
Office of Inspector General

Audit Report

GROWTH OF DOMESTIC AIRLINE CODE SHARING WARRANTS INCREASED ATTENTION

*Office of the Secretary and the
Federal Aviation Administration*

*Report Number: AV-2013-045
Date Issued: February 14, 2013*





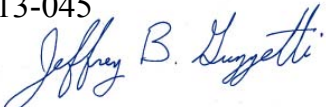
**U.S. Department of
Transportation**

Office of the Secretary
of Transportation
Office of Inspector General

Memorandum

Subject: **ACTION:** Growth of Domestic Airline Code
Sharing Warrants Increased Attention
Office of the Secretary of Transportation
Federal Aviation Administration
Report Number AV-2013-045

Date: February 14, 2013

From: Jeffrey B. Guzzetti 
Assistant Inspector General
for Aviation and Special Program Audits

Reply to
Attn. of: JA-10

To: General Counsel
Assistant Secretary for Aviation and
International Affairs
Federal Aviation Administrator

Over the past decade, the aviation industry has experienced significant growth in the regional airline sector. The number of passengers traveling on regional aircraft ticketed by mainline carriers¹ grew 115 percent from 2000 to 2010.² To gain market share and reduce costs, mainline carriers have increasingly moved to joint marketing arrangements, often called “code share agreements.” In these agreements, mainline carriers purchase seat capacity from an independent regional airline or contract for the services of a regional airline to fly passengers to their larger hub airports. Today, regional airlines account for over half of all scheduled commercial passenger flights, operating more than 13,000 flights daily and carrying approximately 160 million passengers annually.

The 2009 accident of a Continental Connection flight, operated by Colgan Air, raised concerns regarding the role a mainline carrier plays in advancing the safety of its regional partner and the processes used to disclose a code share carrier to passengers. In response to this accident, on June 15, 2009, the Secretary of

¹ For purposes of this report, a mainline carrier is a passenger air carrier with annual operating revenues greater than \$1 billion that is also the predominant marketing carrier in a code share relationship with a smaller domestic regional airline.

² Percentage derived from OIG analysis of approximately 118 million legs of travel in 2000 and 2010 as reported in BTS’s Origin and Destination Survey (DB1B) database, which represents a 10 percent sample of 35-39 large certificated carriers, depending on the quarter.

Transportation and the Federal Aviation Administration (FAA) Administrator initiated a *Call to Action on Airline Safety and Pilot Training* for FAA, air carriers, and labor organizations to jointly identify and implement safety improvements to ensure a common level of safety between domestic code sharing partners.

The ranking members of the House Committee on Transportation and Infrastructure and the Subcommittee on Aviation requested that we review regulatory oversight of domestic code sharing. Accordingly, our audit objectives were to (1) examine the Department of Transportation's (DOT) and FAA's roles in reviewing agreements between mainline air carriers and their regional partners, (2) assess FAA policies and procedures to ensure an equivalent level of safety between mainline carriers and their regional partners, and (3) determine whether passengers have adequate information to make informed decisions when purchasing an airline ticket. Although there are other types of code share arrangements, the sole focus of this audit is on code share relationships between major U.S. air carriers and their domestic regional partners. During our audit, we reviewed four major and eight regional carriers who participate in code share agreements.

We conducted this review in accordance with generally accepted Government auditing standards. Exhibit A details our scope and methodology.

RESULTS IN BRIEF

DOT's Office of the Secretary (OST) and FAA do not review most domestic code share agreements. OST is required to assess potential economic impacts on competition for domestic code share agreements between two major carriers. However, because just 20 percent of active Part 121 carriers are considered "major," the number of agreements that OST is required to review is limited. OST is not required to maintain a list of domestic agreements that it has reviewed and does not track the number of active domestic code share agreements. FAA, as safety regulator, is not required to review any domestic code share agreements and does not voluntarily do so. FAA considers domestic code share agreements to be purely financial arrangements and relies on its oversight of individual carriers to ensure the safe operation of passenger flights. As a result, most domestic code share agreements go into effect without being reviewed by any DOT regulatory entity.

FAA does not have procedures to advance the Agency's commitment to ensure the same level of safety between mainline air carriers and their code share partners. As part of the *Call to Action*, FAA officials stated that mainline air carriers should find specific ways to ensure that their partner carriers implement the most effective safety practices. While FAA sponsors biannual information sharing

events across the industry, it has not taken steps to encourage mainline carriers to consistently share safety information and best practices with their code share partners. As a result, some safety programs developed internally between code sharing partners are more robust than others. For example, one major carrier meets with its code share partners on a monthly basis to discuss safety initiatives/practices but some of the major carriers we reviewed do not meet as frequently with their code share partners. Further, because FAA does not review domestic code share arrangements, the Agency has not assessed whether certain aspects of these agreements, such as financial incentives based on performance, could have unintended safety consequences.

Passengers have sufficient pricing and scheduling information to make ticketing decisions, but some confusion still exists about which airline is operating their flight because carriers, travel agencies, and advertisers all disclose this information differently. For example, online ticket sellers have considerable latitude in the manner in which they disclose code share information. While some Web sites display the operating carrier prominently on the itinerary, others name the operating carrier in small footnotes at the end of the itinerary, causing the consumer to have to search for the information. Conversely, while travel agents are required to follow specific rules for verbally disclosing code share operators, 14 of 16 randomly selected travel agents we surveyed were not following these rules. However, according to OST, travel agents are not prioritized for oversight because there are too many of them and the percentage of passengers traveling with tickets purchased from travel agents is relatively low. Passengers also do not have access to reliable information on airline customer service and complaint records. OST provides some of this information, but it is inconsistently presented and does not include all carriers in accordance with OST guidelines. For example, airline complaint records may group regional code share operator data with the mainline code share partner data under a business name, such as United Express, so consumers are not able to distinguish which operator actually received the complaint.

We are making recommendations to enhance OST and FAA monitoring of domestic code share relationships and to increase consumer awareness of code sharing.

BACKGROUND

Most mainline air carriers and their regional counterparts create joint marketing agreements, often referred to as code share agreements, whereby the airlines coordinate their flight schedules to facilitate the interchange of passengers. Under these agreements, the mainline carrier often allows the regional airline to (1) use the mainline carrier's flight designator code to identify flights and fares in

computer reservation systems, (2) use the mainline carrier's logos and uniforms, and (3) participate in joint promotion and advertising activities.

