

OFFICE OF THE CITY CONTROLLER



**HOUSTON AIRPORT SYSTEMS
CONCESSIONS DIVISION**

**COMPLIANCE AUDIT OF CONCESSIONAIRE CONTRACT
NO. 30046 - JDDA SSP (JOINT VENTURE)**

Ronald C. Green, City Controller

David A. Schroeder, City Auditor



OFFICE OF THE CITY CONTROLLER
CITY OF HOUSTON
TEXAS

RONALD C. GREEN

July 15, 2011

The Honorable Annise D. Parker, Mayor
City of Houston, Texas

**SUBJECT: 2012-01 HOUSTON AIRPORT SYSTEMS (HAS), CONCESSIONS DIVISION –
COMPLIANCE AUDIT OF CONCESSION CONTRACT NO. 30046 (JDDA SSP JOINT
VENTURE)**

Mayor Parker:

The Controller's Office, has completed a Compliance Audit of Concession Contract No. 30046 between Houston Airport Systems (HAS) and the Joint Venture of 'JDDA SSP'. The Agreement provides HAS with concession operations (Restaurants, Shops, etc.) at the various airports as a service to travelers. One element of the Agreement is to pay HAS revenues based on a percentage of gross sales earned by the various concessionaires. Therefore, the objectives of this audit were to determine that:

- JDDA SSP reported and paid the correct amount of revenue due HAS;
- Deductions from gross sales were allowed according to the Agreement;
- Required insurance coverage was in compliance with the Agreement.

It was noted during the course of the audit that the locations were in good operating condition, offered quality product and had solid internal controls over the sales process, *however* gross sales reported for purposes of determining revenue owed to the City was not in compliance with the contract terms.

The significant issues identified that were related to the audit objectives, noted that:

Subsidiaries associated with the Joint Venture were:

- Withholding 2% of revenue paid to the City claiming franchise fees that are contrary to the contractual definition and not of arms length, resulting in an underpayment to the City of **approximately \$295,000**;
- Deducting the 14% Mixed Beverage Tax from gross sales, resulting in underpayment to the City of **approximately \$68,000¹**; and
- Not providing audited Statement of Gross Sales.

Management from both JDDA SSP and HAS provided responses and/or comments to each of the issues and, as such, are attached to the end of the report as separate exhibits. Additionally, sections of specific responses are embedded in the report within the related finding.²

¹ Considering that the deduction of MBT from Gross Sales has been common practice throughout the airport system, we estimated the impact since 1998. The result was a total of approximately \$2.3 million less revenue to HAS.

² Under Generally Accepted Government Auditing Standards 8.33, "Auditors should include in their report a copy of the written comments, or a summary of the comments received."



**OFFICE OF THE CITY CONTROLLER
CITY OF HOUSTON
TEXAS**

RONALD C. GREEN

We appreciate the overall cooperation we received from HAS and JDDA SSP throughout the project and we note the commitment from HAS to recover the amounts identified in the attached report.

Respectfully submitted,

Ronald C. Green
City Controller
Houston, Texas

xc: City Council Members
Andy Icken, Mayor's Office
Mario Diaz, Director, Houston Airport Systems
David Schroeder, City Auditor

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EXECUTIVE SUMMARY

INTRODUCTION

The Controller's Office Audit Division (Audit Division) has completed a contract compliance audit of one of Houston Airport System's (HAS) restaurant concessions. The Audit Team selected the "Managing Agent Agreement for Food and Beverage Services" (Agreement) between the City of Houston (COH) and JDDA SSP. The Agreement, which originated in 1990, has not been competitively bid since then. The current amendment (4th) became effective September 27, 2007 and ends December 31, 2016, with a two-year extension option.

BACKGROUND INFORMATION

HAS operates COH's three airports; George Bush Intercontinental Airport (IAH), William P. Hobby (HOU), and Ellington Field. HAS has contracts with managing concessionaires to provide shopping and dining facilities located throughout the two major airports, IAH and HOU. *Four Families* has food and beverage facilities located at HOU; while *CA One* and *JDDA SSP* are located at IAH.

