

HB

210

FISCAL NOTE

STATE OF ALASKA
1997 LEGISLATIVE SESSION

BILL NO. HB 210

Revision Date: _____ Dept. Affected: DOT&PF
 Title: Airport Duty-Free Concessions BRU: Anch/Fbks International Airport
 Component: Airport Operations
 Sponsor: Representative Rokberg
 Requester: House Transportation COMPONENT SERIAL NO. 1812, 1813

Expenditures/Revenues (Thousands of Dollars)

OPERATING EXPENDITURES	FY 98	FY 99	FY 00	FY 01	FY 02	FY 03
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0
CAPITAL EXPENDITURES	0.0	0.0	0.0	0.0	0.0	0.0
CHANGE IN REVENUES ()	0.0	0.0	0.0	0.0	0.0	0.0

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1006 GF/MHTIA						
Other						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY97) cost: \$ 0.0

POSITIONS

FULL-TIME	0	0	0	0	0	0
PART-TIME	0	0	0	0	0	0
TEMPORARY	0	0	0	0	0	0

ANALYSIS: (Attach a separate page if necessary)

The Department of Transportation and Public Facilities anticipates no additional costs associated with passage of House Bill 210

Prepared by: Sam Kito III Phone: 465-3900
 Division: Office of the Commissioner Date: 4/28/97
 Approved by: [Signature] Date: 4/28/97
 Agency: Department of Transportation and Public Facilities
Special Assistant
Commissioner

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HB 210

BILL SUMMARY. DOTPF may extend a duty free concession contract if department determines that the extension will maintain or improve the competitive position of the airport and maintain or increase the concessionaire's revenues.

PROSPECTIVE ONLY. No retroactive provision, although DGG's testimony before Senate indicated that they wanted this bill to apply to existing contract. If this bill is prospective only, then it isn't needed because the airport can already provide options for extension in the ITB or RFP. The criteria to support an extension raises policy issues.

RETROACTIVE PROBLEMS. Legal concerns if made retroactive:

1. Violation of competitive principles because this would be a material modification since the possibility of an extension was not included in the ITB, and an extension creates a new contract. Kenai Lumber v. LeResche, 646 P.2d 215 (Alaska 1982)
2. Airport regulations require that a lease, permit or concession be noticed to the public prior to award and that the general terms and conditions of the contract be described. 17 AAC 40.340. The duty free concession was for 5 years, and no extension was noticed.
3. Duty free concession ITB provided that the contract terms were not negotiable. Disclaimers were included; no warranty for increases or decreases in customer flow. (3 bidders)
4. Would appear to be a special act since there is only one duty free concession contract and thus prohibited under AK Constitution, Art. II, Sec. 19.
5. Litigation is likely if the DGG contract is extended because another bidder has already alleged that the airport favored DGG. The court found that the assertions of impropriety were not patently frivolous and that the airport had a reasonable basis to cancel the solicitation. Paul Wholesale v. State, 908 P.2d 994 (Alaska 1995).
6. FAA waiver would be required for term beyond 5 years. 49 CFR 23.107.

ALASKA STATE LEGISLATURE

House of Representatives

COMMITTEE ASSIGNMENTS

LABOR & COMMERCE COMMITTEE, CHAIRMAN
SPECIAL COMMITTEE ON OIL & GAS, MEMBER
JUDICIARY COMMITTEE, MEMBER
CORRECTIONS BUDGET SUBCOMMITTEE, MEMBER
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INTERIM:
716 WEST 4TH AVENUE, SUITE 640
ANCHORAGE, AK 99501
PHONE: (907) 258-8191
FAX: (907) 258-2916

SESSION:
STATE CAPITOL
JUNEAU, AK 99801-1182
PHONE: (907) 465-4968
FAX: (907) 465-2040

Representative Norman Rokeberg

SPONSOR STATEMENT HOUSE BILL 210 BY REPRESENTATIVE NORMAN ROKEBERG

House Bill 210 - An Act relating to the extension of contracts for the sale and delivery on in-bond merchandise at international airports.

House Bill 210 is a straight forward bill that would provide the Department of Transportation and Public Facilities (DOT/PF) with more flexibility to extend the term of a duty free concession contract at the Anchorage International Airport, if such extension would be in the state's best interests. The bill does not mandate that DOT/PF do anything; it just provides a tool that may be used to maintain the competitive position of Anchorage International Airport in the marketplace.

The duty free/general merchandise concession at Anchorage International Airport at one time generated revenues in excess of \$100 million and fees to the state approaching \$19 million annually. The changing nature of the international airport market (i.e., rerouting around Anchorage as a stop, opening of Soviet air space, long-haul jets) has greatly impacted the market with a resulting decline in revenues and fees to Alaska.

