



Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: William F. Sherry, A.A.E.

SUBJECT: SEE BELOW

DATE: October 3, 2011

Approved

Date

10/6/11

COUNCIL DISTRICT: City-Wide

**SUBJECT: APPROVAL OF AMENDMENTS TO THE FOOD & BEVERAGE AND
RETAIL CONCESSION AGREEMENTS TO INCORPORATE A NEW
PRICING POLICY AND OTHER REVISIONS**

RECOMMENDATION

- (a) Approve a First Amendment to the AMS-SJC JV Airport Retail Concession Agreement, Second Amendments to the Airport Food and Beverage Concession Agreements with Areas USA SJC, LLC and Host International, Inc.; and
- (b) Approve a Second Amendment to the Host Airport Retail Concession Agreement to
 - (1) Revise the Concession Agreement provisions regarding customer pricing; and
 - (2) Revise provisions regarding concession concepts and space layouts to reflect current concession operations at the Airport.

OUTCOME

Approval of the Amendments to the Food & Beverage and Retail Concession Agreements ("Agreements") will revise the pricing methodology and requirements to a simpler and more flexible approach that will benefit both the concessionaires and Airport staff, while maintaining reasonable prices for the traveling public. Exhibits will be updated to reflect the current Airport layout and the concession concepts and square footage. Changes to administrative and reporting requirements will clarify aspects of the Agreements.

BACKGROUND

On October 12, 2007, the City released a Request for Proposals ("RFP") for a new food & beverage and retail program for the Airport. On June 10, 2008, Council approved Resolution No. 74413 that

authorized the City Manager to negotiate and execute Agreements with AMS-SJC JV for a retail concession, Areas USA SJC, LLC for a food & beverage concession, and Host International, Inc. for a retail concession and a food & beverage concession. The majority of the concession program is complete and 25 food and beverage locations and 19 retail locations have already opened.

The concessionaires must adhere to the pricing methodology and requirements in the Agreements, the Airport Tenant Guidelines, and their responses to the RFP. Prices are set by surveying prices at five local off-Airport concessions for each product and averaging those prices to determine the street price. The Airport allows a mark-up of no more than 10% over this street price.

The Office of the City Auditor performed a concession audit as requested by the Airport. The objective was to determine whether the Airport's food & beverage and retail concessions are in compliance with the pricing requirements. The audit report documented pricing inconsistencies and determined that the current price-setting process is burdensome and should be streamlined. Concessionaires have also indicated that the price-setting process is difficult to apply and is time consuming. Council requested the Director of Aviation ("Director") to jointly develop a revised pricing methodology and process with the Airport's concessionaires guided by recommendations in the audit report and to incorporate the changes in the Agreements.

The Airport layout and the concession areas have changed since the Agreements were executed. Terminal B was completed and the square footage of the concession areas has been constructed and measured. In addition, some concession concepts changed due to the financial climate and some subconcessionaires originally included in certain concessionaire proposals chose not to be part of the program. The current Agreement exhibits do not reflect these changes.

ANALYSIS

Reasonable pricing of concession products and services is an important aspect of the passenger experience. The RFP and the Agreements require that prices are not higher than 10% of comparable off-Airport concession locations (referred to as "street plus 10%"). However, the audit report determined that the process and methodology to set prices is burdensome, inconsistent, and unclear. The audit report included the following recommendations:

- (1) Provide guidance to concessions and obtain consistency in compliance with the Agreements, as well as preclude unnecessary and burdensome price comparisons.
- (2) Amend the Agreements by replacing the agreement sections specifying the price comparison process with a reference to the Airport pricing policy, and eliminate the provision that if fewer than the required five price comparisons are obtained, that only street pricing can be charged.
- (3) In order to ensure pricing of street plus 10%, a streamlined process, and compliance with the Agreements, work with the concessions to lower prices and implement other actions such as posting/prominently displaying prices.

