



34th Annual Basics of Airport Law Workshop and 2018 Legal Update

Session #5

NEGOTIATION OF AIRLINE USE & LEASE AGREEMENTS

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SESSION OVERVIEW



- Introduction
- Basic Overview
- Legal Underpinnings
- Potential Rate-Setting Methodologies
- Components Contained Within Methodologies
- The Hit List – Frequent & Significant Issues
- War Stories / Lawyer Therapy Session
- Wrap Up & Questions

Questions OK!

“Huh” & What does
THAT mean?

?????

PLANNING & THE NEGOTIATION PROCESS

- When should an airport start the process?
- What IS the process?
- The role of the airport attorney.
- Don't go it alone...consultants and special counsel.
- The best laid plans...

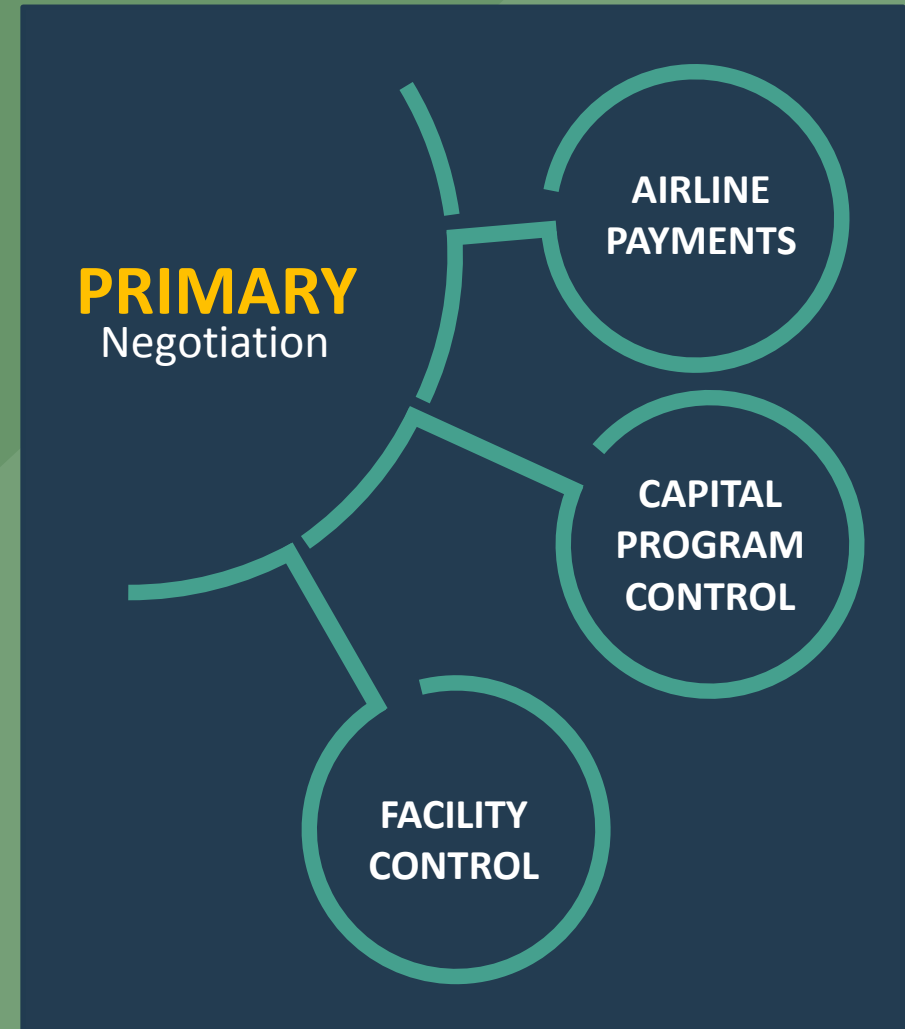
THE BASICS

- What are we really talking about?
- Rates & Charges for Privilege of Using Airport
- Landing Fees, Terminal Use (Holdrooms, Common Areas, Exclusive Use Areas), Other
- Do you really NEED a contract?
- What DO you REALLY Need?
- The Rate-Setting Methodology
- Recipes and Main Courses May Vary but...

