**PORT OF SEATTLE**
**MEMORANDUM**

**COMMISSION AGENDA** | **Item No.** 7a
**Date of Meeting** December 13, 2011

**DATE:** November 28, 2011

**TO:** Tay Yoshitani, Chief Executive Officer

**FROM:** Mark Reis, Managing Director, Aviation Division
Deanna Zachrisson, Manager, Aviation Concessions Business

**SUBJECT:** Aviation Concessions Program Principles and Practices

## SYNOPSIS:

The Airport is well-known for its award-winning concessions program. Attractive storefronts, a good mix of shops, quality food service, great customer service and overall high standards distinguish this program from many other airports and are the result of the new leasing structure begun in 2005. This structure combines prime concessionaires and direct leases with many small and independent retail and restaurant operators and certified Disadvantaged Business Enterprises and allows both well-known national brands and local companies to serve Airport customers. The concessions program generated approximately $32 million in revenue to the Port in 2010, and represents the third largest source of non-aeronautical revenue.

In anticipation of the 2015-17 releasing and redevelopment of much of the concessions space at Sea-Tac, staff has begun developing a series of principles and practices to guide future strategies. In June of this year, staff initiated a stakeholder outreach process to gain their perspectives to help inform the releasing/redevelopment program. These stakeholder groups included prime concessionaires, labor, tenant and non-tenant local business, small/disadvantaged operators and airlines. A total of 53 individuals representing 36 companies and organizations participated. Staff also conducted an analysis of concessions models and practices at other airports. The purpose of this memo is to provide updated information on the current concessions program, summarize stakeholder perspectives, relay current research on airport best practices, articulate legal and strategic challenges, and provide recommendations for future principles and practices.

## BACKGROUND:

In 2005, the Port introduced a new leasing structure that combined prime concessionaire contracts (through which one company operates four or more units) and direct leases with many small and independent retail and restaurant operators. The multi-unit prime concessionaire lease agreements, illustrated below, include the majority of the Airport's 84 concession units. With the exception of duty free, these agreements are for a 12-year term.

Multi-unit Prime Agreements by Concessionaire

| Category | Concessionaire | Expiration | Units | Square footage | ACDBE subtenants | Subtenant SF |
|---|---|---|---|---|---|---|
| Food | Host International* | 12/31/16 | 17 | 28,842 | 8 | 9,641 |
| Food | Host/Seattle Rest. Assoc. | 12/31/16 | 7 | 15,035 | 2 | 2,797 |
| Food | Concessions International | 12/31/16 | 5 | 4,687 | 1 | 1,774 |
| News/Gift | Hudson Group | 5/31/17 | 22 | 32,018 | N/A | N/A |
| Duty free | HG Retail | 2012 | 3 | 7,074 | N/A | N/A |
| Total Units /Sq ft | | | 54 | 87,656 | 11 | 14,212 |

*Including Anthony's operated by HMSHost

Direct lease units are primarily concentrated in the Central Terminal area. Staff has worked since 2005 to add direct lease opportunities to the concourses as well.

Direct Lease Operators by Category

| Category | Expiration | Units | Square Footage |
|---|---|---|---|
| Food* | 5/31/15 | 7 | 7,064 |
| Spec. Retail** | 5/31/15 | 7 | 9,452 |
| Services | 2012-16 | 5 | 4,783 |
| Total Units/Sq ft | | 19 | 21,299 |

*Includes Vino Volo Wine Bar expires 2017.
** Includes Hudson Bookseller & More (former Borders)

During the 2012-14 periods, staff anticipates opportunities to lease approximately 10 vacant or undeveloped units throughout the terminal as direct lease opportunities (available to both prime concessionaires as well as smaller business operators). The performance of the program since the introduction of direct leasing has proven that judicious leasing of single-units to meet passenger needs increases sales for all types of concessionaires and increases job opportunities. Earlier this year, the Port Commission authorized retention of a leasing consultant who will begin work in early 2012. We anticipate recruiting new concessionaires and executing some new direct leases in 2012. In addition, staff anticipates issuance of a Request for Proposals for the Airport's duty free business in early 2012.

This combination of larger prime concessionaires and smaller direct leases has enabled the Airport to introduce competition between multiple operators and, thus, brought about more local character, better customer service, better product quality, greater variety and lower prices. Gross sales increased from $90 million in 2003 (the last year prior to the opening of Concourse A, with concessions operating under the new structure) to $158 million in 2010, an increase of 75.5%. (During this same period, enplanements grew by only 10%). Revenue to the Port has increased 82% between 2003 and 2010. This success has continued in the third quarter of 2011, with total Airport concession sales up 7.4% over last year. Employment in concessions businesses has grown more than 100% (732 jobs in 2003 to 1,508 jobs in November 2011).

## AVIATION STRATEGIC GOALS:

The concessions program supports several of the seven Aviation Division strategic goals. Concessions revenues represent the third largest source of non-aeronautical revenue. As we consider what principles and practices we wish to help guide the future of the program, it is important to understand the connection to these goals:

**Operate a *world-class* airport by anticipating the needs of our tenants, passengers and the region's economy.**
The Airport's concessions program has been lauded by the airport industry and the community for the improvements made since 2005. In fact, the concession program is, in many independent observers' views, the single greatest contributor to Sea-Tac's evolution to world-class airport status. Continued renewal and innovation in the concessions program is necessary to achievement of this goal.

**Become one of the top ten *customer service* airports in the world by 2015.**
To a significant share of the flying public, concessions is the single most important element of customer service. Quality, price, diversity of offerings and local flavor are the characteristics most often cited as contributing to high quality concessions experience.

**Maximize *non-aeronautical net income*.**
Concessions revenues are crucial to the Airport's ability to reinvest in infrastructure and meet the traveling public's needs (e.g., free Wi-Fi). The recent growth in concessions income has been a critical offset to the declining parking revenue. A high quality concessions program induces higher passenger, meeter/greeter and employee spending and, thus, airport revenue.

**Lead the airport industry in *environmental innovation*, and minimize the airport's environmental impact.**
The Airport cannot fully attain its sustainability goals without the active support and participation by concessionaires. Concessions directly and indirectly account for 70% of waste generated at the Airport and are responsible for a significant portion of the 1,300 tons of recyclable and compostable material diverted from local landfill each year. Concessions donate 10,000 lbs. each year in meals to local food banks, equaling 150 meals per week.

