

Memorandum



CITY OF DALLAS

DATE 25 April 2014

TO The Honorable Members of the Transportation and Trinity River Project Committee:
Vonciel Jones Hill (Chair), Lee Kleinman (Vice Chair), Monica Alonzo, Tennell Atkins, Sandy Greyson,
and Sheffie Kadane

SUBJECT Dallas Love Field Gate Leases

On Monday, 28 April 2014, the Transportation and Trinity River Project Committee will be briefed on the Dallas Love Field Gate Leases. The material is attached for your review.

A handwritten signature in black ink, appearing to read 'Theresa O'Donnell'.

Theresa O'Donnell
(I) Assistant City Manager

c: A.C. Gonzalez, City Manager
Warren M.S. Ernst, City Attorney
Craig D. Kinton, City Auditor
Rosa A. Rios, City Secretary
Daniel F. Solis, Administrative Judge
Ryan S. Evans, (I) First Assistant City Manager
Jill A. Jordan, P.E., Assistant City Manager

Forest E. Turner, Assistant City Manager
Joey Zapata, Assistant City Manager
Charles M. Cato, (I) Assistant City Manager
Jeanne Chipperfield, Chief Financial Officer
Shawn Williams, (I) Public Information Officer
Elsa Cantu, Assistant to the City Manager – Mayor & Council



City of Dallas Aviation

Love Field Gate Leases

Transportation & Trinity River Project Committee

28 April 2014



Background

- Dallas Love Field
 - 20 gates (per the five-party agreement and Wright Amendment Reform Act)
 - 4.2 million enplanements in 2013
 - Classified as a “Medium Hub” by Federal Aviation Administration [“FAA”]
- Airports can lease gates on following basis
 - Exclusive use – Airlines have full control, including branding and scheduling, over space
 - Preferential use – Airlines have control but gives right for airport to allow **new** entrants to operate at gates that are not being fully utilized
 - Common use – gate space and time of use is managed by the airport

Background

- Dallas Love Field [“DAL”] has leased all available gates on a preferential use basis
 - Southwest Airlines - 16 gates
 - United Airlines - 2 gates
 - American Airlines - 2 gates
- Typically, ten flights or “turns” per gate is full utilization

Background

- American filed for bankruptcy in November 2011
- In February 2013, American and US Airways proposed a merger as a way out of bankruptcy for American
- In August 2013, the United States Department of Justice [“DOJ”] and attorneys general from six (6) states and the District of Columbia filed an antitrust lawsuit in an attempt to stop the proposed merger

Terms of Proposed Settlement

- In November 2013, DOJ announced a proposed settlement of the antitrust litigation
 - DOJ is requiring gates and slots to be divested to low-cost carriers
- In December 2013, the bankruptcy court approved the merger; however, the antitrust suit is still awaiting final resolution

Terms of Proposed Settlement

- Under the terms of the proposed settlement, American will divest
 - 52 slot pairs at Washington Reagan National Airport
 - 17 slot pairs at New York LaGuardia Airport
 - 2 gates at Boston Logan International Airport
 - 2 gates at Chicago O'Hare International Airport
 - 2 gates at Miami International
 - 2 gates at Los Angeles
 - 2 gates at Dallas Love Field

Terms of Proposed Settlement

- Asset Preservation Order and Stipulation:
 - “Defendants shall not, except as part of a divestiture approved by the United States...remove, sell, lease, assign, transfer, pledge, or otherwise dispose of their respective divestiture assets”
- Proposed Final Judgment:
 - “‘acquirer’ or ‘acquirers’ means the entity or entities, approved by the United States in its sole discretion”

Current Status

- To date, there has been interest expressed in the two (2) gates, should they become available
- The City has not actively solicited interest for the gates from any airline

Issues

- Because of Love Field's unique history, there are three key controlling documents that affect the leasing activities
 - Wright Amendment Reform Act
 - The Five-Party agreement
 - City's use and lease agreement with American Airlines