The three managing concessionaires at the airports, their gross sales, and the amount remitted to HAS for Calendar Year 2010 are as follows in **TABLE 1**

Managing Concessionaire	Gross Sales Reported	Revenue Remitted to HAS	Average Percentage of Gross Sales Remitted to City
Four Families	\$22,579,690	\$3,099,260	13.73%
CA-1 / DNC	\$33,169,490	\$3,449,044	10.40%
JDDA SSP	\$20,533,442	\$2,499,024	12.17%

AUDIT SCOPE

Based primarily on the following criterion, the Audit Team selected the "Managing Agent Agreement for Food and Beverage Services" between HAS and JDDA SSP, a joint venture consisting of JDDA Concessions Management, Inc. and Creative Host Services, Inc¹:

- The Agreement has not been competitively bid since January 10, 1990;
- City Management's concerns that JDDA Concession Management, Inc. needed to improve the quality of service in order to be considered for renewal;
- The amount of revenue generated and remitted to HAS;
- The media, legal, and political controversies surrounding the renewal of the Agreement.

While the Agreement contains many requirements and conditions ranging from demolition and build-out costs of concessions, to compliance with the Federal Government's Disadvantaged Business Enterprises Program, the Audit team focused on Calendar Year 2010 reported gross sales, with an emphasis on detailed testing of July and November 2010.

¹ Shortly after the Agreement was effective, Creative Hosts changed its name to SSP America Texas, Inc.



AUDIT OBJECTIVES

The primary objectives of this audit were to determine:

1. Whether JDDA SSP paid/reported the correct amount of revenue due HAS;
2. Deductions from gross sales were allowed according to the Agreement;
3. Required insurance coverage was in compliance with the Agreement.

AUDIT METHODOLOGY

We conducted this contract compliance audit in accordance with Generally Accepted Government Auditing Standards issued by the Government Accountability Office and the International Standards for the Practice of Internal Auditing as promulgated by the Institute of Internal Auditors. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained meets these standards to support our findings and conclusions based on our audit objectives.

PROCEDURES PERFORMED

In order to obtain sufficient and appropriate evidence that provided reasonable assurance to support our conclusions related to the objectives identified above, we performed the following:

- Obtained and reviewed relevant documentation and performed interviews with appropriate personnel from the primary parties to the Agreement;
- Obtained and reviewed financial information required by the Agreement for propriety and compliance;
- Performed substantive testing of transactions and other relevant supporting documentation for existence, occurrence, completeness, accuracy, and compliance with terms of the Agreement.



SUMMARY CONCLUSIONS, SIGNIFICANT ISSUES, AND RECOMMENDATIONS

Based on the evidence obtained as a result of the audit procedures performed to meet our audit objectives, the summary conclusions and significant issues are listed below.

CONCLUSION 1

JDDA SSP had controls in place that were operating effectively to accurately capture revenue activity at the point of sale, however (a) they were not submitting audited financial information to HAS (see *Detailed Finding #3*), (b) nor were they remitting the correct amount of revenue to HAS (see *Detailed Findings #1 & 2*) (**Audit Objectives 1 & 2**).

Deductions are being made to gross sales not in compliance with terms of the contract resulting in a shortage of revenues remitted to HAS in the estimated amount of (\$362,500) due to the following two items:

- Five of SSP America Texas' restaurants do not meet the Agreement's definition and terms of "Nationally Branded". As a result, JDDA SSP owes HAS an additional 2% of their gross sales which equates to approximately \$294,500 for the period February 2009 – January 2011.
- JDDA SSP is deducting the Texas "Mixed Beverage Tax" (MBT) from gross liquor sales (including beer and wine.) The terms of the Agreement **excludes** the MBT deduction of 14% as allowable. We estimated the underpaid amount to be approximately \$68,000 as of 12/31/2010.

