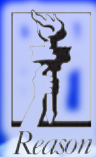

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Annual Privatization Report 2014
Air Transportation

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A. Airport Privatization

1. Overview

In the 25 years since British Prime Minister Margaret Thatcher's government privatized the former British Airports Authority, airport privatization has become a global phenomenon. Governments in Europe, Asia, Australia and New Zealand, Latin America and the Caribbean subsequently privatized major airports. By the end of 2010 a study by Airports Council International (ACI)

Europe found that 22% of Europe's 404 principal airports were either wholly investor-owned or had mixed (public/private) ownership.[1]

In terms of passengers handled, 48% of all European air passengers in 2010 used airports with either mixed or fully private ownership. The International Civil Aviation Organization (ICAO) in 2012 issued a new report, "Manual on Privatization in the Provision of Airports and Air Navigation Service" (Document 9980).[2] It explains how airport privatization fits into international aviation law, and replaces an earlier document, ICAO Circular 284 from 2002. And in May 2013, ACI Director General Angela Gittens told an Aero Club of Washington audience that 450 commercial airports worldwide have some form of private-sector participation in their management or ownership.

Only a few governments besides the U.K. have sold airports outright (though many in Europe have sold majority or minority stakes). Elsewhere in the world, the primary mode of privatization has been via a long-term lease or concession. Some of the larger privatized airports have acquired full or partial ownership interests in other airports. This process has created a global airport industry, with significant investment recently coming from pension funds and infrastructure investment funds.

Table 1 is excerpted from a table of the world's 100 largest (by revenue) airport groups. Of these 100 largest airport entities, the 38 in the table are either fully or partially owned by investors (or were in the process of becoming so, as in Spain and Portugal at the time this 2012 table was prepared). Some of these global airport groups also manage overseas airports, on a contract basis, without actually obtaining an ownership share. Several smaller airport companies had 2012 revenues below the threshold for inclusion in the top 100, so are not included in the table. Total revenue for the 38 privatized entities was $35.6 billion, which is 46% of the revenue of the entire top 100 airport groups. Of these 38 airport groups, ACI reports that 25 of them are now listed on stock exchanges around the world.

Table 1: Largest Privatized Airport Groups, 2012

Airport Group	Global Rank*	Main Airports	2012 Revenue ($M)	Privatization Status
AENA	1	Madrid, Barcelona	4,267	In process
Heathrow Airport Holdings	2	London Heathrow	3,923	Full
Aeroports de Paris	3	Paris de Gaulle and Orly	3,406	Partial
Fraport	4	Frankfurt	3,150	Partial
TAV Airport Holding	14	Istanbul & Ankara	1,418	Full
Incheon International	15	Seoul	1,417	Planned
Malaysia Airports Holdings	17	Kuala Lumpur	1,154	Partial
GMR Infrastructure	19	New Delhi, Hyderabad	1,123	Partial
Beijing Capital International	21	Beijing	1,089	Partial
Southern Cross Airports Holdings	22	Sydney	1,079	Full
Flughafen Zürich	23	Zürich	1,017	Full
Airports of Thailand	24	Bangkok	980	Partial
New Kansai International Airport Company	25	Kansai, Osaka	947	Planned
SEA Aeroporti di Milano	26	Milan Malpensa and Linate	930	Partial
Flughafen Wien	30	Vienna	784	Full
Airports Company South Africa	31	Johannesburg, Cape Town	779	Partial
Guangzhou Baiyun International	33	Guangzhou	742	Partial
Aeroportos di Roma	35	Rome Fiumicino and Ciampino	740	Full
Australia Pacific Airports	42	Melbourne	611	Full
Copenhagen Airports	43	Copenhagen	609	Partial
Aeroportos de Portugal (ANA)	44	Lisbon	587	In process**
Flughafen Düsseldorf	45	Düsseldorf	549	Partial
Brussels Airport Company	46	Brussels	540	Full
Aeropuertos Argentina 2000	49	Buenos Aires EZE & AEP	511	Full
Brisbane Airport	50	Brisbane	506	Partial
Abertis Airports	57	London Luton	412	Full
Aeropuertos del Sureste (ASUR)	61	Cancun	390	Full
Athens International	64	Athens	381	Partial
Grupo Aeroportuario del Pacifico (GAP)	65	Guadalajara, Tijuana	377	Full
Perth Airport	68	Perth	357	Full
Auckland International	73	Auckland	345	Partial
Flughafen Hamburg	75	Hamburg	324	Partial
Aeroports de la Cote d' Azur	84	Nice	264	Partial
Operadora Mexicana de Aeropuertos (OMA)	86	Acapulco, Monterrey	215	Full
Hannover-Langenhagen	91	Hannover	178	Partial
SAVE Aeroporto Marco Polo	94	Venice	172	Full
Birmingham Airport Holdings	96	Birmingham	170	Partial
Adelaide Airport	99	Adelaide	152	Full

*Source: "Airport Group Financials," *Airline Business*, November 2013

**Sale to Vinci Group was completed in early 2013 for $4 billion.

2. Airport Industry Changes

The global airport industry is dynamic, with a number of changes in ownership during 2013, especially in the airports divisions of Spanish company Abertis and German company Hochtief, as well as Ferrovial's stake in London's Heathrow Airport.