Wright Amendment Reform Act of 2006

Based on local Five-Party Agreement

- City of Dallas, City of Ft Worth, American Airlines, Southwest Airlines, DFW International Airport
- Flight restrictions end on October 13, 2014, however the following restrictions will remain
 - No international flights
 - Love Field capacity limited to twenty (20) gates
- **Required City & Southwest Airlines to collaborate** on modernization of Love Field

Local Five Party Agreement

Other provisions

- City negotiated a voluntary noise curfew precluding scheduled service between 11pm and 6am
- Both Cities are to oppose efforts to initiate commercial passenger service at any airport other than DFW until October 2014
 - If another airport within 80 mile radius attempts to initiate commercial service, both cities will work to bring that service to DFW, or if that fails, to airports owned by Dallas or Fort Worth

Use & Lease Agreements

- Twenty (20) year term, ending 2028
 - Airlines with little activity can exit leases early in 2018 and 2023
- All gates leased on a “Preferential Use” basis, rather than exclusive
- All baggage areas (outbound & inbound) leased as “common use”
- Office, operations and ticket counter space leased as exclusive use
- All space subject to “accommodation provisions” for **new** entrant airline access to terminal

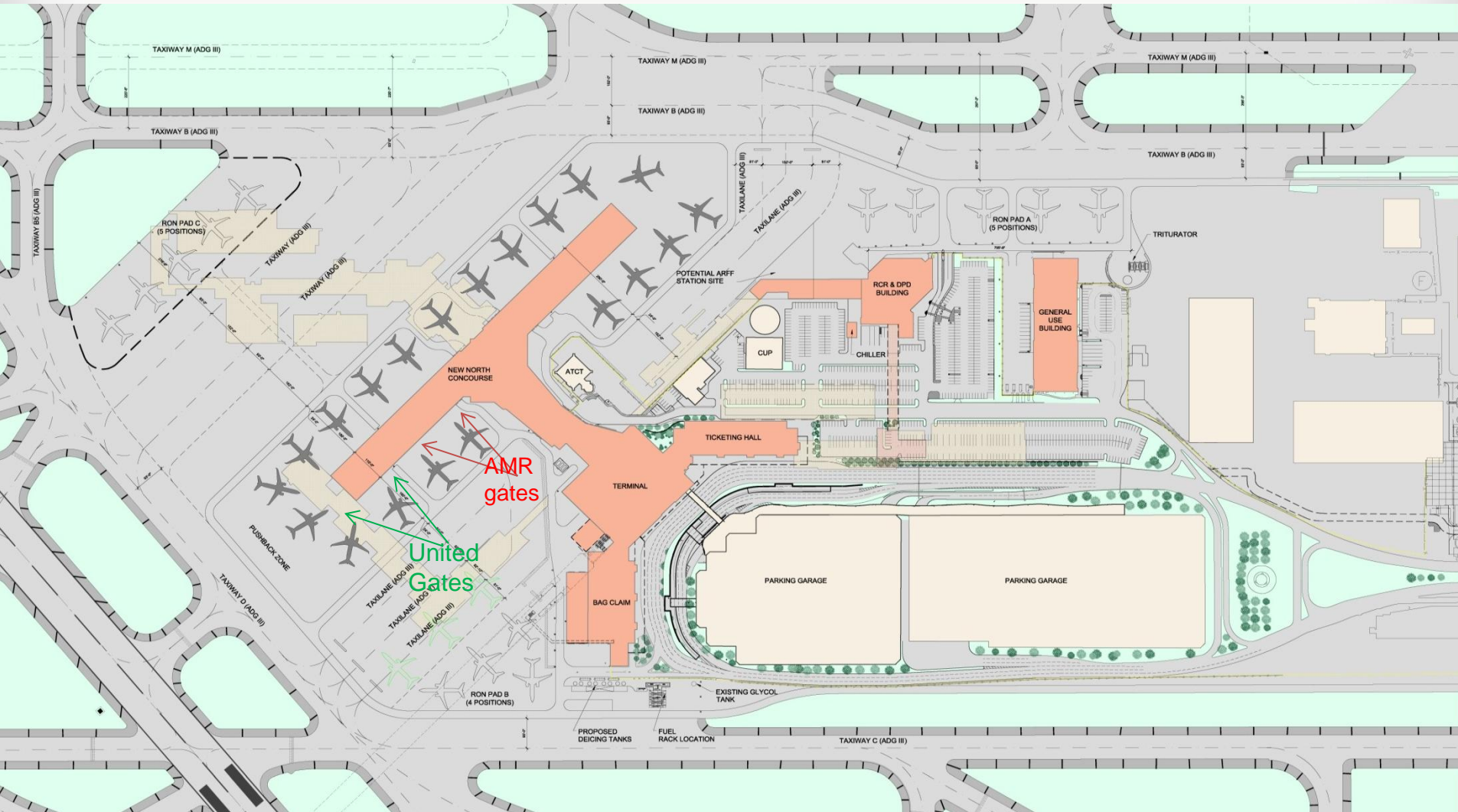
Use & Lease Agreements

- Leases are structured to be consistent with the Five-Party Agreement commitments
 - **Expanded scope** of the lease of terminal space, included **terms for the use of the Airport**, including the airfield, aircraft parking ramp;
 - Incorporated Landing Fee & new Apron Fee in lease rate model
 - Incorporated new **cost recovery rate model** approved in the Term Sheet Allocates Airport costs to Terminal, Apron, Airfield cost centers
 - Airlines pay cost of Love Field Modernization Program (“LFMP”) thru allocations of cost to square foot rental rate
 - Protects non-airline tenants from paying for LFMP
 - Developed **guidelines** for future capital improvements [“CIP”];
 - CIP funded in rate base, **airlines have approval rights** for certain capital improvements affecting their rates

Use & Lease Agreements

- Allows for the sub-lease of the gates
 - American Sub-leased to Delta in July 2009
 - American Sub-leased to Seaport Airlines in June 2011
- If the right to use the preferential gates ceases, they become common use