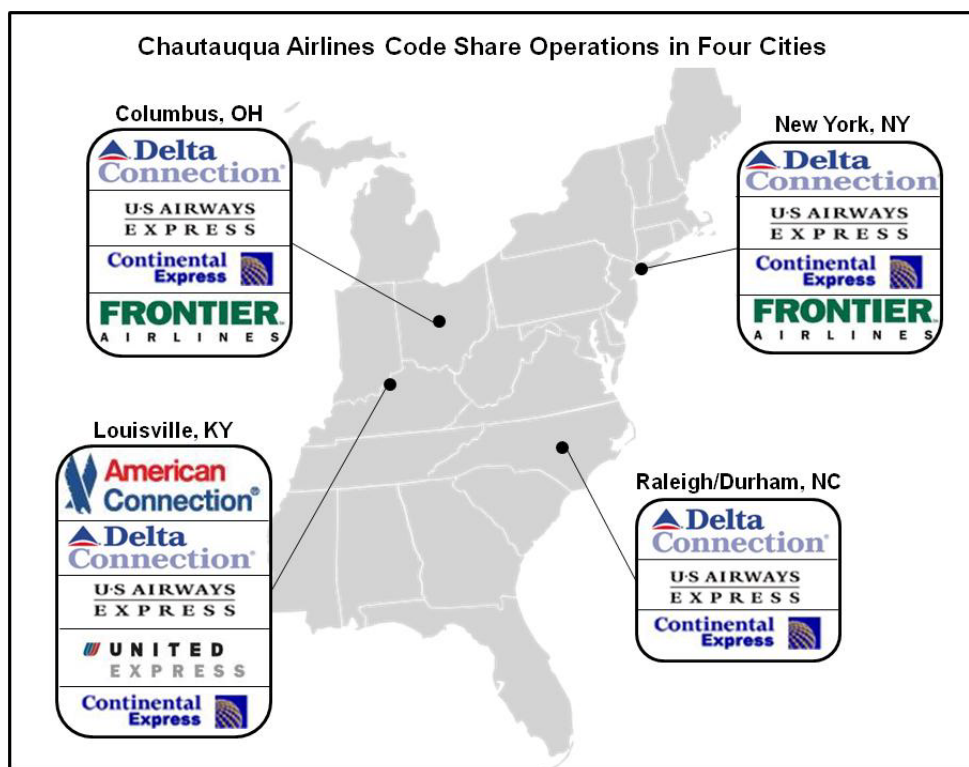
Code sharing provides benefits to passengers, regional carriers, and mainline carriers. Passengers can benefit from lower fares and more seamless travel. For example, code sharing focuses the passenger on the marketing carrier to resolve issues throughout the passenger's flight experience, giving them "one stop" for complaints, concerns, or issues. Regional carriers benefit from the connection to the mainline carrier, since the mainline carrier sells the tickets, schedules the aircraft, and often provides ground and fuel services. Mainline carriers benefit by gaining access to additional and smaller aircraft for bringing passengers to hub airports with no ownership stake.

Major passenger air carriers have increased the number of their advertised flights operated by regional airlines under code-sharing agreements in an effort to cut costs and gather feeder traffic from smaller cities. For example, in 2011, the percentage of the advertised flights of American, Delta, United, and US Airways operated by code-share regional air carriers was 61 percent, up from 40 percent in 2000.³

Ticket sellers are required to disclose the operator of a flight during itinerary searches but the name of the operating carrier is often minimized because regional carriers use the marketing and branding of their mainline partners. For example, some regional carriers have code share agreements with multiple mainline carriers, and use different "doing business as" names when operating for their major carrier partners on different domestic routes (see figure 1).

³ Southwest Airlines and its merger partner AirTran were excluded from this analysis since neither airline uses domestic code sharing in their operations.

Figure 1. Different Business Names of One Code Sharing Airline



Source: Airline Web sites, March 2012

NEITHER OST NOR FAA ARE REQUIRED BY LAW TO REVIEW ALL DOMESTIC CODE SHARE AGREEMENTS

OST and FAA are not required to review all domestic code share agreements, despite the increased prevalence of these agreements in the marketplace. While the number of domestic code share partnerships has increased in recent years—up 16 percent in the past year alone⁴—current law requires that OST review only a small portion of domestic code share agreements and does not require FAA to review any of them for potential safety impacts. As a result, most domestic code share agreements go into effect without being reviewed by any DOT regulatory entity.

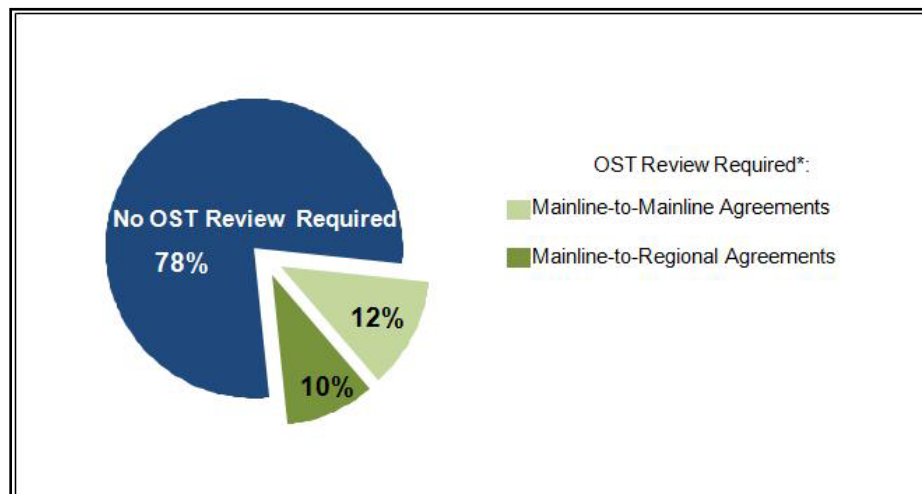
Most Domestic Code Share Agreements Are Not Reviewed for Their Potential Economic Impact, and None Are Reviewed for Their Safety Impact

OST, under its responsibility to review certain domestic code share agreements for unfair competition, is only required to review those agreements between two major carriers based upon their operating revenue and percentage of market

⁴ U.S. General Services Administration Code Share Fact Sheets for FY 2011 and FY 2012.

capacity.⁵ A “major” carrier is one defined by the Bureau of Transportation Statistics as having at least \$1 billion in annual operating revenue. However, only 20 percent of active Part 121 certificate holders are considered “major.” As a result, the number of agreements between mainline and regional carriers that OST is required to review is limited. According to our analysis,⁶ in 2012, OST would only have been required to review about 22 percent of active domestic code share agreements, as shown in figure 2 below.