These revenues and fees are again increasing as the new concessionaire works to attract a broader market and as more international airlines consider Anchorage as a stop. The current concession contract is held by a group of Alaskans--the David Green Group. The concessionaire needs to make substantial additional investments in leasehold improvements to attract world-class brand merchandise. An extension of the lease term would allow the concessionaire to amortize its tenant improvements over a reasonable length of time, as well as enhance the competitive position of our duty-free concession versus New York and Hong Kong. The resulting increase in gross revenue would be in the state's best interest.

Your support of this legislation would be appreciated.

ED1:4/14/97

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Representative Norman Rokeberg

SECTIONAL ANALYSIS HOUSE BILL 210

By Representative Norman Rokeberg

House Bill 210 - An Act relating to the extension of contracts for the sale and delivery of in-bond merchandise at international airports.

Section 1 - Permits the Department of Transportation and Public Facilities to extend a contract for the sale or delivery of in-bond merchandise at an international airport if: (a) the contractor agrees, (b) the extension is in the state's best interest and (c) such extension would maintain or improve the competitive position of the airport in the marketplace.

Anchorage International Airport Duty Free/General Merchandise Concession

Background:

The duty free/general merchandise concession (DF/GM concession) at the North Terminal of Anchorage International Airport (AIA) is operated by the David Green Group, J.V. (DGG) until its agreement termination in July 2000. DGG is requesting that the State grant an term extension of 40 months to facilitate the expansion and improvement of the retail spaces.

The AIA DF/GM concession at one time produced one of the world's highest revenue per passenger airport operations resulting in an extremely valuable State asset that generated significant revenues for the airport and its operators. In 1988, transit passengers totaled 1.5 million passengers and concession retail sales exceeded \$100 million per year with fees paid to the State approaching \$19 million annually. However, with the opening of Soviet air space and a new generation of long-haul jets coming on-line the market drastically declined by 75% in the number of transit passengers with annual sales plummeting to a low of \$7 million and concessions fees to \$1 million (See attached Charts A through C for passenger traffic, airport concession fees and gross revenue history).

DFS Ltd, the world's largest duty free operator and incumbent AIA concessionaire, did not even submit a bid to the State to retain the concession that it operated for 25 years. It was deemed to have eroded in the value to the point of not worth the effort. In fact, DOTPF had to put the bid proposal out for a fourth time before it even got any interested bidders. At that point, the successful bidder was the David Green Group (DGG).

The DGG was awarded the concession for a term of five years beginning on August 1, 1995. During their first year of operation they increased sales by 50% to over \$10 million with expectations that there will be an additional 50% sales growth in the second year. This has been the result of local management control, a focused marketing strategy, hard work, passenger growth and appropriate investment. The recent increases in international transit passengers present a narrow window of opportunity to revitalize the standing of the DF/GM concession. The increase enhances the credibility of the DF/GM concession opportunity, so that it is once again to viably market the facility to high-end merchandise suppliers. Many of these suppliers expect the surrounding company of other prestige brands. World class brands such as Hermes, Cartier, Coach and Christian Dior have expressed renewed interest in Anchorage, but only if a high-end retail environment is created.

Because of the highly competitive nature of the duty free business globally and the changes occurring in the Asian, European and North American economic market, airports and concessionaires are making significant investments to attract retail sales growth. Consequently, if AIA is to maintain their position in the marketplace or to expect any growth it is essential that the necessary investment(s) be made to insure a competitive presence. DGG believes that additional investment in the infrastructure of their concession would yield a significant increase in retail sales and fees to AIA. However, not enough time remains under the current concession agreement to adequately amortize the investment.

The State directs the airport and its AIA Revenue Fund to be self-sustaining to maximize revenue opportunities where feasible, as is the case with most airports in the world. There is a limit on the amount airports can derive through increased landing fees before discouraging air carriers using their facilities. Increasing competition between airlines has meant that airports have turned to retailing as an alternative source of revenue. A London Financial Times study stated, "the portion of income derived from landing fees fell from 27% in 1983 to 25% in 1993. This reflects pressures from both airlines and regulatory bodies to keep these charges low." In the case of AIA, the State fees derived from the DF/GM concession sales enhances the attractiveness of the international terminal, better serves the traveling public and enables the State to mitigate other operational costs currently borne by the air carriers. While DGG certainly intends to work aggressively to enhance the duty-free concession to the extent economically prudent under the existing agreement, the regrettable reality is that it is not commercially feasible for DGG to undertake the necessary proposed scope of investments under the current contract term.