## STAKEHOLDER OUTREACH:

In order to gain the perspectives of all the constituencies which currently or could benefit from the airport concessions program, staff initiated a concessions stakeholder outreach process in June 2011 (Exhibit A, Summary of Stakeholder Process). The outreach has engaged all stakeholders, including:

- Airlines
- Current independent operators
- Labor representatives
- Prime concessionaires
- Prospective local operators
- Small/Airport Concessions Disadvantaged Business Enterprises (ACDBE businesses)
- Traveling public

**Process:** At the outset, staff understood the critical importance of structuring and executing a process with the greatest degree of impartiality possible. We retained experienced local public involvement professionals, -- Rita Brogan, with PRR, Inc. -- to impartially facilitate the outreach. The stakeholder groups were chosen carefully to reflect a comprehensive, balanced reflection of interested parties. The process was also designed to ensure that individual stakeholder groups' views would be both heard and considered in a fair and balanced manner, regardless of the number of physical participants.

As a further means of assuring that all types of stakeholders would be heard with the greatest degree of clarity, the process included both individual stakeholder group meetings as well as a combined stakeholder group meetings. Participants were provided with materials to be used for discussion and facilitation of the meetings in advance. The final meeting summaries also were distributed to participants in advance of inclusion in this memo with the opportunity to correct potential inaccuracies.

The major elements of the process were:

- Staff workshops to develop draft principles and practices;
- Research of concessions industry best practices;
- Six meetings with individual stakeholder groups;
- Business and leisure traveler focus groups (Exhibit C, Focus Group Report);
- Compilation and integration of the input from the initial meetings;
- Two meetings with all stakeholder groups to review initial "findings", and;
- Development of a summary of prevalent and divergent views on the issues.

We asked the stakeholders for their input regarding a set of draft principles and practices for the concessions program (Exhibit B, Draft Principles and Practices). The draft principles were structured into four categories: customer experience, financial stewardship, concessionaire selection process, and social/environmental responsibility.

**Areas of Agreement:** The stakeholders were in general agreement on many of the draft principles and practices discussed in the first phase of individual stakeholder group meetings (Exhibit D, Meeting Summaries). The clearest areas of agreement were:

- *There should be a mix of offerings at Sea-Tac Airport;*
- *Important to encourage a strong sense of place;*
- *"Green" practices and sustainability;*
- *The selection process should be efficient and fair and limit barriers to entry;*
- *The cost of doing business at the Airport is high and policies should reflect this reality.*

**Areas of Disagreement:** Several areas of disagreement were also identified. A discussion of these subjects (based on the multiple perspectives articulated) was prepared to facilitate more in-depth discussions in the second set of two joint stakeholder meetings (Exhibit E, Stakeholder Discussion Summary).

The five key issues are the focus of more detailed examination below. Opinions primarily diverged on issues related to the appropriate role of the Port as a landlord and lessor. Most airport stakeholders said they would like the Port to limit its role to focusing on what it directly controls. Two key areas identified were providing facility support to reduce operating costs, and streamlining concession build-outs to reduce high investment costs.

Organized labor, on the other hand, believes that the Port has a social responsibility to elevate the living standards of workers (Exhibit F, Combined Stakeholder Meetings Summary).

In addition to the outreach work, Sea-Tac concessions staff led a working group of industry professionals, both airport managers and concessionaires, in an Airport Council International North America (ACI-NA) study of concessions industry 'best practices'. This work benefited the stakeholder effort by informing the stakeholder participants on current 'best' practices with regard to contractual terms and other processes that affect concessions business and operations. The study entailed review of industry surveys and other secondary research available. This ACI-NA effort is still on-going, with Sea-Tac staff in the lead, and the working group presented results at the ACI-NA Annual Concessions Conference in Atlanta on November 7, 2011 (Exhibit G, Concessions Industry Best Practices).

## KEY ISSUES:

As noted above, the stakeholder process identified five significant issues. In this section, we offer a necessarily concise statement of the issue, followed by an assessment of the information germane to deliberation of appropriate principles and practices. That information includes some or all of:

- Perspectives of the various concessions stakeholders
- Industry research and practices at other airports
- Implications for the goals articulated above
- Data or information from Sea-Tac concessions operations
- Legal analysis

These key issues are:

- The balance of multi-unit operators ("prime concessionaires") and direct leasing
- Participation by small and/or disadvantaged (ACDBE) businesses
- High investment costs and other barriers to entry
- Street pricing policy
- Port requirements regarding concessionaire labor/employment practices

***ISSUE 1: How should the Port balance the mix of multi-unit operators ("prime concessionaires") and direct leases?***

With some exceptions, stakeholders generally agree that a mix of multi-unit operators and ACDBE/small and independent local businesses works well for the Airport. They also agree that there needs to be a balance of concepts, and that the mix should reinforce a "sense of place". There is disagreement, however, regarding how the Airport should best achieve this mix and sense of place.

**The Sea-Tac Model:** The hybrid model that the Airport adopted in 2005 combined the traditional prime airport operators with other single unit direct leases. The significant increases in both sales and revenue are a clear indication that this infusion of new operators into the program has had tremendous results. Prime concessionaires currently lease and operate 64% of the Airport's 84 concessions units, or 71% as measured by the amount of total concessions square footage. ACDBE tenants (subtenants of primes and direct lessees) operate 16% of total square footage, with the remaining 13% operated by other independent direct lease tenants.

**Prime and Direct Lease Operators:** Prime concessionaires play an important role in meeting the needs of the traveling public and understand the unique challenges of operating in an airport. In addition, these concessionaires hold exclusive licensing agreements with some of the most sought-after brands in airports, such as Starbucks Coffee and Brooks Brothers. There are competitive differences, however, between prime concessionaire companies and it is critical that airports make thoughtful selection of prime concessionaires. Chosen wisely, prime concessionaire operators of multiple units can form the foundation of an excellent concessions program.

