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# *Office of Inspector General*

# *Audit Report*

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## **IMPROVEMENTS NEEDED IN DOT'S PROCESS FOR IDENTIFYING UNFAIR OR DECEPTIVE PRACTICES IN AIRLINE FREQUENT FLYER PROGRAMS**

*Office of the Secretary of Transportation*

*Report Number: AV-2016-068*

*Date Issued: June 16, 2016*






# Memorandum

**U.S. Department of  
Transportation**

Office of the Secretary  
of Transportation  
Office of Inspector General

Subject: Improvements Needed in DOT's Process  
for Identifying Unfair or Deceptive  
Practices in Airline Frequent Flyer Programs  
Office of the Secretary of Transportation  
Report No. AV-2016-068

Date: June 16, 2016

From: Charles A. Ward   
Assistant Inspector General  
for Aviation Audits

Reply to  
Attn. of: JA-10

To: General Counsel

For more than 30 years, airlines have offered frequent flyer programs to encourage travel on their respective airlines and secure customer loyalty. An estimated 630 million members are currently enrolled in various frequent flyer programs worldwide, with over 300 million members enrolled in U.S. air carrier programs. In a July 2014 letter and subsequent conversation with our office, Representative Alan Grayson expressed multiple concerns with airlines' frequent flyer programs, such as changes to frequent flyer programs with little to no notice, the devaluation of frequent flyer awards and benefits over time, and the availability of award seats.

The Department of Transportation (DOT) requires that airlines<sup>1</sup> disclose their frequent flyer program rules in their customer service plans. Moreover, DOT has authority to investigate unfair and deceptive practices and unfair methods of competition in air transportation,<sup>2</sup> including consumer complaints regarding the rights of passengers who hold frequent flyer miles.<sup>3</sup> Accordingly, we initiated this audit to review: (1) DOT's oversight of air carriers' compliance with frequent flyer program disclosure requirements, (2) DOT's process for reviewing passenger complaints regarding unfair and deceptive practices, and (3) airlines' practices regarding the availability of award seats and valuation of frequent flyer miles.

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<sup>1</sup> Certificated or commuter air carriers and foreign air carriers that operate scheduled passenger service or public charter service to and from the U.S. using aircraft originally designed to have a passenger capacity of 60 or more seats.

<sup>2</sup> 49 U.S.C. § 41712.

<sup>3</sup> Section 408 of the FAA Modernization and Reform Act of 2012 (The Act) (codified at 49 U.S.C. § 42302 (note)).

To conduct our work, we met with DOT and airline officials and reviewed their processes for reviewing and resolving consumer frequent flyer complaints. We conducted our work in accordance with generally accepted Government auditing standards. Exhibit A details our scope and methodology, and exhibit B lists organizations we visited or contacted.

## **RESULTS IN BRIEF**

DOT conducts oversight of air carriers' frequent flyer program disclosures as part of its compliance inspection process. DOT reviews the customer service plans periodically during its overall onsite air carrier inspections. All three airlines we reviewed had disclosed their rules in their plans as required by DOT.

DOT's reviews of passenger complaints related to frequent flyer terms and conditions, however, have not proven sufficient in determining whether airlines have engaged in unfair and deceptive practices. From 2012 through 2014, consumers filed 76 frequent flyer complaints with the Department against U.S. air carriers, and DOT analysts chose not to forward any of these complaints to DOT attorneys for further review. Yet, our review of 36 of these complaints showed that 4 (11 percent)<sup>4</sup> warranted additional review. For example, a consumer complained that a carrier announced its intent to impose a fee for using miles to upgrade only 2 weeks before the change took effect. Although DOT considers a change to terms and conditions without reasonable notice to be an example of an unfair or deceptive practice, DOT took no further action on this complaint and forwarded it directly to the airline to resolve with the consumer. DOT officials acknowledged the need for analysts to receive additional training to ensure they track and pursue complaints on practices that are potentially unfair or deceptive.