RECOMMENDATION 1

JDDA SSP should:

- Reclassify their SSP franchises to non-branded (increasing the applicable payment percentage from 12% to 14%);
- Cease deducting the 14% MBT from gross sales;
- Pay HAS the cumulative and retroactive adjustment related to both items; and
- JDDA SSP should provide audited annual *Statements of Gross Sales* to HAS.

CONCLUSION 2

The insurance certificates revealed coverage that was not in compliance with contract terms.² (See *Detailed Finding #3*) (**Audit Objective #3**)

RECOMMENDATION 2

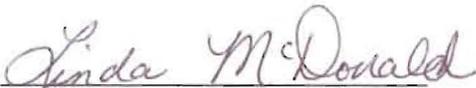
JDDA SSP should provide to HAS, proof of insurance coverage to verify the minimum requirements are met.

² In response to these issues, JDDA SSP Management has taken steps to correct many of the discrepancies.



ACKNOWLEDGEMENT

The Audit Team found the restaurants to be well-managed, clean, and attractive. We would like to thank JDDA SSP's management team and SSP America Texas' staff located in IAH for their professionalism and cooperation in providing us with the documentation available to them on a timely basis.


Linda McDonald, CPA
Auditor-in-charge


Arnie Adams, CFE, CIA
Audit Manager


David Schroeder, CPA, CISA
City Auditor



DETAILED FINDINGS, RECOMMENDATIONS, AND MANAGEMENT RESPONSES

1. FRANCHISE FEES AND RELATED PARTY TRANSACTIONS

BACKGROUND:

The Agreement between JDDA SSP and HAS defines “Nationally Branded” in *Section 3.1.13*, as: “... food and beverages, nationally or internationally recognized, sold by Concessionaire, its joint venture partners, or Subcontractors where a royalty or franchise fee is charged by a franchisor and paid by Concessionaire, its joint venture partners or Subcontractors for the privilege of selling such food and beverages from the Facilities.”

The percentage of gross sales paid to HAS is defined and differentiated between branded vs. non-branded and is listed in *Section 8.4* as³:

- “12% of branded food gross sales
- 14% of non-branded food gross sales
- 15% of alcoholic beverage gross sales”

SSP America states that all their restaurants are franchised except one, the Center Bar, which accounted for 1% of the food sales in Calendar Year 2010. Five of the nine restaurants are franchised by a subsidiary of SSP (Franchisor), and three are franchised by companies unaffiliated with SSP. The five restaurants and the SSP Franchisor(s) are as follows:

- *SSP Financing UK Limited*, located at 1 The Heights, Brooklands, Weybridge, Surrey KT13, ONY, United Kingdom (which is the owner of *Select Service Partner UK Limited*) is the Franchisor of **Upper Crust**, and charges a 5% fee based on gross sales;
- *Select Service Partner UK Limited*, located at 1 The Heights, Brooklands, Weybridge, Surrey KT13, ONY, United Kingdom is the Franchisor of **Real Foods; Camden Foods; and Panopolis**, and charges a 2% fee based on gross sales. (Note: the Franchisor’s address for the previous four franchises is identical.);
- *Select Service Partner SAS*, located at Immeuble Garonne, 40 Avenue de Terroirs de France, 75012, Paris, France is the Franchisor for **Le Grand Comptoir**, and charges a 2% fee based on gross sales.⁴

FINDING:

Franchise fees are being deducted by the five sub-contracted restaurants owned by the parent company and partner to the joint venture. The franchise fee agreements that support the designation of “Branded” products were dated subsequent to the audit request. The franchise fees paid to the franchisor were adjusted based on costs incurred by the franchisor and not the percentage specified in the agreements. This activity reflects a related party transaction, not of arms length, which represents approximately \$294,500 less revenue to HAS for the period of February 2009 – January 2011.

³ JDDA SSP pays HAS a Minimum Annual Guarantee fee (MAG) per enplaned passenger or a percentage fee of gross sales, whichever is higher. The percentage of gross sales has historically been higher.

⁴ See Appendix 1 for explanation of organizational structure and contractual relationships

RECOMMENDATION:

JDDA SSP should reclassify their SSP franchises to non-branded and remit the 2% difference (approximately \$294,500) to HAS (12% of Gross Sales for Nationally Branded and 14% of gross sales for Non Branded.)

