MEMORANDUM

TO: CHAIRMAN JOSE R. LIFOIFOI

CC: BOARD OF DIRECTORS
EXECUTIVE DIRECTOR
COMPTROLLER
LEASE COMPLIANCE OFFICER

FR: SPECIAL COMMITTEE ON MASTER CONCESSION AGREEMENT

RE: INFORMATIONAL REPORT ON CPA MASTER CONCESSION.

Your Special Committee on Master Concession Agreement is pleased to report to the Board on its findings and submits this Informational Report on the CPA Master Concession ("Report") as follows[1]:

BACKGROUND:

THE FIRST MASTER CONCESSION AGREEMENT:

On November 13, 1985 CPA entered into a Master Concession Agreement ("MCA") with Duty Free Shoppers Ltd. ("DFS"). The MCA followed the enactment of P.L. 4-60 which expanded on the prior mandate that no more than one duty-free concession be permitted at each port of entry. The use of a "Master Concession" under the law as expressed by the Legislature, could further help the Commonwealth "maximize its revenues, make capital improvements in its ports of entry . . . operate is ports of entry in an orderly, efficient and attractive manner, and ensure the availability of good service and quality at its ports of entry" as well as promote tourism and improve the economy.

At the time that P.L. 4-60 took effect, CPA and DFS had an Existing Lease

---

[1] The Master Concession materials are attached to this Report and are referenced with respect to the tabs on the bound materials.

Agreement for the use of the CPA facilities as well as a separate Rota Lease Agreement. The MCA terminated the Existing Lease Agreement for facilities and formalized a global and exclusive agreement to sell Merchandise at CPA premises including vending machines; in-flight catering; signs; and advertising. Tab 10 at 9-13. The term of the MCA was for twenty (20) years. The consideration for CPA from DFS was a percentage of the Gross Sales and warehouse fees. DFS paid no other fees or charges under the MCA. CPA was responsible for the facilities used by DFS. The MCA proceeded between CPA and DFS following its execution without any remarkable issues or disputes.

THE FIRST PUBLIC HEARING ON MASTER CONCESSION:

On May 28, 1996 CPA issued a Notice of Public Hearing on a proposed grant/extension of a successive master concession agreement with DFS. Tab 7. On June 14, 1996 CPA conducted a Public Hearing pursuant to 4 CMC § 2206(a) with respect to a proposed grant of a "Successive Master Agreement" with DFS Saipan Limited[2]. Tab 8. What was the reason for this hearing? DFS wanted an extension of the MCA with now having only ten (10) years remaining on its agreement. A public hearing was required under the law. The articulated reason, advanced by CPA, for the extension under consideration was because of CPA's ongoing projects and the need for additional funding sources. CPA was negotiating with DFS for "some cash advance as part of the extension" so that a ten-year extension would be granted at the extension of the existing contract. The projects required capital infusion and in CPA's view DFS would be willing to pay additional consideration for a ten-year extension.

PUBLIC COMMENTS AT THE HEARING:

The question at the Public Hearing was whether or not CPA would proceed with an extension of the MCA. At the Public Hearing, CPA received comments of support for the extension and answered inquiries as to the terms of the MCA. CPA informed that DFS "guarantees the airport bond by issuing an annual letter of credit." CPA reported that because of the letter of credit which guarantees 100%

---

[2] Prior to that hearing on May 1, 1996, CPA and DFS executed an Agreement to Enter into Subconcession Agreements where DFS agreed to subcontract its exclusive rights to operate concessions on Tinian and Rota. CPA would handle this area of the concessions and no longer DFS. In return, DFS received additional space to expand its Saipan Airport Operating Facility. Tab 6.

of the outstanding balance of the bond, "CPA earns low interest rates."[3] There was no authority cited for this proposition in the minutes.

Other parties at the Public Hearing inquired as to the opportunities for sublease agreements for smaller shops. The concern was that DFS was denying interested applicants space for smaller shops. CPA assured that such was not the case and that any interested party should submit a letter of interest and that CPA would review and evaluate the request and meet with DFS to allow for such opportunities. Further, it was noted that DFS was "giving up" the food and beverage concessions to LSG. LSG would operate these operations and would be the entity to give out the sub-concession operations in the CPA terminals, such as ice cream stands or coffee stands. LSG would evaluate interested sub-concession applicants and forward them to CPA which would have the final decision. LSG would be responsible for ensuring that activities were "first class" rated and met the standards of quality services. Other comments included concerns about having space for local arts, handicrafts and local food. DFS informed of its efforts to secure vendors for their products but without success and indicated it would continue to allow opportunities for such local vendors.

