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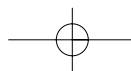
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Legal and regulatory reviews

Airport privatisation in the USA: Recent legal developments and future outlook

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OVERVIEW

Virtually all airports in the USA with scheduled passenger services, along with most large general aviation airports, are owned and controlled by a government entity or some combination of public entities.¹

This is not to suggest that private entities are not actively involved in US airport operations and development. A commonly cited statistic is that upwards of 90 per cent of employees at commercial service airports in the USA work for private companies.² Further, there have been several attempts to enlist private participation in US airports short of entirely turning the airport over to a private entity, including permitting private entities to manage airport operations or specific airport functions and facilities.³

Notwithstanding the role of private entities in airport operations, the governance and management of passenger service airports in the USA remains principally a public function.

Privatisation pilot programme

The debate over airport privatisation has been underway in the USA since the

concept of privatising public services and utilities took hold internationally in the late 1980s. The two most significant actions by the US Government to address airport privatisation occurred in 1996.

First, Congress adopted an airport privatisation pilot programme in the Federal Aviation Reauthorisation Act 1996.⁴ The legislation authorises the Federal Aviation Authority (FAA) to approve the sale or lease of up to five airports to private entities.⁵ One of the five airports must be a general aviation airport, and only one airport can be a large hub airport (ie accounting for more than 1 per cent of all US passenger boardings).⁶ The legislation authorises the FAA to exempt the airport sponsor and private operator from certain legal requirements, and imposes terms and conditions on the sale or lease to ensure continued compliance with other requirements.⁷

The FAA thereafter published detailed instructions for submitting an application under the programme.⁸ The procedures require the airport sponsor to submit a preliminary application to the FAA and reserve one of the five spots, select a private operator and reach substantial agreement on the terms of the privatisation

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transaction, coordinate with airlines and other airport users to obtain approvals in accordance with the statute, and file a final application.⁹ In response to a final application, the FAA will publish notice of the application, commence a 60-day public comment period, render a final decision and, upon approval, issue requested exemptions.¹⁰

The second event in 1996 on the issue of airport privatisation was a report prepared by the US General Accounting Office — now the Government Accountability Office (GAO) — entitled, ‘Airport Privatisation: Issues Related to the Sale or Lease of US Commercial Airports’.¹¹ This report summarised the history of privatisation efforts in the USA and attempted to isolate the legal and non-legal impediments to privatisation. Many of these impediments involved requirements of federal law and FAA policy that undermined the financial feasibility of privatisation.

Chief among these is the fact that the FAA considers sale or lease proceeds to be airport revenue, which under federal law can be used only for airport purposes.¹² Considering that the primary financial incentive on the part of most government entities looking to sell or lease an airport is the infusion of money that could be used for other purposes, the GAO correctly characterised the prohibition on revenue diversion as ‘the major obstacle’ to privatisation.¹³

Moreover, because the private entity purchasing or leasing an airport also must comply with federal obligations such as the prohibition on revenue diversion, privatisation was not considered desirable from the private entity’s point of view. Almost by definition, restricting a profit-motivated entity’s ability to obtain a return on its investment eliminates the incentive to assume ownership or lease of an airport.

Other obstacles were not so easily defined, and the GAO reported that the uncertainty was enough to dissuade privatisation.¹⁴ For example, federal law and FAA policy were not entirely clear as to whether an airport sponsor selling or leasing an airport to a private entity must reimburse the federal government to compensate for prior federal grants. Similarly uncertain was whether the sponsor of a former military airfield transferred by the government for commercial use must return any property in the event of a sale or lease to a private entity.

The application of federal laws and FAA policies on the imposition of landing fees and other rates and charges has created further uncertainty. During the development of the privatisation pilot programme, the FAA was updating its rates and charges policy in response to a separate statutory mandate.¹⁵ The GAO reported that the FAA’s decision to require use of historic rather than market value for the airfield could further discourage privatisation.¹⁶ Private operators were unsure whether they could pass on their full costs and receive a return on investment under the historic cost standard. Airlines were unsure what standards would apply and were concerned that private operators would dramatically increase rates and charges.