JDDA SSP MANAGEMENT RESPONSE:

“...A. The Subject Five Concessions Satisfy the Requirements of Section 3.1.13

...Section 3.1.13 of the Agreement defines “Nationally Branded” to include the following three elements:

- (1) Nationally or internationally recognized food and beverages;*
- (2) Sold by Concessionaire, its joint venture partners or subcontractors;*
- (3) Where a royalty or franchise fee is charged by a franchisor and paid by Concessionaire, its joint venture partners or subcontractors for the privilege of selling such food and beverages from the Facilities.*

By applying the three elements to the facts in this case, it shows that all of the elements of “Nationally Branded” are satisfied with respect to the five franchises at the Airport in Houston. In the same order as above:

(1) The five concessions are all operated under nationally and internationally recognized food and beverage brands. In the aggregate, these brands are operating in 144 restaurants across 15 countries, including the United States. With the public exposure gained in international airports and train stations, the five brands are being exposed to hundreds of millions of people each year. Please see the attached Exhibit 1 for breakdowns by brand, country and site.

(2) In satisfaction of the second element above, the food and beverages from these five restaurants at IAH are being sold by a subcontractor, SSP America IAH (a joint venture comprised of SSP America Texas, Inc., Imperial Concessions, Inc., and Charles Bush Consulting, LLC) (“Subcontractor”).

(3) Subcontractor pays a royalty and/or a franchise fee to the respective franchisors for the privilege of selling such food and beverages from the five restaurants at the Airport, thus satisfying the third element.

Nothing in the Audit Report finds or concludes that any of the Section 3.1.13 required elements are missing in the present case. To the contrary, the Audit Report bases its Findings and Reconciliation on entirely different factors that are not included within the definition of “Naturally Branded,” and are not otherwise supported by the Agreement.

As a result, the five franchises satisfy the requirements of the Agreement for the 12% Percentage Rent classification as “Nationally Branded food/non-alcoholic beverage.” (Agreement Section 8.4.1, page 28)....”

“...B. The Five Franchises Constitute Commercially Independent Transactions

In the Audit Report Finding for Section 1 (page 5), it is concluded that the Percentage Rent Rate should be increased to 14% because the “activity reflects a related party transaction, not of arms length.” As a basis for this conclusion, the Audit Report relies on three factors, which are not included in the Agreement with respect to the definition of “Nationally Branded” or the calculation of Percentage Rent.

“Franchise fees are being deducted by the five sub-contracted restaurants owned by the parent company and partner to the joint venture.”



Office of the City Controller
Audit Division

“The franchise fee agreements that support the designation of ‘Branded’ products were dated subsequent to the audit request.”

“The franchise fees paid to the franchisor were adjusted based on costs incurred by the franchisor and not the percentage specified in the agreements.”

*In Section 1, page 5 of the Audit Report, and in the diagram attached as **Appendix 1** to the Audit Report, the franchisors of the respective five brands are accurately identified (“**Franchisors**”). It is also correct to say that the Franchisors are affiliates of the SSP companies that own portions of Concessionaire and Subcontractor. However, both Concessionaire and Subcontractor also include owners who share no ownership interest or affiliation with the Franchisors.*

Specifically, in each of the five subject restaurants, the franchisee is a joint venture comprised of SSP America Texas, Inc., Imperial Concessions, Inc., and Charles Bush Consulting, LLC. In other words, two of the three owners of the Subcontractor are entirely independent from, and unrelated to SS. Because Imperial Concessions, Inc., and Charles Bush Consulting, LLC have no relationship with the Franchisors, these five franchises at the Airport are commercially independent of the Franchisor, and these franchise relationships constitute arms length transactions...”

