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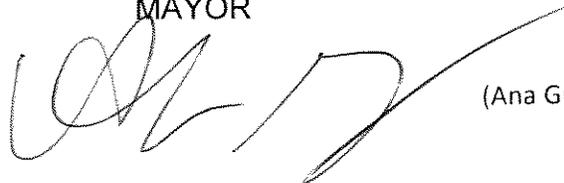
TRANSMITTAL

TO Gina Marie Lindsey, Executive Director Department of Airports	DATE JAN 29 2015	COUNCIL FILE NO.
FROM The Mayor	COUNCIL DISTRICT 11	

Request to Approve a First Amendment to a 10-Year Concession Agreement with DFS Group L.P. for Development and Operation of Duty Free Merchandise Concessions at the Los Angeles International Airport

Transmitted for further processing, including Council consideration. See the City Administrative Officer report attached.

MAYOR



(Ana Guerrero)

MAS:WDC: 10150050t

OFFICE OF THE CITY ADMINISTRATIVE OFFICER

Date: January 28, 2015

CAO File No. 0150-03519-0017

Council File No.

Council District: 11

To: The Mayor

From: Miguel A. Santana, City Administrative Officer



Reference: Communication from the Department of Airports dated January 9, 2015; referred by the Mayor for report on January 14, 2015

Subject: **LOS ANGELES WORLD AIRPORTS REQUEST FOR A FIRST AMENDMENT TO A 10-YEAR CONCESSION AGREEMENT WITH DFS GROUP L.P. FOR DEVELOPMENT AND OPERATION OF DUTY FREE MERCHANDISE CONCESSIONS AT THE TOM BRADLEY INTERNATIONAL TERMINAL AT THE LOS ANGELES INTERNATIONAL AIRPORT**

SUMMARY

The Los Angeles World Airports (LAWA; Department) requests approval to execute a First Amendment to a concession agreement with DFS Group L.P. (DFS Group; contractor), a subsidiary of LVMH Moët Hennessy Louis Vuitton, based in Los Angeles, for the operation and management of duty free concessions at the Los Angeles International Airport (LAX), extending the current 10-year term (with three one-year options) by one year for a total of 11 years (with three additional one-year options).

The proposed extension will (1) provide the contractor with a longer term in order to depreciate its capital investment in various duty free concession spaces in the new Tom Bradley International Terminal (TBIT) and Terminal 2, which will also relieve LAWA of its obligation to reimburse the DFS Group for increased construction costs for building infrastructure improvements--these costs were incurred as a result of delays by LAWA in delivering the contracted duty free space in the Tom Bradley International Terminal and Terminal 2 due to overlapping construction activities involving the two terminals and construction of the duty free shops' spaces; (2) resolve the issue of approximately \$1.02 million (or 5.8 percent above the original estimate) in cost overruns incurred by the DFS Group in its efforts to meet LAWA's scheduled opening of airline boarding gates in the new TBIT and develop a scope of work for the entirety of the Terminal 2 concourse; and (3) provide LAWA with an additional \$33 million in revenue over the one-year extension period. If approved, the proposed amendment, subject to City Attorney approval as to form, will become effective in the first quarter of 2015, which will extend the contract expiration date to September 18, 2024.

The DFS Group is the duty free operator at LAX managing 15 duty free stores in the Tom Bradley Terminal's West Core and Terminals 1 through 8. On August 15, 2012, the Council concurred (C.F. 12-1231) in the Board of Airport Commissioners' (Board) action authorizing the LAWA General

Manager to award a 10-year concession agreement to the DFS Group that is estimated to provide \$150 million in revenue to LAWA annually. As part of that agreement, the contractor is responsible for designing, constructing, and operating 15 duty free concession venues at LAX.

The current agreement includes a termination clause for convenience allowing the Department to terminate the agreement, with not less than 180 days prior written notice, in instances where airport operations—whether for convenience or efficiency—require use of the space.

