

33<sup>rd</sup> Annual Basics of Airport Law Workshop and 2017 Legal Update

## Session #16

# COMMERCIAL AIRPORT AGREEMENTS AIRLINES & OTHER PARTIES A BRIEF OVERVIEW

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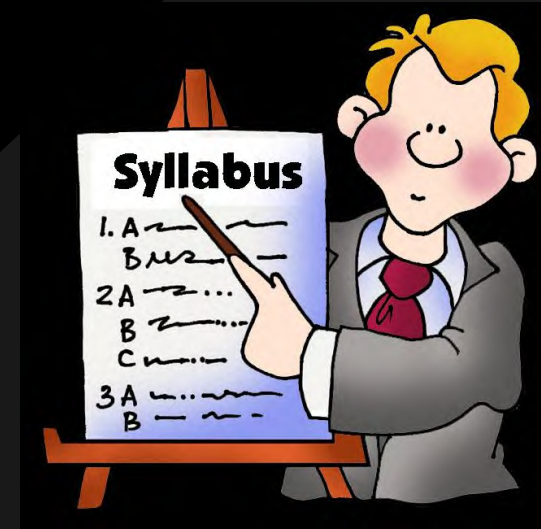
# SESSION OVERVIEW

- Basics
- Generalities
- Questions and discussion welcome
- Goal: give a good working knowledge and overview



# SESSION OVERVIEW

- Introduction to applicable Grant Assurances
- Grant Assurances and airport agreements
- Non-aeronautical agreements
- Legal/financial framework
- Building blocks for agreement
- Airport-airline business relationship
- Airline agreements
  - Ratemaking methodology
  - Facility management provisions
  - Capital project consultation
- Other considerations
  - Affiliate airlines
  - Environmental
  - Insurance
  - Bankruptcy



# GRANT ASSURANCES

- Grant Assurance 5: Preserving Rights and Powers
- Grant Assurance 19: Operation and Maintenance
- Grant Assurance 20: Hazard Removal and Mitigation
- Grant Assurance 21: Compatible Land Use
- Grant Assurance 22: Economic Nondiscrimination (Aeronautical Only)
- Grant Assurance 23: Exclusive Rights (Aeronautical Only)
- Grant Assurance 24: Fee and Rental Structure
- Grant Assurance 25: Airport Revenues
- Grant Assurance 29: Airport Layout Plan
- Grant Assurance 31: Disposal of Land



# NON-AERONAUTICAL LEASE AGREEMENTS

- Stickiest area
- Grant assurances: No prohibition on using airport property for non-aeronautical revenue production
- Surplus Property Act and Sec. 16/23: Some conveyances *do prohibit* non-aeronautical use.
- Required for non-aeronautical uses:
  - FMV rent
  - Showing that aeronautical uses have been accommodated and that any future aeronautical users can be reasonably accommodated.
  - Provisions in interim–use agreements requiring the leasehold to revert to the sponsor if property is needed for aeronautical use (“clawback”).
  - The land is shown as non-aeronautical on the Airport Layout Plan (ALP).
  - FAA concurrence

# NON-AERONAUTICAL LEASE AGREEMENTS

## ■ Landmines

- Non-aeronautical uses not depicted on ALP
- Overly long lease terms excessively (generally over 50 years) or useful life improvements (rights & powers, disposal of property)
- Below FMV lease rates or rates that are not sufficient to recover the cost to operate and maintain the airport (self sustainability)
- No escalation clauses (self sustainability)
- No reversionary clauses or removal of obsolete improvements upon lease expiration (rights and powers, self sustainability)
- Airport support for the non-aeronautical activities in the absence of a means for the airport to recover these costs. (ex. maintenance, support services (trash and snow removal))