HAS COMMENT:

“...We agree that JDDA SSP should pay the 2% on all past gross sales that it deducted for “franchise fees” based on:

- 1) In the JDDA SSP Joint Venture, SSP America, Inc. owns less of the Joint Venture (49%) than JDDA (51 %) however SSP America, Inc. is responsible for managing the day-to-day operational affairs of the Joint Venture including, without limitation, brand relations and contracting, cash flow and financial, procurement, and general supervision of the operations on behalf of and in the name of the Joint Venture.*
- 2) In the SSP America IAH Joint Venture, SSP America Texas, Inc. is a 70% owner of the Joint Venture.*
- 3) SSP America, Inc., SSP America Texas, Inc., and Select Service Partner UK Limited all appear to an extension of one or the other.*

If JDDA SSP is able to produce more convincing documentation that a bona fide franchise exists between Select Service Partner UK Limited and SSP America IAR, and that the parties involved in the franchises are not a subsidiary, entity or extension of Select Service Partner UK Limited, then the extra 2% in fees may not be due...”

2. DEDUCTIONS OF 14% MIXED BEVERAGE TAX

BACKGROUND:

The Agreement between JDDA SSP and HAS defines “Gross Sales” in Section 3.1.11 as:

“...the aggregate dollar amount of all sales, including Concessionaire’s receipts from all sales made at or from all the Facilities, regardless of where the order is received or delivered, and any other revenues of any type arising out of or in connection with the Concessionaire’s operations in the Facilities, whether performed by the Concessionaire, its Subcontractors, joint venture partners, subsidiaries, associated companies, or any other entity corporate or otherwise, for cash or credit or otherwise, of every kind, name and nature, regardless of where or whether collected, as if the same had been sold for cash.”

It goes on to state what may be excluded or deducted from the computation of gross sales, and the following deduction is the basis for this finding:

“Section 3.1.11.1 Any and all retail sales tax, and any related direct taxes upon the consumer and collected by the Concessionaire on such sales.”

Based on the Texas Alcohol and Beverage Commission (TABC) website, the Mixed Beverage Tax (MBT) is described as follows:

“ A gross receipts tax is imposed on the amount received from the sale or service of mixed beverages or from the sale, preparation, or service of ice or nonalcoholic beverages that are sold prepared or served for the purpose of being mixed with an alcoholic beverage and consumed on the premises of the mixed beverage permittee.

The mixed beverage tax is imposed on the person or organization holding the mixed beverage permit and not the customer. It may not be added to the selling price as a separate charge and may not be backed out from the amount received. Any reimbursement you choose to collect from your customer must be clearly labeled as “reimbursement”. Reimbursements, however, become part of the tax base. An amount labeled as a “tax” is fully due to the state, in addition to the mixed beverage tax.”

TABC defines “Mixed Beverage Gross Receipts Tax” as:

“A 14% tax paid by the holder of a mixed beverage or private club permit. The permit holder is responsible for the tax and pays it to the Comptroller’s Office. The permit holder can charge the tax to the consumer and label it a “reimbursement”, but they have to pay tax on the reimbursement they collect as well.”

FINDING:

SSP America’s gross sales amount on liquor sales are reported to HAS with the 14% MBT deducted. Based on the definition provided by the TABC and the specific language in the current Agreement, the MBT should not be deducted as an adjustment to Gross Sales/Revenues.⁵ From the period July 2009 to December 2010, the affect of the MBT deduction from Gross Sales has resulted in approximately \$68,000 less revenue to HAS for this contract⁶

⁵ Dallas Airport system reported the same issue and has received refunds back from most concessionaires. They are currently renegotiating the contract language to allow the Mixed Beverage Tax paid to the state as a deduction to Gross Sales.

⁶Considering that the deduction of MBT from Gross Sales has been common practice throughout the airport system, we estimated the impact since 1998. The result was a total of approximately \$2.3 million less revenue to HAS.



RECOMMENDATION:

JDDA SSP should cease deducting the MBT from Gross Sales and remit the total amount to HAS. (See footnote #2 and 3)

JDDA SSP MANAGEMENT RESPONSE:

"...For the reasons summarized below, we also respectfully disagree with the Finding and Recommendation regarding the Mixed Beverage Gross Receipts Tax ("MBT")."