Pursuant to Charter Section 606, the Board of Airport Commissioners (Board) may authorize the Department to proceed with executing the First Amendment to the Duty Free Merchandise Concession Agreement, subject to the approval of the Council. The above-referenced aspects of the proposed First Amendment, and this report, are based upon revised information received from the Department subsequent to the initial request submittal.

BACKGROUND

The Los Angeles International Airport Master Plan was approved by the Council in December 2004 and by the Federal Aviation Administration in May 2005. Subsequently, the Board adopted an LAX Development Program for capital projects to modernize the airport with a budget of approximately \$3.3 billion during its early years. The location for several of the capital improvement projects is the new Tom Bradley International Terminal and surrounding acreage. There are, in addition, a number of capital projects that will enhance other terminals as well as facilities and spaces within the LAX Central Terminal Area. As with the retail concessions, the duty free concessions are an integral part of the airport's development program. As such, through a competitive process approved by the Council on August 15, 2012 (C.F. 12-1231), the DFS Group was authorized to develop and operate duty free shops utilizing approximately 37,600 square feet of concession space (7,900 square feet of which will be used for storage space in the Tom Bradley Terminal) in eight passenger terminals and the Bradley West Core of the Tom Bradley International Terminal, in effect, nearly doubling the square footage available for duty free concession operations from that of the previous layout.

Ten years was originally considered, by both LAWA and the DFS Group, to be the optimal term for the original 2012 contract for the following reasons: (1) because the projected concessions revenue from the Bradley West project represent an important part of the Department's Plan of Finance formulated to issue the bonds to finance the project, LAWA's intent was to balance a higher revenue stream with a reasonable debt service; and (2) because the level of investment by the DFS Group is considerable (at least \$42 million over five years), the investments must be depreciated over the useful life of the agreement in order to avoid an accelerated write-down of the cost and, thereby, constraints on the DFS Group's ability to compensate LAWA.

At the time of the new Tom Bradley International Terminal construction, the DFS Group was required to build out its duty free shop space to coincide with the scheduled opening of the TBIT gates. To do so, however, resulted in an overlap of construction activities that both delayed the delivery of the space to the DFS Group and resulted in increased costs to the DFS Group of approximately \$1.02 million (or 5.8 percent above the original budget). To help remedy the problem of an unplanned increase in expenditures, LAWA and the DFS Group agreed to a one-year term extension—from 10

years to 11 years—to enable the contractor to achieve the original intent of the contract, which is a 10-year term, in order to depreciate its investment over the cash flow projections from the duty free shop operations.

Proposed First Amendment

Per the Department, extending the current contract is beneficial for both parties in that DFS Group is able to (1) lengthen the depreciation period for its extensive investment in airport improvements (a minimum of \$42 million over the initial 10 years of the agreement) and (2) according to LAWA, maintain its world-class facilities and customer service, as well as helping to keep LAX competitive in the airport duty free market. The Department, on the other hand, (1) is relieved of its financial obligation, which resulted from construction delays, to the DFS Group; (2) receives additional revenue of approximately \$33 million over the one-year extension period; and (3) continues to benefit from superior duty free venues and customer service that have been designed to help LAX successfully compete with other of the world's leading airports. The original 10-year term was determined by LAWA to be optimal in that it would (1) enable the Department to balance a higher revenue stream with the optimum debt service in order to service the bonds issued to finance the Bradley West project; and (2) avoid an accelerated write-down of the DFS Group's considerable investment that might otherwise constrain its ability to fully compensate LAWA. The proposed extension will enable the DFS Group to better depreciate its capital investment and allow the Department to successfully resolve the problem of cost overruns without costly and time-consuming settlement negotiations with and/or a significant cash reimbursement paid to the contractor.

Alternatives to Approving the Proposed First Amendment

According to the Department, there are no viable alternatives to approving the proposed First Amendment with the DFS Group in that, if the proposed amendment is not executed, one or more of the following could occur: (1) the contractor would not be able to fully depreciate its capital investment in various duty free concession spaces in the new Tom Bradley International Terminal in a timely manner, thus requiring LAWA to make a cash settlement payment to DFS Group for building infrastructure improvements it has made; and (2) it would preclude LAWA from realizing an additional \$33 million in revenue over the one-year extension period.

