



# San Francisco International Airport Competition Plan Update August 2001

## **Introduction**

Pursuant to Section 155 of the Wendell H. Ford Aviation Investment and Reform Act for the 21<sup>st</sup> Century (AIR-21, Public Law 106-181, the San Francisco Airport Commission presented a Competition Plan to the United States Department of Transportation (DOT) and the Federal Aviation Administration (FAA) on August 8, 2000. The following is the 2001 update to the Competition Plan submitted in August 2000 in accordance with Program Guidance Letter 00-3, "Periodic Updates to the Plan." Those items not specifically updated are still current with the August 2000 submittal.

## **General Update**

The Airport opened its approximately 2.5 million square foot new International Terminal Complex ("ITC") for full operations on December 10, 2000. The ITC, which is a state-of-the-art facility, is both the largest international terminal and the largest common use terminal in the United States. Since its successful opening, all of the ITC's systems have been functioning well, including such key elements as the Airport-owned telecommunications and common use baggage systems.

SFOTEC, LLC, formed by all 25 airlines operating out of the ITC, operates and maintains the Airport-owned common use equipment related to handling flights and passengers at the ITC. This equipment includes baggage handling, flight, baggage and display systems, gate management equipment, passenger loading bridges and pre-conditioned air and 400 hertz power systems. All such activities and gate scheduling practices are under the oversight of the Airport and require review and approval. The Airport maintains all telecommunications and multiple-use flight information displays.

## **Section #1 - Gate and Facility Availability**

The Airport currently has 85 operational gates, 44 of which can handle wide-body aircraft. Of the 85 gates, 21 are in the Airport's new ITC. The Airport expects to activate the 3 remaining gates in the ITC after altering or reconstructing certain gates in existing domestic boarding areas.

The following chart summarizes current gate availability and lease arrangements at SFO:

**SFO Gates - Lease Arrangement Summary**

<b>Exclusive Gates</b>	<b>2000<sup>(a)</sup></b>	<b>2001</b>
Alaska Airlines	3	3
American Airlines	8	8
Continental Airlines	5	5
Delta Airlines	8	8
Northwest Airlines	3	3
Southwest Airlines	2	0
TWA	7	7
United Airlines	23	23
US Airways	5	5
<b>Total Exclusive Gates</b>	<b>64</b>	<b>62</b>
<b>Percentage of Total</b>	<b>86 %</b>	<b>73 %</b>
<b>Common/Preferential Use</b>	<b>10</b>	<b>23</b>
<b>Percentage of Total</b>	<b>14 %</b>	<b>27 %</b>

(a) Through December 10, 2000 when the new International Terminal opened.

Airport staff continues to monitor the use of all airport gates and to work aggressively with airlines to ensure there are no barriers to new entrants. The Airport has greatly enhanced abilities to monitor gate usage in the ITC through computer-generated reports from the Airport Operations Data Base. The technology provides real time capability for Airport staff to monitor ITC gate utilization rates, aircraft turn times and any other related information. This provides the Airport with the capability to closely monitor gate scheduling practices by SFOTEC and ensure maximum gate utilization rates within the ITC.

In constructing the ITC gates the Airport invested approximately \$4.2 M to provide the capability for the gates to handle domestic as well as international customers and to provide the necessary baggage claim facilities to support such domestic operations. The Airport has had domestic operators utilizing ITC gates, in the common-use environment, since opening in December 2000.

In FY 2000/01, there were 185,853 passenger aircraft departures accommodated from a weighted average of 79.5 gates (74 for the first six months and 85 for the second six months), representing an average gate utilization of 6.4 turns per day. This ratio is relatively high for an origin-destination airport, particularly with the large number of international flights.

In March 2001, Southwest Airlines ceased operations at SFO. The two exclusive gates they had been utilizing under a 30 day Space Permit have reverted to the Airport and have been made available to a number of carriers on an as needed basis. For example, Sun Country has operated from the gates in May 2001 and Air Canada has utilized the

gate for arriving flights. In addition, American Trans Air, Vanguard and USAirways have been offered rental of the gate(s) and chose to make other arrangements.