Abertis spent much of 2013 divesting most of its airports portfolio, in order to refocus its efforts on toll roads and other surface transportation infrastructure. In February, the Bolivian government nationalized the three airports that were being operated by Abertis under long-term concessions. In June Abertis sold its 90% stake in London's Luton Airport to its co-owner, AENA. The latter then sold part of its stake to AXA Private Equity, a French infrastructure fund, which now owns 49% of Luton. Following that transaction, Abertis sold a portfolio of airport stakes to U.S./Canadian company ADC & HAS. The latter now has major stakes in Belfast International, Stockholm Skavsta, and the terminals at Orlando Sanford. Abertis also sold Cardiff airport to the government of Wales. At year-end, it still retained a stake in Mexico's GAP and the concession for the Montego Bay Airport in Jamaica, both of which it seeks to sell.

Another airport group undergoing changes is Hochtief Airports, a division of German construction firm Hochtief. The Spanish firm ACS Infrastructure acquired Hochtief in 2012, and since ACS is focused primarily on surface transportation, it has been divesting Hochtief's airport assets. In mid-2013 Hochtief reached agreement with the Public Sector Pension Investment Board of Canada (PSP Investments) to acquire most of those assets, including its stake in Sydney International Airport, for $1.44 billion. Now renamed AviAlliance, the former Hochtief Airports owns partial stakes in Athens, Budapest, Düsseldorf, Hamburg and Tirana (Albania).

In 2013, Ferrovial continued to reduce its airport holdings in the U.K. In February it accepted a bid of £1.5 billion ($2.4 billion) from Manchester Airport Group and Industry Funds Management for Stansted Airport, which it was required to divest by the U.K. Competition Commission. After agreeing to divest Stansted, Ferrovial changed the name of the remaining entity from BAA to Heathrow Airport Holdings (HAH). By November 2013 it had reduced its ownership of HAH to 25%, after selling 8.65% to the Universities Superannuation Scheme, a major UK pension fund. HAH has also been reported as having discussions with advisors about possibly divesting its remaining non-London U.K. airports: Southampton, Aberdeen and Glasgow. Ferrovial is

widely believed to be planning a major investment in the forthcoming privatization of Spanish airports company AENA.

While toll road concession companies Abertis and ACS are de-emphasizing airports, their Italian counterpart Atlantia is doing the opposite. Atlantia—Italy's largest toll roads company—agreed early in 2013 to acquire Gemina, the owner of Aeroportos di Roma (AdR). Investors in Atlantia include the Benetton family, Singapore Investment Corporation and Goldman Sachs. The friendly stock-swap merger is scheduled to be completed by the end of 2013. The combined (airport plus toll roads) business will have an estimated market capitalization of $13.3 billion. Under AdR's concession agreement through 2044, Atlantia plans a $16 billion modernization of Rome's two airports, according to *Public Works Financing*. But implementation of those plans may be held up by the ongoing financial problems of the airports' major airline, Alitalia.

Another ownership change is the French government's announcement in late May 2013 that it plans to reduce its stake in Aeroports de Paris from 54.5% to just over 51%, hoping to raise $900 million to invest elsewhere.

Table 2 lists the 15 largest global airport groups by number of airports and annual passengers handled.

Table 2: Largest Global Airport Groups, 2013

Operator	Country	Airports	2012 Passengers	Privatization Status
AENA Aeropuertos	Spain	70	250 million	To be privatized
Infraero	Brazil	65	194 million	Concessions for largest airports
Airports Authority of India	India	125	160 million	Concessions for largest airports
Aeroports de Paris	France	29	139 million	Part-privatized
Fraport	Germany	13	100 million	Part-privatized
Schiphol Group	Netherlands	7	90 million	Corporatized
Heathrow Airport Holdings	UK	4	82 million	Privatized
TAV Airports	Turkey	10	72 million	Private
Flughafen Zürich	Switzerland	11	67 million	Privatized
Corporacion America	Argentina	60	50 million	Private
Global Infrastructure Partners	UK/US	3	47 million	Private
Vinci Airports	France	23	40 million	Private
Vantage Airport Group	Canada	11	34 million	Part-privatized
HNA Airport Group	China	13	25 million	Part-privatized
ADC & HAS	US/Canada	3	19 million	Part-privatized

Source: "Private Lives," Gunter Endres, *Airline Business*, November 2013

3. Global Airport Privatizations in 2013

The largest airport privatization activity in 2013 continued to be in Europe and South America.

