that reduction, PAC would have used airport revenue to fund the interest payments. As a result, the \$982,741.23 in airport revenue used in connection with the line-of-credit guarantee has been fully recovered. PAC has also addressed the misuse of airport revenues stemming from the misuse of credits cards and other PAC funds.

We appreciate the additional time that you provided to allow us to respond to your concerns. If you have any additional questions, please do not hesitate to call me at 617.621.6539 or e-mail me at troskelley@andersonkreiger.com.

Thank you.

Sincerely,



T.J. Roskelley

cc: Michael Giardino
James S. McNider, III, Esq.
Christine Zaleski, Esq.

Enclosures