 - Common use gates are managed by the airport and available to all airlines requesting space to conduct flights until full

Gate Assignments*



*As per current leases

Analysis

- The City has not received formal proposals nor has it solicited any
- City retained a consultant, L.E.K. Consulting L.L.C., to evaluate the public statements of plans by the interested carriers
- Goal was to be prepared for further discussions with American and the Department of Justice regarding the disposition of the gates
- On April 16, 2014, the City received notice from the Department of Justice that American and Virgin American had reached an agreement and that agreement satisfies the Department of Justice

Consultant Credentials

- L.E.K. is a leading strategic advisor to the global airline industry, whose clients include more than half of the top fifty (50) airlines around the world
- Chief architect of the merchandizing (ancillary revenue) movement in the U.S. industry and around the globe
- Extensive work with the most successful and innovative airports and airport groups around the globe
 - Numerous successful engagements developing innovative retail masterplans
 - Traffic forecasting
 - Buy- and sell-side advisory work for airport privatizations

Consultant Scope of Work

- Identify key benefits to Dallas Citizens and Dallas Love Field
- Determine what aligns strategically with continued support of DFW
- Establish weighted criteria to evaluate the public plans from each airline
- Create framework for how the City will evaluate common use proposals, if necessary

Best for Dallas Citizens & Travelers

- Carrier with quality customer service
- Responsible carrier, sensitive to impacts to the community including noise
- Carrier willing to be part of the community
- Broad network with multiple destinations
- Enhancing competition
- Carrier offering various products and services

Best for Love Field

- Fiscally sound carrier
- Modern Fleet
- Sub-lease, carrier manages schedule
- Team player on airport operations and emergency management
- Supports mission of airport
- Environmentally sensitive, cognizant of noise issues
- Diversity of tenants

Best Strategically with DFW

- Minimizes direct competition to ongoing success to DFW
- Focus on domestic routes
- No diminution of service at DFW
- Service that compliments what is presently available at DFW
- Balancing needs of both DFW and Love Field