# AERONAUTICAL LEASES

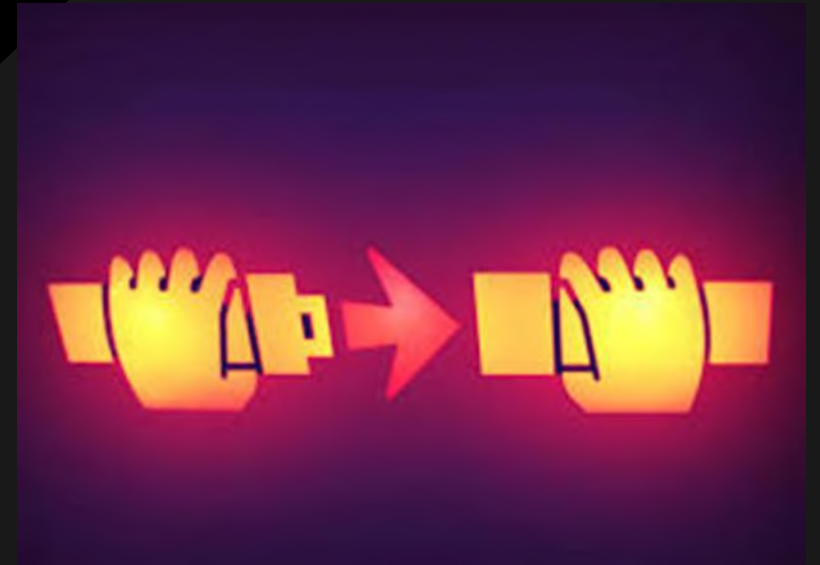
FAA MISSION STATEMENT:

We're not happy  
Until you're not happy

- Rates may be below fair market value BUT...
- Obligation to make airport as self-sustaining as possible (Recovery of sponsor's cost to operate and maintain the airport; Policy Regarding Airport Rates and Charges)
- Agreements cannot be unjustly discriminatory
- Can make reasonable distinctions between airport tenants with regard to lease terms (including lease rates)
- No exclusive rights
- Lease must be subordinate to incorporate federal obligations and grant assurances

# AIRLINE USE & LEASE AGREEMENTS

- The biggie at most airports
- High stakes, long term impact
- Affects every aspect of the airport
- This part of session - only 3 more hours
- Light snacks will be brought in





# PREVIEW OF WHAT IS AHEAD

- Pre negotiation preparation
- Building blocks
- Three classifications of airline operating agreements
  - Residual
  - Compensatory
  - Hybrid
- Special Areas of Concern



# PRE-AGREEMENT PREPARATION

## Sources

- ACRP
  - [www.trb.org](http://www.trb.org)
  - Scroll across top to “Publications”
  - Click on “By Subject”
  - Click on “Aviation”
- **Airport Cooperative Research Program Report 36: Airport/Airline Agreements—Practices and Characteristics**

## Preparation

- Recent agreements from other airports
- Internal discussions with airport departments

# GOALS AND OBJECTIVES

- Typical agreement takes 24 months to negotiate
- Determining business arrangement and rate setting
- Leverage
  - LAX
  - PHL
  - CLT
- Operation by ordinance



# USE SUBJECT MATTER EXPERTS

- Security
- Environmental
- Insurance/risk management
  - Environmental insurance
  - Cybersecurity insurance