In April 2001, American Airlines purchased TWA. The purchase, however, did not include the TWA leasehold at SFO. Three of the seven exclusive leasehold gates are used by TWA (continuing separate flight operations subsequent to the purchase), and the other four gates continue to be utilized by America West, National Airlines and American Trans Air as they have been for a number of years.

In October, Airport expects the leasehold to be rejected in bankruptcy court proceedings and to revert to SFO. Full integration of the two carriers' schedules at SFO is expected to occur in December 2001. At that time, the Airport intends to make the gates available to airlines on a combination of 30 day Space Permits and a preferential assignment/joint use basis.

The two events outlined above are expected to create Airport-controlled domestic gate capacity for the first time in many years. These domestic gates, controlled by the Airport, are readily available to new air carriers wishing to inaugurate service or existing carriers wishing to expand service at SFO.

### **New Entrants**

In May 2001, Vanguard, a low cost carrier, initiated daily service from San Francisco to Kansas City. Airport staff was able to offer Vanguard the use of the Airport gates vacated by Southwest Airlines or a sub-lease arrangement with two carriers. For a variety of reasons Vanguard chose to begin operations under a sub-lease and a ground handling arrangement with Continental Airlines on one of their leased gates. In addition, the Airport continues to have discussions with domestic and foreign-flag carriers regarding the initiation of service to SFO. Airport management is hopeful that one or more of these carriers will initiate service at SFO within the next year

## **Section #2 - Leasing and Subleasing Arrangements**

### **Independent Contractors/Ground Handlers**

A great deal of consolidation has occurred in the ground handling industry in the past year. For example, all three SFO ground handlers providing aircraft loading and unloading services are or will be acquired by another, larger entity; Ogden has been acquired by Menzies, Dynair by Swissport and Monarch Aviation is in the process of finalizing a purchase by Globe Ground North America LLC which recently acquired Hudson General's North American operations. The Airport has been advised that the consolidation will be effective in September 2001. The Airport will meet to address with the Airline Community the feasibility of any additional independent contractors/ground handlers in this category by the end of this calendar year.

There are a total of thirty-two independent contactors providing services to the airlines operating at SFO. In addition to the three ground handlers providing aircraft loading and unloading services there are twenty-nine additional independent contractors certified under the Airport Quality Standards Program (QSP) to provide services to the airline community. The services covered by QSP include aircraft loading and unloading, aircraft

fueling, ground service equipment fueling, cargo handling, ramp sweeping, pre-board security screening, skycap services, and processing, passenger check-in, passenger boarding, aircraft maintenance and repair, and cabin cleaning. Attachment A reflects the independent contractors providing services at SFO and the QSP approved category of service they are permitted to offer.

### **Complaint Resolution**

The Airport strives for resolution of complaints at the lowest possible level and staff works closely with airlines and other tenants to resolve any disputes that may occur. The Airport has supported the formation of several Committees that provide a forum for dialogue and problem solving. These committees are well established and aviation tenants are encouraged to participate in them.

#### **Airport Airline Affairs Committee /Airline Liaison Office**

The Airport meets quarterly with the general membership of the San Francisco Airport Airline Affairs Committee (SFAAAC), which represents all airlines at SFO. The Airport also participates regularly in a monthly meeting/conference call with the SFAAAC's Executive Finance Subcommittee. Within these forums, the Airlines and Airport seek to not only review issues and concerns but also address any areas of potential disagreement that may exist.

In an effort to facilitate communications with the Airlines related to implementation of the Airport's Near Term Master Plan Program (NTMPP), in July 1994, San Francisco International Airport became one of the first airports to fund the formation of an Airline Liaison Office (ALO). The ALO function was originally established to assist the airlines and the Airport in their mutual efforts to implement the NTMPP. Through the years, the role of the ALO function has evolved to provide assistance to the airlines and Airport related to a multitude of operational, financial, environmental and miscellaneous other airport affairs type issues. For these reasons, the Airport has decided to continue funding the ALO although the NTMPP is nearly complete. To the extent an issue cannot be resolved with the assistance of the ALO/SFAAAC, items are documented and addressed formally in writing between the parties.