Figure 2. OST-Required Review of Domestic Code Share Agreements



Source: OIG analysis of domestic carrier code share agreements

* Indicates OST review required if the agreement affects more than 15% of available seat miles

OST does not voluntarily review other agreements because it believes that agreements between major carriers are the only ones with the potential to adversely impact the market. Consequently, most domestic code share agreements are not reviewed by OST. However, the addition or cancellation of code share agreements between major carriers and non-major carriers may affect competition and consumer access in smaller markets (e.g., subsequent to its merger with Northwest, Delta announced that it was suspending its Delta Connection service to 24 smaller markets as the carrier seeks to adjust service to these markets). By reviewing only the domestic agreements between the largest carriers, OST may be missing competitive and economic impacts on those smaller markets.

FAA, in its role as aviation safety regulator, is not required to review any domestic code share agreements for their potential safety impacts even though they may

⁵ Under 49 U.S.C. § 41720, OST must review any agreement “between two or more major air carriers that affects more than 15 percent of the total number of available seat miles offered by the major air carriers.”

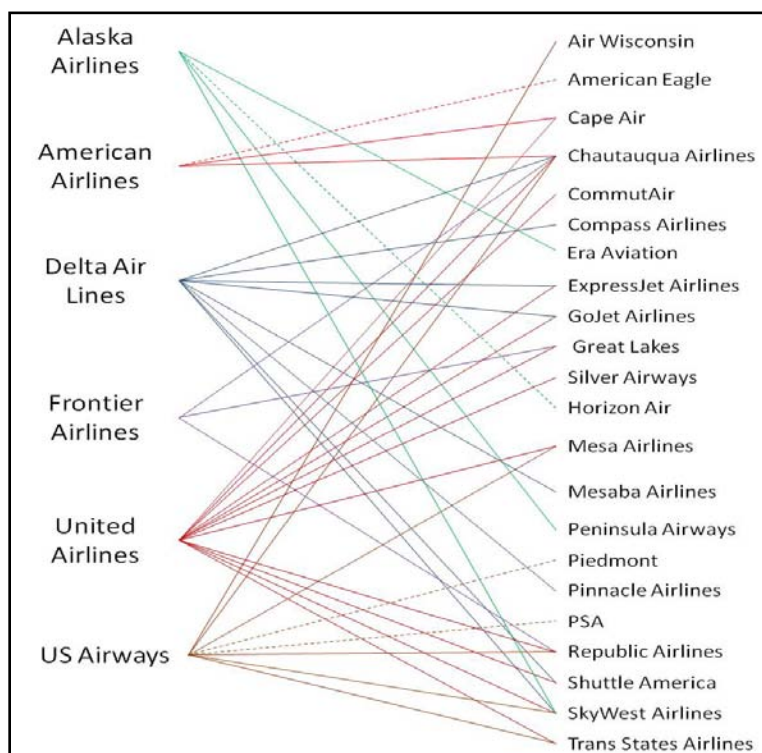
⁶ Because OST does not maintain any records or lists of domestic code share agreements and does not approve all domestic agreements, the percentage cited is based on an OIG analysis of the number of active domestic code share relationships between “major carriers” (as defined by Bureau of Transportation Statistics) compared to ALL active domestic code share relationships.

request code share agreements from air carriers. In its 2009 *Call to Action on Aviation Safety and Pilot Training*, FAA committed to work with DOT “to develop the authority to review agreements between air carriers and their regional partners.” Despite this commitment, FAA did not pursue this effort because it believed that the largest passenger airlines had already taken steps to increase communication, data sharing, and cooperation with their partner airlines. As a result, domestic code share agreements go into effect without consideration of their possible impact on air carrier safety.

OST Does Not Have Sufficient Information Regarding the Current State of Domestic Code Sharing

OST does not (1) have a documented process for reviewing domestic code share agreements, (2) keep records of which agreements it has reviewed, or (3) maintain a list of active domestic agreements. As such, OST does not know how many domestic code share agreements exist at any given time. This is despite the fact that as code share partnerships have evolved, the current code share landscape has become extraordinarily complex, as shown in figure 3.

Figure 3. Domestic Airline Code Share Agreements as of December 2012



Source: OIG analysis of FAA, RAA, and air carrier data

* Dashed lines indicate subsidiary relationships. A subsidiary corporation or company is one in which another, generally larger, corporation, known as the parent corporation, owns all or at least a majority of the shares. As the owner of the subsidiary, the parent corporation may control the activities of the subsidiary.

OST's limited review of this complex domestic code share environment coupled with its lack of recordkeeping for the domestic agreements it *does* review leaves a gap in DOT awareness of the code sharing economic landscape. This puts the Department and FAA at a disadvantage as they attempt to understand carrier relationships and partnership responsibilities.

FAA LACKS PROCEDURES TO ADVANCE AN EQUIVALENT LEVEL OF SAFETY BETWEEN MAINLINE CARRIERS AND THEIR REGIONAL PARTNERS

FAA does not take an active role in reviewing domestic code share agreements for possible safety impacts. Even though the 2009 Colgan accident revealed different operating standards between that regional operator and its mainline partner, FAA has not developed policies to ensure that code share partners advance a common level of safety.

FAA Has Not Taken Steps To Encourage Implementation of Safety-Sharing Programs Between Code Share Partners

FAA has not provided guidance to the industry on how best to implement safety information-sharing programs or outlined its expectations for sharing best practices within code share partnerships. Due to differences in airline safety practices, safety information sharing between code share partners is imperative. For example, NTSB determined that the Crew Resource Management training provided to the pilots of Colgan Air Flight 3407 was not as robust as their code share partner's (Continental Airlines) training. Following the accident, Colgan officials expanded their Crew Resource Management training to include some of the components of Continental's program.

