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December 15, 2006

VIA FEDERAL EXPRESS
VIA FACSIMILE

Mr. Donald Jansky
Assistant General Counsel
Office of General Counsel
Texas Department of State Health Services
1100 W. 49th Street
Austin, TX 78756-3199

Re: EMS Subscription Rule

Dear Mr. Jansky:

This firm represents PHI Air Medical Group ("PHI"), a national FAA-certificated air ambulance carrier with operations in Texas. PHI representatives were present during the Governor's EMS and Trauma Advisory Council meetings in Dallas on November 18 and 19 and listened with great interest to your preliminary comment that the State may not be able to regulate air ambulance subscription programs based upon federal preemption. PHI wishes to initiate a subscription program in some of the local Texas jurisdictions in which it operates, and has sought our advice on this matter.

We have reviewed the Texas regulation governing subscription programs, 25 TX. ADC Section 157.11 (the "Regulation"), and are aware of the pending amendments. We agree with your preliminary analysis and respectfully submit that the Regulation, both in its current form and with the proposed amendments, is preempted as applied to air ambulance carriers by Section 105 of the Airline Deregulation Act, 49 U.S.C. Section 41713 (the "ADA"). Therefore, we do not believe that PHI or other air ambulance carriers should be obligated to comply with it. PHI has requested, however, that we seek your concurrence with our views prior to expanding its subscription program into Texas. We will summarize the basis for our conclusion and then provide a detailed analysis. We would greatly appreciate a response within 30 days indicating whether you concur.

SUMMARY

The ADA preempts any "law, regulation or other provision having the force and effect of law related to a price, route, or service of an air carrier." Its purpose is to promote competition and efficiency among air carriers for the benefit of consumers, through lower prices and enhanced service.

As you know, in a typical subscription program, an air carrier offers an alternative (discounted) rate structure to its prospective passengers pursuant to which they essentially prepay that part of the carrier's fare that is not covered by insurance. In exchange, the carrier agrees to accept what the passenger's insurer pays as payment in full at the time of transport. In addition to the savings achieved by members, carriers who establish effective membership programs may be able to reduce their overall rate structure to all their passengers, and/or provide a higher level of service.

Any state regulation that limits or burdens a carrier's ability to implement such a program would, on its face, be "related to a price, route, or service of an air carrier," and would therefore fall squarely within the purview of the ADA's preemption. Such regulation would also frustrate the intent of the ADA by precluding the discounts and potentially enhanced level of service inherent in subscription programs. For these reasons, the Regulation as a whole is expressly preempted by the ADA as applied to air ambulance carriers. When looked at individually, the various parts of the Regulation also fail to survive preemption under the ADA.

A more detailed analysis follows:

DISCUSSION

1. The Preemption Provision of the ADA.

As you are aware, air ambulance carriers are extensively regulated by the Federal Aviation Administration ("FAA") under the Federal Aviation Act, which was amended by the ADA in 1978. Congress enacted the ADA after "determining that 'maximum reliance on competitive market forces' would best further 'efficiency, innovation and low prices' as well as 'variety and quality'. . . of air transportation services." Morales v. Trans World Airlines, Inc., 504 U.S. 374, 378 (1992). To achieve this goal, Congress included a broad preemption provision in the ADA intended to protect air carriers from state regulation that might hinder competition. That section provides, in relevant part, as follows:

> a state, political subdivision of a state, or political authority of at least two states may not enact or enforce a law, regulation or other provision having the force and effect of law related to a price, route, or service of an air carrier that may provide air transportation under this subpart.
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> 49 U.S.C. Section 41713(b).

The seminal Supreme Court case interpreting this provision, Morales v. Trans World Airlines, *supra*, construed it expansively. In that case, several airlines sued to enjoin State Attorneys General in Texas and other states from enforcing state deceptive practices laws against airline advertising and related conduct. The Attorneys General, acting through the National Association of

Attorneys General ("NAAG"), had adopted guidelines that contained detailed standards governing, among other things, the content and format of airline fare advertising, the awarding of premiums to regular customers (i.e., "frequent flyers"), and the payment of compensation to passengers who voluntarily yield their seats on overbooked flights. In striking down the NAAG guidelines, the Supreme Court stated, in relevant part, as follows:

> [The ADA] expressly preempts the states from enacting or enforcing any law, rule, regulation, standard or other provision having the force and effect of law relating to rates, routes, or services of any air carrier. For purposes of the present case, the key phrase, obviously, is "relating to." The ordinary meaning of these words is a broad one - "to stand in some relation; to have bearing or concern; to pertain; refer; to bring into association with or connection with," Black's Law Dictionary 1158 (5th ed. 1979) - and the words thus express a broad pre-emptive purpose. . . . State enforcement actions having a connection with or reference to airline "rates, routes or services" are preempted under [the ADA].
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> Morales, 504 U.S. 374, 383.