AIRPORT-AIRLINE BUSINESS RELATIONSHIP

AIRLINE AGREEMENTS

- Establish what airlines can do at airport and what airport is obliged to do for airlines
- 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.



OBLIGATORY LEGAL STUFF

- Quite a bit of legal underpinnings
- Grant Assurances
- Federal legislation
- FAA policy
- FAA decisions
- Court decisions

Remember, this is just Rates & Charges 101!

LET'S SCARE THE
ATTENDEES . . .



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

And...
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And...
FAA Rates &
Charges
Policy

And... Case
Law (FAA
and Courts)

DISTILLING IT ALL DOWN: CORE PRINCIPLES

- Exclusive use
- Competition / Access
- Reasonable terms without unjust discrimination
- Residual terminal methodology by agreement only

SOUNDS EASY, RIGHT?

trick question

DRILLING DOWN: VARIATIONS ON TWO BROAD PARADIGMS

Let's keep oversimplifying things . . .
. . . but not for too much longer!



RATES & CHARGES METHODOLOGY

01

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

02

Compensatory

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

03

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”)

AIRPORT-AIRLINE BUSINESS RELATIONSHIP

BALANCING AIRPORT AND AIRLINE OBJECTIVES

	Airport Objectives	Compromise	Airline Objectives
Airline Payments	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