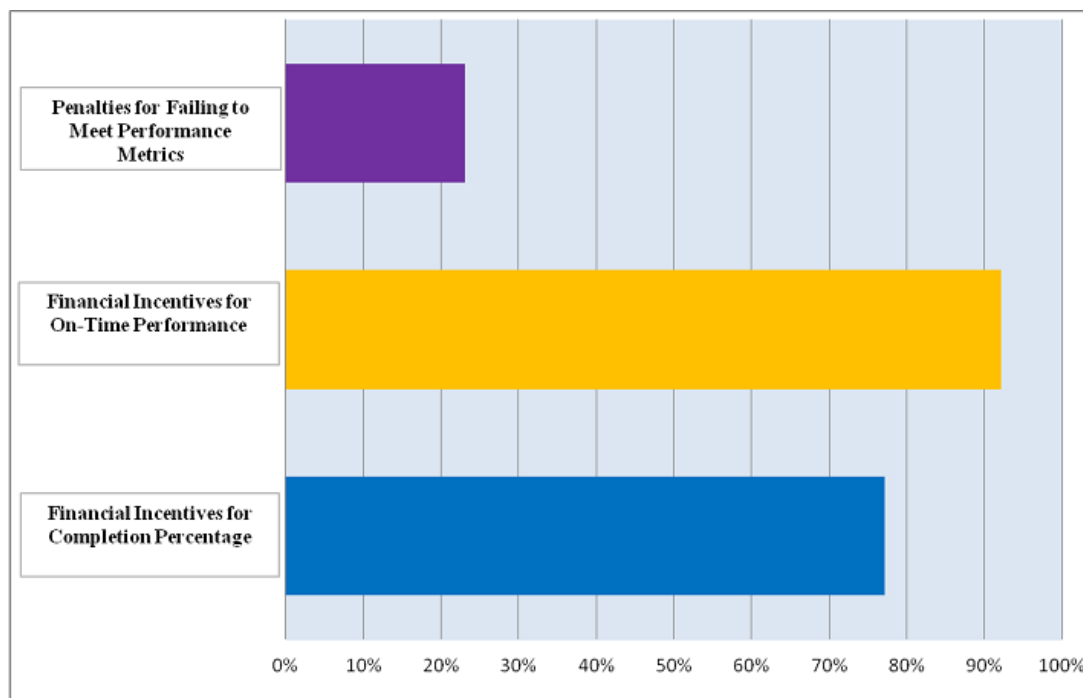
FAA officials stated in the 2009 *Call to Action* that major air carriers should seek specific and concrete ways to ensure that their code share partners adopt and implement the larger company's most effective practices for safety. We found that mainline carriers have begun implementing safety information sharing practices—five mainline carriers we reviewed have established code share safety programs with their regional partners. Yet, we found differences in the amount, type, and frequency of information being shared between carrier partnerships. For example, one mainline air carrier we reviewed tracks and reviews airline safety metrics and then shares this information with its regional partners on a monthly basis. However, not all mainline carriers review, track, and/or trend such metrics.

FAA Does Not Assess the Effects of Code Share Agreements on Safety

FAA does not review performance metrics contained in code share agreements to ensure they do not have an adverse impact on safety. This is because FAA officials believe oversight of each individual air carrier will ensure the safety of the airline industry. However, most code share agreements contain compensation models or performance stipulations that can directly affect the regional carriers' operations. For example, the agreements we reviewed state that regional partners (1) will only be compensated if they achieve certain baseline performance requirements (such as achieving a 95 percent completion rate⁷ for 3 months of any consecutive 6 month period), (2) may be penalized financially for failing to achieve the performance requirements, and/or (3) can receive incentives for exceeding established goals.

In the 13 domestic code share agreements we obtained as part of our air carrier reviews, almost all (92 percent) contained financial incentives for on-time performance. Some also contained penalties for failing to meet metrics or incentives for high completion rates as shown below.

Figure 4. Percentage of Code Share Agreements With Incentives/Penalties



Source: OIG analysis of 13 major to regional carrier agreements

While we recognize that performance metrics can be an important aspect of a successful business relationship, there may be potential safety implications with

⁷ Completion rate is the ratio of scheduled flights to flights that actually reach their destination.

meeting those metrics. This concern was highlighted during the Call to Action Safety Forums in the summer of 2009, in which participants stated that economic issues at air carriers can influence safety program decisions. However, since FAA does not review any domestic code share agreements, the Agency does not know whether the incentives or penalties included within these agreements could result in unintended safety vulnerabilities or whether this information could be beneficial in its air carrier oversight.

SOME AIR CARRIER OPERATING INFORMATION IS NOT READILY ACCESSIBLE TO PASSENGERS

While passengers have sufficient pricing and scheduling information when purchasing an airline ticket, they may not obtain a clear understanding of which airline is responsible for the safe operation of their flight. Although current regulations⁸ require that online ticket sellers and traditional travel agents inform passengers which carrier is operating their flight before purchasing a ticket, there is significant variation in the way online ticket sellers comply with these regulations. Furthermore, traditional travel agents are not evaluated for compliance with the disclosure requirements. Additionally, consumers have access to performance and complaint data for air carriers when making purchasing decisions; however, these data are not reliable or complete for regional carrier code share operations.

Compliance With Code Share Disclosure Regulations Varies Among Online Ticket Sellers

While OST has been vigilant in enforcing regulations for online ticket sellers (including the air carriers themselves), these entities still have considerable latitude in how they disclose code share information, which can lead to consumer confusion. Current law requires that online travel agencies⁹ provide code share disclosure to passengers in schedules and itineraries, but the manner in which this information is presented sometimes obscures the code share relationship.¹⁰ As shown below, online ticket agent code share disclosures are different enough in presentation that consumers may find it difficult to discern. For example:

- Some online ticket agents display disclosures about the operating carrier separately from the flight number, with no symbol indicating that there is additional information about the flight (see figure 5). This increases the chance that consumers will overlook the disclosure, because there is no indication that

⁸ 49 U.S.C. § 41712 and 14 C.F.R. Part 257 mandate disclosure of code share information.

⁹ Online Travel Agencies are Internet sites that sell tickets for air travel.

¹⁰ 14 C.F.R. § 257.5 (c) mandates the requirement for written code share disclosure.

there is additional information for any of the flights and the disclosure is presented in small print at the end of the itinerary.

Figure 5. Example of Online Code Share Disclosure

Depart: 10:46 a.m. Wed., May. 11, 2011 Lexington, KY (LEX)	Arrive: 11:14 a.m. Wed., May. 11, 2011 Chicago, IL (ORD - O'Hare)	Flight Time: 1 hr 28 mn	OnePass Miles/Elite Qualification*: 323 /100%	Flight: UA6851 Aircraft: Canadair Regional Jet 200 Fare Class: Economy (W) Meal: None See On-Time Performance View Seats
Change Planes. Connect time in Chicago, IL (ORD - O'Hare) is 1 hour 46 minutes.				
Depart: 1:00 p.m. Wed., May. 11, 2011 Chicago, IL (ORD - O'Hare)	Arrive: 3:09 p.m. Wed., May. 11, 2011 Cleveland, OH (CLE)	Flight Time: 1 hr 9 mn	OnePass Miles/Elite Qualification*: 316 /100%	Flight: UA570 Aircraft: Airbus A320 Fare Class: Economy (W) Meal: None See On-Time Performance View Seats
Change Planes. Connect time in Cleveland, OH (CLE) is 4 hours 3 minutes.				
Depart: 7:12 p.m. Wed., May. 11, 2011 Cleveland, OH (CLE)	Arrive: 8:25 p.m. Wed., May. 11, 2011 Washington, DC (IAD - Dulles)	Flight Time: 1 hr 13 mn	OnePass Miles/Elite Qualification*: 288 /100%	Flight: UA6058 Aircraft: Embraer RJ145 Fare Class: Economy (W) Meal: None See On-Time Performance View Seats
Change Planes. Connect time in Washington, DC (IAD - Dulles) is 1 hour 55 minutes.				
Depart: 10:20 p.m. Wed., May. 11, 2011 Washington, DC (IAD - Dulles)	Arrive: 11:12 p.m. Wed., May. 11, 2011 Charlottesville, VA (CHO)	Flight Time: 52 mn Travel Time: 12 hr 26 mn	OnePass Miles/Elite Qualification*: 85 /100% Total Miles: 1,012	Flight: UA3881 Aircraft: Saab 340/340B Fare Class: Economy (W) Meal: None See On-Time Performance View Seats
Flight UA 6851 is operated by UNITED EXPRESS/SKYWEST AIRLINES. Flight UA 570 is operated by United Airlines. Flight UA 6058 is operated by UNITED EXPRESS/EXPRESSJET AIRLINES. Flight UA 3881 is operated by UNITED EXPRESS/COLGAN AIR. Note: Flight 3881 is serviced by a non-jet equipment type.				