Award seats were available for the vast majority of flights we reviewed. For example, we examined the availability of seats for two airlines using frequent flyer miles for 660 roundtrip flights on 11 dates. Of those, 99 percent of the flights had award seats available for the dates selected, with 63 percent available at the carriers' lowest award levels. Also, we determined the average number of frequent flyer miles redeemed for an award seat increased during our review period for one airline but decreased slightly for the second airline. However, we were not able to determine how many miles were redeemed at different award levels, since airlines do not publicly disclose this information. In addition, although air carriers disclose that award seats may not be available for all flights, they do not fully inform consumers that limitations are decided using complex computer modeling to forecast demand for each flight. According to the airlines, there is similarity between the retail-price model for a ticket and the award model. For example, as a

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<sup>4</sup> Percentage is not weighted.

flight nears capacity, the ticket price will rise, and the number of miles required to obtain an award seat will also rise.

We are making recommendations for DOT to improve its process for reviewing consumer complaints for unfair and deceptive practices. We also encourage air carriers to be more transparent with award-seat availability and redemption information.

## **BACKGROUND**

DOT has authority under Title 49, United States Code, Section 41712 to investigate and prohibit unfair and deceptive practices and unfair methods of competition in air transportation, including consumer complaints regarding the rights of passengers who have frequent flyer miles. The Department's Office of Aviation Enforcement and Proceedings (OAEP), a division within the Office of the General Counsel, enforces DOT's air travel consumer protection rules.

DOT analysts review the complaints, including frequent flyer complaints, and determine if they pertain to a regulated area. DOT sends all consumer complaints it receives to the airline and asks it to reply to the consumer. If the complaint pertains to a regulated area, the analyst asks the airline to send DOT a copy of its reply. Any complaint the analyst believes is a potentially unfair or deceptive practice should be referred to Department's attorneys along with the airline's response. Air carriers are required to send an acknowledgement to the consumer within 30 days and a substantive response within 60 days. DOT may ask airlines to provide follow-up information if the complaint involves a regulated area; if the complaint does not pertain to a regulated area, the case is closed after the complaint is sent to the airline.

## **DOT CONDUCTS OVERSIGHT OF AIR CARRIERS' FREQUENT FLYER PROGRAM DISCLOSURES**

DOT conducts oversight of air carriers' frequent flyer program disclosures as part of its compliance inspections. These onsite inspections of air carriers focus on the carriers' compliance with consumer protection areas, which include the carriers' customer service plans.<sup>5</sup> DOT conducts five or six of these onsite inspections annually. We reviewed customer service plans for Virgin America, Delta Air Lines, and American Airlines and found all in compliance with requirements to disclose frequent flyer rules in their customer service plans. The Department conducted its most recent onsite inspections of Virgin America, Delta Air Lines, and American Airlines in July 2011, March 2012, and April 2012, respectively

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<sup>5</sup> Certain U.S. and foreign air carriers are required to adopt customer service plans that address 12 service areas, including disclosing frequent flyers rules.

and found no evidence of violations regarding the carriers' frequent flyer programs. In addition to reviewing air carriers' compliance with the disclosure regulations, DOT selects a sample of complaints that were submitted directly to air carriers, and looks into a frequent flyer matter if a frequent flyer complaint is selected in the sample.

## **DOT'S REVIEW PROCESS FOR FREQUENT FLYER COMPLAINTS DID NOT EFFECTIVELY IDENTIFY POTENTIALLY UNFAIR OR DECEPTIVE PRACTICES**

DOT has not actively pursued its authority to investigate complaints regarding the rights of passengers who hold frequent flyer miles and to investigate and prohibit unfair and deceptive practices. Although consumers filed 76 frequent flyer complaints with DOT related to frequent flyer terms and conditions against U.S. air carriers for calendar years 2012 through 2014, DOT analysts did not forward any complaints to its attorneys to investigate for potential violations of unfair or deceptive practices. Instead, DOT sent the complaints to the air carriers to resolve without any additional research to determine whether the air carriers were involved in unfair or deceptive practices. In addition, the analysts sent letters to the complainants which stated that the complaint did not fall under Department rules.