Love Field Gate Recommendations

Assessment of optimal use of American's divested
Love Field gates for the City of Dallas

April 28, 2014

In its settlement with American, the DOJ is requiring AA to divest its two preferential use gates at Dallas Love Field (DAL)

- American Airlines will have to relinquish the gates at all airports under “commercial terms and conditions identical to those pursuant to which the gates and facilities are leased to New American”
 - There is no restriction on whether American can receive compensation for sub-leasing the gates
 - The DOJ’s intent with the divestiture is to create competition for American out of Dallas by leveraging the more convenient location of DAL to give an advantage to a new entrant
 - The DOJ claims rights to approve the selected carrier; their focus is on increased competition and facilitating new opportunities for low cost carriers
- “... The goal of the divestiture remedy is to enhance the ability of the LCCs to frustrate coordination among the legacy carriers ...”

The U.S. Department of Justice

- The DOJ prefers the gates be assigned to an LCC versus remain open for common use, to ensure that a new entrant has the right number and time for slots to compete effectively
 - The final agreement prohibits the merged company from reacquiring an ownership interest in the divested slots or gates
- “... Section XII of the proposed Final Judgment prohibits the merged company from reacquiring an ownership interest in the divested slots or gates during the term of the Final Judgment ...”

The U.S. Department of Justice

Delta (DL), Virgin America (VX), and Southwest (WN), have expressed interest in American's (AA) two gates at DAL



| | | | | | |
|--------------------------------------|--|---|---|--|--|
| Proposed routes (flights/day) | <ul style="list-style-type: none"> ● ATL (6) ● LGA (5) ● MSP (3) ● DTW (3) ● LAX (5) | <ul style="list-style-type: none"> ● LAX (4) ● SFO (4) ● LGA (4) ● DCA (4) ● ORD (2) | <ul style="list-style-type: none"> ● CLT ● PHL ● DTW ● MSP ● EWR | <ul style="list-style-type: none"> ● SFO ● SJC ● OAK ● SMF ● SEA ● PDX | <ul style="list-style-type: none"> ● BOS ● RDU ● MEM ● IND ● ECP ● CHS |
| Proposed aircraft | <ul style="list-style-type: none"> ● CRJ-900 (76 seats) ● Boeing 717 (110 seats) | <ul style="list-style-type: none"> ● A320 (146 seats) | <ul style="list-style-type: none"> ● 737-700 (143 seats) ● 737-800 (175 seats) | | |
| Additional considerations | <ul style="list-style-type: none"> ● Requesting gates for common use, which Delta would then use as needed ● Requires 3 gates for its full plan, implying potential access to United's gates | <ul style="list-style-type: none"> ● Dallas area expansion plans contingent upon obtaining 2 DAL gates ● Virgin has stated that they would exit DFW | <ul style="list-style-type: none"> ● Southwest already has 16 of 20 gates at DAL ● Southwest cannot fly out of DFW without relinquishing DAL gates, so this is their most realistic expansion opportunity | | |
| Proposal thesis | <ul style="list-style-type: none"> ● Provide DAL with 1-stop access to global destinations | <ul style="list-style-type: none"> ● Offer a competing network of flights with a differentiated product and lower fares to large business markets from DAL | <ul style="list-style-type: none"> ● Introduce meaningful competition to American Airlines and more destinations from DAL | | |

Given the City's responsibilities, Dallas residents and the local business community should be seen as the primary stakeholders in the gate decision

Stakeholders

Primary needs and motivations:

Primary stakeholders

| |
|--------------------------|
| Dallas residents |
| Local business community |

- Greatest number of non-stop destinations from Dallas (DAL + DFW)
- Low fares
- Greatest number of non-stop destinations from Dallas (DAL + DFW)
- Best possible flight schedule / frequency of service
- New convenient premium class service at DAL
- Increased business activity

Secondary stakeholders

| |
|-----------------------|
| DAL airport |
| DAL airport employees |
| DFW airport |

- Maximum traffic through the airport, increasing airport revenues
- Minimum risk of airline service level changes
- Maximum job creation
- Minimum direct route overlap between DFW and DAL, to reduce potential passenger loss