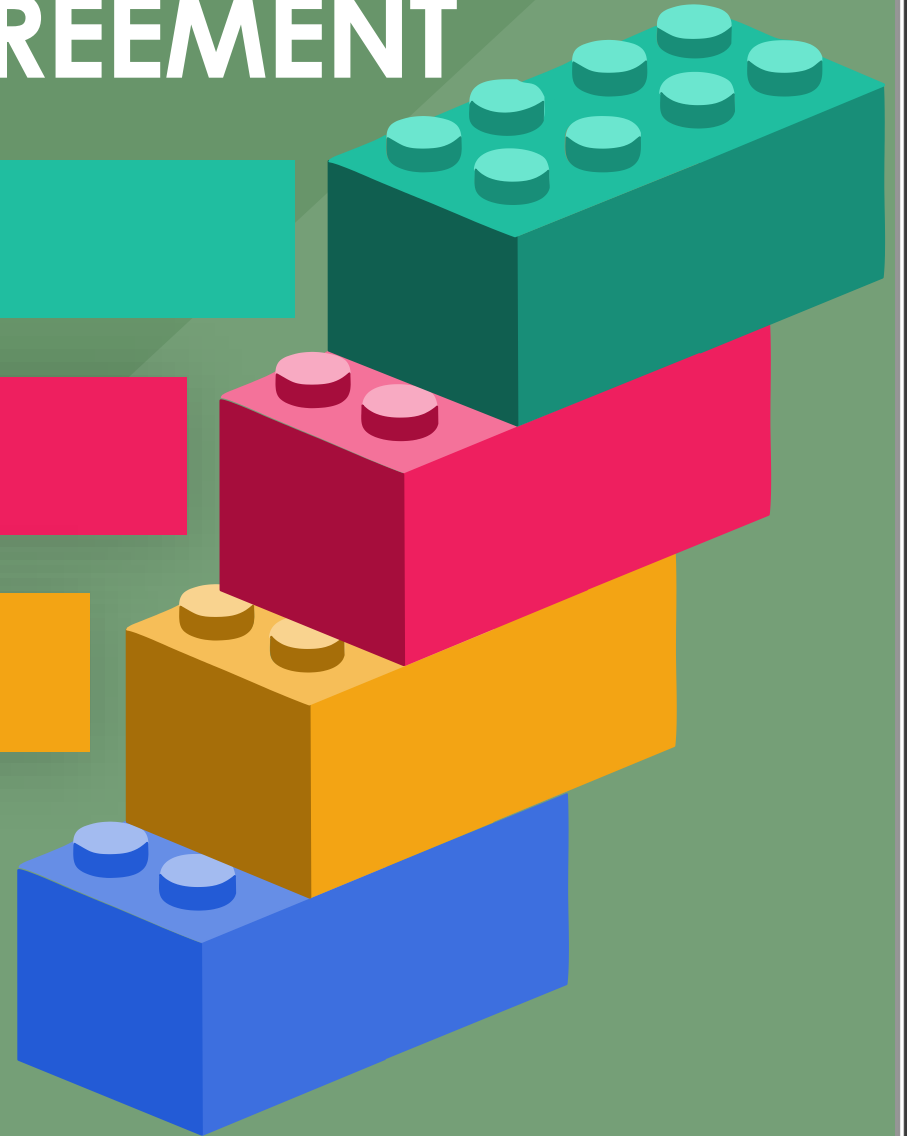
BALANCING AIRPORT AND AIRLINE OBJECTIVES

	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 airline	Preferential treatment of incumbents
	Historical agreement and relationships	Identify needed changes	Historical agreement and relationships

COMPONENTS OF A RATE-SETTING METHODOLOGY

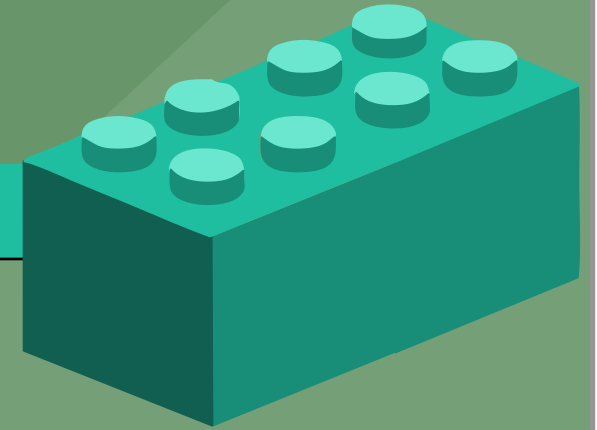
BUILDING BLOCKS FOR AGREEMENT

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



BUILDING BLOCKS FOR AGREEMENT

TYPICAL AIRPORT COST CENTERS



Cost Center	Spaces Included
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 & Administrative</i>	<i>Indirect expenses allocated to other cost centers</i>

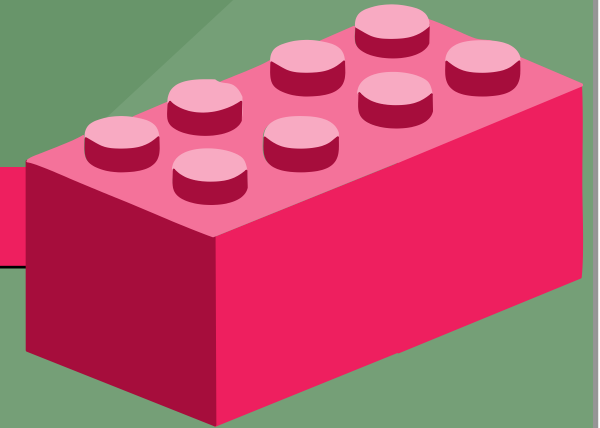
BUILDING BLOCKS FOR AGREEMENT COST CENTER ALLOCATIONS

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 & 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