Other Airport Duty Free Concessions:

AIA competes with selected major Asian and North American airports for the discretionary spending of both transit and destination travelers. This international competition for the sale of duty-free/general merchandise has entered a new era of competition, particularly in these airports across the Pacific Rim (See Chart D from trade press, Datamonitor). Other existing airports, such as, Los Angeles, New York and Vancouver are also investing capital to improve their passenger facilities. The retail opportunities available to the international travelers are thus being continually elevated. Progressive leasing authorities recognize that to remain competitive they must work with their concessionaire(s) to viably compete for discretionary travel retail sales. For example, at JFK in New York, a group of four major international airlines, i.e., Korean Air, JAL, Lufthansa and Air France, are constructing a world class terminal facility by 1998 to complement the high standard level of passenger service expected of them. This competing facility will contain over 17,000 square feet of retail space, as compared to AIA's current 8,000 sq. ft. of retail space. This is a significant increase of their existing retail areas and improves their competitiveness for air travelers spending on this major route transiting Anchorage.

Examples of Asian airport investments are noted in Chart D (attached) through the year 2000 for new or improved airport operating and retail facilities. The new Chek Lap Kok Airport opening in 1997 will dramatically increase retail shopping space by 15,000 sq. ft. over the current congested facility in Hong Kong. Many of these airports are direct competitors to AIA and its international merchandise concession.

Major international airports in the U.S., such as Sea-Tac, Portland and Las Vegas work with their concessionaires to grant them term extensions when substantial investments and efforts are made to improve merchandise facilities. The airports recognize the necessity to compete for customer spending in order to receive additional fees from cooperative concession agreements as this to operate and upgrade their facilities for expected future growth.

Legislative Need:

Conversations with the AIA's staff demonstrate a recognition of the competitive nature of the retail business and a belief that additional investment(s) would yield greater financial and competitive returns. However, they feel that they need the broadened authority under existing statutes to extend the term of the agreement for the benefit of the airport.

The introduction of the proposed amendment would allow the State and DOTPF to extend the term of the duty free concession agreement for 40 months if deemed to be in the best interest of the State and designed to improve AIA's competitive position in the marketplace. Absent this amendment, AIA would be constrained from having the flexibility to react to the already changing competitive environment. Giving DOTPF this flexibility both enhances the value of the concession and the State asset by generating additional fees to AIA, lowers operating costs and rates which would attract further new international air carriers to this airport.