#### **Station Managers/International Terminal Operators Committee**

The Airport has two other formal organizations that represent all airlines operating at SFO. The first of these is the International Terminal Operators Committee representing those airlines that operate in the ITC. The second group is the Station Manager Committee. This Committee is comprised of the local manager for each Airline serving SFO.

The Airport has a long established practice of meeting monthly with both groups to review items of security, safety and other general topics affecting airline operations. Minutes are kept of the meeting, chaired by an airline representative. This meeting provides a forum for resolution of complaints typically involving airline operations, safety, airport rules and security.

Airlines and any other tenant desiring to make a formal complaint regarding specific rule or policy violations are directed to outline their complaint in writing to the Airport Director. The Director assigns the complaint to the appropriate staff member for investigation and recommendations for handling and a final decision is issued to the airline or other tenant in writing.

### **Forced Accommodation/Recapture of Space**

Section 206 of the Lease and Use Agreement does require that a Signatory Airline at the request of the Airport make its gate hold rooms and passenger loading bridges available to accommodate new entrant and other scheduled airlines if the Signatory Airline or its sub tenants are not using such space. The Airport has invoked this provision in the past to ensure that the temporary gate needs of new entrant airlines were met.

In the Lease an Operating Agreements and modifications to the Lease and Use Agreements of eight Signatory Airlines, specific to space in the ITC, the Airport incorporated protocols for ITC space reallocation and recapture in the event exclusive spaces are being under utilized and are reasonably necessary to accommodate a new entrant or to accommodate the needs of existing carriers when a significant shift in market share has occurred. As the Airport implements the next phase of the Master Plan, domestic terminals will begin to incorporate multiple user technology and, while honoring existing lease commitments, available domestic gates will be provided under a thirty day revocable Space Permit for preferential use by a carrier or with a lease incorporating preferential use methodology.

### **Section #3 - Patterns of Service**

The major change in air service at SFO since a Competition Plan was submitted to the FAA in August 2000 is the departure of Southwest Airlines on March 5, 2001. Southwest operated 14 flights per day -- six to Phoenix (PHX) and eight to San Diego (SAN.) Non-stop SFO-PHX service is currently provided by America West and United. Non-stop SFO- SAN service is currently provided by United only. Similarly, nonstop Oakland-San Diego service is provided only by Southwest. This provides the San Francisco Bay Area passengers a choice between the two airlines.

In a letter to its "Rapid Rewards" passengers in the Bay Area in February 2001, Southwest said:

*Our San Francisco service is being discontinued for compelling business reasons. Unfortunately, our operations there have not been profitable for a considerable period of time, and service into and out of that airport produces a disproportionate amount of flight delays rippling across our system. By reallocating this aircraft capacity, we will be able to satisfy strong customer demand at our other California airports, including the Bay Area.*

*With 115 daily departures from Oakland and 71 departures from San Jose, we feel confident that these two choices will offer flights at convenient times to the same destinations you traveled to and from San Francisco.*

The Bay Area was the only metropolitan region in the nation where Southwest operated from three airports. In addition, Southwest operated a relatively small number of flights from SFO compared to Oakland and San Jose, and to other markets it serves.

Southwest operated their 14 daily flights at SFO from two gates under a 30-day permit. The availability of terminal facilities was not an impediment to serving the SFO market.

In light of Southwest's decision to exit the SFO market, the Airport prepared an analysis of the carrier's operations and traffic on the SFO- PHX and SFO- SAN routes in the years 1996 through 1999 (please see Tables 1 and 2).