Many local stakeholders believe that the concessions mix should favor familiar, locally owned concepts, which they emphasize have a greater stake in cultivating their local brand and providing good customer service. Local operators also believe that locally owned concepts in the Airport generate more local jobs and keep dollars in the local economy. There is a body of research that suggests that this is a valid argument. In several studies conducted by the research firm Civic Economics, in communities such as San Francisco, Austin, Grand Rapids, and Andersonville in suburban Chicago, the local economic return was proven to be greater as a result of consumer spending with locally owned businesses as compared to when a company was headquartered elsewhere. The most recent study in Grand Rapids in 2008, argued that for every $100 dollars spent at a locally owned business, $68 stays in the local economy compared to $43 in a non-local company. Money that leaves the local economy goes to supporting remote administration and other non-local business services such as marketing, accounting, architecture design, signage manufacture, etc. No such study has been conducted in the Seattle market; however, there seems to be a general consistency in findings among the studies that have been done.

Prime concessionaires and labor representatives believe that local ownership is not a requirement in order to provide passengers with local concepts. They give examples such as Kathy Casey Dish D'lish and Anthony's, which are popular local concepts operated under license agreements by HMSHost. In fact, prime concessionaires have recently developed local concepts for their different markets, as airports now typically demand local flavor in their concessions.

**Finding the Balance:** Airports' strategic choices determine the nature of their concessions businesses, for example; Denver International Airport has made the strategic decision to favor local concepts and small operators. As a result, they solicit their opportunities as single units in order to assure that as many kinds of operators as possible have the ability to compete. On the other hand, Salt Lake City International decided to group most units in packages of 10-15 units each. The result is a greater presence of the larger national concessionaire companies.

In addition, most airports now place restrictions on the 'ownership' any one concessionaire can hold in a concessions program. At San Diego International, no one operator will control more than 30% of the total square footage available in its new concessions program. At Denver International, no one concessionaire can control or operate more than 10% of net concessions square footage. At San Francisco International, no operator can hold more than eight contracts at any one time.

**Revenue Generation:** The generation of non-airline revenue is one of the most important factors to be considered when evaluating the choice of management approach. In November 2011, the Airport Cooperative Research Program (ACRP) of the Transportation Research Board published a 258-page research report about airport concessions programs and offered comparative data from the top 35 U.S. airports on revenue generation (Exhibit H, ACRP Report, pgs. 126-136). This study was funded by the Federal Aviation Administration.

Airports typically measure their performance in sales per enplaned passenger (SPE). Using this metric, the report compared the four most common management approaches in airport concessions; private developer/manager, direct leasing, prime concessionaire and hybrid. The private developer/manager model demonstrated the highest average spend rate or SPE at $9.32, closely followed by the direct leasing approach at $9.14. Eight of the 35 airports surveyed (including Sea-Tac) use the hybrid model and these achieved an average SPE of $8.89. Airports managing only prime concessionaires achieved an SPE of $7.59. However, sales are only one piece of the revenue puzzle. A more complete picture is provided when SPE is paired with percentage rent to the airport. The effective percentage rent can be calculated by dividing rent paid by sales. By this comparison, direct leasing results in the highest overall return on sales, followed by private developer/manager, hybrid and prime concessionaire approaches.

**Selection Approaches:** Stakeholders, with the exception of labor, did not support targeting opportunities to specific types of operators (i.e., the creation of a percentage goal for direct leases vs. prime operators). They feel that the Port should structure its opportunities in such a way so all types of operators should be able to compete, and that the best concept to meet the needs of the traveling public should be the foremost driving factor in selection. Small businesses and local businesses also feel strongly that the Port must make the solicitation process simpler. They do not have the staff or other resources to respond to complicated and demanding Requests for Proposals. Prime concessionaires do allocate generous resources to competing for opportunities and emphasize that packages should be large enough to provide the economies of scale they need for their operation, particularly if they are expected to have union labor. They do not like the strategy of some airports, such as San Francisco and Denver (mentioned above), which offer nearly all of their opportunities as individual unit solicitations.

Labor representatives advocate for a significantly different model from the current structure. They would like to see no more than three prime concessionaires (two food and beverage, one retail) who employ no less than 90% of the airport’s concessions employees. The approach would require the solicitation of very large packages, perhaps 20 to 25 units in each.

This approach has a number of significant drawbacks from the current model, aside from the obvious constraints on competition between operators. Packages of this size effectively limit the competition to large prime concessionaires with the capital necessary to build out so many units. Even smaller prime concessionaires would not be able to compete for a contract of this size. Prime concessionaires also are more likely to launch legal protests when competing for large value contracts. If a losing proposer faces the prospect of not having another chance at a large airport opportunity in the next 10 years, it is more likely to protest the outcome of a selection.

Additionally, so many units in one contract mean that the Airport has few other opportunities to achieve direct ACDBE participation and, therefore, must rely on prime concessionaires to sublease units to ACDBEs. The complications of subleasing are discussed under Issue #2. An ACDBE joint venture for a contract of this size is impractical because the capital investment required by FAA guidelines would be beyond the reach of an ACDBE.

It should also be noted that this approach would require the Airport to continue large-scale concessions transitions in which dozens of units are changing hands and being reconstructed at the same time. These large-scale simultaneous transitions present significant customer service, staff workload, financial and construction coordination challenges. For example, the last unit conversion from the 2005 transition from the master concessionaire was not completed until 2008. As noted below under Issue #3, this is also very costly for concessionaire companies.

**Conclusions:**

- Careful selection of prime concessionaires can build a solid foundation for a concessions program, and provide sought-after brand names. The best mix for Sea-Tac seems to be a balance of prime concessionaires with local and/or small business operators.
- Offering future packages of units for multi-unit operators scaled to between four and six units each could foster this balance. Larger prime concessionaires can certainly compete for and be awarded multiple contracts, while the solicitation still allows smaller operators an opportunity to compete.
- There are barriers to local and small business participation, such as complicated RFP processes, that the Port should seek to reduce. Local operators, including small business, want the opportunities to compete and do not support any measures that constrain competition.
- There appears to be validity to the idea that consumer spending with locally owned businesses keeps a greater share of dollars in the local economy.
- Labor representatives advocate for large contracts with large prime concessionaires.