The former Marianas Visitors Bureau, at the Public Hearing, requested space to provide tourist brochures and other information for its activities. CPA informed MVB that it would address the agency's concerns and cited a provision in the MCA for such activities providing for marketing or sales of local products or local food. The Isla Gift Shop was cited as an example of such an activity. These were the issues or concerns related to the MCA in June of 1996.

In the Legislature, there was support for DFS' request for the extension. In particular, the Tenth CNMI Senate adopted Resolution No. 10-13 supporting a Successive Master Concession Agreement with DFS. Tab 13. The Resolution was an emphatic statement of support for DFS because of its hiring of local residents in addition to its civic support for various worthy causes.
The Public Hearing was a necessary process for the effort to consider DFS'

---

[3] At that time CPA had in place Airport Revenue Bonds, 1985 Series A, in an amount of $13.6 million, issued pursuant to a Bond Indenture Agreement. Under Section 22 of the MCA, if CPA defaults under the Bond Indenture DFS would have "the right, but not the obligation, to cure and prevent any default or anticipated default by CPA under the Bond Indenture, at the expense of CPA." This means that DFS would be able to back up and pay for any difference in the bond payment or default amount, but that CPA would have to pay DFS.

request for a ten year extension. With an extension of the MCA DFS would benefit with extended sales and operations at the CPA facilities. The agreement, which would have expired on November 13, 2005, would bring the MCA, through a "Successive Master Concession Agreement" ("SMCA") to expire on November 13, 2015. On August 8, 1997 CPA and DFS Saipan Limited executed the SCMA. Tab 4. This is the current Agreement which is in effect between CPA and DFS.

THE SUCCESSIVE MASTER CONCESSION AGREEMENT TODAY:

The SCMA charges DFS $1,000 per year for the granting of a master concession. SCMA at 2. As additional consideration for CPA's agreement to the SCMA, DFS agreed to pay $1 million dollars to CPA concurrent with the execution of the SCMA. SCMA at 7. As with the MCA, under the SCMA DFS had exclusive rights to the sales of Merchandise; Vending Machines; In-flight catering; Signs and Advertising. SMCA at 9-11. In return, DFS paid a Percentage Concession Fee which is today 18% of Gross Sales of DFS (originally at 15%). Further, DFS pays a rate for Warehouse Fee rental. This was set to be at $1.52 per square foot but was negotiated and agreed to by CPA to be at $1.15per square foot. The *See,* Tab 7. DFS requested the reduced rate at the time of the First Amendment to the SCMA on April 13, 2012. At that time, DFS was not using the warehouse area and was indicating its intent to relinquish the warehouse back to CPA. However, the parties agreed to the reduced rate and DFS agreed to continue to use the warehouse and pay for the reduced rate[4].

With respect to fees generated from the SCMA, in FY 2008 CPA received $1.65 million from the Gross Sales percentage and $221,255 from the Warehouse Fees. In FY 2011 this amount increased to $1.8 million and $234,600 respectively. In FY 2013, CPA received $2.6 million from Gross Sales and $234,600 from Warehouse Fees. The total cumulative amount earned from DFS from FY 2008 through FY 2013 for Gross Sales and Warehouse Fee is $12.73 million dollars.

With respect sub-concessions, CPA receives approximately $837,000 per year from LSG for its food and beverage sub-concession operations. LSG operates the

[4] There has been discussion with the Department of Homeland Security that the agency may require additional footage for its arrival immigration screening area. DFS understands and agrees that should DHS require that additional area, DFS would relinquish the required property and its rent would be reduced proportionately. At this time DHS has not indicated that it will take any portion of the warehouse area.

food concession sales in the East and West Terminals. LSG no longer operates sub-concessions outside the departure terminals. As to sub-concession fees, in 2006 CPA received $387,905 in sales collections which were at 16%. CPA also received 13% from LSG under the Ground Lease Agreement. In 2013, CPA received a total of $760,726 from LSG from its sub-concession operations.