In enacting and later refining the privatisation pilot programme, Congress recognised and addressed several of these perceived barriers. For example, under the statute: (1) airports sponsors are exempt from the prohibition on revenue diversion upon receiving the consent of 65 per cent of air carriers at a primary airport (by number of carriers and landed weight) or 65 per cent of based aircraft owners at a non-primary airport;¹⁷ (2) airport sponsors are exempt from repaying past grants or returning property previously conveyed

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by the US Government;¹⁸ (3) private operators are exempt from the prohibition on revenue diversion;¹⁹ and (4) fees charged to air carriers cannot increase faster than the rate of inflation unless a higher amount is approved by 65 per cent of the air carriers (by number of carriers and landed weight).²⁰

Airport participation in the privatisation pilot programme

Airport response to the privatisation pilot programme has been subdued. In the years immediately following the creation of the programme, five airports submitted preliminary applications to the FAA, but only one airport, Stewart International Airport, New York, received final approval. As explained below, the private operator, National Express Group, recently sold its lease to the Port Authority of New York and New Jersey, essentially reversing privatisation of that airport. The FAA either rejected the other applications, or the airport proprietor withdrew. In 2006, the City of Chicago submitted and the FAA accepted a preliminary application to privatise Midway Airport; however, Chicago has not yet submitted a final application.

This tepid response suggests either that government efforts to remove barriers to privatisation have not worked or that barriers outside of federal government control limit industry interest in privatisation. Numerous theories for the low level of participation have been advanced in the years following the establishment of the privatisation pilot programme. For example, in 2004, the FAA offered the following explanation in its Report to Congress, as required under the statute:

'First, local governments are reluctant to give up control of the airport to a private

entity. Second, airlines have traditionally opposed airport privatization based on their perception that the loss of governmental control may produce higher costs. Finally, and perhaps most importantly, the public sector has access to tax-exempt financing and other low cost financing options that may not always be available to the private sector.'²¹

Other observers generally have agreed with this assessment, although numerous theories have been advanced.²² In particular, several observers have recognised that US airports are currently heavily privatised and surmised that full privatisation may not materially improve current conditions.²³ Airports have explained that their limited interest results from concerns that the programme is too restrictive in terms of the types of airports that can participate, the supermajority approval requirement is tantamount to veto power held by the airlines at an airport, and the approval process is too time intensive and risky.²⁴ The timing of the programme also may have played a role; the post September 11th downturn in the industry almost certainly undermined the nascent efforts at privatisation under the programme.²⁵

RECENT DEVELOPMENTS

Stewart International Airport

On 1st November, 2007, the Port Authority of New York and New Jersey assumed control of Stewart International Airport upon acquiring the lease from National Express Group (NEG).²⁶ The move essentially reverses the only fully privatised airport in the USA under the privatisation pilot programme.

Stewart Airport, located 60 miles north of New York City, is owned by the State of New York, having been deactivated as a US Air Force base and transferred to the

state from the Department of Defense in 1970. In 2000, the State of New York received FAA approval under the privatisation pilot programme to privatise the airport through a long-term lease. The terms of the 99-year lease included an initial payment of \$35m, plus lease payments beginning in year 10 of the lease totalling 5 per cent of gross airport income.²⁷ Because it did not receive an exemption from the prohibition on revenue diversion, the State of New York was obligated to reinvest the lease payments in projects at Stewart and other state-owned airports.

In preparing its 2004 Report to Congress on the status of the privatisation pilot programme, the FAA relied extensively on the details of the Stewart privatisation as an indicator of whether privatisation was working.²⁸ The FAA found that NEG's planned capital improvements, operating profits and customer service compared favourably with the State of New York's.²⁹ The FAA did not offer any general conclusions as to whether the privatisation pilot programme could be declared a success based on the experience at Stewart Airport. Indeed, the experience at Stewart did not lend itself to general conclusions considering, for example, NEG's short tenure in operating Stewart, the fact that Stewart constituted the only participant in the privatisation pilot programme, and the fact that the State of New York had not sought an exemption from the prohibition on revenue diversion.

Only a few years after beginning the long-term lease, NEG decided to abandon airport management as a core business function and began marketing its lease of the airport. The Port Authority of New York and New Jersey became interested in acquiring control over Stewart Airport, principally as a means to relieve congestion at its other passenger service

airports: John F. Kennedy International Airport, LaGuardia Airport and Newark Liberty International Airport. In 2007, the Port Authority paid \$78.5m to NEG to acquire the remaining 93 years of the long-term lease from the State of New York.

In many respects, the de-privatisation of Stewart Airport is not a particularly useful indicator of the viability of airport privatisation in the USA. The transfer appears to have been opportunistic, and not necessarily a failure in privatisation's ability to confer the anticipated benefits. Moreover, whether or not assumption of the lease would have been attractive to another private operator, \$78.5m can be characterised as a reasonable expense from the perspective of the Port Authority, particularly when viewed in relative terms and compared with the high cost of congestion and delay and the cost of building a new reliever airport.