***ISSUE 2: How should the Port maintain (or increase) participation in the concessions program by small and/or ACDBE businesses?***

The Airport is required to provide concessions opportunities for small, minority or woman owned disadvantaged businesses as a condition of receipt of federal Airport Improvement Project grants. Participation by ACDBEs in an airport's concessions program is measured by the percentage of gross sales generated by disadvantaged operators. Currently, the Airport's goal with the Federal Aviation Administration (FAA) for ACDBE participation in 2011-14 is nearly 20% of gross sales. This current goal is consistent with the gross sales achieved in 2010. In comparison to other large airports, the Sea-Tac ACDBE goal is modest. Dallas/Fort Worth International, Denver International, and Baltimore Washington International airports all achieve ACDBE goals in the range of 30-40%.

**Responsibilities for Participation:** The Airport has two means of meeting its FAA goal. The Airport may directly lease with ACDBE businesses, or require its prime concessionaires to contract with ACDBEs in subtenant or joint venture relationships. Historically, most airports, including Sea-Tac, burdened their prime concessionaires with achievement of the FAA goal. In the most recent prime concessionaire contracts, these operators are required to generate 25% of gross sales with ACDBEs. With the introduction of direct leasing, the Airport has begun to develop its own contractual relationships with ACDBEs to generate sales toward the goal. This has been particularly helpful because prime concessionaires can only be required to make "good faith efforts" to achieve their 25% goal. Of the current prime concessionaires, Concessions International and Hudson Group fully meet their ACDBE participation requirement. Direct lease ACDBEs are generating 29% of the total ACDBE sales and are as a group the largest contributor to achievement of the Airport's goal.

**ACDBEs as Subtenants to Prime Concessionaires**: In the stakeholder process, nearly all food and beverage subtenants expressed a preference for a direct leasing relationship with the Port, rather than a subtenant relationship to a prime. Most commonly, they cited a lack of mentoring, operational support or buying power advantages that supposedly are the benefits of becoming a subtenant. In addition, they cited that their direct working relationships are with Airport concessions staff, and not their prime concessionaire. Not all airports choose to work directly with their subtenant ACDBEs, but Sea-Tac staff has regarded them as tenants of equal standing as any other, despite the lack of contractual relationship with the Port. In other words, ACDBE subtenants, from a practical day-to-day standpoint, are managed in the same fashion as direct lease ACDBEs or any other tenant.

In the stakeholder process, ACDBEs pointed out that their subtenant status has exposed them legally to problems of their prime concessionaire. This also affects the Airport's ability to generate ACDBE sales via subtenant arrangements. Specifically, the collective bargaining agreement between prime tenant Host International and HERE Local 8 has been in legal dispute for many years over the interpretation of a clause related to requirements for subtenant lessees to employ bargaining unit workers. The other prime food and beverage concessionaire, Concessions International, has an identical provision in its contract. The union has sought, through binding arbitration and the courts, to force the termination of ACDBE subtenants who fail to employ bargaining unit employees. However, an ACDBE operator cannot use the labor of the prime concessionaire without violating a key element of their ACDBE certification, which requires them to demonstrate "independent control" of the business.

The ACDBE subtenant relationships under prime concessionaires also have cost the Port significant revenue. In 2005, when the Port sought to provide rent reductions and an extended term to ACDBE subtenants due to higher than expected investment costs, the Port could only make these changes via amendments to the prime concessionaire agreements. Thus, as a condition of passing on rent relief and the term extension to ACDBEs via their subtenant agreements, the Port also had to provide rent relief and the term extension to the prime concessionaires.

**Rent Structures for Small Scale Operators**: When considering the terms of future lease agreements, staff believes that greater use of tiered rent structures, which are becoming more standard for the industry, will benefit both the Port and tenants in times of uncertainty. A tiered rent structure provides that the percentage rent due the Port increases as sales increase. This structure is in place with the Central Terminal tenants and has been very successful. A tiered rent structure may have helped the Port avoid lease amendments to provide relief when ACDBEs were impacted by airline relocations, as rents would have adjusted automatically. However, a tiered rent structure for a prime concessionaire lease would likely be different from that appropriate for an ACDBE due to the prime concessionaires' having multiple units. As a result, separate tiered rent structures for a large-scale prime and a smaller scale subtenant would be needed, which adds complexity to lease agreements.

**Level of ACDBE Participation**: Various stakeholders have differing views as to whether the Airport should strive to increase, sustain or decrease ACDBE participation -- and the best vehicle for that participation.

ACDBEs point out that their ability to provide living wages and good benefits hinges on the quality and scale of their opportunities. An ACDBE operator with several good, high volume locations affords the ability to provide good job opportunities, and increase the Airport's ACDBE participation at the same time. ACDBEs would like to have more opportunities. On the other hand, labor advocates maintaining the same level or even decreasing this participation if ACDBE businesses do not provide "living wages" and family health care.

Increasing direct lease opportunities for ACDBE businesses, either to sustain or increase overall ACDBE participation, however, is not a straightforward or easy task for the Port. Federal guidelines do not allow airports to allocate or "set aside" opportunities for ACDBEs. Rather, the Port would need to reach out to experienced and financially stable small restaurant and retail operators with the hope that ACDBE certification may be a possibility for them.

**Conclusions:**
Inclusion of ACDBE operators in the Airport's concessions program has been successful but fraught with challenges. Based on 'lessons learned' and input from the stakeholder

process, the Port should give careful consideration to its goals for future inclusion and how to achieve it:

- The current participation goal in prime concessionaire contracts is 25%, but actual achievement for the Airport is 20%.
- Greater participation would be consistent with levels achieved at other comparable airports.
- Achieving ACDBE participation with direct leases (versus subleases) would be less problematic for the Airport and for ACDBEs.
- However, achieving greater ACDBE participation with direct lessees will require a more aggressive outreach commitment by the Port.

***ISSUE 3: How can the Port reduce the high costs of investment by concessionaires, and reduce other barriers to entry?***

The issue of initial concessionaire build-out costs at Sea-Tac is well-documented. When a new group of tenants built out units in 2004-05, the costs were higher than anticipated, which led to a Port relief package in which tenants were reimbursed for certain construction and materials costs, provided rent reductions and received a two-year term extension on 10-year leases. It is in the interest of Port as well as future concessionaires to examine this issue before a period of greater concessions construction activity begins in conjunction with lease transitions in 2015-2017.