Highlights from Table 1 include:

1. Southwest has been gradually reducing flights and capacity (seats) on both routes, and its traffic has been following suit.
2. On the SFO-PHX route, Southwest, United, and America West each provided about one third of the seats in 1999. Whereas United and America West filled about 74% of their seats, however, Southwest's load factor was only 57%.
3. On the SFO-SAN route, United provided about 60% of the capacity in 1999 compared to 40% by Southwest. Again, United filled 76% of its seats, while Southwest's load factor was only 62%.
4. To each destination, Southwest operated at higher load factors from SJC or OAK than from SFO.

Highlights from Table 2 include:

1. The Bay Area air travel markets to both PHX and SAN are relatively mature; they exhibited O&D traffic growth of less than 1% per year from 1996 to 1999.
2. Southwest has commanded a much larger share of each O&D market at SJC and OAK than at SFO. To PHX, Southwest's 1999 shares at SJC and OAK were roughly double its share at SFO (30%). To SAN, Southwest had an 87% share at SJC and a virtual monopoly at OAK, compared to only a 40% share at SFO.
3. Southwest has been far more dependent on connecting traffic on its two SFO routes, whereas its flights from SJC and OAK to both PHX and SAN have carried mostly local O&D traffic. About 40% of its traffic on the SFO-PHX route, and 20% on the SFO-SAN route, has been comprised of lower-yielding connecting passengers. Virtually all of Southwest's traffic from SJC and OAK to PHX was local O&D, as was nearly 90% of its traffic from SJC and OAK to SAN.

Faced with declining levels of relatively low-yielding traffic and low load factors at SFO and much lower shares of the market than at SJC and OAK, SFO management concludes that Southwest has made a business decision to deploy its assets to more lucrative markets. The delays to its system that the SFO congestion problem brought were also a likely a contributing factor.

Airport management believes that SFO will retain a large proportion of the 400,000 annual enplaning passengers that were carried by Southwest, based on several factors, including:

1. Southwest has long provided service to both PHX and SAN from the other Bay Area airports, yet a substantial number of passengers (400,000 per year) chose to fly from SFO in 1999. For most of those passengers, we believe that preference will likely carry over to the benefit of United and America West (and any other carriers that may decide to operate nonstop service from SFO in these markets in future).
2. United (to PHX and SAN) and America West (to PHX) both provide frequent service at relatively competitive fares to those offered by Southwest. These will be critical factors as they seek to capture the 286,000 local O&D travelers that used Southwest on those routes in 1999.
3. We believe that some of the O&D passengers carried by Southwest used its low fares to make connections with other carriers, particularly international flights, at SFO. (We have no statistics to support this belief because Southwest does not interline with other carriers.)
4. With respect to beyond traffic (i.e., Southwest passengers connecting at PHX and SAN), Southwest held less than a 10% market share in all but four markets of any significant size. We expect most of Southwest's 114,000 beyond passengers will simply use services operated by other carriers at SFO rather than shift to SJC or OAK.

Other noteworthy changes in air service in the past year include:

1. As mentioned earlier, in May, 2001, Vanguard initiated daily service from San Francisco to Kansas City.
2. Departures by United Express (Skywest Airlines) decreased by 15 flights per day in June 2001 compared to June 2000, reflecting the reduction in United Airline's domestic-to-domestic connections and Airport management's request to United to up gauge the equipment type on such flights to in an effort to reduce delays. On the basis of information from November 2000 through February 2001, SFO has seen a noticeable reduction in delays as a result of United making changes to its flight schedule.
4. Beginning in September 2001, Suntrips will be relocating its Mexico flights from SFO to OAK. Suntrips operates seven weekly departures to Mexico from SFO.
5. United added a third daily nonstop to London Heathrow.
6. Although United transferred its Beijing daily service from SFO to Chicago O'Hare it has increased Shanghai service from five to seven frequencies per week.
7. Korean Airlines has added one frequency per week to Seoul, Korea effective June 1, 2001.
8. Virgin Atlantic Airways has added four departures per week to London (Gatwick) effective June 20, 2001.

9. Swissair has increased service from Zurich from five to seven frequencies per week.
10. Air France has added three frequencies per week to Paris.
11. Skywest (United Express) has announced the implementation of five regional jets to replace some propeller driven aircraft operations in September 2001.