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In response to the audit report, the Airport developed a pricing policy (Attachment A) to incorporate many of the report's recommendations and best practices from other airports. The process to develop the pricing policy was inclusive and the concessionaires were consulted throughout the process and given drafts of the pricing policy to review and approve. All concessionaires have accepted the terms of the pricing policy and it has been incorporated as Exhibit Q in the proposed Agreement Amendments.

The pricing policy replaces the pricing provisions in the Agreements and conflicting provisions in the Airport Tenant Guidelines. The number of comparable off-Airport concession locations has been reduced from five to a maximum of three and the concessionaires and Airport can agree to alternate pricing methodologies should local comparables not be available. Off-Airport locations that are partially or fully protected from competition, such as hotels, are no longer allowed; however, other Bay Area airports are permitted as comparable locations for branded concessions, but without additional mark-up.

With the goal of fostering competition and enhancing customer service, the RFP split both the food & beverage concessions and the retail concessions into two packages with locations in each terminal. Proposers could only be awarded a maximum of one retail and one food & beverage package. This continued competition is expected to keep prices affordable and concessionaires are strongly encouraged not to charge in excess of street plus 10%. The Airport will continue to require off-Airport comparable prices and should the Director determine that prices are excessive, the Airport will strictly enforce pricing that does not exceed street plus 10%.

Since the execution of the Agreements, Terminal B was completed, the majority of the concession locations were constructed, and Fresh Attractions, a retail concept intended to be temporary, has been allowed to remain due to reduced passenger levels and lower than projected sales. The Amendments revise the Airport layout to include Terminal B, update the square footage of each concession location with field verified measurements, identify concession concepts that have changed during the implementation of the program, and provide the Director with the authority to determine when it is appropriate to replace Fresh Attractions with an alternative concept.

During the implementation of the Agreements, it was determined that dates in the Agreements that are set by actions occurred at times that are difficult to administer and vary between the different Agreements. In addition, a reporting redundancy and an inaccurate Section reference were also discovered. The proposed Amendments address these issues as well.

EVALUATION AND FOLLOW-UP

The Director of Aviation will be responsible for coordination of these Amendments and monitoring the pricing to ensure that concession products remain affordable to the traveling public.

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PUBLIC OUTREACH/INTEREST

- Criterion 1:** Requires Council action on the use of public funds equal to \$1 million or greater. **(Required: Website Posting)**
- Criterion 2:** Adoption of a new or revised policy that may have implications for public health, safety, quality of life, or financial/economic vitality of the City. **(Required: E-mail and Website Posting)**
- Criterion 3:** Consideration of proposed changes to service delivery, programs, staffing that may have impacts to community services and have been identified by staff, Council or a Community group that requires special outreach). **(Required: E-mail, Website Posting, Community Meetings, Notice in appropriate newspapers)**

This item does not meet the above criteria requiring additional notification; however, it will be posted on the City's Website for the October 25, 2011, Council Meeting.

COORDINATION

This item has been coordinated with the City Attorney's Office, the City Auditor's Office and the City Manager's Budget Office.

COST IMPLICATIONS

None.

CEQA

Not a project, File No. PP10-066(e), Service agreements involving no physical change to the environment.

/s/
Kimberly B. Aguirre for
WILLIAM F. SHERRY, A.A.E.
Director of Aviation
Airport Department

For questions please contact William F. Sherry, Director of Aviation at (408) 392-3611.

Attachment

Exhibit A

Pricing Policy

The intent of the Pricing Policy is for prices and quality of products and services at the Airport to be comparable to off-Airport (street) locations within Santa Clara County, California. Multiple concessionaires operate at the Airport and it is expected that competition for customers will ensure that prices and quality of products and services remain at a level that closely matches street comparables.

Pricing Requirements and Comparables

Concessionaire is responsible for establishing comparable locations for the purpose of instituting a pricing structure for their concessions under the following guidelines:

1. Name brand stores
 - a. If a concession has a street location within Santa Clara County, that location will be designated as a comparable store. Concessionaire may submit comparable pricing from a minimum of one (1) street location and no more than three (3) street locations.