Another sub-concessionaire is Del Benson. Del Benson's advertising contract at the CPA facilities. The Del Benson agreement, called the Agreement to Administer Advertising Concession, runs annually between Del Benson and DFS and is automatically renewed annually for so long as the SCMA is in effect. As of today, Del Benson is informed that all his advertising contracts at the Saipan Airport Terminal may not exceed November, 2015 and will terminate on the same expiration date as the SCMA. As to the Del Benson Agreement, in 2006 CPA received $22,325 from his advertising sales operations. In 2013, CPA receives on average approximately $28,000 from his advertisement sales in the arrival area of the airport. Lastly, there is an advertising contract for Hana Tour. Hana Tour provides its advertising on the baggage carts at the departure and arrival area of the airport terminals. As to this concession, CPA receives approximately $14,000 per year from Hana Tour for its advertisements at the Saipan Airport.

FINANCIAL REPORTING BY DFS UNDER THE SCMA

Section 7 of the SCMA discusses the procedures for fiscal reporting and accounting between DFS and CPA. Section 7(a) requires DFS to file the concession fees accrued for the prior month, which states all gross sales, concession fees and any credits against the fees. Section 7(b) requires DFS to keep full and accurate books showing its Gross Sales and other information. DFS has the right, at all reasonable times, to inspect and audit such books and records. DFS agrees to retain/maintain and make available all records for a three-year period. DFS is also to provide an audited financial statement pursuant to the SMCA and also agrees that CPA itself may direct an audit of DFS' records to verify any sales or credits.

The CPA Comptroller reported to your Committee that based on her review of the SCMA and files, DFS is in compliance with this provision. DFS provides audited financial statements consistent with the SCMA. CPA's auditor, per the Comptroller, has not cited any deficiencies or concerns as to DFS under the SCMA. The monthly reporting requirements are backed up by the annual audits and CPA has found on good cause to undertake an independent audit.

WALK-THROUGH INSPECTION OF THE DFS OPERATIONS AREA

Your Committee conducted a walk-through of the DFS operations area under the SCMA at the Saipan International Airport. DFS operates retail sales in the central area between the East and West Terminal. Departing passengers enter into the DFS sales area following the TSA Inspection area as they proceed to their terminal gates. DFS also uses the warehouse area for its operational needs.

CPA Management described to your Committee that under the SCMA, CPA is responsible for the facilities including providing the connections for utilities, telephone and restrooms for DFS's operational needs. CPA provides the access control badging for DFS employees for which DFS pays the appropriate charges or fees for the badging. Management noted the ongoing concerns registered by DFS with respect to the leaks in the roof facility. During the heavy rains there are leaks and DFS has registered its concerns to CPA. Management is undertaking measures to make the roof repairs at the present time. Beyond the retail area, DFS is not responsible for any other operational areas. For example, under the sub-concession agreement, LSG now provides the seating areas and food/beverage sales in the East and West Terminals. LSG provides the seating and layout for the food concessions.

As to the restroom facilities in the departure terminals, CPA is responsible for these facilities as well as the air-conditioning system. At the present time CPA is undertaking the renovation of the airport restrooms with the AIP funds with the FAA grant program. The restroom renovation work is ongoing in all areas of the Saipan International Terminal.

Your Committee notes that under Section 5(c) of the SCMA, in the event CPA fails within a reasonable time to make repairs or provide emergency power, DFS shall be permitted to make such repairs or rent or purchase a generator for power supply. Those reasonable costs or charges would be credited against the concession fees and deducted from payments due to CPA. In the review of the history of the SCMA, there is no information that either party has ever exercised or had any issue as to this provision. Neither DFS nor CPA Management inform that there has been any issue as to facility deficiencies or power supply for DFS to take action and assert its rights under this provision.

DFS' UNSOLICITED SUBMISSIONS TO CPA REGARDING THE SCMA

Following the establishment of your Committee, DFS took the initiative to submit its own comments or information. On March 10, 2014 DFS submitted its "Limited Response to Five Tasks Assigned to Committee." ("DFS Response"). The DFS Response is attached and DFS took the liberty to provide its own comments as to the Committee's tasks.