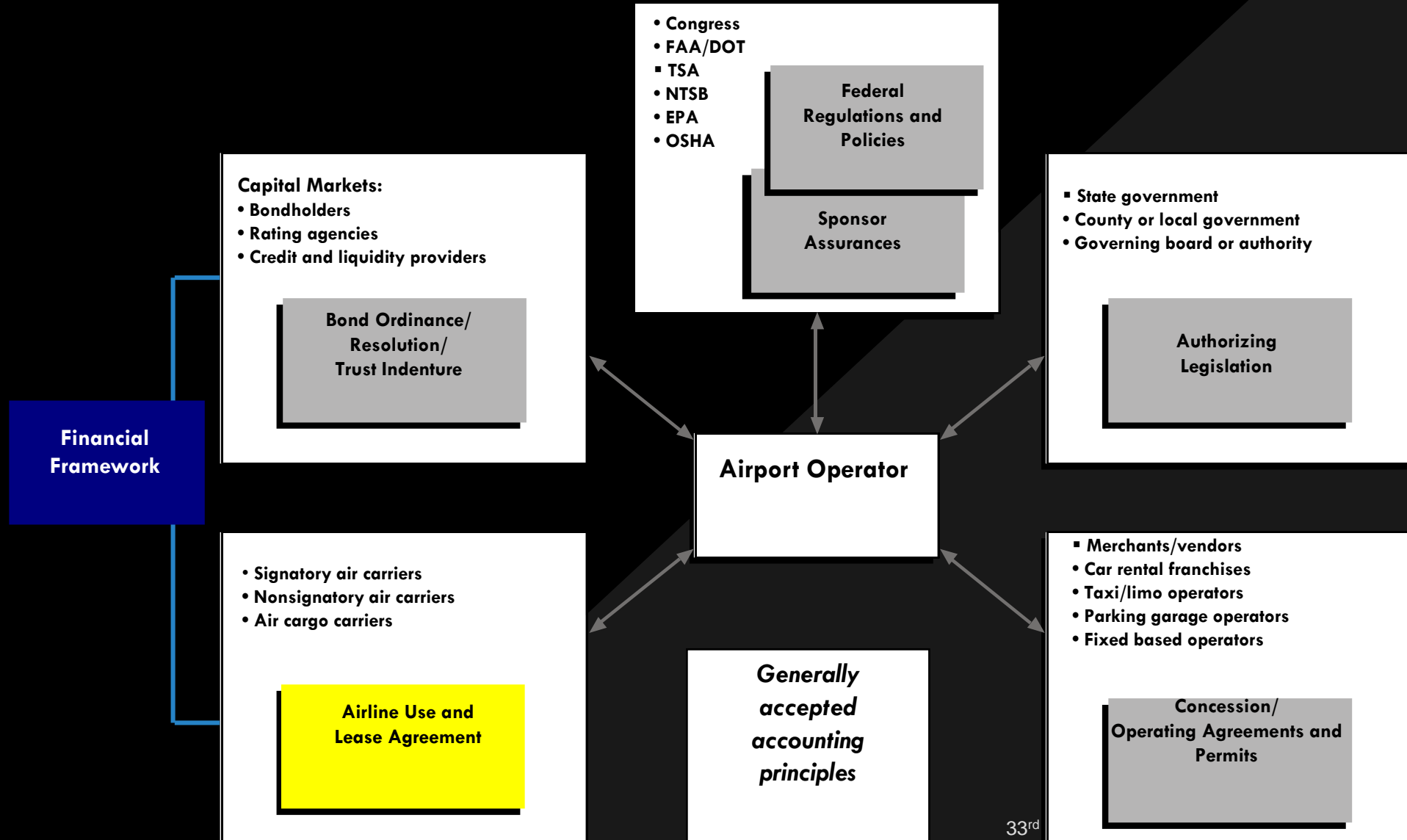
# FOCUS AREAS

- Political
  - Board of Directors, Mayor, City Council
- Financial
  - Pre-approved list
    - Capital projects
    - R&R
  - Authorized vs. funded
  - MII

# YOUR PLAYING UNIQUE FIELD

- **Limitations:** what are your fixed elements?
- **Legal:** federal law, bond ordinances, existing agreements
- **Physical:** Built space, projects under construction; rentable space; airlines' needs
- **Financial:** flow of funds, PFCs, debt service, bond reserves, bond covenants

# AIRPORT LEGAL-FINANCIAL NETWORK



# DIGGING IN: AIRPORT-AIRLINE AGREEMENTS



# BUILDING BLOCKS

- Cost centers
- Cost center allocations
- Terminal space inventory
- Capital program and sources of funding