Additionally, while DOT officials told us they consider an air carrier's change to the terms and conditions of its frequent flyer program without reasonable notice to be an unfair or deceptive practice, they rarely investigate whether this practice occurs. According to DOT officials, few complaints reach the threshold of an unfair or deceptive practice.

Yet, our review of 36 of the 76 frequent flyer complaints determined that 4 (11 percent) were potentially unfair or deceptive regarding changes to terms and conditions without reasonable notice and warranted additional review. For example, a consumer complained that a carrier announced its intent to impose a fee for using miles to upgrade a class of service only 2 weeks before implementation of the change. The change was announced on April 8, 2014, and implemented on April 23, 2014. DOT took no further action and forwarded the complaint directly to the airline to resolve with the consumer. However, there was no indication that the analyst determined whether or not the air carrier provided reasonable notice to consumers.

Based on our follow-up review with the air carriers, we concluded that this complaint was the only one of the four that was still potentially unfair or deceptive. However, DOT did not follow up with the airlines for any of the four complaints to determine if the changes were made with reasonable notice.

DOT officials said they currently consider two factors in determining whether notice is reasonable: (1) how significant the change is, and (2) whether notice was given far enough in advance to allow the consumer to benefit from the program prior to the change. However, without any specific guidance on what constitutes “reasonable,” DOT analysts use their judgment to determine whether to initiate an investigation or leave it to the airline to resolve. DOT officials acknowledged the need for analysts to receive additional training to ensure they track and pursue complaints that are potentially unfair or deceptive.

Air carriers have great latitude with their programs because the terms and conditions state that frequent flyer miles are the property of the airlines, not the consumer. They reserve the right to change their frequent flyer rules, regulations, and travel awards and benefits at any time with or without notice. DOT is considering developing a rule requiring air carriers to provide reasonable notice of changes to their frequent flyer programs; however, DOT officials have not determined if and when the rule will be required. Regardless, even in the absence of a specific regulation for reasonable notice, DOT can take enforcement action under the unfair or deceptive practice statute.

## **AIR CARRIERS PROVIDE LIMITED INFORMATION ON HOW AWARD SEAT AVAILABILITY IS DETERMINED**

For the vast majority of flights we reviewed, seats were available for purchase with frequent flyer miles. In March 2015, we conducted a review to determine the availability of award seats, in real time, at various redemption levels. We searched the Web sites of both American Airlines and Delta Air Lines to determine if award seats were available in 60 of their domestic markets (30 for each airline).<sup>6</sup> For 660 roundtrip flights and 11 dates selected,<sup>7</sup> we found:

- 99 percent of flights had award seats available at least at one redemption level;
- 63 percent of flights had award seats available at the lowest redemption levels (20,000 or 25,000 miles for a roundtrip); and
- 13 percent of flights had award seats available at the lowest redemption level during the holiday week, a period of high demand.<sup>8</sup>

We attempted to obtain historical data on award redemptions at various award levels, but found that airlines either do not track—or do not publicly share—

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<sup>6</sup> Virgin America was not included in the review of seat availability because, unlike American and Delta, there is a direct correlation between the cost of a ticket and the number of miles needed to redeem an award.

<sup>7</sup> We randomly selected 10 departure dates in 2015 and set the return date for 7 days later. The 11th date (December 20, 2015, departure and December 27, 2015, return) was selected because it is a high-travel-demand holiday week.

<sup>8</sup> Percentages are not weighted.

detailed historical information about how many award miles customers redeem at different redemption levels. Using available information for calendar years 2010 through 2013, such as airlines' annual reports and other data,<sup>9</sup> we were able to determine that the average number of frequent flyer miles used to redeem an award increased for Delta Air Lines and decreased slightly for American Airlines. The average miles used to redeem an award on Delta increased from 22,000 to 24,636, while on American the average miles used decreased slightly from 22,987 to 22,782. However, information regarding redemption levels for specific routes or destinations was not publicly available.