Midway Airport

On 14th September, 2006, the City of Chicago submitted to the FAA a preliminary application to privatise Midway Airport. The FAA accepted the application on 3rd October, 2006, thereby reserving the single slot in the privatisation pilot programme for a large hub airport.

Earlier in 2006, the Illinois legislature had removed a few likely obstacles to privatisation. The Local Government Facility Lease Act 2006³⁰ addresses future airport expansion, use of lease proceeds and labour issues, including unionised labour, wages and retention of existing airport employees. Further, the Act preserves the tax exempt status of the airport upon lease to a private operator.

In its preliminary application, the City of Chicago identified numerous goals and objectives for the planned privatisation,

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many of which were targeted at the statutory criteria and FAA approval procedures. Aside from stating its intent to transfer control through a lease of 50 or more years, Chicago did not, in the preliminary application or appended request for qualifications, provide details with respect to the terms and conditions of the lease. In particular, Chicago did not give any indication of the new rate-setting methodology that would be used for amended use agreements with signatory airlines.

Although not stated expressly in the preliminary application, Chicago is motivated to privatise Midway Airport in order to generate revenue to both pay down Midway-related debt and, equally important, fund a considerable shortfall in Chicago's municipal employee pension programme.³¹ The Local Government Facility Lease Act expressly limits Chicago's use of lease revenue to construction and maintenance of infrastructure and to the employee pension fund.³² In light of the paramount goal of generating revenue, Chicago indicated in its preliminary application that it intends to select the 'qualified respondent offering to pay the largest concession payment for entering into the proposed long-term lease/concession agreement'.³³

Chicago thereafter began discussions with the airlines in order to secure the supermajority approval required to obtain an exemption from the prohibition on revenue diversion. Although the airlines, including the dominant carrier, Southwest Airlines, were initially opposed, the City reports that it has received Southwest's approval, plus that of the airlines necessary to meet the supermajority requirements (ie 65 per cent of airlines by number and landed weight).³⁴ Chicago won this support by committing to a rate-setting structure that caps fees for six years and ties future increases to inflation.³⁵

In February 2008, the City issued a request for qualifications from interested firms or investment groups. On 1st April, the City announced that it had received statements of qualifications from six teams.³⁶ On 30th September, 2008, after submission of this paper, the City of Chicago announced a tentative agreement with a consortium led by Citi group's Citi Infrastructure Investors and YVR Airport Services Ltd., including an up-front lease payment of US\$2.521bn.

With the approval of the airlines and a tentative agreement with a private operator, a clear path to privatising Midway Airport is now visible. Nevertheless, it remains to be seen how the signatory carriers respond to the specific terms of the proposed airline use agreement and whether the FAA finds that the proposed lease agreement satisfies the statutory criteria and approval procedures.

General Mitchell International Airport

Although it has not submitted even a preliminary application, Milwaukee County, Wisconsin, is debating whether to enter the privatisation pilot programme and pursue a long-term lease of General Mitchell International Airport.³⁷ Similar to the City of Chicago, Milwaukee County is motivated principally by a need to find revenue to offset a projected \$20m annual operating deficit in the County's transit system. Privatising the airport is considered an alternative to increasing taxes to fund the local transit system. At least one privatisation proponent has argued that privatising the airport is financially feasible.³⁸

FAA Reauthorisation

In its proposed bill to reauthorise the taxes and allocation scheme for the FAA

and airports, the Bush Administration proposed three material changes to the privatisation pilot programme: (1) increasing the number of slots from five to 15; (2) granting airports an exemption from the prohibition on revenue diversion upon consulting with airlines or based airport users; and (3) permitting the private operator to impose fees at a rate higher than inflation.³⁹ However, the US House of Representatives did not adopt any such changes in the programme in the reauthorisation bill it approved, and no comparable changes are included in the bill under consideration in the US Senate.⁴⁰

FUTURE OUTLOOK

Gauging the viability of privatising US airports remains challenging. Predicting the future requires gleaning lessons from the short-lived privatisation of Stewart Airport, attempting to apply experiences in the privatisation of airports worldwide to the unique regulatory regime in the USA, and evaluating the constraints and opportunities presented by the privatisation pilot programme in constantly shifting conditions within the industry.