# BUILDING BLOCKS: TYPICAL COST CENTERS

Cost Center	Spaces
Terminal	Passenger terminal buildings, baggage claim, loading bridges
Other Buildings & Grounds	Airline and GA hangars, fueling facilities, other land/building leases
Cargo	Airline freight, express, and mail handling facilities
Airfield	Areas for aircraft landing, taking-off, taxiing, safety areas, and parking; terminal and cargo apron areas
Parking & Roadways	Short term, long term, and shuttle parking areas; rental car facilities; airport access roads
Reliever Airport	General aviation reliever
<i>General and administrative</i>	<i>Indirect expenses allocated to other cost centers</i>

# BUILDING BLOCKS: COST CENTER ALLOCATIONS

Cost allocations  
**MUST** be reasonable  
and transparent

## What are you allocating?

- Operating
  - O&M expenses
  - Equipment and capital outlays
  - Bad debt, assessments, settlements, judgments
- Capital
  - Debt service and coverage
  - Amortization of investments
  - Net of grants and PFCs
- Reserves
  - Debt service
  - O&M
  - Renewal and replacement

## How are you allocating it?

- Ensure cost recovery
- Connect charges with use
- Basis for allocating costs
  - Activity
  - Accounting system with time card records or work orders
  - . . . or management judgment
- Allocating indirect expenses
  - Direct expenses
  - 50% revenues/ 50% direct expenses
  - Negotiated percentages
  - . . . or management judgment

# UNDERSTAND *YOUR* COST CENTERS

## Airline

- Airfield area
- Terminal complex
  - Ticket counters
  - International facilities
  - Baggage claim
  - Baggage system
    - Airport vs airline owned
    - Conventional vs automated
  - Transit system/people mover
  - Airline tenant finishes and equipment
    - Landside terminal
    - Loading bridges
    - Airport vs. airline owned
- Concourse ramp area
- Fueling system

## Non-Airline

- Rental car facilities
- Concessions
- Public parking
- Employee parking
- Commercial vehicle facilities
- Cargo area
- Airline maintenance/support areas
- Tenant leased land
- Airport maintenance
- General aviation
- Mail facility
- Snow equipment