**Study of Sea-Tac Costs:** In 2008, the Port commissioned a study of build-out costs and other costs relative to the sales potential of food and beverage concessionaires (Exhibit I, Jacobs Report, pgs. 20-22). That study showed that build-out costs for concessionaire construction in 2004-2007 were higher than at comparable airports (30% higher than at Denver International Airport). In the stakeholder process, concessionaires estimated that build-out costs are at least 100% higher than for a street location. They assert that much of this cost stems from the lengthy Port design review process (typically at least 26 weeks) in which several departments and/or workgroups weigh in on tenant designs, which leads to many design revisions. These extended timeframes drive up costs, because the operators' design team must respond to Port-mandated changes.

**Unique Airport Costs:** Other costs are driven by the Port's facility requirements, which tend to be more strenuous than for a street location. As an example, international building code requirements for sanitary waste lines stipulate cast iron, whereas the Port requires stainless steel. The Port will typically require more extensive venting and fire suppression systems. Sea-Tac is not unique among airports; most or all have higher build-out costs. Some of these costs are justifiable or unavoidable as a consequence of the unique airport environment; however, most stakeholders believe there is significant room for improvement in the Port's process.

Another source of increased cost in the 2004-5 transition resulted from having a newly constructed building. Some tenants were required to bring electricity, gas, water and communication lines to their space. By ensuring that all needed infrastructure exists at the lease line would help to address some of the high costs. The concessionaires state that it would be easier to obtain bank financing if investment costs were lower and the length of lease terms was clearly adequate for debt amortization. Labor representatives would like to see the Port offer low-interest investment loans to smaller operators; however, State law currently prohibits such a practice.

**Contractor Availability:** Concessionaires agreed that construction costs are also high due to a lack of balance in supply and demand for construction services. There are a limited number of contractors that are willing to build at the Airport and they are able to charge a premium for their services. In addition, intense periods of concessionaire construction activity exacerbate this problem, placing concessionaires at the mercy of this small number of contractors. The Port could make a sizable impact in this area by engaging in outreach to increase the number of contractors willing and able to work at the Airport, and by staggering lease term expirations to avoid huge spikes in construction activity.

**Higher Costs, Greater Potential:** The costs of operating in the airport are also much higher than on the street. The airport facility tends to be more labor-intensive due to extended hours of operation with some concessions open nearly 24/7. There are also many examples of undersized or antiquated infrastructure (such as the freight elevator problem in the Central Terminal) to support concession operations that place additional labor burden on operators. Concessionaires incur costs of security badging for new employees. Onsite storage costs are high as well. Concessionaires who need significant storage often will lease less expensive warehouse space off-site, but then be required to make deliveries to the Airport.

Concessionaires acknowledge that sales potential at the Airport far exceeds that of a street side location. With nearly 32 million passengers annually, no other “retail” location can compete with these customer volumes. At the same time, an airport is not a risk-free environment for a restaurant or retail shop. Recent airline industry changes such as mergers, bankruptcies, and consolidations have exposed concessionaires to significant risk.

**Conclusions:**

- The concessionaires’ concerns regarding high build-out costs are legitimate. Concessionaires cite the same issues uniformly regardless of ownership type and airport location.
- The Port should conduct a thorough review of the tenant concession process and determine where cost savings in time and process can be achieved without

sacrificing safety and quality. This could entail benchmarking against other airports with lower build-out costs.

- The Port should consider providing needed infrastructure to a concessions unit lease line or provide tenant reimbursement for these improvements that will remain beyond the tenant's lease term.
- Staggering lease expiration dates may help reduce construction costs by moderating demand for construction services. The Port should evaluate the merit of undertaking more outreach to increase the pool of available builders.

***ISSUE 4: Should the Port continue to require 'street pricing' for products and services sold by concessionaires?***

The current street pricing policy was adopted by the Port Commission in 2002 and went into effect with the opening of Concourse A in 2004. At that time, the street pricing requirement and its application were relatively new for the industry. The street pricing trend in airports was a direct result of decades of perceived "price gouging" by concessionaires which enjoyed monopoly or near monopoly positions.

**Data on Street Pricing:** In the November 2011 Transportation Research Board report on airport concessions programs, the pricing policies of U.S. airports was a subject of study (Exhibit J, ACRP Report, pgs 149-150). Data showed that the majority of airports have a 'street pricing' or 'street pricing +10%' policy. Among food and beverage programs, 43% of surveyed airports had 'street pricing +10%' and another 33% had strict street pricing. The use of 'street prices' as the basis of pricing policies has become the norm at U.S. airports over the last 10 years.

With the introduction of street pricing policies at other airports, there are now more opportunities for Sea-Tac to benchmark the practical application of its policy with other airports. Street pricing is one of the most debated policies between airports and concessionaires today, and there is a little empirical data to support either position that street pricing positively impacts sales or has little impact. It has proven difficult to isolate price from other factors such as location, quality of product and customer service in the overall value perception of travelers. An airport's pricing policy decisions are perhaps then more a matter of principle related to the customer experience.

**Stakeholder Views:** In the stakeholder process, there was broad consensus that the Airport needs to do a better job at marketing the street pricing policy to the community. Many travelers still assume that prices are higher at the airport – perhaps due to historical pricing at Sea-Tac or the customers' experience at other airports. The traveler focus groups generally confirmed this.

Local Seattle businesses with Airport and street locations (e.g., Ivar's and Fireworks) indicated that they are compelled to hold the same prices at both locations because their customers compare prices and find it unacceptable to pay more at the Airport. For these businesses, there is no question that they will hold street prices.

Many other operators, chiefly prime concessionaires and ACDBE subtenants, emphasized that the pricing policy needs to reflect sales volume potential and take into account percentage rents, investment costs, wages and other costs. These groups advocated for street pricing +10% in order to compensate for high investment and operating costs. Uniformly, however, concessionaires agreed that it is not in the best interest of airport businesses to charge unreasonably high prices because it will discourage spending.

Labor representatives advocate a "street pricing plus" policy of up to 15% above street prices if concessionaires passed on the higher margin to their employees in the form of wages and benefits.

**Conclusions:**

- Street pricing has been the policy at the Airport since 2004; however, there are still widespread perceptions that airport prices are high. The Airport needs to market street pricing.
- With little data to substantiate the impact of street pricing on sales, the matter of street pricing becomes more reflective of an airport's philosophies regarding the customer experience for its passengers.
- The street pricing policy in future lease agreements might appropriately be related to the Port's efforts to reduce high costs of investment and operation for concessionaires. Those stakeholders that advocate for a percentage add-on to street pricing cite high costs as the reason.