Source: Continental.com itinerary search conducted on May 2, 2011

- Some ticket sellers use the “doing business as” names for air carriers *before* the name of the actual operating carrier (see figure 6). This could confuse the consumer with the impression that the carrier is either owned or operated by the marketing carrier and implies that the flight is actually operated by a marketing carrier’s brand name.

Figure 6. Example of “Doing Business As” Names in Online Code Share Disclosures

12:33 PM BOI - 2:33 PM DEN
United 6786 View seats
Operated by UNITED EXPRESS/ SKYWEST AIRLINES
Flight details
connecting to
4:34 PM DEN - 7:32 PM DAL
United 6016 View seats
Operated by UNITED EXPRESS/ EXPRESSJET AIRLINES
Flight details

Source: United.com itinerary search conducted on April 5, 2011

Current variation among Web sites can make it difficult for consumers to locate and/or understand the disclosure of which carrier is operating their flight. According to some OST officials, prescribing uniformity among Web sites could reduce flexibility and stifle innovative approaches to presentation that are beneficial to consumers. Additionally, some OST officials state that uniformity is not necessary to achieve the Agency's statutory mandate to prohibit deception. Nevertheless, OST has proposed a rule, targeted for publication in May 2013, to codify Web site disclosure of code share operations, but the extent of the proposed changes is unclear until the rulemaking effort is finalized.¹¹

OST Does Not Proactively Assess Traditional Travel Agent Compliance

OST does not actively survey traditional travel agents for compliance with code share disclosure regulations, although they account for about \$60 billion of total air travel sales. Current law requires that travel agents provide disclosure of code share travel both orally to passengers before booking transportation and in written itineraries.¹² However, according to Department officials, OST does not prioritize oversight of this sector of ticket sellers because there are far too many of them and because the percentage of passengers purchasing travel through traditional travel agents is relatively low.

Even so, our survey results show that closer oversight of travel agents may be warranted. In our sample,¹³ we found that travel agents do not consistently provide verbal disclosure of code share flights. For example, 14 of 16 travel agents we randomly contacted failed to disclose or properly identify the operator of code share flights—even after being asked to identify the name of the actual operating carrier. In most of those cases, the travel agents actually provided *incorrect* information regarding which carrier was operating the flight. This would seem to indicate that the public could benefit from enhanced OST oversight of this segment of the ticketing industry.

OST Data for Consumers on Airline Complaints Are Inconsistent and Incomplete

Consumers currently do not have access to complete information regarding airline customer service and complaint records when purchasing an airline ticket. OST provides consumers some of these data in its monthly Air Travel Consumer Report,¹⁴ but the data are inconsistently presented and do not include all carriers

¹¹ SNPRM: Enhancing Airline Passenger Protections III; RN 2105-AE11.

¹² 14 C.F.R. § 257.5(b) mandates the requirement of oral code share disclosure to prospective customers.

¹³ Similar to OST compliance verification, our survey was conducted via telephone with a specific itinerary containing a known code share flight.

¹⁴ The Air Travel Consumer Report is a monthly product of DOT OST's Office of Aviation Enforcement and Proceedings. It is designed to assist consumers with information on the quality of services provided by the airlines.

due to the thresholds established by OST. OST collects and reports consumer complaints, except those that are safety or security related (which are handled by FAA and the Transportation Security Administration, respectively). However, the manner in which the data are presented limits the report's utility, especially for consumers looking for information on regional carriers (e.g., on time performance or customer service complaints on flight crew performance, which are the responsibility of the operating carrier). For example, the report:

- Only includes complaints that are made directly to OST and not those made to the airlines;¹⁵
- Only lists those airlines that receive 5 or more complaints in a month or 10 or more complaints in a year. If the total number of complaints against an airline is below this threshold, the complaints are published in a category called "Other U.S. Airlines;"
- Categorizes complaints based on the consumer's *perception* of who the operating carrier is that caused the complaint;¹⁶ and
- Often groups regional carrier data with mainline code share partner data. As an example, over half of the reports issued in 2011 included complaint statistics for "United Express," which is not an air carrier—United Express operates as a United Airlines' code share "brand." Therefore, complaints against "United Express" should be counted against the responsible partner on which the complaint was based. For example, if a passenger's baggage was late or he/she was involuntarily bumped from a flight, most likely the fault lies with the mainline carrier's gate or luggage systems or agents, and therefore should be attributed to the mainline carrier.

According to a recently published notice of proposed rulemaking, OST is considering adding a requirement that smaller carriers report data for OST's "on time performance" reporting, but has not yet identified any changes to how customer complaints might be published in the future.¹⁷ As a result, the impact of changes to consumer transparency in the Air Travel Consumer Report will not be fully known until OST's rulemaking effort is finalized. At the time of our review, the Air Travel Consumer Report provided unreliable information regarding regional carrier complaint data.

¹⁵ Except for disability/accessibility related complaints.

¹⁶ For example, if a consumer files a complaint against a mainline carrier for service that was actually performed by one of its domestic code share partners, the complaint will be recorded against the mainline carrier because that is how the consumer reported it to OST.

¹⁷ SNPRM: Enhancing Airline Passenger Protections III; RIN 2105-AE11.