Anchorage International Airport - North Terminal

Chart "A" - Transit Passengers

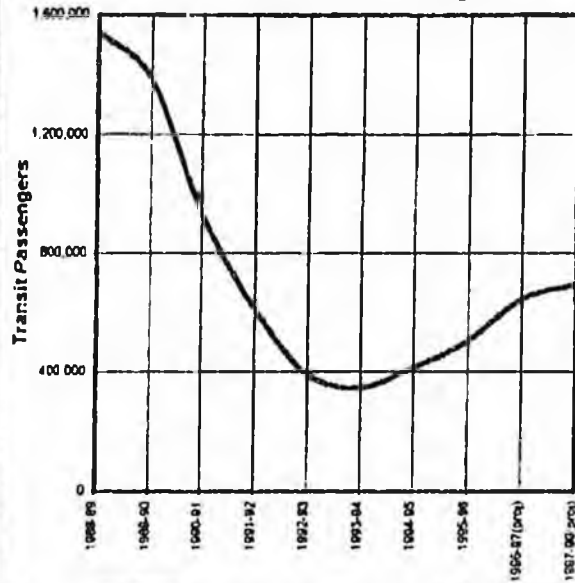


Chart "B" - Gross Revenues

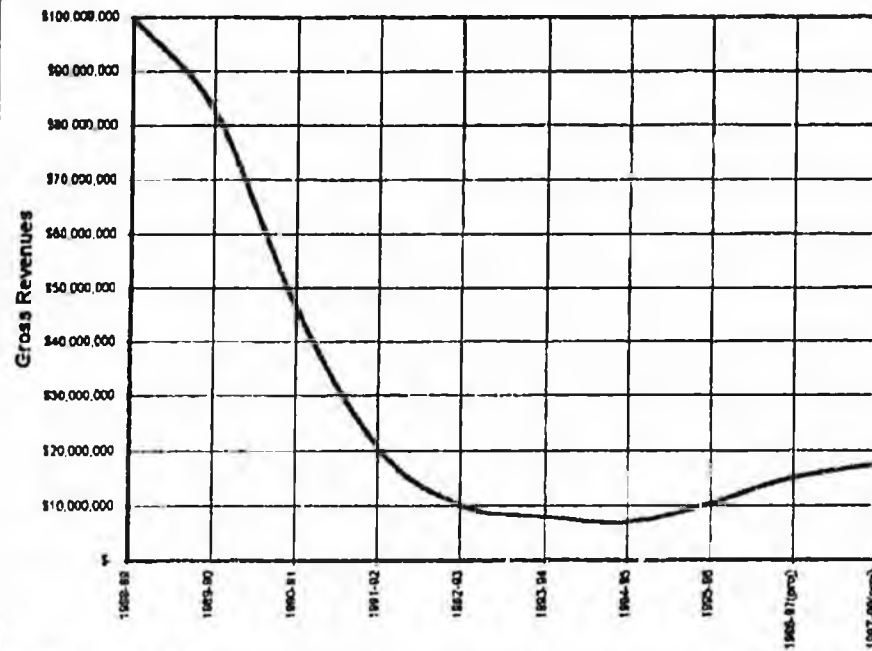
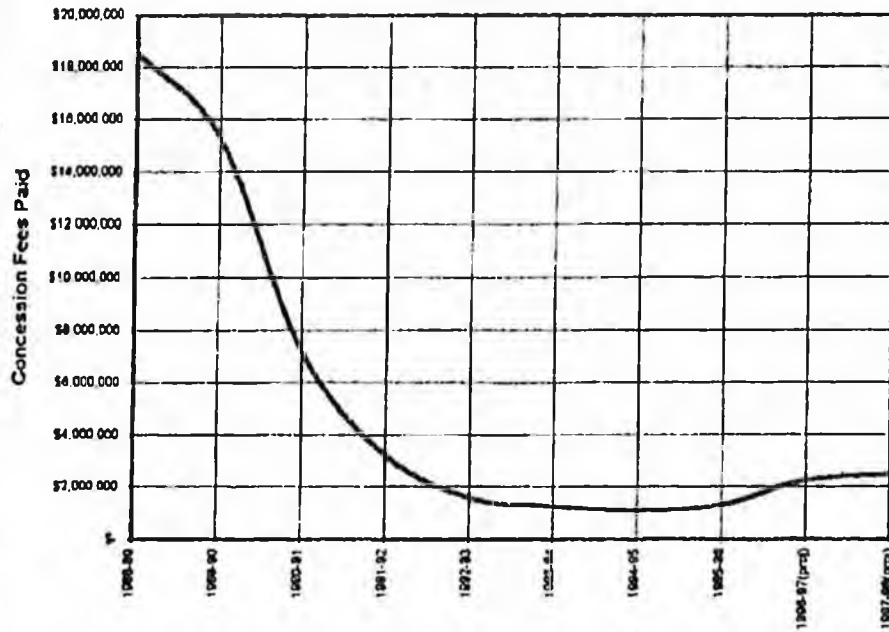


Chart "C" - Concession Fees Paid



▲ DGG acquires concession (Aug 1995)

It is estimated that spending on airport infrastructure in Asia will amount to \$75bn by the end of the century, with the new airports in Hong Kong, Seoul and Kuala Lumpur accounting for half of this, and China for a further \$10bn. Development is also taking place in the developed countries of the region: in 1995, the new Osaka/Kansai airport was opened in Japan. The region's major airport investment programmes for the rest of the decade are shown in Table 4.4. Beyond this, perhaps another \$50bn of investment will be needed in the period 2000-10.

Table 4.4: Investments in major Asian airports, 1995-2000

Airport	Country	Opening date	Investment \$m
Hong Kong Chek Lap Kok	Hong Kong	1997	21,000
Kansai	Japan	1995	15,000
Seoul Kimo International	South Korea	1997	13,000
Kuala Lumpur	Malaysia	1998	7,500
Bangkok	Thailand	2000	3,200
Shanghai	China	1999	2,800
Kobe	Japan	1998	2,800
Guangzhou	China	1997	1,760
Narita	Japan	2002	1,360
Macao	Macao	1995	913
Taipei	Taiwan	1996	700
Ho Chi Minh	Vietnam	2000	558
Beijing	China	2002	500
Manila	Philippines	2003	484
Singapore	Singapore	1996	300

Source: trade press, Datamonitor

There is also evidence that growth is not only occurring in these large regional airports, but is also spreading to a host of secondary cities such as Kota Kinabalu (Malaysia) and Cebu (Philippines). This growth is being driven by tourism and government programmes to reduce congestion in the largest cities and spread the benefits of industrialisation to other parts of the country. The key countries experiencing this growth are China, India, Indonesia, Malaysia, the Philippines, South Korea, Taiwan and Thailand. A third phase of development will occur later in Cambodia, Laos, Mongolia and Vietnam.

China's airports

This section focuses on China, one of the key growth areas on the continent. Not only is China a rapidly expanding air travel market, it has a huge airport expansion programme and has been a major destination for foreign retailers over recent years. Over the 25-year period to 1993, the growth in air passengers in China averaged 21% per annum to reach 53m passengers.