Airports also pointed to FAA policy statements that apparently support alternative valuation methods. FAA's Order 5190.6A recommends that long term leases include automatic escalation provisions based on recognized economic indicators. In addition, the Order identifies a fee for use of landing areas based on a specified percentage of ticket sales to enplaning passengers as acceptable. Neither of these methodologies would produce rates based on historic costs.

Finally, airports stated that the DOT Office of the Inspector General (DOT/OIG) has criticized the failure of airports to obtain fair market value for aeronautical rentals. The DOT/OIG position indicates that use of methodologies other than historic cost is at least permitted, if not mandated by assurances relating to maintaining a fee and rental structure that will make the airport as self-sustaining as possible.

*Air carrier comments:* Air carriers considered the concept of using historic costs for asset valuation to be sound and consistent with Federal law. While parties might mutually agree to another valuation method, the policy must provide that only historic cost valuation may be unilaterally used, to protect against rampant overcharging and accumulation of excess surpluses by airports. Airports have access to capital for replacement of assets without generating excess revenue from other valuation methodologies. The use of historical cost valuation is quickly and easily verifiable and eliminates instability in the rate base.

*FTC comments:* The staff of the Bureau of Economics of the Federal Trade Commission (FTC) submitted comments on the proposed policy, with the caveat that the comments do not necessarily represent the views of the Commission or of individual commissioners. FTC staff took the position that the requirement to use historic costs will not promote the efficient use of resources. Historic cost valuation will likely result in prices that are below the value of airport facilities. When prices are below the value of facilities, excess demand results. If a community is served by two airports built at different times and fees are based on historic costs, airlines will be attracted to the older, lower-cost airport and avoid the newer, more expensive one. Demand at the older airport would have to be rationed by nonprice means.

Carriers compete by offering connecting service over various hubs. Because fees charged by hub airports are a determinant of air fares, it is important that competition between carriers not be distorted by a pricing system for airport services that reflects the age of facilities, rather than true economic costs.

FTC staff recognized that airport services are not generally produced in competitive markets. Therefore, airport proprietors might possess monopoly market power in pricing their services. However, FTC staff maintained that there are effective means for the Department to regulate the pricing of airport services other than cost of service pricing based on historic costs.

While cost-of-service regulation based on historic costs has typically been used in the United States, FTC staff commented that this approach has a number of defects. Failure to use a pricing system that reflects opportunity costs could lead to greater levels of airport capacity than is warranted by economic efficiency, as excess demand leads to congestion and delays which in turn lead to calls for new capacity.

Even if a cost basis other than historic costs is used, FTC staff believed that cost-of-service regulation can be a source of economic inefficiency. One regulatory alternative that addresses some of these shortcomings is price-cap regulation. Under price-cap regulation, the regulator sets a price ceiling, but the firm is free to charge any price below this ceiling. The price ceiling is adjusted periodically by a factor that is independent of the firm. Price cap regulation has been used in the privatization of nationalized industries in the United Kingdom, including airports, and in the telecommunications industry in the United States.

*Final policy statement:* The final policy retains the historic valuation principle proposed; for property other than airfield and land, however, the policy permits airport operators to use other valuation methods if the methodology does not result in total aeronautical revenues exceeding total aeronautical costs and if the methodology is applied consistently for similar facilities. If an airport proprietor uses valuation other than historic costs for establishing any aeronautical charge, the airport operator will be responsible for demonstrating that the methodology is justified, upon complaint by an air carrier or other aeronautical user. Where similar facilities have a different historic cost basis, the cost may be averaged across all similar facilities to produce a common rate.

The Department recognizes, as many of the airports and FTC staff commented, that valuation based on other than historic cost may be justifiable in certain situations. Nonetheless, we continue to believe that the use of historic cost asset valuation methodology is consistent with the objectives and direction of the AAIA and Public Law 103-305, in addition to being the most widely accepted methodology under applicable standards for both public finance accounting and ratemaking. The financial and accounting standards issued by the Financial Accounting Standards Board and the Government Accounting Board, which form the basis of Generally Accepted Accounting Principles (GAAP), prescribe historic cost valuation as the accepted accounting convention for valuing the assets of local government enterprise functions such as airports. The valuation of assets for purposes of an accurate financial statement is somewhat different from the objective of establishing lease rates, but does indicate the longstanding general acceptance of historic cost valuation as the standard.

As recognized by commenters on both sides of the cost valuation issue, historic cost has also been the standard for use in the establishment of rates in regulated industries. However, as several commenters noted, the rates charged by airport proprietors are not perfectly analogous to public utility rates, and the Department has not strictly applied the principles of public utility ratemaking law in developing the policy. Nevertheless, many of the reasons for the use of historic cost apply to both public and private enterprise activities. Historic cost is the simplest, most direct, and easiest-to-verify measure of cost. Moreover, in a regulatory system in which the proprietor's revenue is limited to the costs of providing services, historic cost valuation provides for full reimbursement of actual costs incurred by the proprietor. The airport fee policy adopted by the Department does limit the revenue that can be generated from aeronautical uses to the costs of providing services, and historical cost valuation is, therefore, both sufficient and appropriate for determining the amount of revenue (and the limit on reasonable fees) that can be collected for aeronautical uses. The use of an alternative methodology such as replacement cost valuation, for example, would generate funds in excess of past and current costs, and could result in the accumulation of excess funds that could be used for the replacement of the facilities being used or for any other airport purpose. The accumulation of surplus aeronautical revenues for replacement of facilities is not permitted by the policy adopted, which limits charges to recovery of costs for facilities in use. Nor are the surplus funds that