European Developments

Early in 2013 the government of Portugal sold a 50-year concession for Aeroportos de Portugal (ANA) to winning bidder French infrastructure giant Vinci Concessions. Vinci paid $4.04 billion for the four largest airports in Portugal, plus five in the Azores and one in Madeira. Its winning bid topped several other bids, and puts Vinci into the relatively small group of major global airport firms. Besides the 10 ANA airports, it holds interests in 13 others in France and Cambodia.

The next large European privatization will likely occur in Spain, which came close to privatizing AENA, its airport and air traffic control provider, under a previous government in 2011. Those plans were put under review and then temporarily shelved by the new government. Six consortia had been qualified to bid, with Madrid Barajas estimated to be worth $5.2 billion and Barcelona El Prat $2.3 billion. But in autumn 2013 discussion in Madrid has returned to privatization of AENA (which is now the world's largest airport group, by revenue, per Table 1). The Spanish government is still struggling with large budget deficits and too-high debt, so a sale comparable to what Portugal has accomplished would be worth considerably more, given that AENA's 2012 revenue was seven times that of ANA. Prior to proceeding with the sale, the government is likely to separate the air traffic control unit from AENA, and is rumored to be considering the sale of a 51% stake in the airport company, possibly as early as the first quarter 2014.

The Greek government still retains 55% of the new Athens Airport developed about a decade ago under a long-term concession agreement. While it agonizes over whether to offer that stake via an initial public offering (IPO) of shares, it is moving closer to a plan to lease its 21 regional airports for 30 to 35 years. In exchange for bailouts provided by EU institutions, the government is under heavy pressure to reduce its national debt via asset sales. Investors consider Thessaloniki Airport and certain island airports (such as Crete) to be the most attractive. A plan put forth in the first half of 2013 by the Development Minister would split the regional airports into two groups, each of which would be leased as a package.

The other major development in Europe was the Turkish government's competition for a 25-year concession to finance, develop and operate a new $6.5 billion airport for Istanbul. It will be linked to the third Bosporus Bridge, currently under development. The airport is intended to have three runways and 750,000 square meters of terminal space, and would be the world's fourth-largest airport. In May, the government selected as the winning bidder a five-company consortium of Kolin, Mapa, Kaylon, Cengiz and Limak for the project.

Latin American and Caribbean Developments

The next major privatization is taking place in Brazil, which already has major upgrades being made to three of its largest airports under long-term concessions granted in 2012. Now two additional airport deals are under way: to upgrade Rio de Janeiro's Galeao International Airport and Belo Horizonte's Confin Airport. Pre-qualified teams, including a number of the leading global airport firms, submitted bids in a one-day auction held in mid-November. The winner for each would be the team submitting the highest bid above the government's reserve prices of $2.231 billion for Galeao and $505 million for Confin. In addition to the up-front fee, the concession company must pay Brazil's civil aviation agency ANAC 5% of gross annual airport revenue over the life of the concessions (25 years for Galeao and 30 years for Confin). For Galeao, the winner was the team led by infrastructure giant Odebrecht teamed with Singapore's Changi Airport Group, which bid $8.6 billion. The winner for Confin was the team led by CCR, bidding $827 million.

Jamaica is embarking on its second large airport privatization project. After the success of its build-operate-transfer concession that resulted in a large new terminal at Sangster International Airport in tourism capital Montego Bay, it is now seeking a similar deal for the capital city's airport. Norman Manley International in Kingston needs both a new terminal and an upgraded main runway. A team of advisors including Arup and Ernst & Young is developing the plan for the concession and the procurement process.

Two "reverse privatizations" (i.e., nationalizations) took place in the region during 2013. Bolivia's socialist government nationalized the three airports that were modernized by Lockheed Air Terminal (later Airport Group International) in the 1990s. The AGI contracts were subsequently acquired by TBI, and were later sold by them to Abertis, as noted previously. Also, the Bahamas government acquired the Grand Bahama Airport Company in July from its owner, Hong Kong's Hutchison Whampoa. The latter retains ownership of the Freeport Harbor Company and the Freeport Container Port. The Ministry of

Transport is setting up airport authorities for both Grand Bahama (Freeport) and Abaco (Marsh Harbor).

Asian Developments

India in recent years has used long-term concessions to upgrade and modernize the existing airports of New Delhi and Mumbai and to create new ones at Bengaluru and Hyderabad. In these concessions, the Airports Authority of India (AAI) retains 26% of the concession company, leaving majority control with investors. These arrangements have enabled two Indian firms, GMR and GVK, to become global players in airport privatization. And although AAI has taken political flak over high charges at the privatized airports, its inability to modernize major airports itself has led to an expansion of the program. In September 2013 AAI announced upcoming concessions for six more airports. RFQs for Chennai and Lucknow were issued that month, with others to come for Ahmedabad, Guwahati, Jaipur and Kolkata. The concessions will all be for 30 years, but this time around AAI will take 49% of airport revenues.