Other stakeholders not included in this analysis

| |
|-------------------|
| DOJ |
| American Airlines |

- Increased competition for AA in Dallas
- Greater LCC presence in Dallas and nationally
- Minimize number of competitors in the Dallas area
- Minimize direct route overlap

We have excluded "other stakeholder" considerations from our analysis in order to remain objective; The DOJ's needs do not necessarily overlap with the needs of the primary stakeholders

The City's main objective should be to maximize O&D passenger throughput across both DAL and DFW, as that would represent maximum utility for stakeholders

Objectives

| Objectives |
|--|
| <p>Tier 1 objectives</p> <p>1 Increase non-stop destinations from DAL</p> <p>2 Maximize O&D passenger throughput across DAL & DFW</p> |
| <p>Tier 2 objectives</p> <p>3 Lower fares from DAL</p> <p>4 Minimize route overlap with DFW</p> <p>5 Add convenient premium class service at DAL</p> |
| <p>Tier 3 objectives</p> <p>6 Increase number of DAL jobs</p> <p>7 Airline stability and commitment at DAL</p> <p>8 Add a partner that will contribute to the community</p> |

Needs met

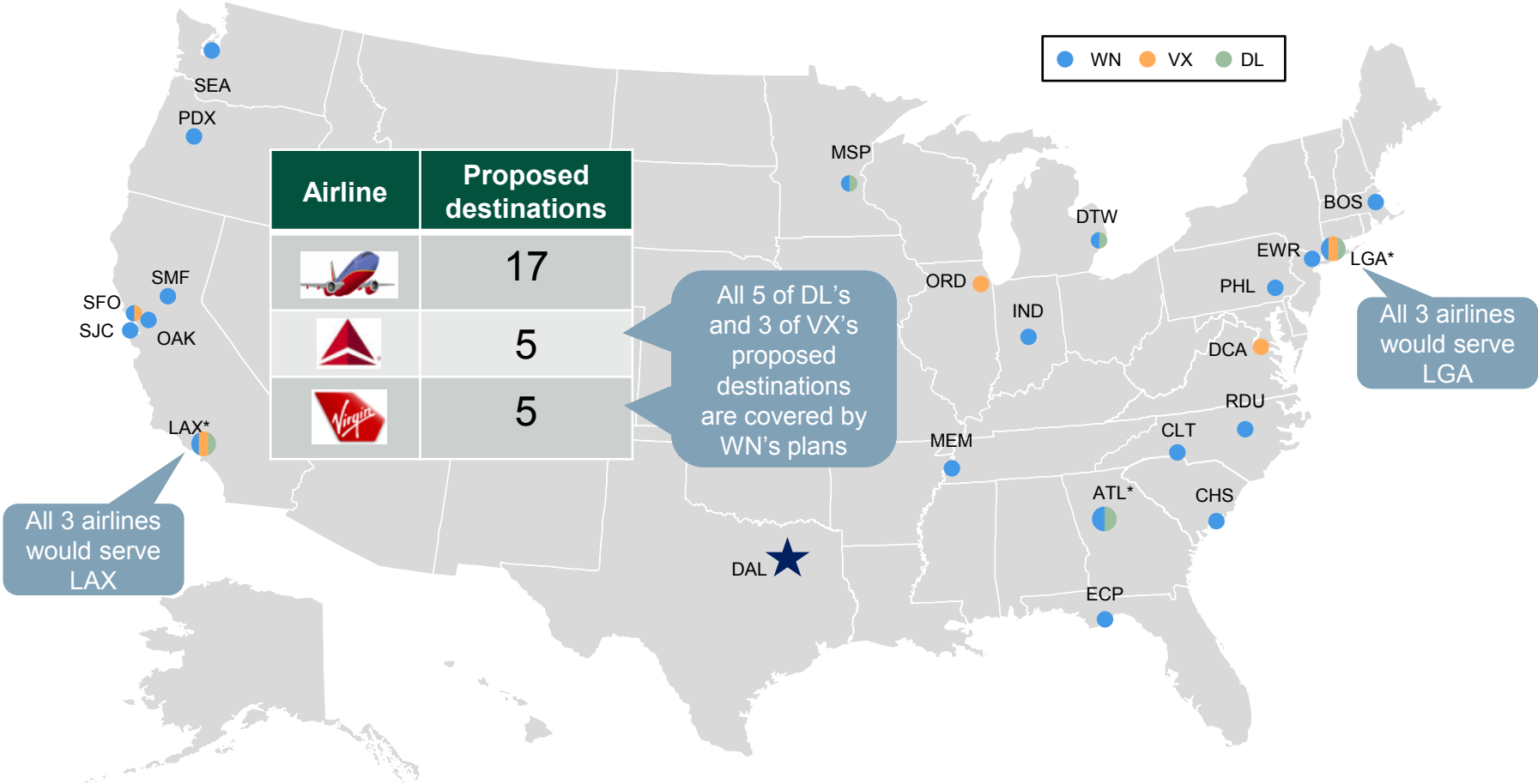
- More non-stop destinations from DAL
- Greatest number of key routes being served (demonstrated by demand)
- Maximize DAL aero & non-aero revenue
- Maximize local economic growth
- Maximize indirect jobs in Dallas
- Lower fares caused either by an increase in competition or new LCC entrant
- Limited cannibalization of existing DFW passenger volume
- New premium (first class) service to key cities from the more convenient DAL location (vs. DFW)
- Increase DAL jobs
- Minimize risk to DAL and City of Dallas given reliance on limited airlines; ensure longstanding commitment
- Commitment to the community