The Court made it clear that preemption under the ADA can be either express or implied. Implied preemption can occur if a state regulation has a "forbidden significant effect upon fares." Restrictions on advertising have such an effect because "[a]dvertising serves to inform the public of the . . . prices of products and services, and thus performs an indispensable role in the allocation of resources. [citations] Restrictions on advertising serve to increase the difficulty of discovering the lowest cost seller. . . and reduce the incentive to price competitively." Morales, 504 U.S. 374, 389.

The Morales court further observed that a state law need not be one specifically addressed to the airline industry to be preempted by the ADA as a law "relating to rates, routes, or services" of an air carrier; the ADA expressly preempts all laws "relating to" rates, routes or services, including laws of general applicability that fall within its sphere, even if those laws are consistent with the ADA's substantive requirements. Morales, 504 U.S. 374, 389; see also, Lawal v. British Airways PLC, 812 F.Supp. 713 (S.D. Tex. 1992)

Numerous subsequent decisions have followed the Supreme Court's lead in broadly construing the preemptive effect of the ADA. Any state law or rule that could cause rates in one jurisdiction to differ from those in other jurisdictions is preempted. Illinois Corporate Travel, Inc. v. American Airlines, Inc., 682 F.Supp. 378 (N.D. Ill. 1988), affirmed, 889 F.2d 751 (7th Cir. 1989). Preemption has been deemed to apply in numerous cases in which states have attempted to impose unfair or deceptive business practices prohibitions and similar statutory regimes of general application upon air carriers. See, e.g., American Airlines, Inc. v. Wolens, 513 U.S. 219 (1995); Sam L. Majors Jewelers v. ADX, Inc., 117 F.3d 922 (5th Cir. 1997); Trujillo v. American Airlines,

Inc., 938 F.Supp. 392 (N.D. Tex. 1995), affirmed without op., 98 F.3d 1338 (5th Cir. 1996). Similarly, several courts have followed Morales in finding that advertising by carriers is out of bounds for state regulators. For example, In Musson Theatrical, Inc. v. Federal Express Corporation, 89 F.3d 1244, amended on denial of rehearing on other grounds, 1998 W.L. 117980 (6th Cir. 1998), rehearing en banc denied (January 15, 1998), the court held that Congress intended the Federal Department of Transportation to be the sole legal control on possible advertising fraud by air carriers.

In addition to striking down regulations that implicate advertising and rates directly, the courts have also struck down regulatory provisions purporting to control the entry of air carriers, including air ambulance carriers, into state or local jurisdictions. For example, in Hiawatha Aviation of Rochester, Inc. v. Minnesota Dept. of Health, 389 N.W.2d 507 (Minn. 1986), the court held that the state of Minnesota was preempted from controlling entry into the field of air ambulance service by the ADA. In a more recent case, a federal district court in Missouri found that the ADA preempted that portion of Missouri's ambulance licensing law that mandated a determination that the "public convenience and necessity" required a proposed ambulance service, as a condition of granting licensure. Rocky Mountain Holdings vs. Ronald W. Cates, Director, Missouri Department of Health, No. 97-4165-CV-C-9 (W.D. Mo. Central Division 1997). The court held that "in making the determination of public convenience required by the Missouri provision, the state is making decisions having a connection with or reference to the rates, routes or services of an air carrier." Slip Op., pages 13 and 14.

As the touchstone for finding a wide range of regulatory constraints to be invalid, the courts routinely note that the ADA's preemption clause serves the statute's goal of promoting maximum reliance on competitive market forces, as opposed to state regulation, in shaping the contours of the air carrier industry. See, e.g., Branche v. Air Tran Airways, Inc., 342 F.3d 1248 (11th Cir. 2003). In other words, any regulation that hinders competition among air carriers is suspect and must fall if it relates to rates, routes or services. See generally, 149 ALR Fed. 229 ("Construction and application of Section 105 Airline Deregulation Act, pertaining to preemption of authority over prices, routes and services.")

Notably, the FAA itself has been active in opposing state regulation of air ambulance carriers that intrudes upon its authority under the ADA and other provisions of the Federal Aviation Act. In a case currently pending in Tennessee, the Department of Justice very recently filed a "Statement of Interest of the United States of America" on behalf of the FAA in which it urged the court to strike down Tennessee regulations purporting to regulate safety and related equipment of air ambulance carriers. See "Statement of Interest of the United States of American" in Air-Evac EMS, Inc. v. Kenneth S. Robinson, M.D., Commissioner of Health, and Tennessee Board of Emergency Medical Services, No. 3:06-0239 (M.D. of Tenn.). As one of its reasons for opposing the Tennessee regulations, the Department of Justice states:

> In 1978 Congress included a provision within the ADA expressly prohibiting a state from enacting any regulation "relating to rates,

> routes or services of any air carrier." [citing Morales and the ADA]. This express preemption provision is interpreted broadly, applying even to those state laws that have only an indirect effect on rates, routes or services. See Morales, 504 U.S. at 383-384, 386 . . . Accordingly, the preemption provision applies to any state regulation having a connection with or reference to a price, route or service. Id. at 384.
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> Statement of Interest of the United States of America, *supra,* at 9-10.