Your Committee will decline comment on the DFS Response because the submission was neither solicited by CPA nor required by CPA at this juncture of the matter under consideration. In addition to discussion on the areas tasked to the Committee, the DFS Response also advances how DFS would propose that CPA undertake the question of how it wishes to proceed with the airport master concession issue.

Your Committee believes that the DFS Response comments at this point may be premature and more appropriate for the Public Hearing phase. Understandably, DFS is eager and anxious to be heard on its views as to the master concession issue urging an extension in its favor. Your Committee appreciates DFS's initiative and views the DFS Response as an effort to be informative and contribute to the information-gathering process rather than any effort to influence the Committee's tasks. Indeed, your Committee is not tasked with making any recommendation or findings and so the DFS Response may be considered at the appropriate time by the full Board and Management. The appropriate time will come when the comments in the DFS Response may be annexed to the CPA record and your Committee is confident that the Board and the community will receive all comments including those from DFS as the Board deliberates on the question presented.

COMMITTEE'S IDENTIFIED AREAS FOR CONSIDERATION OR DISCUSSION ON MASTER CONCESSION

Your Committee has identified several areas which the Board may wish to discuss and solicit more information, whether from DFS or other sources, on the master concession issue as follows:

1. The Scope of the Master Concession: Your Committee observes that the original MCA was a true "Master Concession" for it provided DFS with the

complete and exclusive operations in a comprehensive scope at all CPA terminals (airport and seaport) on all three islands. However, subsequent to that in the SCMA the parties agreed that LSG would operate a sub-concession for food and beverage. CPA and DFS agreed to carve out this exception in the SCMA for LSG to undertake a sub-concession. Following that agreement, DFS and CPA again agreed to carve out the advertising portion of the SCMA to permit Del Benson and Hana Tour to undertake advertising at the airport terminal on Saipan. DFS would not handle advertising at the CPA terminals outside of its immediate retail area.

Your Committee believes it would be a prudent discussion with the Board and CPA Management to discuss the question of the scope of the Master Concession. Does CPA continue to wish a true "Master Concession" like the original MCA? Or does CPA wish to limit the kind of concession for consideration to the existing SCMA as modified for the food/beverage and advertising sub-concessions? Your Committee does not recommend or make further comment as to which direction to take except to note that the history of the MCA and SCMA suggest that the scope of the master concession warrants further discussion and consideration.

Along the same lines, your Committee also observed that DFS has relinquished its retail duty-free sales for Tinian and Rota. The seaport operations for retail are periodic when cruise ships dock at the harbor. Your Committee believes that the Board and Management should consider whether CPA's plans for the Tinian and Rota airports warrant requiring the incumbent concessionaire to maintain duty-free sales operations at those airports (and seaports) or exclude them from the master concession as is the present case.

2. The Master Concession Retail and TSA Screening Area Considerations: Your Committee observed in the walk-through that there are some logistical considerations at the present time with existing retail area and the TSA screening leading into the DFS retail sales area.

Your Committee would invite the Board and Management to discuss the retail area for the Master Concession operations. Is more space needed and if more space is required, what are the existing or future plans for the departure terminal facility? For example, if additional retail space is needed, will the expansion proceed toward the underused West Terminal area and how will that affect the gate operations and food/beverage concessions?

As to screening concerns, tt appears that there may be additional comments or suggestions necessary from the Department of Homeland Security and TSA, as well as DFS, as to the logistics of the current screening area. It is clear that back in 1996 the matter of screening was not a great logistical concern but the changes in the screening operations and the increasing passenger load may warrant further discussion on this space area concern. In its Response DFS noted that it "gave up" 1,000 feet of its retail space area for TSA needs without any reduction in rent. Whether TSA will require additional space or will have expansion needs merits discussion.

3. Amusement and Gambling Devices: Section 8(q) of the SCMA prohibits CPA from permitting or licensing the operation of any amusement or gambling device at any port of entry at which DFS maintains its operations. Your Committee observes that with legislation permitting electronic gaming and casino on Saipan, the Board and Management may wish to consider this restriction on CPA facilities. There may be a revenue stream available to CPA which can be realized with the permission of gaming or gambling devices at the CPA airport and seaport facilities. There is not discussion of the reason for the restriction gaming or gambling devices on CPA facilities. Your Committee suggests that there be a discussion or at least a review of this issue on the subject of the master concession.