#### **Section #4 – Gate Assignment Policy**

No update to last Plan submittal.

#### **Section #5 – Financial Constraints**

SFO rates and charges have increased significantly as the \$3 billion near-term Master Plan nears completion, reflecting the new debt service and operating expenses associated with a 2.5 million square foot addition in terminal space. The average airline payment per passenger increased from \$7.68 in FY 2000 to a projected \$16 in FY 2002. In accordance with the rate-making procedures in the Lease and Use Agreement, these costs are spread evenly across all terminal space. In addition, there are common use equipment charges for airlines using the new international terminal.

SFO's new international terminal opened on December 10, 2000. The cost to operate from the new facility is significantly higher than from the old terminal because (1) there is more joint use space in the new terminal, (2) the average terminal rental rates increased (as described above), and (3) the cost of the new common use equipment (the equipment in the old facility was fully amortized). In consideration of these higher facility costs, SFO management worked with the San Francisco Terminal Equipment Company (SFOTEC) -- which maintains, operates, and assesses airline charges for the common use equipment in the new international terminal -- to establish a separate tier of charges for domestic airlines.

Airport management also identified two baggage claim carousels for domestic operations to reduce the burden of FIS carousel joint use space on domestic carriers. These changes made it more economical for domestic airlines, such as Ryan International, to operate domestic flights from the new international terminal. Ryan had approached the Airport for assistance in this area.

SFO has been one of the last large-hub airports to levy a passenger facility charge (PFC). On July 27, 2001, the FAA approved SFO's first PFC application to impose and use approximately \$113 million in PFC revenue, under a \$4.50 per enplaning passenger PFC, beginning October 1, 2001. PFC revenue under this application is to fund eligible costs of planning, feasibility, and environmental studies related to runway reconfiguration at SFO. These costs would otherwise be included in the landing fee rate.

In addition, the Airport has initiated a new PFC application (PFC#2) to fund a portion of the eligible costs associated with the development of the new international terminal and to develop and implement a precision runway monitoring system. PFC#2 would provide well-balanced PFC program for SFO – part airfield and part terminal – and would allow

the Airport to reduce the costs to operate from the new international terminal to stimulate new service. Because the PRM cannot be financed with tax-exempt debt (like most other Airport facilities) the use of PFC revenue for this system would significantly reduce the associated interest carrying costs, thereby reducing the landing fee rate. The PRM would only be eligible for PFC funding if it is selected under the AIR-21 pilot program to permit cost-sharing of air traffic modernization projects. The FAA is expected to make this determination shortly.

## **Section #6 – Airport Controls over Capacity**

The Lease and Use Agreement sets forth the rate-making methodology and MII provisions in effect at SFO.

### **Rates and Charges Policy**

There have been no major changes in SFO's rates and charges policy in the last year.

### **Majority-In-Interest Provisions**

SFO's MII clause was negotiated (1981) shortly after airline deregulation (1978). Many leases negotiated at that early stage of deregulation have much more stringent MII provisions. The features of SFO's MII clause that make it more flexible include:

1. Unlike other airline MII provisions, the signatory airlines cannot "veto" a project. If a majority-in-interest disapproves of a project, the only consequence is that the Airport must *defer the project for six months*, after which the Airport can proceed with the project if it so chooses.
2. An MII must *disapprove* not *approve* a project. This places the burden on the airline industry to write to the Airport and gather sufficient votes to defer a project.
3. Two criteria must be met in the MII test -- 50% of the signatory airlines accounting for 50% or more of the landed weight. At airports such as SFO, where one airline accounts for a large share of the landed weight, that airline cannot control MII because it must obtain support from the other signatory airlines to achieve the 50% in number part of the MII test.
4. There is no cap on project costs. If a project costs more than originally estimated and/or grants are lower than estimated, the project is not subject to further MII review.
5. There is no "conditional" MII approval.
6. Project formulation activities such as planning, conceptual design, architectural, and engineering studies are not subject to MII review.