**DOT Policy requires
cost allocations to be
reasonable and
transparent**

UNDERSTAND YOUR COST CENTERS

AIRLINE

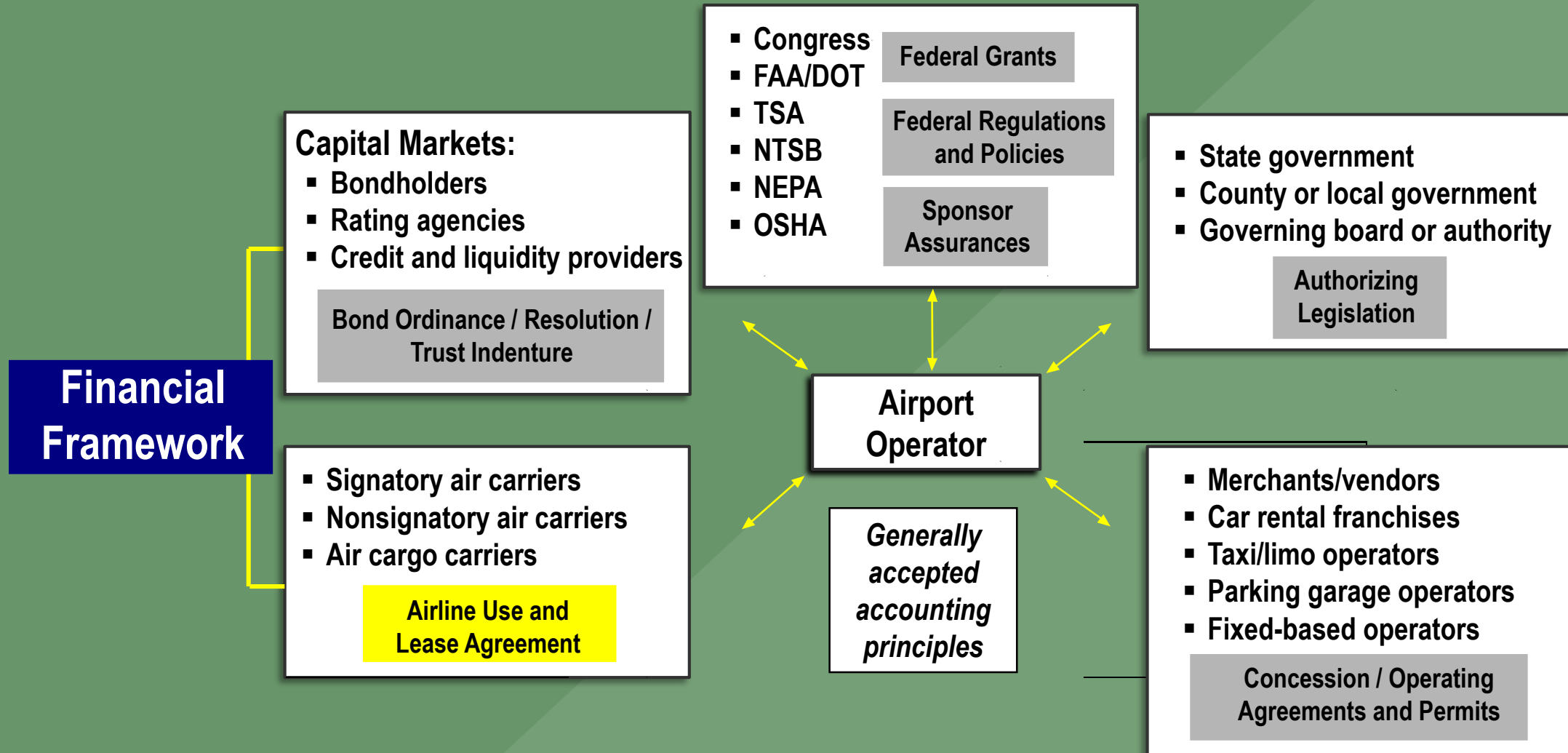
- Airfield Area
- Terminal Complex
 - Ticket Counters
 - International Facilities
 - Baggage Claim
 - Baggage System
 - Airport Owned?
 - Airline Owned?
 - Conventional
 - Automated
 - Transit System/People Mover
 - Airline Tenant Finishes and Equipment
 - Landside Terminal
 - Loading bridges
 - Airport vs. Airline owned
 - Concourse Ramp Area
 - Fueling System

NON-AIRLINE

- Rental Car Facilities
- Concessions
- Public Parking Area
- Employee Parking Area
- Commercial Vehicle Facilities
- Cargo Area
- Airline Maintenance/Support Areas
- Tenant Leased Land
- Airport Maintenance
- General Aviation
- Airport Mail Facility
- Airport Hotel