Airlines also do not fully disclose how they determine availability of frequent flyer award seats. For example, American Airlines' customer service plan indicates that awards at the lowest redemption level are subject to capacity controls, but it does not describe how the airline makes these determinations. Specifically, airlines determine availability for award seats based on actual demand and a complex model that forecasts demand.<sup>10</sup> If an airline forecasts that demand for a flight will be high,<sup>11</sup> such as during peak travel times, award seats at the lowest redemption level may not be available. Therefore, even though a customer can book seats 11 months prior to his or her travel date, if the airline projects demand will be high for that flight, the customer may be unable to obtain a seat at the lowest award redemption level. According to the airlines, the retail-price model for a ticket and the award model are similar. As a flight nears capacity, the ticket price will increase, as will the number of miles required to obtain an award seat. Both American and Delta offer award seats at the highest redemption level if a seat is available, but neither guarantees a minimum number of seats at the lowest redemption level on any flight.

In two prior audits,<sup>12</sup> we reported that carriers provided limited information on frequent flyer award redemptions and the information provided was of marginal value to consumers. We recommended that air carriers provide the public with a more comprehensive report of frequent flyer redemption information, such as the percentage of successful redemptions and frequent flyer seats made available in the top origin and destination markets. The airlines opposed this recommendation. In a follow-up review, we recommended that DOT examine, through rulemaking, the need to standardize the reporting of frequent flyer redemptions to provide more meaningful comparison of program benefits. DOT responded that OAEP and the

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<sup>9</sup> 10-K Annual Reports Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 and award redemption data provided by American Airlines Legal and Government Affairs Managing Director.

<sup>10</sup> American and Delta use an "algorithm" that forecasts demand for each flight.

<sup>11</sup> Some events that result in a forecast for high demand are major holidays, Super Bowl locations, and historical data.

<sup>12</sup> *Airline Customer Service Commitment* (OIG Report No. AV-2001-020), February 12, 2001; and *Follow-up Review: Performance of U.S. Airlines in Implementing Selected Provisions of the Airline Customer Service Commitment* (OIG Report No. AV-2007-012), November 21, 2006. OIG reports are available through our Web site at <http://www.oig.dot.gov/>.

Assistant Secretary for Aviation and International Affairs would discuss whether there was a demonstrated cause to proceed with a rulemaking. This recommendation was closed, and no further actions were taken.

Ultimately, since there are no specific requirements in these areas, airlines are free to use their own discretion and business principles to decide how to disclose information regarding their award-travel algorithms and redemption history to consumers.

## **CONCLUSION**

Airlines' frequent flyer programs are widely popular and warrant oversight given the hundreds of millions of consumers who participate. Although DOT has limited regulations regarding these programs, the Department has sufficient authority to investigate and prohibit unfair or deceptive practices and protect the rights of passengers who hold frequent flyer miles. We recognize that airlines have wide latitude with the terms and conditions of their frequent flyer programs. However, the Department is missing opportunities to strengthen oversight and be more proactive in determining whether airlines have engaged in unfair or deceptive practices. Improved oversight through training and rulemaking will provide consumers with better protection of their frequent flyer programs.

## **RECOMMENDATIONS**

To strengthen oversight of airlines' frequent flyer programs, we recommend that DOT:

1. Provide training to DOT analysts on what constitutes unfair or deceptive practices.
2. Define what constitutes reasonable notice for consumers regarding changes to frequent flyer programs' terms and conditions, and require airlines to provide such notice.

## **AGENCY COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE**

We provided a draft of this report to DOT on March 21, 2016, and received its response on April 20, 2016, which is included in its entirety as an appendix. Our initial draft contained three recommendations, including a two-part recommendation, denoted as 3(a) and 3(b). In its response, DOT concurred with the first two recommendations and 3(a), but did not concur with 3(b). We have modified our recommendations in this final report, as detailed below.



Specifically, DOT concurred with recommendation 1, as written, and plans to complete actions to implement the recommendation by June 30, 2016. We consider this recommendation resolved but open pending DOT's implementation of training for its analysts on what constitutes unfair or deceptive practices.

DOT also concurred with our draft recommendations 2 and 3(a) regarding defining what constitutes reasonable notice to consumers about changes to frequent flyer programs' terms and conditions. Since the corrective actions needed were substantially similar, these recommendations are now combined under our final recommendation 2. The Department plans to address this recommendation through rulemaking by December 31, 2018. Hence, we consider this recommendation resolved but open pending completion of the rulemaking.