Certainly, the City of Chicago's experience over the next year or more will add valuable data as to the prospects for privatisation of US airports. Other cash-strapped communities may be emboldened to pursue the remaining slots in the programme and experiment with privatisation if Chicago is successful.

The potential exemption from the prohibition on revenue diversion is likely to remain the principal motivation for pursuing privatisation. Under current law and FAA policy, revenue diversion remains an all-or-nothing proposition. Aside from grandfathered airports that were diverting revenue before the prohibition was put in place, there are very few exceptions to the

otherwise strict requirement to use airport revenue exclusively for airport purposes.⁴¹ While communities might be content to divert a small amount of airport revenue to offset temporary declines in fiscal revenue and shortfalls in other government programmes, the current regulatory scheme essentially requires that communities descend into dire financial circumstances and then fully privatise at potentially great financial reward. This scheme creates an inherent limit on the pool of candidate airports.

While it is likely that worsening conditions in the US economy will put more communities in dire straits and prompt serious consideration of airport privatisation, the poor condition of the aviation industry may provide something of a counterweight. While some communities may be able to offer enhanced certainty in airport rates and charges — as Chicago has done at Midway — most airlines are likely to be extremely sceptical of any new rate-setting methodology in a time of financial crisis. Thus, airline opposition may blunt any increased interest in airport privatisation.

For many communities not in such dire financial conditions that simply are looking to improve airport management and operations, the alternatives to privatisation are likely to offer better choices. Two viable alternatives are (i) transferring control to an airport authority and (ii) partial privatisation.

While many airports in the USA are directly controlled by officials and staff of the government entity, some airport sponsors have transferred power to an authority whose role is limited to operating an airport and possibly other transportation infrastructure. Many states permit the creation of airport authorities, whether by a single government entity or multiple government entities acting

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together, with concomitant powers to operate and develop airports.⁴² Several communities have reported positive results upon turning airport governance over to an airport authority.⁴³

Transferring control over to an airport authority may be considered superior to privatisation in part because of the very public dimension of US airports. As stated in the FAA's 2004 Report to Congress, many communities simply do not want to cede control over an airport to a private operator. Most communities in the USA carefully track and are keenly aware of the economic impact of commercial service airports and their role in economic development. Using an authority might be considered a compromise for those communities looking to enhance the focus on airport operations and management but who fear that privatisation would reduce government oversight and accountability.

Secondly, there are numerous options for achieving greater private participation in airport operations and development short of full privatisation. Airport proprietors in the USA have turned airport management over to private entities, as well as the management of specific functions and facilities.⁴⁴ While the merits and viability of different approaches to partial privatisation are subject to debate, there are several examples of the successful privatisation of airport management. Here again, considering the legal, political and financial impediments to full privatisation, partial privatisation may be a better solution for communities looking to enhance airport management and operations.

In addition to the availability of potentially superior alternatives, the current limits of the privatisation pilot programme are likely to impede further participation. The City of Chicago has reserved the only spot in the programme available for a large hub airport. None of

the remaining 30 large hub airports can participate. The supermajority of airlines needed to obtain an exemption from the prohibition on revenue diversion will continue to make it difficult for communities motivated principally by the desire to siphon money from the airport for other public purposes.

These and other limits to privatisation resulting from the privatisation pilot programme are likely to be the easiest to address as Congress obviously can change the programme. In the short term, the FAA's proposal to relax certain statutory requirements seemingly will not be adopted by Congress as part of FAA reauthorisation. Similar proposals may garner more support if there is some indication of renewed interest in privatisation or a reason to believe that specific changes would prompt renewed interest.

One significant gap in the privatisation pilot programme concerns general aviation airports. The law was plainly intended for and directed at passenger service airports. While Congress reserved a spot for general aviation airports and amended the law in 2003 to provide a means for general aviation airports to receive the exemption from the prohibition on revenue diversion (by obtaining consent from 65 per cent of based aircraft owners), the standards and requirements remain, for the most part, relevant to passenger service airports. Thus, there may be further changes to the programme that are necessary to elicit interest from general aviation airports.

At the most general level, the very limited interest in privatisation, even after the Government removed certain legal barriers and created a mechanism by which to remove others, suggests its own conclusion. The impediments to privatisation appear to be deeply-rooted and not merely reflective of the particular experi-

ence at individual airports or the limits of the privatisation pilot programme. Without renewed efforts to identify and overcome the true impediments, the privatisation of US airports is likely to remain an exceedingly rare occurrence.

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