CONCLUSION

Airline code sharing continues to play an increasingly important role in creating a seamless travel experience for consumers, while providing benefits to both mainline and regional carriers. However, OST and FAA oversight of domestic code sharing has not kept pace with recent industry changes, which may indicate a need for heightened attention of code share partnerships and guidance to domestic code share partners to improve safety programs. In light of the growing complexity and number of code sharing arrangements, OST and FAA need to reconsider their processes for enhancing opportunities for code sharing carriers to have an equivalent level of safety with their mainline partners. Furthermore, although OST has taken some steps towards improving consumer transparency through its proposed rulemaking, further action is needed to improve the information that consumers use to make ticketing decisions. Without these improvements, it will become increasingly difficult for regulators to monitor the economic and safety impacts of code share relationships and for consumers to easily understand which carrier is operating their flight.

RECOMMENDATIONS

To enhance management attention and improve consumer awareness of domestic code sharing, we recommend that OST:

1. Determine how the Department could take a more active role in reviewing domestic code share agreements between mainline carriers and their regional partners (such as developing a more formal process for identifying which domestic agreements to review), and develop and implement an action plan for doing so.
2. Assess whether consumer complaints should be attributed to a mainline and/or operating carrier instead of the mainline code share “brand” in the Air Travel Consumer Report.
3. Increase sampling of travel agents for code share disclosure to improve compliance with current OST regulations.

To further advance commitments with the Call to Action, we recommend that FAA:

4. Publish best practices guidance for safety-sharing practices among Part 121 air carriers and their code share partners.

5. Review code share agreement performance metrics, such as financial incentives for on-time performance, to ensure they do not have unanticipated or adverse impacts on safety.

AGENCY COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE

We provided OST and FAA with our draft report on October 10, 2012, and received their formal joint response on February 1, 2013, which is included in its entirety as an appendix to this report. OST concurred with recommendations 2 and 3 and provided responsive planned actions and reasonable implementation timeframes. OST partially concurred with recommendation 1, and while its response generally meets the intent of our recommendation, we are requesting additional clarifying information on its planned actions, as detailed below. FAA partially concurred with recommendations 4 and 5, and its proposed actions for recommendation 4 satisfy the intent of our recommendation. We are requesting that FAA reconsider its response for recommendation 5, as detailed below.

OST partially concurred with recommendation 1, questioning the benefits of performing additional reviews of domestic code share agreements beyond what is statutorily required. However, as noted in our report, code share agreements have become significantly more prevalent in recent years. In the last year alone, the number of domestic code share agreements increased by 16 percent; yet, under the current requirements, the Department would have only been required to review approximately 11 out of all 51 (22 percent) active domestic code share agreements, limiting its visibility into the growing field of code sharing. The increased use of these agreements and their potential impact on the aviation industry, particularly on smaller carriers that are financially reliant on them, is an area that bears watching. OST's planned actions to monitor industry developments in the upcoming year is a positive step. However, we are requesting OST provide additional information on how it plans to accomplish this endeavor, such as how it will monitor the industry and who within the Department will be responsible for this effort. As a result, we consider this recommendation resolved but open pending additional information.

In response to recommendation 4, FAA partially concurred and stated that it intends to require each Part 121 air carrier to implement a safety management system (SMS), rather than publishing guidance on best practices for safety sharing among air carriers as we recommended. An SMS is intended to provide a comprehensive, process-oriented approach to managing safety. FAA further stated that the SMS Final Rule is undergoing executive review and that the Agency will provide an update on its progress toward issuing the rule by June 30, 2013. Because a component of SMS emphasizes the formal communication of safety

issues, FAA asserted that a tailored SMS program within each airline would be a more effective method for meeting the intent of our recommendation. This action satisfies the intent of our recommendation, and we consider it resolved but open pending issuance of the final rule.

In response to recommendation 5, FAA partially concurred, noting that it already monitors other leading indicators that may impact safety (including impacts from mergers, takeovers, or changes in ownership and OST economic authority requirements). We recognize that performance metrics, such as financial incentives, are an important aspect of successful business relationships. However, most regional air carriers are financially dependent on these code share arrangements, warranting an additional precautionary step from FAA to review any potential impacts of these metrics. Also, at a series of FAA-hosted Safety Forums in 2009, industry representatives reported that while safety is their top priority, economic factors can influence operational decisions that affect safety. FAA's review of the performance metrics included in code share agreements would offer the added assurance that there are no unintended safety consequences. Therefore, we are requesting that FAA reconsider its response to this recommendation.

ACTIONS REQUIRED

We consider recommendations 1, 2, 3, and 4 resolved but open pending the completion of planned actions. In accordance with DOT Order 8000.1C, we request that OST provide additional clarifying information for recommendation 1, FAA reconsider its position for recommendation 5, and both offices provide their responses within 30 days of this report.

We appreciate the courtesies and cooperation of OST and FAA representatives during this audit. If you have any questions concerning this report, please call me at (202) 366-0500 or Tina Nysted, Program Director, at (404) 562-3770.

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cc: DOT Audit Liaison, M-1
FAA Audit Liaison, AAE-100

EXHIBIT A. SCOPE AND METHODOLOGY

We conducted this audit in accordance with generally accepted Government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. We conducted this review between September 2010 and October 2012 using the following methodology.

We interviewed OST representatives to obtain information on the number of code share relationships in existence and the domestic code share approval process. We also interviewed FAA Headquarters representatives (Flights Standards and Office of Analysis and Information Staff) to obtain information on the Agency's role in the safety oversight of domestic code share relationships. We also met with OST Office of the Assistant General Counsel for Aviation Enforcement and Proceeding to determine how it monitors compliance with and investigates violations of the DOT aviation economic, consumer protection, and civil rights laws, and how it reviews aviation economic licensing matters.

We interviewed FAA Certificate Management Office (CMO) personnel with designated oversight of respective air carriers engaged in code sharing agreements. We also met with mainline and regional airline officials to determine how and at what level within each organization code sharing agreements are developed, implemented, sustained, and reviewed (including what factors or metrics are used to determine suitability or performance).

To gain a better understanding of domestic code sharing relationships, we visited five (out of 34 possible) air carriers and their respective CMOs for review. We selected these carriers for review based on the differences in the carriers' current code share arrangements. For example, the code share relationships consisted of both independent carriers as well as those operating as wholly owned subsidiaries. We also visited FAA and OST offices that were directly or indirectly responsible or knowledgeable of code sharing regulations and oversight.

In addition, we met with both representatives of airline and travel related industry groups to identify their policies, guidance, or initiatives on code sharing relationships and safety oversight programs, as well as initiatives on passenger ticketing and code share disclosure.

We also performed Web site searches of domestic flights from various air carriers to known code share destination and randomly contacted 16 different travel agent offices via telephone with ticketing requests for these known code share itineraries

to determine whether the travel agent was providing the required code share disclosure.