Stakeholders supported

- Residents
Business community
- Residents
Business community
DAL airport
DAL airport employees
- Residents
Business community
- DFW Airport
AA
- Business community
Residents
- DAL airport
DAL airport employees
- Residents
DAL airport
DAL airport employees
- Residents
Business community

1 Southwest's proposal would likely lead to the highest number of non-stop destinations from DAL

Proposed DAL destination airports for WN, VX and DL

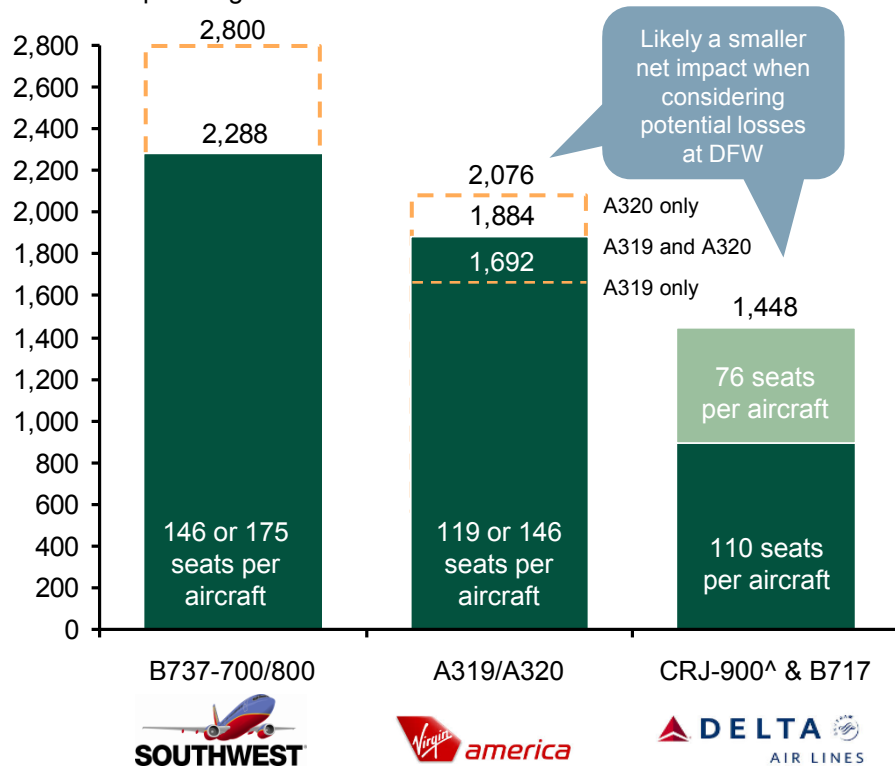


Note: * Current/planned WN destinations w/out gates ^Includes destinations from Delta's and Virgin's proposals that Southwest is already planning to fly with its existing gates
 Source: Project team analysis of company proposals and Dio Mii