***ISSUE 5: Should the Port place requirements on the labor or employment policies/practices of its concessionaires?***

The subject of labor requirements for Airport concessionaires was the subject of greatest debate in the stakeholder process. Although such requirements would be placed on concessions employers, the effects were acknowledged by all parties to have great significance – positive or negative depending on the perspective – for not just current and potential concessionaire businesses of all kinds, but also for airlines, concessions employees, the traveling public, as well as for the Port's management of the future concessions program.

**Worker Retention Advocacy:** The Hotel and Restaurant Employees (HERE) and the United Food and Commercial Workers (UFCW) advocate that the Port Commission adopt a resolution regarding worker retention and labor harmony. In addition, they advocated for state legislative requirements that Sea-Tac adopt such a requirement during the 2011 legislative session. The HERE proposal submitted as part of the stakeholder process is included in the meeting summaries (Exhibit D).

**Legal Analysis:** The Port's Legal Department has evaluated the various proposals that the Port adopt a labor harmony and/or a worker retention policy. Staff believes that there is a significant legal risk that the courts will find the adoption of a worker retention and/or labor harmony policy as proposed by HERE/UFCW a violation of federal law and an act of contempt of the permanent injunction issued by Judge Barbara Rothstein in 2000 (*CityIce Cold Storage Company v. Port of Seattle*). Outside counsel, Rick Omata, reviewed and concurred in advice provided to the Commission in 2010 and in 2011. Mr. Omata, an attorney in private practice with the firm of Karr Tuttle, formerly served as a trial attorney with the National Labor Relations Board. Labor representatives do not agree with the Port's assessment of the legal risk associated with a labor harmony and/or worker retention policy.

**Previous Legal Actions:** In the *CityIce* case, Judge Barbara Rothstein instructed the Port of Seattle not to take "any action interfer[ing], either by its actions or inactions, with the exercise of federally protected rights of third parties using Port facilities to assign work to their own employees". Judge Rothstein was not focused solely on future agreements the Port might enter into with any unions, but any action of any nature, including policies. In the September 21, 2005 order on summary judgment in the Flying Eagle Espresso case, Judge Marsha Pechman order allowed the plaintiff's claims against the Port of civil conspiracy, violation of 42 U.S.C. Sec. 1983, and tortious interference to move forward to trial and revealed the court's view that there was strong legal and evidentiary basis for the plaintiff's claims (Exhibit K, Order of Summary Judgment). The Pechman order also rejected the defense that the union and the Port were simply seeking "worker preservation". Judge Pechman referred the plaintiff's claim that the Port was in violation of Judge Rothstein's permanent injunction to Judge Rothstein for determination. Ultimately, the Port and HERE settled with Flying Eagle Espresso and paid monetary damages.

**Prospect of Litigation:** There is a high likelihood that a Port-adopted worker retention policy would be challenged in court.

- On July 26, 2011, an attorney representing two existing concessionaires indicated that they believe they have grounds for such a lawsuit if the Commission adopts a policy requiring a commitment by concessionaires that they retain workers of a previous concessionaire for up to 180 days unless there is demonstrated cause to terminate such workers.
- Relevant federal statutes appear to indicate that the successful party in a lawsuit in this matter could recover attorney's fees from the losing party. This could greatly reduce any financial concern of plaintiffs regarding such an action.
- Concessionaires and potential bidders for concessions opportunities are likely to be unhappy with a worker retention policy for several reasons such as those

below. The prospect of some or all of these concerns playing out could strongly discourage small or local businesses (including ACDBEs) from participating in Sea-Tac's concession program. In addition, these concerns could well motivate a concessionaire – or a prospective concessionaire – to bring legal action against the Port.

- Concessionaires are likely to view the initial 180 days as critical to their businesses' success and will view it as important to choose whom they hire without interference from the Port during this period.
- Due to the "successorship doctrine" (see explanation below), if a new concessionaire must hire workers from a pool of employees who used to work for a prime concessionaire, they will be hiring unionized employees, and could be subject to union grievance procedures and an unfair labor practice claim – despite not having negotiated a contract with the union.
- A new concessionaire would not be able to exercise its choice to hire workers of its choice after the 180-day period without risk of disruption of business operations from replacing his or her entire workforce. Such a move to replace its workforce could prompt an unfair labor practice claim that the concessionaire was discriminating against these employees due to their union membership.
- The provisions of a worker retention policy would need to be incorporated into the concessions lease. If a concessionaire violated such a provision, the Port would have to find the concessionaire in default, which could lead to lease termination.

In addition to the potential of the claims noted above, the Port could be subject to other claims regarding a worker retention or labor harmony policy. These lawsuits could allege that a Port worker retention policy is preempted by the National Labor Relations Act and that the Commission exceeded its legal authority. This latter issue arises because the Port is a limited purpose government that does not have the power to mandate that third party employers adopt minimum standards for employment. While HERE believes that there is a proprietary basis for worker retention, staff can find no facts to back up that claim. There is no data that indicate that security at Sea-Tac would be enhanced due to worker retention and, in fact, concessionaires feel strongly that they can provide better customer service if they are able to choose their employees without interference from the Port.

**Successorship Doctrine:** The United States Supreme Court has ruled and made it common law that when a majority of a successor employer's workforce is comprised of workers formerly employed by a predecessor, and the retained employees perform the same type of work at the same location, the successor must recognize and bargain with the union representing the predecessor's employees (*NLRB v. Burns International Security Services, Inc*., 406 U.S. 272 (1972). As a result, the courts may view a worker retention policy as having the coercive effect of requiring a successor to recognize the union representing its predecessor's employees as the exclusive bargaining representative of the successor's employees.

While the draft policy resolution circulated by the Commission on July 26, 2011 stated: "Nothing in this policy shall be construed to imply that any Airport Concession Lessee is required by the Port to recognize any labor organization as the representative of its employees or to enter into a collective bargaining agreement with any labor organization," that statement is unlikely to protect the Port from allegations of coerced successorship and conspiracy with HERE to force recognition of the union. If the majority of a new concessionaire's workforce is comprised of workers retained from a predecessor concessionaire, the National Labor Relations Board will deem the new concessionaire a successor, obligated to bargain with the union.