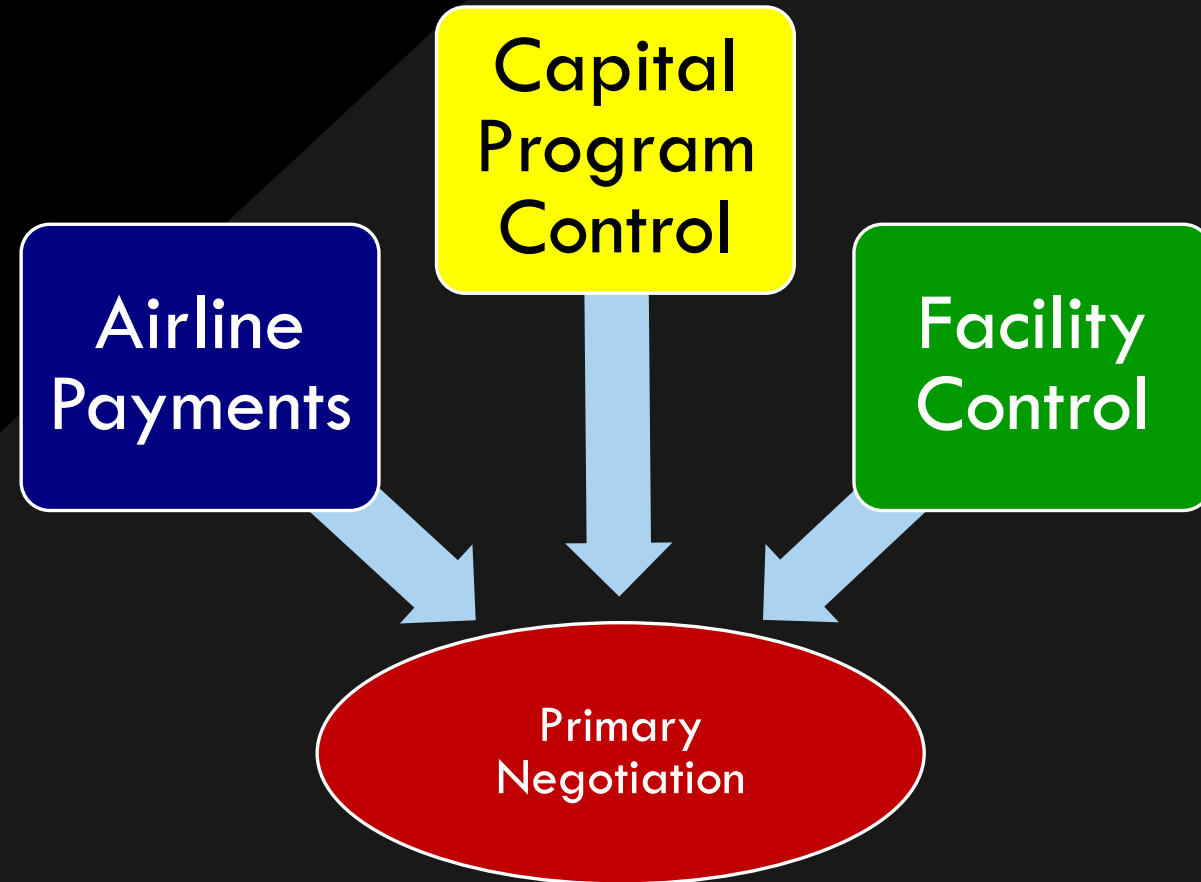
# RATES BY ORDINANCE

- Without agreement, fees set by ordinance, resolution, regulation, or tariff
- Governed by *Rates and Charges Policy* and case law
- Endeavor to be self-sustaining
- Rates must be “reasonable” and not “unjustly discriminatory”
- May not require airlines to cover losses generated by non-aeronautical facilities
- Cost allocation must comply with DOT rules:
  - Aeronautical users shouldn’t pay costs allocable to other users
  - Aeronautical cost-based fees may not exceed the costs properly allocated
  - Roadway costs can be allocated back to other cost centers

## AIRPORT-AIRLINE BUSINESS RELATIONSHIP

# AIRLINE AGREEMENTS

- Establish airline rights and obligations
- Airline payments
  - Costs in rate base and cost center structure
  - Rents, fees, and charges calculation methodologies
- Airline role in capital decisions and consultation
- Control over and use of gates and facilities
- Other provisions: affiliates, insurance, environmental, etc.



# AIRPORT-AIRLINE BUSINESS RELATIONSHIP

## AIRPORT AND AIRLINE OBJECTIVES

	<b>Airport Objectives</b>	<b>Compromise</b>	<b>Airline Objectives</b>
<b>AIRLINE PAYMENTS</b>	Recover all costs	Trend toward compensatory agreements	Stabilize rates Establish rates by formula
	Generate adequate discretionary cash flow	Financial incentives for cost control	Minimize costs
	Provide adequate reserves Meet debt obligations Minimize bankruptcy risk	Extraordinary coverage protection	Avoid paying costs of others

# AIRPORT-AIRLINE BUSINESS RELATIONSHIP

## AIRPORT AND AIRLINE OBJECTIVES

	Airport Objectives	Compromise	Airline Objectives
CAPITAL	Control over capital improvements (no MII)	Triggers for capital construction	Control over capital improvements (strong MII)
FACILITY	Control over facilities (common use)	Preferential use with accommodation and recapture provisions	Control over facilities (exclusive use)
OTHER	Promote air service Attract new entrants	Equitable treatment of all airlines	Preferential treatment of incumbents
	Historical agreement and relationships	Identify needed changes	Historical agreement and relationships