2 Based on fleet plans and potential cannibalization at DFW, Southwest would likely drive the most passenger traffic across both DAL & DFW

Potential DAL passengers per day by aircraft type

Number of passengers*



Commentary

- Based on intended aircraft and gate usage, Southwest is projected to have the highest passenger throughput for DAL
 - While Southwest claims 737-800s would be deployed, 737-700s are more probable on marginal routes
- Virgin could serve nearly as many DAL pax as Southwest, but at some risk to DFW
 - While Virgin proposes using A320s; we have assumed they would split their service between A319s and A320s as a new entrant
 - As Virgin will be pulling out of DFW, the net impact to the Metroplex could only be 1,200 – 1,300 pax/day
- With smaller aircraft planned, Delta is expected to serve fewer passengers than WN or VX
 - Delta proposes using 16 CRJ-900s; while they suggest a 3rd gate would be necessary, we have capped their total flights at 20, matching Southwest
 - As these services would overlap with existing DFW service, it is likely that a substantial number of pax would be pulled from the existing service

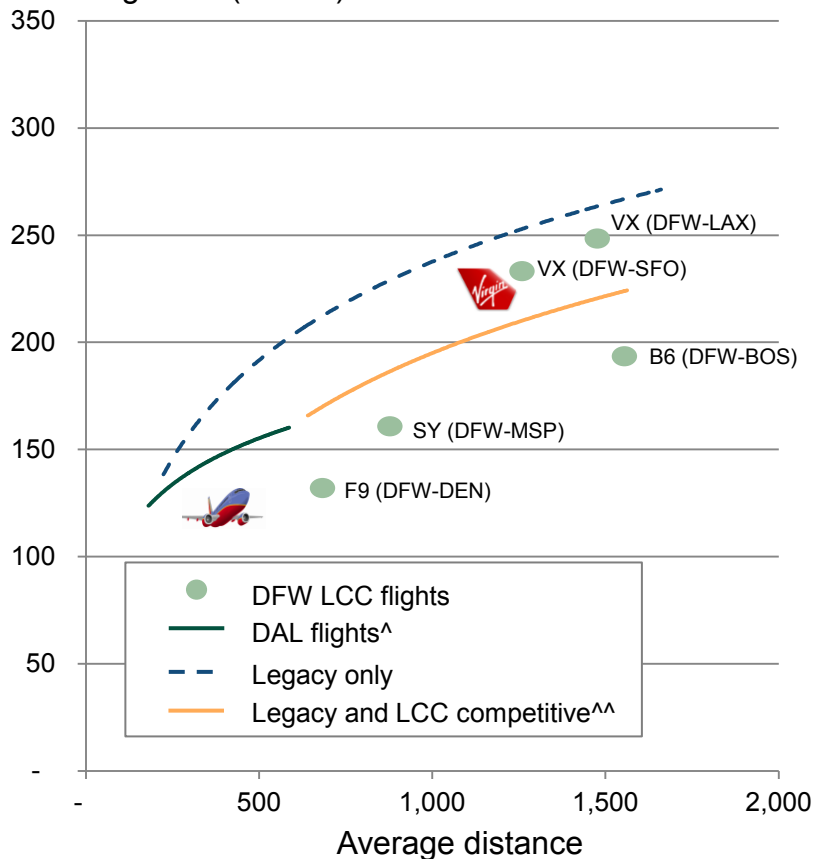
| | | | |
|----------------------------|-----|-----|--------------------------|
| Proposed flights per day** | 20 | 18 | CRJ-900: 14^^ B717: 6 |
| System wide load factor*** | 80% | 79% | 84% |