**Port of Seattle Concerns:** The Port recognizes the right of any employee to organize and engage in concerted activity. But the labor harmony and/or worker retention requirements proposed by organized labor raises concerns for the Port that implementing such requirements could significantly discourage small, local businesses from participating in the airport concessions program, leading to less competition for concessions and loss of concessions revenue, as well as increased expense to the Port related to the enforcement of such requirements.

For example, disagreements regarding worker retention requirements (e.g., whether there was demonstrated cause to terminate a worker, the facts surrounding the worker's performance prior to termination, whether a progressive disciplinary process was followed, or the sufficiency of documentation for the termination) could embroil the Port in disputes between concessionaires and workers/unions over any number of issues.

If the Port found a concessionaire to be in default due to a worker retention policy violation, the Port would lose concession revenues, have additional expenses to find a replacement tenant/concessionaire and/or have to defend a lawsuit attacking the policy that imposed the worker retention requirements. In addition, because the Port has twice been sued and penalized for interfering with the labor relations of third party employers and is subject to a permanent federal injunction enjoining the Port from interfering with the right of lessees to assign work to their own employees, the Port could be exposed to considerable legal risk.

**Stakeholder Views:** The prevalent view of the stakeholders is that the Port should not place mandates on the employment practices of concessionaires. Businesses of all sizes and types want control over their business decisions and the impact of those decisions on their profit and loss statement. The majority of stakeholders believe there are and will remain enough concessions jobs at Sea-Tac that current employees have a choice of where they wish to work and that capable employees will not have trouble finding a new job if their current employer cuts back or does not continue after a concessions transition. These stakeholders believe, however, that many potential concessionaires will choose to invest elsewhere if faced with a mandate to hire specific employees.

Many current concessionaires indicated that they have difficulty finding capable employees who are willing to accept the challenges of working at Sea-Tac (e.g., remote parking, suboptimal public transportation, badging requirements, etc.). Thus, these employers are already highly motivated to hire experienced airport concession employees if they meet their businesses' needs.

The divergent view was offered by representatives of employees of current prime concessionaires. They state that labor harmony agreements do not mandate unionization. They also proposed that the Port limit direct leases to no more than 10% of its concession program and that the remaining 90% be given to prime concessionaires (almost all of which have represented employees).

**Recent Experience at Sea-Tac:** The redevelopment of concessions at Sea-Tac in 2004-05 and the concurrent transition from a single master (prime) concessionaire to the current system of four prime concessions contracts and a variety of direct leases offers important data to the question of whether there is a need for the Port to mandate a worker retention mechanism.

**2004-05 Transition:** As noted in the background information, Sea-Tac made major changes in its concession program about seven years ago. From 1970 to 2004, the airport had a single master concessionaire (HMS Host). Today we have:

- Four prime concessionaires with a total of 54 self-operated units;
- Six Disadvantaged Business Enterprise subtenants of prime concessionaires, operating 11 units, and
- Nineteen direct leases for food and beverage, retail or service concessions.

(The employees of the prime concessionaires are represented; the employees of all the other concessionaires are not.)

As a result of this change:

- Concessions employment grew from 732 in 2003 (the last year prior to the initial changes in the concessions program) to 1,508 as of November, 2011;
- Represented employees grew by 23%;
- Sales have increased 75.5% (2003-2010);

- Revenue to the Port has increased 82%;
- Sea-Tac won two national awards for the best concessions program in the country:
  - Airports Council International Richard A. Griesbach Award of Overall Excellence (2007), and
  - Airport Revenue News Best Concessions Program (2009).

**Employment Mobility:** The second area worth examining relates to the mobility of concessions employees. Concessions employment is quite transitory: concessionaires report an average annual turnover of approximately 20%. A review of data from the Airport Credential Office and reported by concessionaires indicates that, of the 1,508 current concessions employees, 23% have worked at the airport for ten years or longer. Over three-quarters of the employee base began working at the airport after the concessions program transition, and concessionaires report than the typical employee tenure is 2 to 5 years or less.

Experience confirms that capable concessions employees do not have difficulty retaining employment at Sea-Tac. As noted by the stakeholders' comments, employers are highly motivated to retain their employees or attract a good employee from another operator. Two recent examples of concessions employers seeking out employees whose previous employer has ceased operations underline this point: (1) when Borders Books, a direct lease tenant, announced its closure, it allowed other Airport concessionaires to approach their employees (in the bookstore during business hours) to recruit them; and (2) in August 2011, Hudson Retail assumed the duty free business from HMSHost. HMSHost had operated duty free at Sea-Tac for nearly 40 years but, due to changes within its parent company, was exiting the duty free business. Although not required to, Hudson retained all of the HMSHost employees who wished to remain at Sea-Tac. Hudson has increased hours of duty free operation and added 18 new sales associates (all represented by UFCW Local 21). Revenues have increased by 20%. This transition was a decidedly positive outcome for the Port, Hudson and the concessions employees.

Not only have concessions employees been able to find new employment if their previous employer quit operating, they quite often are able to work for more than one concessions operator at the same time. Twenty-four people currently employed by a prime concessionaire also hold a job with an independent operator; nearly as many hold two jobs with two independent employers; and five people work for two prime concessionaires.

In summary, the staff is unaware of instances when a capable non-management concessions employee who wanted to continue working at Sea-Tac was unable to do so.

**Other Airport Policies:** A few airports have adopted some version of a worker retention and/or labor harmony policy, including San Francisco, Oakland, Los Angeles, San Diego, Phoenix and the Port of New York/New Jersey (NY/NJ). All but San Diego and NY/NJ are city airports and, thus, their governing body has general purpose government powers, allowing them to articulate policies related to living wages or other social policies. These are powers that the Port of Seattle does not have, which is relevant to the legal analysis, above.