In 2012 Japan announced the creation of the New Kansai International Airport (NKIA), merging the operations of island-based Kansai International Airport and inland Osaka International Airport. The new company developed a low-cost carrier terminal at Kansai, as well as implementing peak/off-peak pricing; those two changes helped the emergence of a new low-cost carrier market in Japan—and won NKIA the 2013 Transportation Achievement Award from the OECD's International Transport Forum. Government subsidies for Kansai have been reduced to zero, and NKIA plans to offer concessions for the management of both airports.

Ever since 2008 the government of South Korea has been talking about privatizing the large new Incheon International Airport serving Seoul. In 2009, the announced plan was to sell a 49% stake via an initial public offering of shares, but no time frame was given. The proposed sale has turned into a controversial political issue. While it was strongly backed by the outgoing Lee government (whose term ended in December 2012), no enabling legislation was passed by the end of its term. The rationale for the sale was to raise capital to fund an expansion of capacity. Whether the successor government will continue with these plans remains to be seen.

4. U.S. Airport Privatization

Federal Pilot Program

The federal Airport Privatization Pilot Program was enacted by Congress in 1996 to test the idea that private capital and management could improve U.S. airports. Congress acted after a number of city and county governments had attempted to sell or lease their airports but were blocked because of conditions attached to federal airport grants that they had received. The legislation created a limited set of exceptions to those regulations. Under the original pilot program, up to five jurisdictions could apply to the Federal Aviation Administration (FAA) for permission to lease an airport on a long-term basis and transfer the lease proceeds to the general government budget. And the acquirer is allowed to seek profits by operating the airport efficiently. (Neither of those things was legally possible without those provisions.) In the 2012 FAA reauthorization bill, Congress increased the number of slots from five to 10. One slot in the program is still reserved for a general aviation (non-airline) airport, and only one of the remaining slots can be used for an airport meeting the FAA's definition of a "large hub."

Despite several attempts in the late 1990s and early 2000s, no proposed privatization deal met all the pilot program's requirements, especially the airline approval requirement. That requires the agreement to win the support of both (1) 65% of the airlines that provide scheduled service at the airport, and (2) airlines that account for 65% of the annual landed weight (on which landing fees are based) at that airport. When New York's Stewart Airport was leased in 2000, its airlines did not approve, so although the lease went ahead, New York State could only use the proceeds to invest in its handful of state-owned airports, rather than using the proceeds for its overall state government budget.

The situation changed dramatically in 2007 when Chicago reached a deal with the airlines serving Midway Airport, which had applied for the "large hub" slot in the program. With major tenant Southwest Airlines signing on to the deal (which provided airport-charges certainty for many years), the other Midway carriers agreed, and the lease was put out to bid. Unfortunately, the winning bidder in 2009 was unable to finance its $2.5 billion bid during the credit markets collapse, so the airport failed to be privatized.

That situation changed in 2012–13 when Puerto Rico's government worked with the airlines serving Luis Munoz Marin International Airport in San Juan. After some months of discussion, the airport's then-leading carrier, American, agreed to the terms of a draft lease agreement similar to the one airlines had approved

for Midway, and other San Juan airlines followed American's lead. The Puerto Rico Public-Private Partnerships Authority short-listed six potential bidders, including teams led by ASUR, Ferrovial, Fraport, GMR and Zürich Airport. Two of these ended up submitting proposals: Grupo Aerpuertos Avance (Ferrovial and Macquarie) and Aerostar Airport Holdings (ASUR and Highstar Capital). In July 2012, the Aerostar team was announced as the winner. After the required FAA review and public hearing, the agency approved the 40-year lease agreement on Feb. 25, 2013, and the deal was financed soon thereafter. Aerostar made an up-front payment of $615 million and agreed to invest $1.4 billion in the airport over the 40 years of the lease. Aerostar will also share airport revenue with the government, estimated at $552 million.

Chicago had retained its "large hub" slot in the pilot program during the transition from former Mayor Richard Daley to current Mayor Rahm Emanuel. Although he ran for mayor expressing opposition to Midway privatization, after a detailed review of the city's debt, pension liabilities and annual budget deficits, Emanuel decided to revive the Midway lease, encouraged by the success of San Juan. To make the deal more palatable to the city council and voters, the lease term was reduced from the prior deal's 99 years to 40 years, and the terms were changed from the entire amount up front to a combination of up-front payment and annual revenue-sharing. The winning bidder was also required to agree to a newly drafted "Travelers' Bill of Rights." The city got 16 responses to its RFQ and short-listed six teams. In the end, it received only two proposals, from Macquarie/Ferrovial and from Industry Funds Management/Manchester Airport Group. But before detailed negotiations could begin, the latter dropped out. Instead of negotiating with Macquarie/Ferrovial (which the *Bond Buyer* said was readying a fully financed bid for over $2 billion in up-front and revenue-share dollars), the mayor pulled the plug in early September 2013. Shortly thereafter, Chicago relinquished its slot in the pilot program.