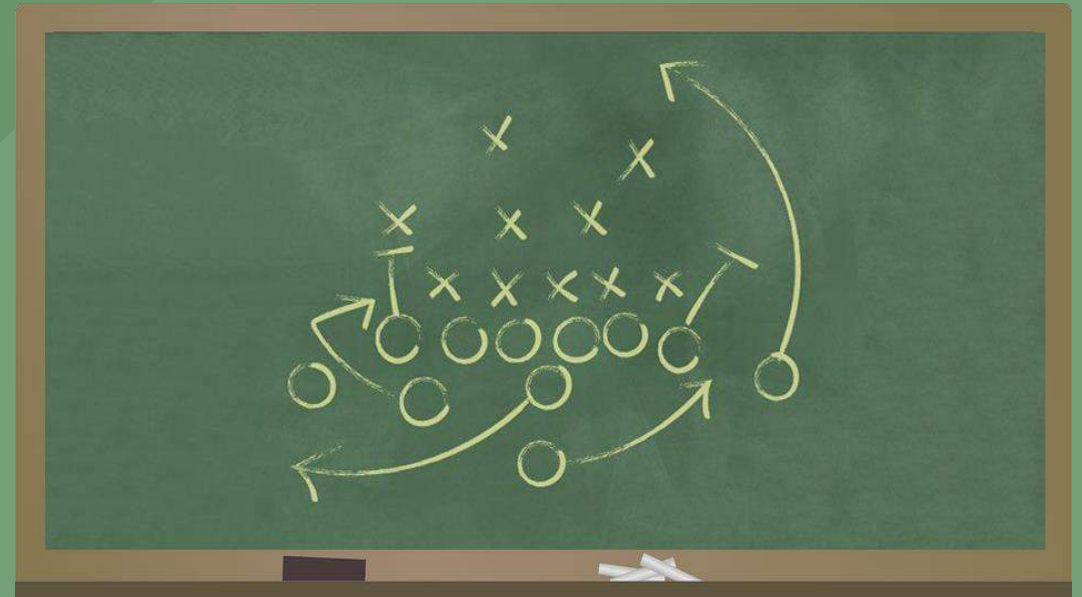
PLACING IT ALL IN CONTEXT

AIRPORT LEGAL/FINANCIAL FRAMEWORK



UNDERSTAND YOUR PLAYING FIELD

- **Limitations:** what are your fixed elements?
i.e., those things that you can't change
- **Legal:** Federal Law, Bond Ordinances, Existing Agreements
- **Physical:** Built space, projects under construction. Survey “rentable space” and needs of airlines.
- **Financial:** Flow of funds, PFCs, Debt Service, Bond Reserves, Bond Covenants



AIRPORT LAWYER'S MOTTO?