San Diego International Airport recently included a 'pass/fail' worker retention requirement in the solicitations for new contracts as the airport transitions from a master concessionaire. Proposers were required to sign a pledge to retain workers in order to submit proposals. The means of enforcing the implementation of the requirement is still undetermined by the airport, and the actual effect of worker retention in San Diego, or whether it will be challenged, will not be known until the transition takes place in 2013. Because nearly all the solicitation packages were tailored in size to accommodate prime concessionaires, only one ACDBE operator was awarded a two-unit contract in heavy competition with other ACDBEs. Although San Diego offered extra points for local businesses, the number of extra points of the total possible was too insignificant to make a difference in any outcome. It would appear that promotion of local, small businesses was either not an objective of the solicitation or other factors discourage small businesses interest.

At NY/NJ, the worker retention policy does not apply at non-Port Authority terminals (the Port Authority does not operate any terminals at John F. Kennedy International). In addition, worker retention only applies to new concessionaires of the same "type" as the outgoing concessionaire. This would seem to suggest that an incoming prime concessionaire would be bound by the policy if it succeeded an outgoing prime, but an incoming small business would not.

**Conclusions:**
Multiple factors convincingly support that the Port should not adopt an explicit worker retention mandate as part of its concessions principles and practices. Such a policy:

- Appears to carry significant legal risk of violating federal law and the permanent federal injunction against the Port directing its tenants to adopt specific labor practices;
- Would likely be challenged in federal court;
- Would require a significant increase in Port staff to manage and regulate;
- Is opposed by the majority of concessions stakeholders (incl. airlines, current independent business, prospective local business, and small/ACDBE business);
- Would very probably reduce small and local business interest in participating in the concessions program; and
- Is unnecessary to protect the continued employment opportunities of capable concessions workers.

It is also important to note that a worker retention and/or labor harmony policy is not necessary to address a fundamental concern of the labor representatives. As is discussed above under the question, “What should be the balance between concessions leases with multi-unit operators (“prime concessionaires”) and direct leasing?”, a reasonable balance of prime concessionaires and direct leases will almost surely result in the continued employment of the represented employees of the prime concessionaires who wish to continue working at Sea-Tac. In the Recommended Principles and Practices, below, staff proposes a balanced approach that will ensure that all current workers of the prime concessionaires who wish to continue working at Sea-Tac will be able to do so.

## RECOMMENDED PRINCIPLES/PRACTICES:

**Leasing Structure:**

- At this time, the Port leases 123,167 square feet of concessions space. Prime concessionaires self-operate 64% of the units and 71% of the concessions square foot space. With their subtenants, primes hold leases on 83% of the square footage. The other 17% of the square footage is assigned to direct lessees.
- Including the new units to be added over the next five years, Sea-Tac concessions space will grow to approximately 136,116 square feet by 2017 (approx. 10%).
- The Airport should maintain its hybrid leasing structure with multi-unit prime concessionaires coupled with direct leases with independent, small and/or ACDBE operators.
- By 2017, the Airport should lease approximately 50% of its concessions space in multi-unit contracts of six units or more and 50% in small packages of three units or less.

**Small/ACDBE Opportunities:**

- The Airport should meet or exceed its current goal of 20% of gross sales by ACDBE operators when all new leases are in place by 2017.
- The Airport should meet the 20% goal through its direct leases.
- The Airport should encourage, but not require, prime concessionaires also to generate ACDBE sales. (FAA-approved joint ventures would be acceptable.)
- The airport should seek additional small businesses operators via the remainder of the direct lease opportunities.

**Airport Facilities/Costs of Investment:**

- The Airport should revise its tenant improvement review and approval process to reduce the capital costs of its concessionaires.
- The Airport should conduct an efficiency analysis of Port processes that have been identified as drivers of high investment and operating costs for concessionaires for possible changes.

- The Airport should consider a policy of providing necessary infrastructure to the lease line and/or reimbursing tenants for improvements made outside concession unit lease lines that provide lasting benefit to the Port and future tenants.
- The Port should seek to expand the number and, perhaps, "certify" contractors with experience performing relevant construction work within the airport terminal.

**Street Pricing:**

- The Airport should retain street pricing as a requirement in current lease agreements, and in new direct leases in the near term.
- Prior to the 2015-17 lease renewals, the Airport should closely study the overall cost picture for concessionaires, including investment costs, before finalizing the street pricing policy in future agreements.
- The Airport should develop rent structures (e.g., tiered rents) to balance the challenges of higher upfront concessionaire costs with the potential for higher margins as sales increase.

**Labor Requirements:**

- The Airport should not adopt any worker retention or labor harmony policy that carries significant legal risk of violating the permanent federal injunction or federal law.
- The Port should encourage continuity of employment that is consistent with federal law by:
- Providing to all new tenants (as well as any existing tenant with an interest) the contact information for current employees or those whose employment has recently ended due to their employer's ceasing operations at Sea-Tac;
- Encouraging all new concessions operators to hire employees who have lost, or at risk of losing, their jobs;
- Provide all employees who wish it the contact information for those recruiting employees on behalf of new concessionaires

## SUMMARY:

The principles and practices applied to Sea-Tac Airport's concessions program will to a very great degree define both the public image of the airport and the economic impact of the Port of Seattle. They will determine in large part the airport's ability to:

- Improve customer service;
- Increase net income;
- Create jobs; and
- Promote small business opportunities.

After extensive outreach to all stakeholders, research on current airport best practices, and evaluation of recent practices at Sea-Tac, the staff believes the recommendations articulated above will best equip the Port to achieve these goals.

**OTHER DOCUMENTS ASSOCIATED WITH THIS BRIEFING:**

Attachment: Power Point
Exhibit A: Summary of Stakeholder Process
Exhibit B: Draft Principles and Practices
Exhibit C: Focus Group Report
Exhibit D: Meeting Summaries
Exhibit E: Concessions Stakeholder Discussion Summary
Exhibit F: Summary of Combined Stakeholder Meetings
Exhibit G: Concessions Industry 'Best Practices'
Exhibit H: ACRP Report, pgs. 126-136
Exhibit I: Jacobs Report, pgs. 20-22
Exhibit J: ACRP Report, pgs. 149-150
Exhibit K: Order of Motion on Summary Judgment (Flying Eagle Espresso vs. Host International, 2005)

**PREVIOUS COMMISSION ACTIONS OR BRIEFINGS:**

July 26, 2011 – Staff Briefing: Concessions Stakeholder Process
July 13, 2010 – Staff Briefing: Concessions Business Review and Future Outlook
July 22, 2008 – Staff Briefing: Concessions Program Update