At the third annual AAAE/LeighFisher conference on airport privatization, held in Washington, D.C. in June 2013, the outlook for U.S. airport privatization was seen as bullish. This was several months after Aerostar had taken over operating San Juan and several months prior to what everyone assumed would be Midway's privatization. Infrastructure investors made presentations, the Aerostar team detailed the San Juan transition process, and the FAA welcomed new applications to the pilot program. Several speakers told of serious queries received from government owners of mid-sized U.S. airports following the San Juan deal. It's not clear how much negative impact the Midway deal's second collapse will have, but there would appear to be two promising categories of

governments willing to consider privatizing their airports. One group is those with airports whose traffic has declined markedly and that need new business models (Ontario, California and St. Louis, for example). The other category is just the opposite: airports in fast-growing urban areas that need to expand but want to off-load the megaproject risk to investors (e.g., Austin). At the time of this writing (late 2013), the FAA has received no new applications for slots in the pilot program.

With San Juan having used one of the 10 slots in the program, the only one still occupied is for the Airglades Airport in Florida. The business plan is to convert Hendry County's small, under-utilized general aviation airport just south of Lake Okeechobee into a large cargo reliever airport for Miami International, focused initially on perishable cargo from Latin America and aircraft maintenance, repair and overhaul. The plan has won the support of the county commission, and two major agribusiness firms adjacent to the airport are part of the Airglades International Airport LLC group that seeks to buy and develop the airport under the pilot program. The airport is just off US 27, a major north-south highway that runs the length of Florida and provides a direct route to Miami International. The company has been steadily building support among cargo and logistics interests and has kept the FAA fully informed.

Airport Public-Private Partnerships Outside the Pilot Program

Branson Airport LLC, serving the country music haven Branson, Missouri, began as a totally private airport. The entrepreneurs who formed Branson Airport LLC, acquired a suitable parcel of land in Branson, received airspace approvals from the FAA, and raised $155 million. With that, they built a one-runway airport with a contractor-operated control tower and a modest terminal building. Because the airport used no federal grant funds, it is not constrained by the FAA grant regulations. Thanks to that, it has been able to offer airlines two-year exclusive rights to link specific cities to Branson. As of autumn 2013 Branson has scheduled service to Chicago Midway, Dallas Love, and Houston Hobby on Southwest and to Denver on Frontier. Despite that success, Branson's passenger traffic is far lower than the forecasts on which its construction was financed. Since January 2011, it has been in default on its revenue bonds, but reached a "forbearance agreement" with bondholders, which Branson Airport LLC has been able to renew several times. It is also suing contractors over the collapse of a portion of its runway in 2011.

The proposed third Chicago airport at Peotone, 40 miles south of the Loop, was conceived along the lines of the Branson model. But over the years, with support

from the local business community, outside consultants and the Illinois DOT, it has evolved into a public-private partnership in which the state DOT will own the land and be responsible for the airside (runways, taxiways, control tower) while the private sector would finance, develop and operate the landside (terminal, parking, etc.). Two positive developments for the Peotone airport occurred in 2013. First, the Illinois legislature enacted a bill, SB 20, formally authorizing a 75-year design-build-finance-operate-maintain concession for the airport. Second, the state DOTs of Illinois and Indiana began development work on the Illiana toll road, which would provide Interstate-quality highway access to the airport site.

Another contender for the “third Chicago airport” position is the airport of Gary, Indiana, which several years ago was renamed Gary/Chicago Airport. It has had only sporadic airline service over the years, and in 2013 lost its only carrier, Allegiant. City officials embarked on a public-private partnership in the hope that professional airport development and management could transform the airport. In spring 2013 the Gary airport authority hired a consultant to develop and implement a PPP process that would attract $100 million for developing the airport (in addition to the city-funded project now under way to lengthen its runway). After receiving about a dozen responses to its RFQ, the airport issued an RFP to the six best-qualified teams. In October it selected Aviation Facilities Company (AFCO) as its preferred developer and began negotiations.

Two failed efforts to transform urban-area general aviation airports under the FAA pilot program have been revived as local PPP deals. The first is a second attempt to transform Brown Field in San Diego. While the first attempt was shot down by local opposition to the plan to turn it into a large cargo airport, the current effort to make it into a general-aviation-oriented “Metropolitan Airpark” won city council approval in October 2013. The Phase 1 development plan calls for adding a fixed-base operator facility of 117,000 sq. ft., with 55 hangars for business jets and smaller planes, and support facilities, including a restaurant and aviation-related office space in the longer-range plan.