Compliance with City Administrative Requirements

The DFS Group has been assigned a Business Tax Registration Certificate number and has approved insurance documents on file with the Department, in the terms and amounts requested. The proposed First Amendment to the Duty Free Merchandise Concession Agreement with the DFS Group must be approved by the City Attorney as to form.

The DFS Group has submitted the Contractor Responsibility Program Questionnaire and Pledge of Compliance and must comply with the applicable provisions. In accordance with the underlying agreement and proposed First Amendment, the DFS Group is required to comply with the provisions of the following standard City contract requirements: Affirmative Action Program; Child Support Obligations Ordinance; Living Wage and Service Worker Retention Ordinances; and the First Source

Hiring Program for all non-trade LAX airport jobs.

Department staff have determined that work specified in the proposed duty free concessions agreement is not subject to the provisions of Charter Section 1022 (Use of Independent Contractors). The DFS Group is subject to the provisions of the Bidder Contributions, City Ethics Commission Form 55 pertaining to the City's contract bidder campaign contribution and fundraising restrictions (Charter Section 470 {c}{12}) that became effective in April 2011. In addition, staff from the Department of Public Works, Office of Contract Compliance, must determine that the DFS Group is in full compliance with the provisions of the Equal Benefits Ordinance prior to execution of the First Amendment.

The Department's Procurement Services staff reviewed the duty free concessions operation and established a goal of 20 percent for the ACDBE (Airport Concessions Disadvantaged Business Enterprise) participation. Staff reports that the DFS Group committed to, and has achieved, a 25 percent participation level.

With respect to the Department's compliance with the requirements of the California Environmental Quality Act (CEQA), the issuance of permits, leases, agreements or other entitlements granting use of existing facilities at a municipal airport involving negligible or no expansion of use beyond that previously existing or permitted is exempt from the requirements pursuant to Article III, Class 1(18) (c) of the Los Angeles City CEQA Guidelines. Pursuant to Charter Section 606 and the Los Angeles Administrative Code Section 10.5, the proposed First Amendment must be approved by the Council in that the underlying Concession Agreement, including the term extension, is for a period longer than five years.

RECOMMENDATIONS

That the Mayor:

1. Approve, subject to City Attorney approval as to form and compliance with the City's Standard Provisions for Contracts including: the Affirmative Action Program, Child Support Obligations Ordinance, Living Wage and Service Worker Retention Ordinances, the First Source Hiring Program for all non-trade LAX airport jobs, the City Ethics Commission Form 55 provisions pertaining to the contract bidder campaign contribution and fundraising restrictions, and the provisions of the Equal Benefits Ordinance; the proposed First Amendment to the Duty Free Merchandise Concession Agreement between the Los Angeles World Airports and DFS Group L.P. to enable the company to better depreciate its capital investment made to duty free concession spaces at the Los Angeles International Airport;
2. Authorize the Executive Director of the Los Angeles World Airports to execute the proposed First Amendment; and
3. Return the proposed First Amendment to the Los Angeles World Airports for further processing, including Council consideration.

FISCAL IMPACT STATEMENT

Approval of the proposed First Amendment will result in a minimum of \$33 million in additional revenue for LAWA over the one-year extension term. No appropriation of LAWA capital or operating funds is required for the proposed contract term extension. The underlying agreement, and the First Amendment, comply with the Department of Airports adopted Financial Policies. Approval of the proposed amendment with the DFS Group L.P. will have no impact on the City's General Fund.

TIME LIMIT FOR COUNCIL ACTION

Pursuant to Charter Section 606, "Process for Granting Franchises, Permits, Licenses and Entering Into Leases," and the Los Angeles Administrative Code Section 10.5, "Limitation and Power to Make Contracts," unless the Council takes action disapproving a contract that is longer than five years within 30 days after submission to Council, the contract shall be deemed approved.

MAS:WDC:10150050