DOT did not concur with our draft recommendation 3(b). Specifically, we recommended that DOT require air carriers to be more transparent about the availability of frequent flyer award redemptions. DOT stated, however, that it did not see a connection to our report's findings. We disagree since our report noted that information on frequent flyer award-redemption levels for specific routes or destinations was not publicly available. We also reported that the process airlines use to determine award-seat availability is unclear to consumers—a concern that prompted our recommendation. In its response, DOT stated that it is not confident that the airlines' complex processes for determining award-seat availability could be effectively summarized for consumers. We recognize there are complexities that would hinder the feasibility of implementing the recommendation. Therefore, we have removed recommendation 3(b) from this final report. Nevertheless, absent a firm requirement, we encourage airlines to provide consumers with more transparency on frequent flyer seat availability when feasible.

We appreciate the courtesies and cooperation of the Department of Transportation and airlines during this audit. If you have any questions concerning this report, please call me at (202) 366-0500.

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cc: DOT Audit Liaison, M-1

## **EXHIBIT A. SCOPE AND METHODOLOGY**

We conducted this audit from September 2014 through March 2016 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 our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

A congressional request from Representative Alan Grayson expressed multiple concerns with airlines' frequent flyer programs. Accordingly, our audit objectives were to assess: (1) DOT's oversight of air carriers' compliance with frequent flyer program disclosure requirements, (2) DOT's process for reviewing passenger complaints regarding unfair and deceptive practices, and (3) airlines' practices regarding the availability of award seats and valuation of frequent flyer miles.

To evaluate DOT's oversight of air carriers' compliance with frequent flyer program disclosure requirements, we visited and interviewed DOT's Office of Aviation Enforcement and Proceedings (OAEP), selected air carriers and industry stakeholders, and analyzed relevant Federal regulations. See exhibit B for a list of organizations visited or contacted.

To determine DOT's process for reviewing passenger complaints regarding unfair and deceptive practices, we interviewed OAEP officials about the process for reviewing complaints regarding the rights of passengers who hold frequent flyer miles. We obtained 76 complaints regarding frequent flyer terms and conditions received by the OAEP from January 1, 2012, through September 24, 2014. We then visited the headquarters of three air carriers: American Airlines, Delta Air Lines, and Virgin America<sup>13</sup> and reviewed actions they took to resolve 36<sup>14</sup> of the 76 complaints received by DOT and forwarded to the carriers to resolve. We analyzed these complaints to identify any potentially unfair or deceptive practices; whether the air carriers provided reasonable notice for changes to their frequent flyer rules; and what actions DOT took to resolve the complaints. Based on the review of complaints at these airlines, we determined the information was sufficient to address our objectives and ended the audit at survey. Therefore, we did not visit or select any additional airlines to review.

To assess airlines' practices regarding the availability of award seats and valuation of frequent flyer miles, we selected 11 dates<sup>15</sup> and randomly selected 30 routes

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<sup>13</sup> Due to the small number of complaints for the non-major carriers, we selected two major and one non-major air carrier because they represented a cross-section of the total complaints received by DOT.

<sup>14</sup> The 36 complaints include all of the complaints received by DOT for the 3 airlines we visited.

<sup>15</sup> We randomly selected 10 departure dates in 2015 and set the return date for 7 days later. The 11th date (December 20, 2015, departure and December 27, 2015, return) was selected because it is a high travel demand holiday week.

from each of American's and Delta's top 300 markets from Origin-Destination information from the Bureau of Transportation Statistics. In real time, we looked at these flights and determined the number of flights with available award seats and how many flights had seats available at the airlines' lowest redemption levels. We did not include Virgin America in this assessment because, unlike Delta and American, there is a direct correlation between the cost of an airline ticket and the number of miles needed to redeem an award.<sup>16</sup>

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<sup>16</sup> On Virgin America, awards can be redeemed for 50 points per dollar. For example, a customer would need to redeem 20,000 points for a \$400 flight (50 points x \$400 = 20,000).