2. Alternate comparable locations
 - a. If a concession does not have a street location in Santa Clara County, the concessionaire and Airport will identify no more than three (3) street locations in Santa Clara County similar in concept, size, and quality.
 - b. If a product or service is not available at the selected street locations, the concessionaire and Airport will identify no more than three (3) alternate street locations in Santa Clara County for that product or service.
 - c. If concessionaire is unable to find a reasonable comparable location within Santa Clara County, the concessionaire shall have the right to request in writing an exemption from the local comparable requirement for approval by the Director. Such request must include reason for requested exemption and provide a detailed explanation of how concessionaire intends to establish pricing for its products or services.

3. Pricing
 - a. Affordable pricing is an essential aspect of the passenger experience at the Airport and concessionaire is strongly encouraged to charge prices that are no more than ten percent (10%) higher than the same product or service offered at the approved street location(s).
 - b. Concessionaire must provide a price justification, to be approved by the Airport, for any product that is different in size or quality for purposes of establishing a reasonable comparable price.

4. Protection from competition
 - a. Stores that are partially or fully protected from competition, such as hotels, amusement parks or sports arenas, and locations that operate using off-price or discount pricing structures, shall not be included as comparable locations.
 - b. Notwithstanding the preceding paragraph, if a branded concession has a location at either Oakland International Airport or San Francisco International Airport, that airport location may be used as the only comparable location. However, prices cannot exceed the prices at that comparable airport location.

5. Product and price submittal
 - a. Concessionaire is required to submit a complete product and price list to the Director for approval at least thirty (30) days prior to the initial concession opening. Such product and price list shall detail all products and services available for sale and the requested price. Differences in size or quality of a product or service shall, all other things being equal, be considered by Airport during its review.
6. Approval of comparables and pricing
 - a. If the Airport and concessionaire are unable to agree on the comparable street locations or prices, the Director will select the comparable street locations for the purpose of establishing prices.

Pricing Display

1. Display of pricing
 - a. Concessionaire is required to prominently and clearly display pricing for all products and services offered at any location(s) at the Airport.
2. Pre-marked or pre-printed price
 - a. Where prices are pre-marked or pre-printed on the item by the distributor or manufacturer, the price charged for the item shall not exceed the pre-marked or pre-printed price.

Price Adjustments and Prices for New Products

1. Written approvals
 - a. Concessionaire must obtain Airport's written approval prior to adjusting prices and prior to pricing new products and services. Any request for price adjustments or price approvals for new products and services must be submitted to the Director at least fourteen (14) days prior to either the price increase effective date or availability of a new product or service, as applicable. Price increases shall be based on increases in prices for the same items at the comparable street locations in Santa Clara County.
2. Price adjustments
 - a. Concessionaire will be allowed to submit pricing adjustments two (2) times per year unless otherwise requested by concessionaire due to market conditions, and as approved by the Director.

Remedies for Exorbitant Prices and/or Insufficient Quality

1. Review of pricing and quality
 - a. At any time, the Director may survey prices and the quality of products and services then in effect at comparable street locations in Santa Clara County. If the Director determines that any prices being charged by concessionaire at the Airport are exorbitant compared to street pricing as identified in the survey, or that any product or service being offered by concessionaire is of insufficient quality compared to the street locations, the concessionaire is required to submit, within seven (7) days, a product and price list with comparables as required in the Pricing Policy. Prices must be adjusted within seven (7) days of the Director's approval.

2. Remedies

- a. Should the concessionaire not provide an acceptable price list with comparables within seven (7) days, the products or services must be removed immediately from the concession location or may be offered at street pricing plus ten percent (10%) as determined by the Director.
- b. Should the concessionaire not replace products or services of insufficient quality with items of sufficient quality within seven (7) days, the products or services must be removed immediately from the concession location.