

THE OFFICIAL JOHN F. BROWN COMPANY
 **RENTAL CAR NEWSLETTER**

Issue 1, Volume 2
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Dear Reader:

When we began this newsletter in August of 2002, it was our intention to publish a semi-regular issue that included any relevant news concerning the car rental industry, as well as a piece addressing particular issues of concern to airports working with the rental car industry. Over time it was our experience that, absent news of bankruptcies, mergers, acquisitions, etc., there simply was not enough “news” concerning the rental car industry at the level that would be significant to airports. However, over time we also received a lot of feedback from our readers that the portion of our newsletters they found most valuable was the “Dear RAC Consultant” piece, wherein we address issues of concern to airport staff working with car rental companies. For this reason, we have decided to sharpen the focus of the newsletter. In this issue, and in subsequent issues, we will attempt, at a minimum, to address an issue, trend or best practice relevant to the management of airport rental car concessions. In additions, when there is significant news concerning the rental car industry, we will include it in the newsletter.

Your response to our newsletter has been very gratifying. We welcome your continued feedback on how we can make this newsletter as valuable a tool to you as possible. And remember, you can find previously published issues on our website at www.johnfbrown.com.

Special Notice:

As some of you know, John F. Brown Company was a sponsor of the AAAE/Rental Car Conference held April 4th and 5th in Jackson Hole, Wyoming. Jim Branda was also a presenter at the conference. Jim provided an overview of the industry over the past year. For those who might be interested, we are attaching a copy of Jim’s presentation to this newsletter.



DEAR RAC CONSULTANT, WHAT I’VE BEEN WONDERING IS...

Are there any trends or new ideas airports should be aware of in the area of rental car gross revenue definitions?

GROSS REVENUES

For purposes of any discussion of trends involving the definition of rental car gross revenues, the issues of the actual definition of gross revenues, the percentage fee charged by an airport, and the concession fee pass through are inextricably connected and must be addressed in tandem.

For many years, the standard approach in the industry was for airports to charge the rental car companies ten percent of their gross revenues. Negotiations between the car rental industry and the airports would focus on the definition of gross revenues, with the rental car companies arguing to keep the definition as narrow as possible by excluding various categories of revenue they argued were either not actual revenue or not appropriate to be included in the definition of gross revenues. Rental car companies took the position that gross revenues should be defined as it

historically had been, as time and mileage and PAI (personal accident insurance), and that all other categories of revenue were not true revenue, but represented some form of cost recovery. Airports, sensing they might be getting the short end of the stick, fought to pull additional items, such as baby seats, cell phone revenue, fuel, etc. into the definition. While this approach gave both sides significant negotiating chips, the results have often been concession agreements containing definitions of gross revenues that are subject to narrower construction by the rental car companies than intended by the airports. This in turn, has led to endless and frustrating audit disputes between the airports and the rental car companies.

In 1993, Orlando (MCO) became the one of the first major airports to adopt a new approach to this dilemma. Orlando (MCO) placed into their new concession agreement an “all-inclusive” definition of gross revenues. In this context, “all-inclusive” means that the definition of gross receipts includes those items historically excluded from gross revenues, such as CDW/LDW, fuel, and all miscellaneous revenues. MCO’s goal in applying an all-inclusive definition of gross revenues was not to increase revenue to the airport. In fact, MCO was concerned about not increasing the net economic effect on the car rental operators, and adjusted their percentage fee to 8.8 percent to achieve an impact on the rental car companies that was considered “revenue neutral” compared to their old definition of gross revenues at ten percent. MCO took this approach to address their concerns about the lack of uniformity and forthrightness among the rental car companies concerning their revenue reporting practices, and to simplify the gross revenue audit process. The accounting staffs at many airports have raised these same concerns over both the rental car companies’ revenue reporting practices and the ensuing challenges of the audit process.

The concept of “revenue neutral” as it applied to rental car concession revenues assumed the premise that rental car companies should not have to pay a rate effectively higher than the traditional ten percent of time and mileage and PAI. When MCO decided to include LDW/CDW, fuel and miscellaneous charges, they determined that these items were about 12 percent of total revenues, so they reduced the ten percent concession fee to 8.8 percent so that the car rental companies would not end up paying more revenue to the airport than under the old definition of gross receipts. Hence the term “revenue neutral.” To this day, when an airport proposes moving to an all-inclusive definition of gross revenues in a new concession agreement, the car rental companies will argue that the percentage fee should be adjusted downward from ten percent so that the impact of the new definition of gross revenues will be revenue neutral.

However, a significant development since the application of the all-inclusive definition approach used at MCO has been the “unbundling” of the concession fee by the rental car companies at all airports, except those located in the few states that prohibit unbundling. This means that whatever the definition of gross revenues, and whatever the percentage of gross revenues payable to the airport, the rental car companies simply pass these fees on to the rental car customer as a separate line on the rental car contract. The financial impact of including more items in the definition of gross receipts is on the customer, not the car rental company. Because these additional items, including CDW/LDW and fuel, generally represent about 12 percent of total revenue, and because ten percent of 12 percent is 1.2 percent, we can assume the average impact on an individual customer is an increase in his or her charges of about 1.2 percent. Each airport must determine for itself whether this increase in costs to the customer is acceptable.

The car rental companies typically designate this concession fee pass through as a “concession recovery fee” or similar nomenclature. For additional discussion of the concession fee pass through, please see our newsletter of August 15, 2002.

This practice of passing through airport concession fees directly to the customer has taken much of the steam out of their arguments that certain revenue items should be excluded from gross revenues because they are primarily cost recovery items and do not represent actual revenue. For example, rental car companies have argued they should not have to pay on CDW/LDW charges because these charges to the customer were simply an attempt to recover costs the companies incurred for damage to vehicles that cannot be reimbursed by third parties. Therefore, when an airport included CDW/LDW in their definition of gross revenues, it cost the rental car company ten percent of its CDW/LDW revenues and allegedly impeded their ability to cover their out of pocket vehicle repair costs. However, with the advent of the concession recovery fee, if an airport charges for CDW/LDW, the rental car company retains all the revenue they charge the customer for this product, and simply requires the customer to pay an additional ten percent of the CDW/LDW charge for payment to the airport. There is no net effect on the rental car company’s revenues. Recently, a growing number of airports are following MCO’s lead by implementing an all-inclusive definition of gross revenues. These airports include LAX, TPA, DTW, BWI, and DAY. Unlike MCO, the majority of these airports also have a ten percent concession fee:

Many other airports, such as DFW, have significantly expanded their definition of gross revenues to attempt to eliminate some of the particularly odious areas of audit disputes.

So the answer is yes, there is a trend in the industry related to the definition of gross receipts. It is not a particularly new idea, but it taken a long time to take hold because of some tough fighting in the part of the rental car industry. That trend is an all-inclusive definition of gross receipts, sometime with a downward adjustment of the percentage fee, but more often with the percentage fee held at ten percent. The results have been significant increases in revenue to the implementing airports and the saving of time and money in the audit process.



JOHN F. BROWN COMPANY
RENTAL CAR PRACTICE AREA

Jim Branda, prior to joining John F. Brown four years ago, was Vice President of Airport Affairs at Budget Rent A Car Corporation, where he spent 14 years. Karen George, prior to joining John F. Brown two years ago, was Vice President of Properties and Chief Airports Counsel of National Car Rental, where she spent 12 years.

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