The other project is the successor to a proposal by New York-based Propeller Investments to privatize Briscoe Field in Gwinnett County as a secondary passenger airport for metro Atlanta. That project was rejected by the county commission in mid-2012 and the pilot program slot was vacated. Instead of giving up on the idea, Propeller has made a preliminary deal with Paulding County to develop passenger service at its relatively new Paulding Northwest Atlanta Airport. The deal structure, as a PPP between Propeller and the county, does not require a pilot program slot—but does, of course, require airfield and

airspace approval from the FAA (as Branson obtained), as well as TSA screening facilities. Both Delta Airlines and Atlanta Mayor Kasim Reed have come out strongly against the plan, vying to protect Atlanta Hartsfield-Jackson Airport from competition.

Airport Facility PPPs

A final category of privatization activity is private-sector finance, development and operation of airport terminals. The Port Authority of New York & New Jersey pioneered this concept in the late 1990s for the new Terminal 4 at Kennedy International Airport. Widely viewed as a success, it produced a state-of-the-art terminal building for which its developer/operator was responsible for all revenues (to cover operating costs, debt service, and hopefully a return on investment). The secondary airport in Orlando—Orlando Sanford—also used this model for both its domestic and international terminals.

Now, the Port Authority, under new leadership, is making use of this model again, for a replacement for the aging and under-sized central terminal at LaGuardia Airport. In response to its 2013 RFQ, the agency received numerous submissions, and in August short-listed four teams for the $1.5 billion project. A replacement terminal is also in the agency's plans for Newark Airport, and may well be procured as a similar PPP project.

B. U.S. Airport Security

The two most important developments in U.S. airport security in 2013 have been the start of a major expansion of risk-based airport screening and the difficult re-start of the TSA program allowing airports to outsource the provision of screening.

1. Expansion of Risk-Based Screening

In late 2011 the Transportation Security Administration launched its first-ever "trusted traveler" program, under the name PreCheck. The idea was to pre-screen a subset of travelers to ascertain their low-risk status and then provide what amounts to pre-9/11 screening lanes for them at the checkpoint. The program was first offered to premium-level frequent flyers of airlines that opted to offer the program and soon became highly popular. The TSA set an initial

goal of having PreCheck in place at 35 airports by the end of 2012, and succeeded when John Wayne Airport's PreCheck lane became operational on Dec. 20th.

With the initial five airlines and their frequent flyer members enthusiastic about the program, and minimal adverse reactions in the media and in Congress, TSA Administrator John Pistole began public discussions early in 2013 about expanding the program—first by encouraging other airlines to join. Late in January, the TSA held an "industry day" to discuss with information technology companies their possible role in recruiting and vetting new PreCheck members to expand its scope beyond airline frequent flyers. Interested companies were invited to submit white papers by April, explaining how they might go about this, presumably making money by charging some kind of registration fee.

The TSA's progress on working with the private sector was interrupted by the government-wide sequester, but on April 30th Pistole announced agreements with Australia, Canada and the European Union that PreCheck lanes would be usable by members boarding international flights to those destinations, rather than only domestic flights as had been the case. The TSA also began publicizing that members of the Customs & Border Protection's Global Entry program could also use PreCheck lanes whenever they fly.

And on July 19th, the TSA announced a major expansion of PreCheck. The agency said it will set up application locations at various airports at which ordinary travelers could apply for five-year memberships in exchange for a background check and an $85 membership fee. At the same time, the agency announced that it would aim to add 40 more airports to PreCheck by the end of the year, and to have 25% of all daily airport travelers in PreCheck by the end of the following year. That ambitious target will rely in part on private-sector recruitment and vetting. The TSA selected three of the firms that submitted concept papers in April to develop full-fledged proposals. In September it announced that JetBlue and Southwest would be joining the program and that the goal would be 100 participating airports by year-end. And it will begin adding a second PreCheck lane to some of the original airports, as demand warrants.

Also in September, the TSA provided some detail on how it will vet the larger set of prospective PreCheck members. Via a *Federal Register* notice, it said it has developed algorithms that will combine airline data on individuals' travel history with the personal I.D. information required of passengers when purchasing a ticket (full name, gender and date of birth). The latter are used by

the agency's Secure Flight system that checks each passenger against the various security watch lists at the time of ticket purchase.

No date has been set for announcement of the companies that will be authorized to recruit, vet and sign up new PreCheck members. Nor has TSA announced the dates and locations of its planned airport sign-up locations. But overall, these changes represent the TSA finally (after 10 years) embracing the risk-based approach to airport screening, in which the extent of screening is tailored to each passenger's estimated risk level: expedited, ordinary or enhanced.