# AIRPORT-AIRLINE BUSINESS RELATIONSHIP CORE DRIVER IN AIRLINE NEGOTIATION

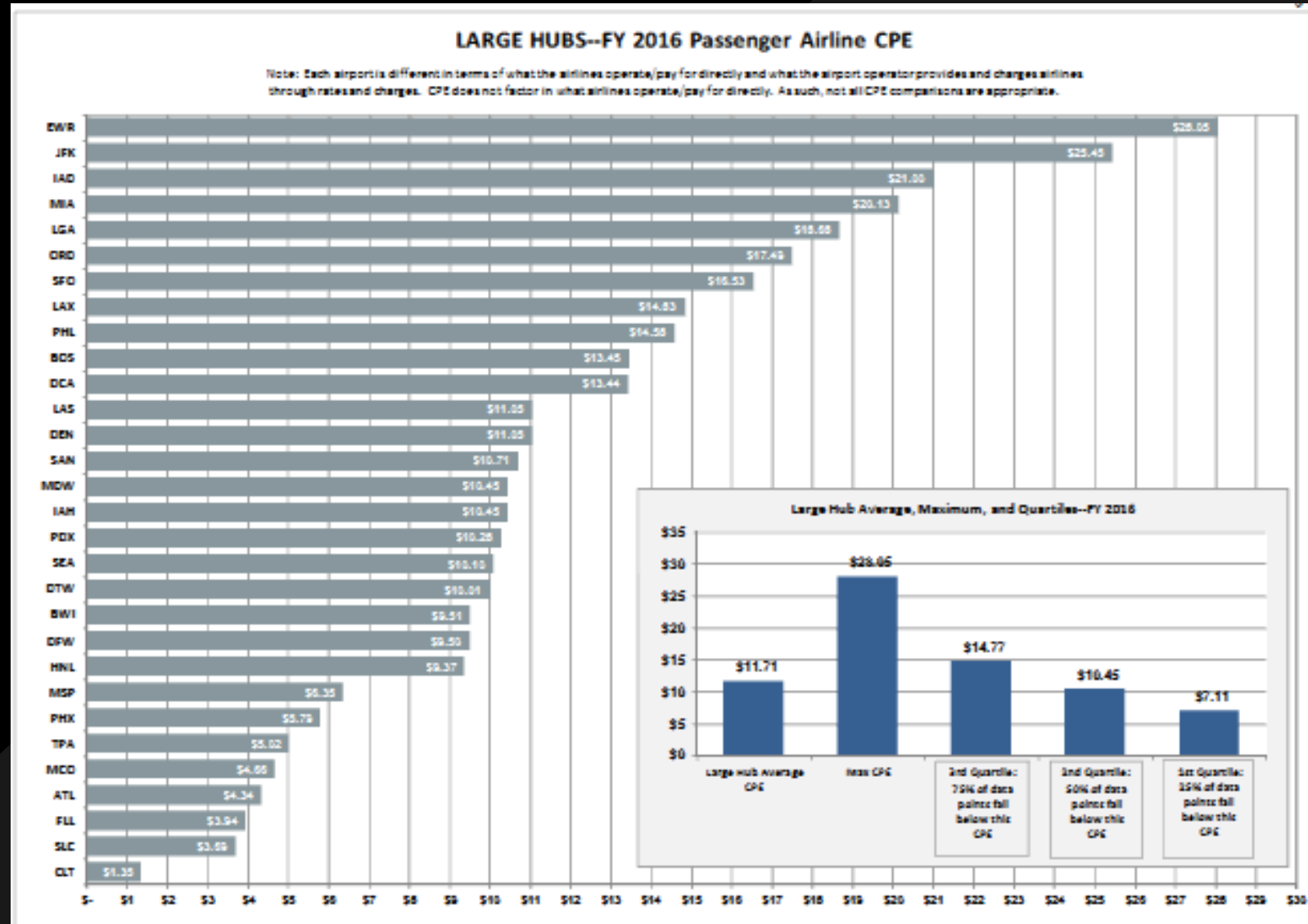
## CPE

For example:

EWR = \$28.05

CLT = \$1.35

FY 2016 data; chart courtesy of WJ Advisors



# CORE DRIVER IN AIRLINE NEGOTIATION

- Cost Per Emplaned Passenger (“CPE”)
- CPE = aggregate cost per passenger at a given airport
- CPE = how expensive is it to service the airport
- $\text{Total Costs} - \text{Revenues} = \text{Net Cost} / \# \text{ PAX}$
- Inverse relationship between passengers and CPE