## **Exhibit A. Scope and Methodology**

## **EXHIBIT B. ORGANIZATIONS VISITED OR CONTACTED**

### **DEPARTMENT OF TRANSPORTATION**

Office of the Secretary of Transportation/Office of Aviation Enforcement and Proceedings

Bureau of Transportation Statistics

### **STAKEHOLDERS**

Advisory Committee for Aviation Consumer Protection

Airlines for America

### **AIRLINES**

American Airlines

Delta Air Lines

Virgin America

**EXHIBIT C. MAJOR CONTRIBUTORS TO THIS REPORT**

<b>Name</b>	<b>Title</b>
Scott Macey	Program Director
Barry DeWeese	Program Director
Terri Ahuruonye	Project Manager
Judy Nadel	Senior Auditor
Joyce Koivunen	Senior Auditor
Susan Crook	Senior Analyst
Audre Azuolas	Writer-Editor
Seth Kaufman	Senior Counsel
Petra Swartzlander	Senior Statistician
Jerrod Sharpe	Senior Economist



U.S. Department  
of Transportation

Office of the Secretary  
of Transportation

GENERAL COUNSEL

1200 New Jersey Avenue, SE  
Washington, DC 20590

## MEMORANDUM

DATE: April 20, 2016

SUBJECT: INFORMATION: Management Response –  
Office of Inspector General (OIG) Draft Report  
on Oversight of Frequent Flyer Programs

FROM: Kathryn B. Thomson  
General Counsel

A handwritten signature in blue ink, appearing to read "Kathryn B. Thomson", with a horizontal line extending to the right.

TO: Charles A. Ward  
Assistant Inspector General  
for Aviation Audits

The Department is committed to ensuring that airlines treat consumers fairly when they participate in frequent flyer programs. We require that airlines make available a reasonable number of seats for award tickets and that consumers have access to frequent flyer program information on airline websites. We appreciate the OIG's efforts in preparing the subject report, which found that airlines are complying with these requirements.

Over the last twenty years, consumer complaints regarding award ticket availability have made up less than half of one percent of the total number of air travel consumer complaints filed with the Department. We have periodically heard concerns expressed in the media and elsewhere that award tickets were not available in sufficient quantities. Our experience did not validate these concerns. Similarly, the OIG found that frequent flyer award seats are widely available. Specifically, 99 percent of the 660 roundtrip flights the OIG examined had award tickets available for the dates selected and 63 percent had award seats available at the carrier's lowest award level. We also note that the OIG found that all three airlines it examined were complying with the Department's rule directing airlines to disclose their frequent flyer rules in their customer service plans and post these plans on their websites in an easily accessible manner.

Based on our review of the draft report, we are in general agreement with the OIG's recommendations for strengthening the Department's oversight of frequent flyer programs. Specifically, we concur with Recommendation 1, as written, and plan to complete actions to implement the recommendation by June 30, 2016.

We also concur with Recommendations 2 and 3(a) regarding defining what constitutes reasonable notice to consumers regarding changes to frequent flyer programs' terms and conditions. The Department currently requires that airlines provide reasonable notice to significant changes to frequent flyer programs but has not defined reasonable notice. While we concur with Recommendations 2 and 3(a), we suggest the OIG combine these two recommendations into a single recommendation since the two recommendations are substantially similar. The Department will address the single recommendation through rulemaking by December 31, 2018.

We do not concur with Recommendation 3(b) that the Department require air carriers to provide more transparency about the availability of frequent flyer award redemptions. We do not see a connection between this recommendation and the findings in the report. In addition, to determine the availability of award tickets, carriers use complex algorithms that weigh numerous dynamic variables, and we are not confident that these processes could be summarized for effective use by consumers. As a result, we request that the OIG remove Recommendation 3(b) from the Final Report.

We appreciate this opportunity to offer additional perspective on the OIG draft report. Please contact Blane A. Workie, Assistant General Counsel, Office of Aviation Enforcement and Proceedings, at (202) 366-9345 with any questions or if the OIG would like to obtain additional details about these comments.