2. Resumption of Outsourced Screening

The news is not as good when it comes to outsourced passenger and bag screening, as allowed for all airports under the 2001 legislation that created the TSA. In January 2011, then-new TSA Administrator John Pistole rejected all pending applications for the Security Screening Partnership (SSP) program and announced that no more airports could participate (other than the original five, plus the dozen other small ones already in the program). Members of Congress in both houses objected, but did not enact any changes. But when the FAA reauthorization bill was enacted in February 2012, it included provisions requiring the TSA to resume accepting applications and to provide Congress with reasons for any that it rejected. TSA then announced that it would resume accepting applications. By fall 2012, TSA had approved preliminary applications from a number of airports in Montana, from Orlando-Sanford in Florida, and from Sacramento International in California.

Despite these developments, 2013 began with no new screening contracts. Sacramento withdrew its application after an all-out union campaign led its elected officials to decide not to proceed. The four-airport solicitation from Montana, begun in October 2012, was cancelled in April 2013 via a letter saying it would be re-started at a later date. Orlando-Sanford's approved application did not result in the TSA soliciting for bidders, and Sarasota-Bradenton's application simply languished. Moreover, scheduled re-bidding of the large screening contracts for San Francisco and Kansas City were also held in abeyance.

What appears to have happened is that the TSA took language from the SPP provisions in the 2012 FAA bill (intended to jump-start resumption of such contracts) and used them to create a new requirement that no such contracts will be awarded if the cost to the government would be higher than what it currently

costs the TSA to provide screening at the airport. So everything was on hold until the TSA finished developing a new cost-efficiency standard for SPP screening contracts.

Unfortunately, as documented by several reports by the Government Accountability Office, the TSA has a terrible track record on such cost comparisons. In a 2009 study (GAO-09-27R), it faulted the TSA for suppressing an outside study that found reported screening costs almost the same between the TSA and contract screening, that the TSA's reported costs were inaccurate, and that the performance of contract screeners was as good as or better than that of TSA screeners. In a follow-up study two years later, GAO said TSA "had made progress in addressing the limitations related to costs" but still had work to do on this (GAO-11-375R). Its latest report on outsourced screening (GAO-13-208) ignored comparative costs altogether. Yet a detailed comparison between TSA-screened LAX and contractor-screened SFO by the House Transportation & Infrastructure Committee in 2011 found dramatically lower unit costs at SFO. It estimated that if the efficiencies realized at SFO via contract screening were applied to LAX, the cost would be 42% less.

The TSA's apparent stone-walling on implementing the 2012 legislative mandate to resume screening led several members of Congress to ask the DHS Inspector General to review the situation. Unfortunately, its June 2013 report (OIG-13-99) focused very narrowly on process rather than substance. It found that the TSA is developing a process to assess the cost of using private screeners at each requesting airport. It also concluded that because each procurement process is unique, TSA must select the evaluation factors to use in each case, do site visits, develop a source-selection plan, etc. Basically, the OIG took TSA's word that the new cost-comparison process would be fair and reasonable—and would be finalized sometime in 2013.

The first solicitation to be released under the new process, on August 30th, was for the four Montana airports. In October, the TSA extended the deadline to Nov. 19th while it sorted out questions from potential bidders.

In July 2013 Reason Foundation released a policy brief calling for substantive reform of the program. The brief—*Overhauling U.S. Airport Security*—reminds readers that under the 2001 legislation, all U.S. airports have a right to outsource their passenger and baggage screening. It also notes that the 2001 law contains a built-in conflict of interest, by making the TSA both the aviation security policymaker/regulator of airport security but also the provider of the most costly component of airport security—screening. For all other aspects (lobby security,

ramp security, perimeter security, etc.) the airport is responsible and is regulated at arm's length by the TSA. Only when it comes to screening is the TSA regulating itself. This is contrary to the practice in Canada and Europe, where there is strict separation between the aviation security regulator and airport screeners, with most such screening being provided by certified screening contractors.

C. Air Traffic Control

1. Global ATC Trends

Since 1987, beginning with New Zealand, more than 50 governments have "commercialized" their air traffic control (ATC) systems. That means they have organizationally separated the ATC function from their transport ministry (putting it at arm's length for safety regulation), removed it from civil service, and made it self-supporting from fees charged to aircraft operators for ATC services. Two of these air navigation service providers (ANSPs) are often referred to as privatized. Nav Canada is a not-for-profit, private company, governed by a board composed of aviation stakeholders. And in the U.K., NATS is a company owned 42% by airlines, 4% by airports, 5% by employees, and 49% by the government. The trade association for ANSPs is CANSO (the Civil Air Navigation Services Organization). As of third-quarter 2013, it had 80 full members, i.e., entities that provide air navigation services. Of those, over 50 are commercialized, including the ANSPs of Australia, New Zealand, Thailand, India, Canada, the U.K., Ireland, Germany, Spain, Portugal, Austria, Switzerland, most of the rest of the E.U. countries and South Africa. Governmental ANSPs include Cyprus, Luxembourg, Greece, the Maldives and the FAA's Air Traffic Organization (which is still embedded within that agency and funded by annual appropriations from the federal budget).