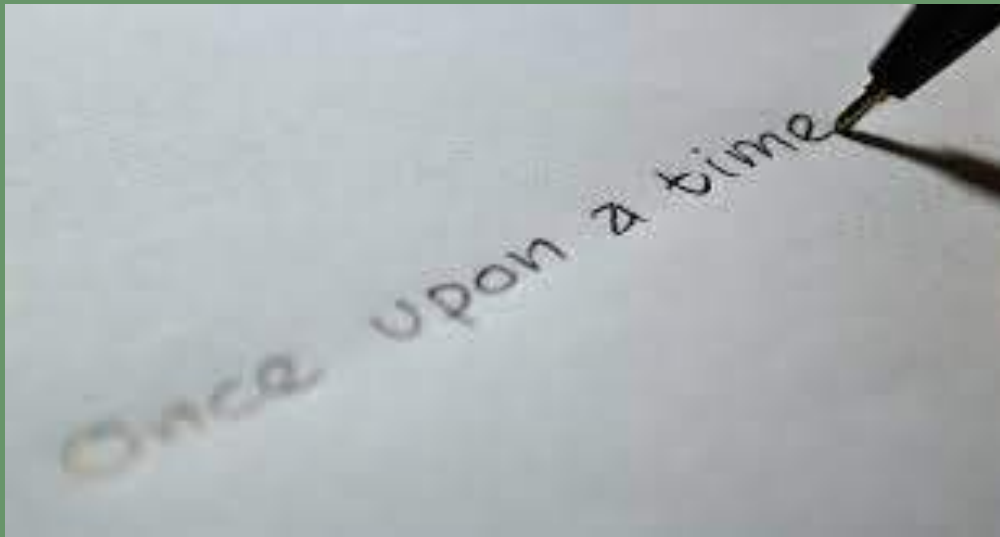
AIRPORT-AIRLINE BUSINESS RELATIONSHIP RATES BY ORDINANCE

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

NUTS & BOLTS

SELECT HOT TOPICS

- Survey of things your super-annuated speakers have had to deal with during their distinguished and long careers



RATES & CHARGES METHODOLOGY

TRENDS

- Term of Agreements
- Away from residual cost rate-making toward compensatory and hybrid methods
- Increased use of “activity-based” rates
- Establishment of cost recovery security fees (security checkpoint, EDS space, exit lane staffing, etc.)
- International / Open Skys

COMMON USE ISSUES

- Changing times = new challenge
- Sponsor obligation to make airport available to all
- Legal standard
- If you have seen one airport

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
- Many airports have obtained “pre-approval” for capital programs in their agreements
- Majority-in-interest (MII) of airlines represent a majority of passengers, landed weight, or payments to airport

FACILITY CONTROL

- What control does the airport have over space? Gates? Ticket counters? Access to baggage, fuel, ground services?
- Ability of existing carrier to expand?
- New entrant carrier access?



FACILITY CONTROL

UNDERSTAND YOUR FACILITY

Types of Space – from Public to Private

- **Terminal:**
 - **Public Areas:**
 - **Common use or joint use:** Costs that can be prorated according to amount of use (# of bags or passengers).
 - **Preferential use:** Airline has right of first use but may have to share. Airport retains right to allow other airlines to use the area “to the extent such other use does not infringe on the Airline’s preferential use as herein defined.”
 - **Exclusive Use:** Traditional leasehold areas that are exclusively used by the Airline.

FACILITY CONTROL

Lease Type	Description	Example Types of Space
Exclusive	Exclusive right to use	Ticket counter, back office, clubrooms
Preferential	First right, airport may assign others if not in use	Gates, holdrooms
Joint	Extraordinary coverage protection	Avoid paying costs of others
Common	Airport assigns	Circulation, restrooms

What is granted to an airline and what rights are retained by the airport is very important.

FACILITY CONTROL

USE-IT-OR-LOSE-IT AND ACCOMMODATION

- If an airline isn't using the space efficiently and someone else needs it, airport can take it back
- Thresholds in airline agreements range from:
 - Ex. 3 to 7 turns per gate per day
 - Airport-wide average utilization
- Primarily applies to gates, but some agreements have similar provisions for ticket counters and associated office space
- Accommodation provisions
 - Ability to reallocate space at select intervals
 - Ability to force sharing
- A note about **competition plans**, PFCs, and Grant Assurances

FACILITY CONTROL TRENDS

- Recent agreements trend toward preferential use
 - Optimize facility use and reduce capital needs
 - PFC funds only for preferential/common use space or exclusive use space with lease less than 5 years
- Preserving the flexibility to reallocate or reassign exclusive use space to accommodate changing mix of airlines and market shares
- Reservation by airport of common use gates
- Move toward common use terminal systems

OTHER CONSIDERATIONS

AFFILIATE AIRLINES

- Affiliate definitions include:
 - Wholly-owned subsidiaries
 - All seats sold in the name of signatory airline
 - Operates under the same trade name and uses essentially the same livery
 - Airlines with a code sharing agreement
- Typically require affiliates and signatory to formally declare relationship
- Affiliates typically do not sign the airline agreement