Finally, Texas state courts have also expansively interpreted the ADA's preemption provision. See Delta Airlines, Inc. v. Black, 116 S.W.3d 745 (Tex. 2003) (finding that an airline's boarding procedures and seating policies relate to "services" provided to customers for purposes of the preemption provision) and Shupe v. American Airlines, Inc., 893 S.W.2d 305 (Tex. App. Ft. Worth 1995), writ granted (August 1, 1995) and judgment aff'd on other grounds, 920 S.W. 2d 274 (Tex. 1996) (finding that claims under the Texas Deceptive Practices Act against an airline were preempted by the ADA).

2. The Texas Subscription Regulation.

As noted above, a subscription program is essentially an alternative rate structure adopted by an air ambulance carrier. In such programs, carriers agree that they will discount their rates by accepting what the passengers' insurers pay as payment in full in exchange for an advance payment of a membership fee. In addition to reduced rates for members, the carrier's overall rate structure for all of its passengers may be favorably affected, and the carrier may have the resources to purchase better equipment or to pay more highly trained staff. In restricting such programs undertaken by air carriers, the Regulation falls clearly and squarely within the purview of the ADA's preemption provision invalidating any state or local law that "relates to" rates and services.

Although we do not believe it is necessary to parse the various provisions of the Regulation to reach the conclusion that preemption applies, a closer examination the its specific provisions demonstrates that each is expressly or impliedly preempted by the ADA under the precedents discussed above.

First, the requirement for a written authorization from the bureau chief elected official of the governmental entity in which the carrier proposes to operate provides unfettered and absolute authority to that official to preclude the carrier from offering an alternative membership rate structure within its jurisdiction. As noted above, the ADA has been construed as prohibiting regulatory schemes which require different rates and rate structures within different jurisdictions. Illinois Corporate Travel, Inc. v. American Airlines, Inc., 682 F.Supp. 378 (N.D. Ill. 1988), affirmed, 889 F.2d 751 (7th Cir. 1989). This provision of the Regulation not only provides elected officials in each local jurisdiction with unfettered authority over an air carrier's rate structure, it also creates the

possibility that the carrier may be required to use a different rate structure in each jurisdiction to satisfy the requirements of such officials. It is therefore preempted on those grounds.

This part of the Regulation must also fall under the rationale of the court decisions in Minnesota and Missouri, in which regulations permitting state or local officials to serve as gatekeepers of the air ambulance marketplace based on economic considerations were found preempted. Hiawatha Aviation of Rochester, Inc. v. Minnesota Dept. of Health, 389 N.W.2d 507 (Minn. 1986); Rocky Mountain Holdings vs. Ronald W. Cates, Director, Missouri Department of Health, No. 97-4165-CV-C-9 (W.D. Mo. Central Division 1997). This part of the regulation has a similar impact, since it may not be feasible for a carrier to enter some jurisdictions without a membership program.

Second, the requirement for air carriers to submit a sample of their subscription contract and application is similarly preempted. The Morales court and its progeny struck down regulations that purported to restrict discounts, frequent flyer miles and other aspects of the economic relationship between carriers and their passengers. In attempting to regulate membership agreements establishing those relationships, including the rates payable and services provided thereunder, the Regulation encroaches on preempted ground.

Third, the requirement to submit a copy of all advertising used to promote the subscription program runs afoul of the preemption provisions as interpreted by Morales and other courts. One of the central holdings of Morales is that states may not regulate advertising by air carriers, since this goes to the heart of competition.

Fourth, the requirement for carriers to provide evidence of financial responsibility is preempted. Bond and insurance undertakings securing performance of financial obligations by air carriers have a direct and substantial impact on the carriers' rates, and therefore relate directly to those rates. The courts have been clear that such nexus is sufficient to trigger preemption.

Finally, the provisions of the Regulation providing for periodic review of the program also impinge upon exclusive federal authority as set out in the ADA. Because the essence of a subscription program relates to rates and services of a carrier, neither the state nor any local jurisdiction has the authority to review that program on a periodic or any other basis, nor may the state or local jurisdiction require the provider to furnish the names and addresses of its customers.

CONCLUSION

For the foregoing reasons, we believe that the ADA clearly preempts the Regulation as applied to air ambulance carriers. Viewed as a whole, the thrust of the Regulation is to restrict programs that enhance competition by providing passengers with reduced rates and potentially enhanced service. When the various parts of the Regulation are viewed in isolation, each addresses an area that is out of bounds under the ADA—market entry, advertising, financial undertakings and other areas which directly and significantly relate to rates and services. We therefore believe our

client should be able to proceed with its membership program without complying with the Regulation.

We are hopeful you will agree with our analysis and respectfully request a response with your views on this issue within 30 days. We appreciate your consideration of this request and would be happy to answer any questions you may have or to discuss these issues further.

Very truly yours,

Mike Scarano

R. Michael Scarano, Jr.

cc: Howard Ragsdale