# RATES AND CHARGES METHODOLOGY

## Residual

- Recover net costs after credit of nonairline revenues
- Financial risk transferred to airlines
- Usually requires airline approval on capital investment decisions
- Limited accumulation of airport equity

## Compensatory

- Recover only those costs allocated to occupied facilities
- Airport assumes financial risk
- Only pay for what you use
- Airport keeps nonairline revenues

## Hybrids

- Mixture of both methodologies
- Balance of risk and facility control
- Carve outs of self-supporting cost centers
- Net revenue-sharing formulas (usually in return for “safety nets”)

## RATES & CHARGES METHODOLOGY

# TRENDS

- From residual toward compensatory and hybrid models
- Increased use of “activity-based” rates
- Establishment of cost recovery security fees (security checkpoint, EDS space, exit lane staffing, etc.)

# CAPITAL PROJECT CONTROL

- Airline approval/disapproval rights vary:
  - None
  - Airport doing project at all
  - Including project costs in airline rates and charges
  - Issuing bonds for project
  - Certain types of projects
- Pre-approval for capital programs in agreements
- Majority-in-interest (MII) of airlines = majority of passengers, landed weight, or payments

# FACILITY CONTROL

## Airlines' rights to their space

Lease type	Description	Example types of space
<b>Exclusive</b>	Exclusive right to use	Ticket counter, back office, clubrooms
<b>Preferential</b>	First right, airport may assign others if not in use	Gates, holdrooms
<b>Joint</b>	Used by many airlines	Bag claim areas
<b>Common</b>	Airport assigns	Circulation, restrooms

## FACILITY CONTROL

# USE-IT-OR-LOSE-IT AND ACCOMMODATION

- If airline isn't using space *efficiently*, airport can take it back for another airline
- Thresholds:
  - turns per gate per day (e.g., 3-7)
  - airport-wide average utilization
- Primarily applies to gates, but may have similar provisions for ticket counters, office space
- Accommodation provisions:
  - Ability to reallocate space at select intervals
  - Ability to force sharing
- Competition Plans, PFCs, and Grant Assurances

## FACILITY CONTROL TRENDS

- Trend toward preferential use
  - Optimize facility use
  - Reduce capital needs
  - PFCs limited to preferential/common use or exclusive (if under 5-year lease)
- Preserve flexibility to reallocate or reassign exclusive use space to accommodate changing mix of airlines and market shares
- Common use terminal systems



## OTHER CONSIDERATIONS

# AFFILIATE AIRLINES

- Affiliate definitions:
  - Wholly-owned subsidiaries
  - All seats sold in the name of signatory airline
  - Operates under the same trade name, livery
  - Code sharing agreement
- Affiliates and signatory formally declare relationship
- Affiliates typically do not sign agreement



## OTHER CONSIDERATIONS

# ENVIRONMENTAL AND INSURANCE

- Often most time-consuming section to negotiate
- Establishes:
  - Types and amounts of insurance to operate at airport
  - Indemnity provisions – a VERY important risk-containment method
  - Environmental procedures, audits, and compliance
- Not only airline property reps, but legal counsel get involved

## OTHER CONSIDERATIONS

# AIRLINE BANKRUPTCY

- Airline bankruptcies are a regular recurrence post 9-11
- Hope for best, but plan for worst
- Impact of bankruptcies and consolidation over past 10 years
- Crystal ball ...



# HONORABLE MENTION: TITLE VI & OTHER REQUIRED CONTRACT PROVISIONS

- Certain language **MUST** be included in ALL contracts
- FAA issued document identifying what needs to be in what
- Not clear what *must* be included
- [https://www.faa.gov/airports/aip/procurement/federal\\_contract\\_provisions/](https://www.faa.gov/airports/aip/procurement/federal_contract_provisions/)



# QUESTIONS?

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