EXHIBIT B. ORGANIZATIONS VISITED OR CONTACTED

Federal Aviation Administration (FAA) Headquarters

Flight Standards National Field Office	Washington, DC
Flight Standards, Air Transportation Division	Washington, DC
Office of Accident Investigation and Prevention	Washington, DC
Office of Aircraft Certification Services	Washington, DC
Aviation Safety Information Analysis and Sharing Division	Washington, DC
Office of Analysis and Information Staff	Washington, DC
International Programs and Policy Office	Washington, DC
FAA Liaison to Department of Defense	Washington, DC

FAA Certificate Management Offices (CMO)

Continental CMO	Houston, TX
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FAA Flight Standards District Offices (FSDO)

Indianapolis FSDO	Indianapolis, IN
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Office of the Secretary of Transportation (OST)

Office of the General Counsel	Washington, DC
(Office of Aviation Enforcement and Proceedings and Aviation Consumer Protection Division)	Washington, DC
Office of Aviation Analysis	
(Air Carrier Fitness Division and Competition and Policy Analysis Division)	Washington, DC
Office of International Aviation	Washington, DC

Regional Air Carriers

Republic Airlines	Indianapolis, IN
Chautauqua Airlines	Indianapolis, IN
Shuttle America	Indianapolis, IN
ExpressJet Airlines	Houston, TX

Mainline Air Carriers

Continental Airlines	Houston, TX
British Airways	London, England

Consumer and Industry Groups

Consumers Union	Yonkers, NY
National Business Traveler's Association	Alexandria, VA
FlyersRights.org	Napa, CA
American Society of Travel Agents (ASTA)	Alexandria, VA
Consumer Travel Alliance	Springfield, VA
Regional Airline Association	Washington, DC
International Air Transport Association	Montreal, Canada

Conferences and Forums

National Transportation Safety Board (NTSB)	
Code Share Symposium	Washington, DC
American Society of Travel Agents (ASTA)	
Legal Symposium	Washington, DC
Delta Connection Carrier (DCC) Training Forum	Atlanta, GA
Future of Aviation Advisory Committee (FAAC)	Washington, DC, Chicago, IL Atlanta, GA Denver, CO

Other Agencies

United States Department of Justice	Washington, DC
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EXHIBIT C. MAJOR CONTRIBUTORS TO THIS REPORT

Name	Title
Tina Nysted	Program Director
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Audre Azuolas	Writer/Editor
Seth Kaufman	Senior Counsel
Petra Swartzlander	Senior Statistician



U.S. Department
of Transportation

Office of the Secretary
of Transportation

GENERAL COUNSEL

February 1, 2013

1200 New Jersey Avenue, SE
Washington, DC 20590

MEMORANDUM

TO: Jeffrey B. Guzzetti
Assistant Inspector General
for Aviation

FROM: Robert S. Rivkin
General Counsel

A handwritten signature in black ink, appearing to read "RSR".

SUBJECT: OIG Draft Report on Domestic Airline Code-Sharing

Airline Code Sharing agreements are marketing arrangements between carriers that are intended to provide more seamless and convenient services for airline passengers by facilitating the coordination of scheduling and ticketing. The Department is in full compliance with statutory requirements with regard to monitoring code-sharing agreements and has established a regulatory framework to ensure that passengers are aware of the arrangements related to a given airline ticket and the airline on which they will fly.

It is, therefore, quite surprising that OIG in opening its draft report describes various reviews and tracking that the Department does not currently perform, none of which are required by statute or regulation, and it implies a deficiency without justifying any need from either a safety or economic perspective. The fact is these actions are not necessary or justifiable. Expanding the listing, tracking, and reviewing of domestic code-sharing agreements would require additional resources without any identified or demonstrable benefit.

With regard to aviation safety, following the February 12, 2009, crash of Colgan Air Flight 3407, Congress and the Federal Aviation Administration (FAA) took swift action to address the need for improvements in pilot training, hiring and qualification programs, beginning with the Agency's *Call to Action on Airline Safety and Pilot Training* and culminating in the passage of the Airline Safety and FAA Extension Act (the Act). Effectively implementing the Act's requirements for all commercial airline travel, not just for service provided by a regional operator, has been key to improving safety by raising standards in pilot training and performance, as well as advancing voluntary programs that yield critical safety information.

The FAA does not make a distinction between "major" and "regional" carriers, as all of those carriers meet the same standards, found in the regulations in Part 121 of Title 14 of the Code of Federal Regulations. The FAA has an extensive certification and oversight process for *all* U.S. airlines that hold an FAA certificate. Each independent code-sharing carrier holds an air carrier certificate and is required to meet the appropriate regulatory standards. The FAA oversees each of these air carriers under the same system of oversight. The FAA believes that all carriers operating in accordance with the regulations meet an appropriate level of safety regardless of whether or not they are in a code-sharing marketing alliance.

RECOMMENDATIONS AND RESPONSES

Recommendation 1: Determine how the Department could take a more active role in reviewing domestic code-share agreements between mainline carriers and their regional partners (such as developing a more formal process for identifying which domestic agreements to review) and develop and implement an action plan for doing so.

Response: Partially Concur. OST's current process and procedures are in full compliance with statutory requirements. Its reviews focus on those code sharing agreements which offer some potential for affecting competition. We note that the OIG report identified no specific instances of code sharing agreements that should have received further scrutiny and bases this recommendation on an assumption that OST may be missing competitive and economic impacts. Additionally, OIG has not identified code-share operations themselves as a problem or specified what exactly OST should look for when reviewing domestic code-share agreements.

Moreover, OST has limited authority to restrict domestic code-share agreements. OIG suggests that OST is responsible for maintaining competitive market conditions, but that overstates our authority. Congress has set forth the limited review OST is to conduct of domestic code-share agreements. Under 49 U.S.C. § 41720, major U.S. carriers must notify OST of certain large-scale domestic code-share agreements. The purpose is to give OST the opportunity to review those agreements for competitive effects, e.g., United/Continental (2008). OST can take action to block or limit a code-share agreement if the agreement violates 49 U.S.C. § 41712, by demonstrating an unfair or deceptive practice or unfair method of competition. However, it is generally not an unfair method of competition to engage in domestic code-share arrangements. This is particularly the case with respect to agreements involving smaller carriers that are not covered by 49 U.S.C. § 41720. OST is unlikely to find an unfair method of competition by reviewing domestic code-share relationships because, as noted in the report, those agreements tend to provide benefits to passengers, regional carriers, and mainline carriers. In terms of passenger costs and services, at a minimum, code-share relationships are overall neutral, and they often improve service and fares to underserved communities. Further evidence of the absence of a problem is the fact that in the past 5 years OST's Aviation Enforcement Office has received 55,181 consumer complaints but of those complaints, only 3 were about code-share disclosure (or 0.0005%). Accordingly, it is unclear what benefit would accrue from the additional review of domestic code-share agreements that OIG is recommending. However, OST will monitor industry developments through the end of this year to determine whether any issues arise that could potentially benefit from closer scrutiny and/or procedural modifications. By January 31, 2014, OST will notify the OIG of whether any such issues have arisen, and whether any further action is planned as a result.