Note: * Calculated as (aircraft seats) x (flights/day) x (system-wide load factor); ** Max potential assumed to be 11 turns per day based on Southwest performance at MDW; typical efficient gate usage is 7-8 turns per day; *** 2012 system wide load factor; ^ Some flights may be operated by an E175 with the same number of seats; ^^ Based on the assumption that Delta only gets two gates (proposing 16 total for 3 gates)

Source: Project team analysis of ADP; company proposals; company seating charts

3 Historically, Southwest has driven a greater fare differential in Dallas than Virgin; however, it has a mixed track record in other markets

Average domestic fares from DAL and DFW
(Q3 2012-Q3 2013)
Average fare (dollars)



Fare differentials from legacy fares in similar markets to DAL/DFW
(Q3 2012-Q3 2013)

| Comparison | Houston (HOU/IAH) | Chicago (MDW/ORD) |
|--------------------------------|-------------------|-------------------|
| Avg. WN fare differential (%) | 20 | 13 |
| Avg. LCC fare differential (%) | 28 | 28 |































Key Observations



- Historically, Virgin has not offered significantly lower fares in Dallas relative to WN or other LCCs
- Neither Southwest nor Virgin typically offer Dallas fares as low as JetBlue, Frontier, or Sun Country
- While Southwest has historically offered lower fares in Dallas, Houston, and Chicago, its track-record is mixed – fares have actually increased ~23% in ATL (vs. 4% nationally) since Southwest took over AirTran

Note: * Only nonstop destinations from DAL with passengers per day greater than 50 passengers per day; NK was not included in this analysis, as they appear to have minimal impact on other carrier's fares; ^ "DAL flights" are all non-stop flights from DAL; ^^ "Legacy and LCC competitive" are routes with both Legacy and LCC presence

Source: Airlines and Aviation: Dallas Business Telegram, Project team analysis of Dio Mii

Southwest is the most attractive option for the City of Dallas, given both expectations for its O&D pax throughput and potential for low fares

| Objectives (% weighting) | |  |  |  | Rationale |
|-------------------------------|---|---|---|---|---|
| Tier 1 (50%) | 1 Increase non-stop destinations from DAL |  |  |  | <ul style="list-style-type: none"> Southwest is proposing 17 new nonstop destinations vs. 5 (DL) and 5 (VX) |
| | 2 Maximize O&D pax throughput across DAL & DFW |  |  |  | <ul style="list-style-type: none"> While both Southwest and Virgin would serve substantial passengers, Virgin would be removing flights from DFW |
| Tier 2 (40%) | 3 Lower fares from DAL |  |  |  | <ul style="list-style-type: none"> Historically, Southwest has driven a greater fare differential in Dallas than Virgin; however it has a mixed track record in other markets |
| | 4 Minimize route overlap with DFW |  |  |  | <ul style="list-style-type: none"> ECP and CHS (both WN) are the only proposed new destinations that are not currently served by DFW |
| | 5 Add convenient premium class service at DAL |  |  |  | <ul style="list-style-type: none"> With both more flights and more first class seats per aircraft, Delta would provide the greatest increase in premium class service at DAL |
| Tier 3 (10%) | 6 Increase number of DAL jobs |  |  |  | <ul style="list-style-type: none"> VX or DL would likely create more jobs at DAL due to the added requirements of supporting an incremental carrier |
| | 7 Airline stability and commitment |  |  |  | <ul style="list-style-type: none"> Delta's scale gives it stability although it has left Dallas before, while Southwest is fully committed as the home-town carrier |
| | 8 Add a partner that will contribute to the community |  |  |  | <ul style="list-style-type: none"> DL or VX represent a greater opportunity to increase corporate partnership with the community (whereas Southwest is already a strong partner) |
| Overall attractiveness | |  |  |  | <p>Southwest is the most attractive option for the City of Dallas</p> |

 Most beneficial
 Least beneficial