In late 2012 CANSO published its third *Global Air Navigation Services Performance Report*. Twenty-six ANSPs provided data for the report, which covers 2007–2011. Most are from Europe, but others include the FAA's ATO, Nav Canada, SENEAM (Mexico), AAI (India), ATNS (South Africa) and Airways New Zealand. The highest productivity, measured as IFR flight hours per controller, was recorded by AAI, followed closely by the FAA ATO and Nav Canada. On cost per IFR flight hour, the least costly among developed countries were Nav Canada, Airways New Zealand and the FAA ATO.

2. U.S. Air Traffic Control

Reform of the funding and governance of the FAA's Air Traffic Organization returned to the U.S. policy agenda during 2013. The triggering event was the federal government's budget problems, dramatized by the sequester of all non-entitlement spending half-way through FY 2013 (Oct. 1, 2012 – Sept. 30, 2013). Implemented in April, that transformed a nominal 5% cut into a 10% cut for the second half of the fiscal year. For FAA, the cut was implemented by furloughs of all controllers for one day out of each 10, and a plan to shut down 149 contract control towers for the balance of the fiscal year. Those two cuts led to extensive public and congressional opposition, with emergency legislation enacted to transfer enough funding from the FAA airport grants account (immune to sequestration) to the operations account, so as to rescind the furloughs after only one week and to avert the closure of contract towers.

These budget problems, combined with a number of the FAA's important NextGen modernization programs being behind schedule and over budget, led aviation stakeholders to begin looking enviously at commercialized ANSPs like Airservices Australia, NATS and Nav Canada, where government budget cuts would have no effect. That's because these ANSPs' funding is provided not by user taxes (paid to the Treasury and spendable only when authorized and then appropriated by Congress) but by fees for ATC services paid directly by aircraft operators to the ANSP itself. In addition to insulating the ANSP from externally imposed budget cuts, this reliable revenue stream is bondable, just like airport revenues are, for large capital programs such as Next Gen.

The FAA's own Management Advisory Council sent a unanimous letter to congressional aviation leaders at the end of February, in advance of the impending sequestration, calling for replacing the agency's unsustainable funding system and creating a new governance mechanism in the form of a board representing aviation stakeholders. In the months following the sequester, at various aviation conferences, leaders of aviation groups including private (general) aviation, airlines, air traffic controllers and pilots called the current ATC funding system broken and needing replacement. Both the aviation trade press and some of the general media picked up on these discussions. By autumn 2013, the FAA Management Advisory Council had voted unanimously that the ATO should be separated from the FAA and converted into a self-supporting ANSP.

About the Author

Robert Poole is Director of Transportation Policy and the Searle Freedom Trust Transportation Fellow at Reason Foundation, a public policy think tank based in Los Angeles and Washington, D.C.

In aviation security, Poole advised the White House and House Republican leaders on what became the Aviation & Transportation Security Act of 2001, enacted in response to the 9/11 attacks. He has authored a number of Reason policy studies on aviation security and is the author of a paper on risk-based aviation security for the OECD's International Transport Forum.

He was among the first to propose the commercialization of the U.S. air traffic control system, and his work in this field has helped shape proposals for a U.S. ATC corporation. A version of his nonprofit corporation concept was implemented in Canada in 1996. He has advised the Office of the Secretary of Transportation, the White House Office of Policy Development, the National Performance Review, the National Economic Council, and the National Civil Aviation Review Commission on ATC commercialization. He is a member of the Air Traffic Control Association and of the GAO's National Aviation Studies Advisory Panel.

Poole's Reason studies helped launch a national debate on airport privatization in the United States. He advised both the FAA and local officials during the 1989–90 controversy over the proposed privatization of Albany (NY) Airport. His policy research on this issue helped inspire the privatization of Indianapolis airport management under Mayor Steve Goldsmith and Congress's 1996 enactment of the current Airport Privatization Pilot Program.

Poole has testified on airports, aviation security and air traffic control on a number of occasions before House and Senate aviation and homeland security subcommittees, and he has spoken on these subjects before numerous conferences over the past decade. He has also done consulting work on several airport privatization feasibility studies.

Poole also edits monthly Reason Foundation e-newsletters on airport and air traffic control policy issues. He received his B.S. and M.S. in mechanical engineering at MIT and did graduate work in operations research at NYU.

Endnotes

[1] Airports Council International Europe, *The Ownership of Europe's Airports 2010*, February 2010, available at: https://www.aci-europe.org/component/downloads/downloads/1457.html

[2] International Civil Aviation Organization, *Manual on Privatization in the Provision of Airports and Air Navigation Services*, Document 9980, 2012, available at: http://www.icao.int/sustainability/Pages/ANSP-Privatization.aspx