

Client Alert

October 2013

Airport Concession Client Alert No. 2

On October 11, 2013, the Japanese Ministry of Land, Infrastructure, Transport and Tourism (MLIT) issued a press release entitled the "Basic Policy on the Operation of Government-Managed Airports Utilizing Private Sector Capabilities," and announced the issuance of a public notice on the Basic Policy to be dated November 1, 2013. The Basic Policy will go into effect on the same date.

In this Client Alert, we discuss how airport usage fees are determined, how the risk of natural disaster will be shared between airport operators and the government in the context of airport privatization in Japan, how ownership of Airport Buildings are determined and the application of Operation Standards and Additional Capital Investments.

Determination of Airport Usage Fees

According to the Law on the Operation of Government-Managed Airports Utilizing Private Sector Capabilities basic operations guidelines will be determined in the Basic Policy.

Under the Basic Policy, the general rule for determining usage fees is that:

"Fees, such as landing fees, will be set at the discretion of the private operators after the implementation of consignment, in order to allow the operations of assigned concessions of government-managed airports to maintain their independence and originality. However, it should be kept in mind that the burden on airport carriers and users should not significantly increase."

The main idea behind the policy is that while private operators may determine usage fees independently, they are also required under the Airport Law to report airport usage fees to the government. Once reported, the government is generally expected to respect the fee structures set by the operators, however, operators may be ordered to revise their fees (including landing fees) if the fees are:

- (i) construed as unfair and discriminatory to particular users; or
- (ii) markedly unreasonable from the perspective of socioeconomic circumstances, or likely to impose extreme difficulty upon the enjoyment of the facilities by users.

In our view, the language of the Basic Policy and Airport Law uses ambiguous descriptions, such as "significantly increase," "markedly unreasonable," and "extreme difficulty" and as a result lacks clarity. A more detailed and measurable standard ought to be provided in the private consignment implementation policy for individual airports to ensure greater certainty. In the case of private consignment, an increase in usage fees from the current rate

may be expected for a certain period of time in a day such as the most congested peak day time. Unless the government pre-determines what is meant by "markedly unreasonable" with respect to an increase in usage fees, private entities may be reluctant to make long-term investments.

According to the Basic Policy, operators assigned concessions shall obtain ownership of the airport buildings and parking lots, and are responsible for the operations of airport facilities. As a result, operators have full discretion in determining usage fees relating to the operation of airport facilities within reason.

For example, in the Haneda Airport Passenger Terminal PFI project, the project contract stipulated that "the Operator shall determine the facility rental fee to be paid by Intra-Airport Businesses, within the scope of a reasonable and appropriate level, and upon negotiations with Intra-Airport Businesses." However, the "reasonable and appropriate" standard is also ambiguous, and does not serve as a measurable standard. As the operators have a monopoly over the operation of airport buildings using the airport land owned by the government, there needs to be a certain limit on the level of fees that can be assessed, but these standards need to be clarified (for example, if fees are equal to or greater than twice the rate of neighboring airports that would clearly be unreasonable, but at what point before that should it be considered reasonable?).

Sharing of Natural Disaster Risk

The Basic Policy provides that following the occurrence of a natural disaster, where damages exceed the scope of "expected" or "anticipated" large-scale disasters and damages, the government may choose to assist with and be responsible for taking measures and implementing steps for recovery from the disaster.

The general rule is that airport operators assigned concessions are responsible for obtaining and paying for reasonable levels of insurance to cover damages caused by a fire, earthquake, tsunami or similar natural disasters, which can be reasonably anticipated. With respect to damages exceeding the above scope, the government will be responsible for recoveries from those natural disasters determined to be necessary by the government.

It is unclear whether a fire, earthquake or tsunami can be properly "anticipated," and reasonable and appropriate levels of insurance obtained. Even under the assumption that the insurance does apply to the scope of damages, in extreme cases coverage would be limited. Therefore, damages exceeding this scope will be borne by the government. However, the limitation imposed by the language "determined to be necessary by the government" will apply and this limitation allows the government to make this determination in its sole discretion, which would render meaningless the notion of risk-sharing between operators and the government.

According to the Basic Policy, the situation above is merely an example, and other characteristics, such as location or geography, will affect how risk is shared with certain airports over others and determined on a case-by-case basis. For example, Sendai Airport, which has a higher tsunami risk than Hiroshima Airport due to its location and recent history, would be subject to a different and more lenient assessment scheme.

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Ownership of the Airport Building

In principle, under the Basic Policy the operators assigned concession will be an SPC with operational business experience. The SPC, or an entity controlled by it, will own the airport buildings and provide for intra-airport businesses (by way of leasing airport buildings). The government will prepare methods whereby after the concession is granted, the operator assigned concession will obtain ownership of the airport buildings from the current owner of those buildings (currently, a public/private joint venture or a private company). The acquisition price for acquiring the buildings will be a proper price for those assets. Currently, there is no clear guidance as to how to determine the proper price in the Basic Policy: it is not possible to value a high price because the airport building is based on a weak lease right whereby a designation of intra-airport business is for three years with a maximum extension period of two years, and the usage right for airport buildings over public land is, in principle, for only a one year period under the National Asset Law. According to the Basic Policy, at the next designation stage for intra-airport businesses, the government and owner of the airport buildings will reach agreement on how to transfer the ownership and how to value the purchase price of the airport buildings. Before the bid for the concession takes place, the method for transferring ownership of the airport buildings and determining the proper price of the airport buildings is expected to be determined, and the bid price submitted based on such method and proper price of the airport buildings.

Operation Standards and Additional Capital Investment

According to the Basic Policy, the government will pre-set operation standards for the operation of airports and ask operators assigned concession to meet these operation standards. The government will also monitor whether operations are properly conducted by the operators assigned concession with respect to certain air transportation safety and the enhancement of user friendliness criteria. For the preparation of operation standards it is hoped that performance based standards will be introduced rather than specification based standards. According to the Basic Policy, the repair policy and additional capital investment policy for the operation and maintenance of aged runway and airport security facilities governing the operating standards should be agreed in the Concession Agreement. The Basic Policy also states that operators assigned concession will have an option, at their discretion, to invest into intra-airport facilities so as to upgrade the function and user-friendliness in order to increase the value of the airport taken as a whole. While the operators assigned concession will be expected to adhere to the operation standards determined by the government, the Basic Policy also makes clear that the operators are ultimately the owners of the airport buildings.

For more information or inquiries into any of the matters covered by this client alert please contact Naoaki Eguchi.