Appendix. Agency Comments

Recommendation 2: Assess whether consumer complaints should be attributed to a mainline and/or operating carrier instead of the mainline code-share "brand" in the Air Travel Consumer Report.

Response: Concur. The OIG report suggests that changing the way consumer complaints to OST regarding code-share "brands" are attributed will increase the transparency of the data that are published in OST's Air Travel Consumer Report (ATCR). As stated in the OIG report, OST's practice has been to attribute complaints to the carrier as perceived by the consumer, which includes attributing a complaint to a mainline code-share "brand" if that is how the consumer attributed it (e.g., United Express, Delta Connection). Carriers then have the opportunity to correct any misperception by the consumer that results in a misattribution of a complaint before the ATCR is published. The number of complaints actually attributed to a mainline code-share "brand" is very small (77 out of 11,546 total complaints in 2011). By comparison, 1,236 complaints were attributed to the corporate name of the code-sharing regional carrier. We have never viewed this practice as problematic because the number of complaints against code-share "brands" is very small and does not detract from the usefulness of the information provided by reporting the nature and number of complaints against the carriers. Going forward, the Aviation Enforcement Office's Aviation Consumer Protection Division will code complaints against either the mainline carrier or the operating carrier, as appropriate, and not the code-share "brand." The ATCR will reflect the change starting with the January 2013 report.

Recommendation 3: Increase sampling of travel agents for code-share disclosure to improve compliance with current OST regulations.

Response: Concur. The OIG's report suggests that traditional travel agents are a significant venue for air travel sales and accordingly should be more closely monitored for compliance with code-share disclosure regulations. We are in the process of initiating a project to sample (make test calls to) the top ten "brick and mortar" travel agencies by revenue, as well as a number of carriers, to determine whether there are issues with disclosure of code-share operations. The Aviation Enforcement Office intends to complete the test calls by June 30, 2013, and will take any enforcement action determined to be necessary. Enforcement action against large entities generally has a deterrent effect across large segments of the industry.

It is also notable that about 2,000 traditional travel agencies sell tickets via the internet. Overall, airlines report that both by revenue and number of tickets sold, over half of all ticket sales are through the internet, either through the airline's own website or a travel agent website. Additionally, online sales continue to increase at the expense of traditional travel agent sales each year. Our numerous enforcement actions against entities with online operations encourage compliance and increases online code-share disclosure.

Finally, it is important to clarify relevant facts regarding the OIG's statement that traditional travel agent operations account for about \$60 billion of total air travel sales. Based on information provided by airlines and ticket agents, the Aviation Enforcement Office believes that the bulk of the revenue generated by non-online travel agent sales results from travel management company operations. The large dollar amount is misleading because a large percentage of those sales are actually corporate travel purchases, generally made by or on behalf

Appendix. Agency Comments

of sophisticated business travelers. Further, those purchases are often conducted through private business-to-business transactions.

Recommendation 4: Publish best practices guidance for safety-sharing practices among Part 121 air carriers and their code-share partners.

Response: Partially Concur. The FAA sees value in many of the safety best practices adopted by certain airlines, such as the Aviation Safety Action Program (ASAP) and Flight Operations Quality Assurance (FOQA). In fact, since the *Call to Action*, participation in FAA's voluntary programs is at an all-time high. Today, over 80% participate in at least one voluntary program (Advanced Qualification Program [AQP], ASAP, FOQA, Line Operations Safety Audit [LOSA]). As of September 2010, as documented in the 2011 Public Law 111-216 report to Congress, 62 of 94 (66%) air carriers participated in ASAP and 33 of 94 (35%) participated in FOQA. As of October 16, 2012, 64 of 84 participate in ASAP (78%) and 40 of 84 (48%) participate in FOQA.

The FAA does not consider publishing best practices guidance for safety-sharing between code-share partners to be the most effective way to further improve safety. Each air carrier must address the safety risks it identifies in its own operation, which may not be the same as those identified in another air carrier's operation. Instead, the FAA intends to require each Part 121 air carrier to implement a safety management system (SMS). SMS is a comprehensive, process-oriented approach to managing safety throughout an organization that includes an organization-wide safety policy; formal methods for identifying hazards, controlling, and continually assessing risk; and promotion of a safety culture. SMS stresses not only compliance with technical standards but increased emphasis on the overall safety performance of the organization. SMS's proactive emphasis on hazard identification and mitigation, and on communication of safety issues, would provide certificate holders robust tools to improve safety. The SMS Final Rule is presently in executive review and the FAA will provide an update by June 30, 2013, on the status of the Final Rule.

Recommendation 5: Review code-share agreement performance metrics, such as financial incentives for on-time performance, to ensure they do not have unanticipated or adverse impacts on safety.

Response: Partially Concur. The FAA recognizes that performance metrics are a necessary element in commercial air carrier operations and that they may factor into operational risks that must be considered in planning oversight. The FAA conducts risk-based surveillance based on diverse and extensive information sources to evaluate an air carrier's ability to balance resources and operational requirements. For example, in its oversight of Part 121 air carriers, the FAA already monitors leading indicators that may impact safety, such as:

- Substantial change in air carrier management;
- Substantial turnover in personnel or reduction in force;
- Labor dispute;
- Rapid expansion or growth;
- Merger, takeover, or change in ownership;

Appendix. Agency Comments

- Enforcement actions:
- Noncompliant attitude:
- Accidents/incidents/occurrences;
- Department of Defense reviews;
- Department of Transportation/Office of the Secretary of Transportation economic authority/insurance requirements;
- Change in fleet type;
- Substantial change in outsourcing;
- Financial distress;
- Substantial passenger or employee complaints; and
- Hotline complaints.

If the FAA identifies specific risks associated with these leading indicators, it takes action to identify these risks and works with the air carrier to mitigate them. The FAA considers its surveillance of business process risks to be sufficiently comprehensive to address the aspects that would be touched by the recommended action. In light of this, the FAA does not see the added utility of specifically reviewing contract agreements between air carriers. Accordingly, the FAA requests that this recommendation be closed.