When the non-MII international airlines signed Lease and Operating Agreements for their new operations in the ITC, they were given the same MII privileges that the Signatory Airlines were given in 1981. The MII is now defined as more than 50% in number of the Scheduled Airlines which, on the date in question, account for more than 50% of the aggregate revenue aircraft weight landed by the Scheduled Airlines at the Airport during

the immediately preceding fiscal year. The term "Scheduled Airlines" includes both original 1981 Signatories and new Lease and Operating Agreement airlines. The Airport's purpose in expanding the MII was to include more airlines in the capital review process. The Airport also intends to expand the MII to include domestic non-Signatory airlines as domestic terminals are remodeled and these carriers are relocated.

A list of those airlines and their respective landed weights at SFO for Calendar year 2000 is outlined in Table 3.

Prior to giving any written notice to the Airport, the MII typically discusses its issues with the Airport regarding proposed capital improvements. Where appropriate and whenever possible, the Airport incorporates changes requested by the airlines. On occasion, the MII sends a letter to the Airport withholding approval and invoking the 6-month waiting period.

In the past year, the MII sent written notice to the Airport of its non-concurrence in the following Airport projects, giving the reasons listed below.

1. Project 4362 -- Alternative Point of Entry (APOE) Building estimated to cost \$9,062,500. The Airport wants to proceed with this project to meet its future telecommunications needs and to provide a vital redundant back-up to the recently installed Minimum Point of Entry (MPOE). The APOE will provide a redundant, self-contained telecommunication system capable of serving the needs of both the Airport Commission and its tenants. The project consists of the construction of an APOE building shell and support systems and the telecommunications equipment (including optical transmission electronics, fiber optic and copper cabling, and telephone switch). The airlines questioned the need for and timing of this project given the current financial climate.

In addition, MII deferred approval of the following airfield capital improvements pending a meeting with Airline Flight Operations Representatives to review and discuss alternative construction phasing plans for the projects. The airlines requested the deferral to provide input into the construction phasing to minimize the operational and schedule impacts to their service at SFO.

2. Project 3479 – Taxiway F1 Extension estimated to cost \$7,244,000.
3. Project 3561 – Runway 10L/28R Overlay and Reconstruction estimated to cost \$15,000,000.
4. Project 3562 – Runway 1R/19L Overlay and Reconstruction estimated to cost \$15,750,000.

Similarly, an MII temporarily deferred approval for the following four projects pending submittal of additional information to the airlines regarding the proposed scope of additional improvements to be undertaken in Terminal 2 as well as the total overall budget for the redevelopment of Terminal 2 (Central Terminal and Boarding Area D):

5. Project 5451 – Terminal 2 Baggage System estimated to cost \$18,582,000.
6. Project TBD – Terminal 2 PLB/PC Air/400 Hz Systems estimated to cost \$8,970,000.

7. Project 4083A – Boarding Area D Apron Rehabilitation estimated to cost \$7,000,000.

The airlines are not opposed to the principle of developing common use facilities in Terminal 2, but are concerned about the estimated cost for the entire project in light of the general state of the economy and the present financial condition of the airline industry. The current cost estimate for the Terminal 2/Boarding Area D project is approximately \$200 million, including the renovation of offices on floors three through six, which was separately approved.

<b>Section #7 – Future Common Use Facilities</b>
--

The Airport is continuing work on the refurbishment of Terminal 2 and Boarding Area D and its conversion from international to domestic operations. Recent studies have confirmed that the facility requires more extensive infrastructure enhancements than originally anticipated and the projected completion date is now planned for November 2004. We are in discussion with carriers regarding potential relocations to the converted terminal.

It is expected that while honoring current lease obligations, expansion gates for existing signatory domestic carriers will be preferential rather than exclusive in nature and new airline leases will have common use features to enhance flexibility and ensure maximum utilization of gates. It is expected that the converted terminal will have extensive common use computer terminal equipment as well as a common-use baggage system and related systems to enable use of the facilities by multiple carriers. The carrier mix and details of common use equipment are still being finalized and will be included in future updates.