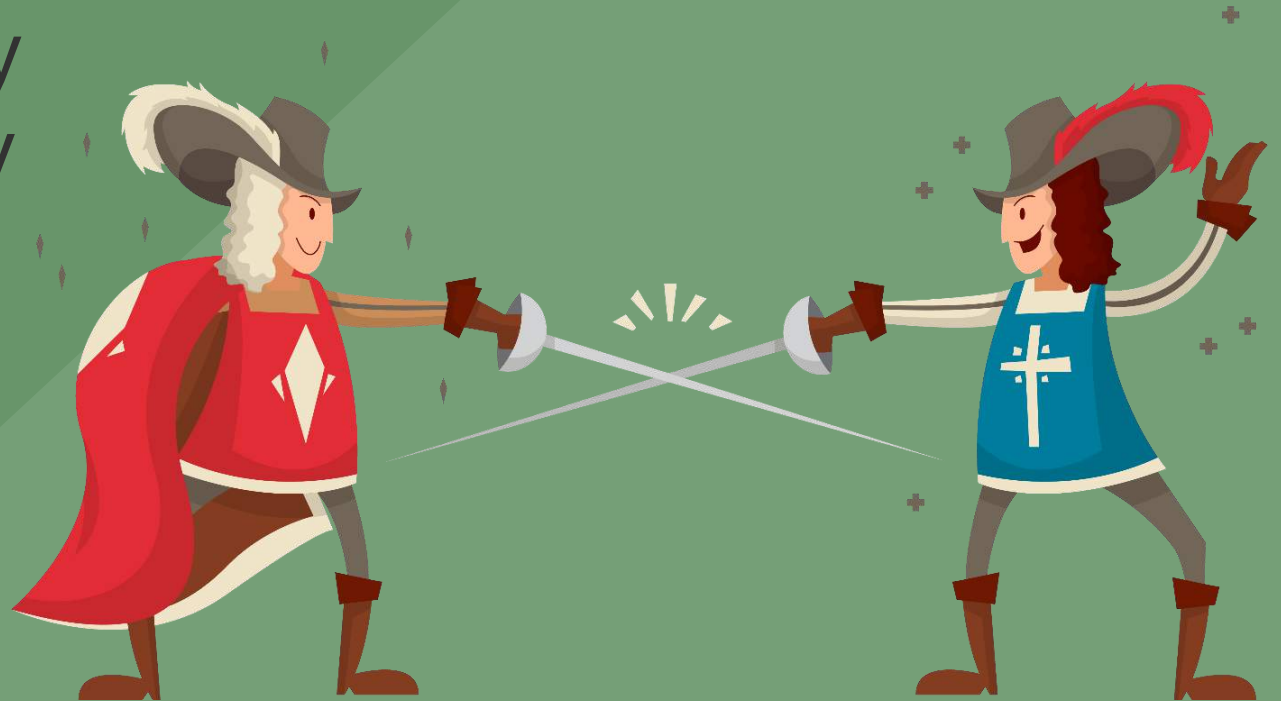
OTHER CONSIDERATIONS

ENVIRONMENTAL & INSURANCE

- Often most time-consuming section of airline agreement to negotiate
- Establishes:
 - Types and amounts of insurance airlines must have to operate at Airport
 - Indemnity provisions – a VERY important risk-containment method for airports
 - Environmental procedures, audits, and compliance
- Not only negotiating with airline property reps, but their legal counsel as well

PER TURN FEES

- Big 4 (or maybe 3) appear to have declared war
- Wide variety of potential iterations
- The CPE argument likely to be proffered by legacy carriers
- Perspective and insight of the battle-worn



IF THINGS DON'T GO SO WELL...

- Rocket Docket
- FAA Route
 - Part 13
 - Part 16
 - Limbo

OTHER CONSIDERATIONS

AIRLINE BANKRUPTCY

- Airline bankruptcies have become a regular occurrence in post 9/11 era
- Hope for best, but plan for worst
- Impact of bankruptcies and airline consolidation over past 10 years
- Crystal ball says...

CONCLUSION / QUESTIONS

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