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

- 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

Capital Markets:
- Bondholders
- Rating agencies
- Credit and liquidity providers

Financial Framework

Airport Operator

Generally accepted accounting principles

Federal Regulations and Policies

Sponsor Assurances

Authorizing Legislation

State government
- County or local government
- Governing board or authority

Merchants/vendors
- Car rental franchises
- Taxi/limo operators
- Parking garage operators
- Fixed based operators

Concession/Operating Agreements and Permits

Airline Use and Lease Agreement

- Signatory air carriers
- Nonsignatory air carriers
- Air cargo carriers

Bond Ordinance/Resolution/Trust Indenture
DIGGING IN: AIRPORT-AIRLINE AGREEMENTS
BUILDING BLOCKS

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

<table>
<thead>
<tr>
<th>Airline</th>
<th>Non-Airline</th>
</tr>
</thead>
<tbody>
<tr>
<td>▪ Airfield area</td>
<td>▪ Rental car facilities</td>
</tr>
<tr>
<td>▪ Terminal complex</td>
<td>▪ Concessions</td>
</tr>
<tr>
<td>▪ Ticket counters</td>
<td>▪ Public parking</td>
</tr>
<tr>
<td>▪ International facilities</td>
<td>▪ Employee parking</td>
</tr>
<tr>
<td>▪ Baggage claim</td>
<td>▪ Commercial vehicle facilities</td>
</tr>
<tr>
<td>▪ Baggage system</td>
<td>▪ Cargo area</td>
</tr>
<tr>
<td>▪ Airport vs airline owned</td>
<td>▪ Airline maintenance/support areas</td>
</tr>
<tr>
<td>▪ Conventional vs automated</td>
<td>▪ Tenant leased land</td>
</tr>
<tr>
<td>▪ Transit system/people mover</td>
<td>▪ Airport maintenance</td>
</tr>
<tr>
<td>▪ Airline tenant finishes and equipment</td>
<td>▪ General aviation</td>
</tr>
<tr>
<td>▪ Landside terminal</td>
<td>▪ Mail facility</td>
</tr>
<tr>
<td>▪ Loading bridges</td>
<td>▪ Snow equipment</td>
</tr>
<tr>
<td>▪ Airport vs. airline owned</td>
<td></td>
</tr>
<tr>
<td>▪ Concourse ramp area</td>
<td></td>
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<tr>
<td>▪ Fueling system</td>
<td></td>
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</tbody>
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**AIRPORT-AIRLINE BUSINESS RELATIONSHIP**

**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
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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 Objectives
- Recover all costs
- Generate adequate discretionary cash flow
- Provide adequate reserves
  - Meet debt obligations
  - Minimize bankruptcy risk

### Compromise
- Trend toward compensatory agreements
- Financial incentives for cost control
- Extraordinary coverage protection

### Airline Objectives
- Stabilize rates
  - Establish rates by formula
- Minimize costs
- Avoid paying costs of others
## Airport-Airline Business Relationship

### Airport and Airline Objectives

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

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AIRPORT-AIRLINE BUSINESS RELATIONSHIP
CORE DRIVER IN AIRLINE NEGOTIATION

For example:

EWR = $28.05
CLT = $1.35

FY 2016 data; chart courtesy of WJ Advisors
Cost Per Emplaned Passenger (“CPE”)

- CPE = aggregate cost per passenger at a given airport
- CPE = how expensive is it to service the airport
- Total Costs – Revenues = Net Cost / # 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

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

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