A. Interpretation by Performance

The MBT fits within the exclusion from "Gross Sales" described in Section 3.1.11.1 of the Agreement.

"Any and all retail sales taxes, and any related direct taxes upon the consumer and collected by the Concessionaire on such sales."

When parties perform an agreement over a period of time with knowledge of the nature of the performance and without objection, that performance will control the meaning of the relevant provisions of the contract. In the performance of the Agreement between the City and Concessionaire since 2007, the MBT has consistently been treated as a deduction from Gross Sales before calculation of Percentage Rent. These four years of consistent performance fully and accurately expressed the intent of the City and SSP with respect to the interpretation of Section 3.1.11.1.

This performance is also consistent with other airports in Texas. In these other Texas airports, sales taxes and MBT are treated the same – as exclusions from Gross Receipts. Even the Audit Report acknowledges that "...the deduction of MBT from Gross Sales has been common practice." (Audit Report, page 7 footnote 6.) Yet, the Audit Report attempts to re-write years of past performance at the Airport with a retroactive and entirely new interpretation.

B. MBT Falls Within the Exclusion

The MBT is a form of sales tax, and thus fits within the first part of the exclusion from "Gross Sales" described in Section 3.1.11.1 of the Agreement (i.e., "Any and all retail sales taxes").

The MBT and the sales tax defined in the Texas Limited Sales, Excise, and Use Tax Act, Section 151.051 et seq are both (1) imposed by law, (2) calculated in the same manner, (4) paid by Concessionaire at the same time each month, and (4) paid directly to the same state agency, the Office of the Texas Comptroller.

The only difference between the MBT and the Section 151.051 sales tax is the mandatory vs. non-mandatory charge to the customer. With sales tax, the retailer is required to add the tax to the sales price (Section 151.052). With MBT, the retailer elects whether or not to collect the tax from the customer. If the retailer does elect to collect the MBT from the customer, the retailer is required to label the MBT on the sales receipt as a "reimbursement." Otherwise, the process and result of the two taxes are identical..."

HAS COMMENT:

"...HAS agrees that JDDA SSP should cease deducting the MBT from Gross Sales for the purpose of calculating percentage fees on alcoholic beverage sales. Notwithstanding, we may wish to consider the option of a compromise settlement of this issue, with material consideration from JDDA SSP..."



3. AUDITED STATEMENTS OF GROSS SALES

BACKGROUND:

Section 6.6.1 of the Agreement states:

*“Concessionaire agrees to provide for the collection of all monies and provide an accounting, **audit and report of all Gross Sales**⁷ to the Director in a timely manner and as required under Article VIII of this Amendment No. 4...”*

Further, in Section 8.5.1.1, it states:

“...a statement of Gross Sales for each facility (or portion of a facility) operated directly by Concessionaire and/or its joint venture partners, separated into the applicable categories set forth in Section 8.4; a calculation of the amount due City under Section 8.4 based upon such Gross Sales; and a schedule showing the total actual payments to City for any reason during the subject year (or portion of year), all of which are certified by an independent third-party Certified Public Accountant who is licensed in accordance with the laws and regulations of the State of Texas.”

HAS Concessions Division relies on the annual “statement of gross sales” for assurance that the gross sales reported by JDDA SSP is accurate. The annual statement is “...certified by an independent third-party Certified Public Accountant who is licensed in accordance with the laws and regulations of the State of Texas.”

As stated in the report provided by the CPA to JDDA SSP,

“...All information included in the report is the representation of the management of the Company.

Our review was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. A review is substantially less in scope than an examination, the objective of which is the expression of an opinion on the statement. Accordingly, we do not express such an opinion.”

FINDING:

JDDA SSP does not provide HAS with an audited Statement of Gross Sales. As noted above, the contract language requires an “audit”, while the Agreement between the Contractor and the CPA firm requested agreed upon procedures in the form of a “review”. DAO CPA, P.C.’s (CPA) engagement with JDDA SSP included verifying that gross sales as compiled by JDDA SSP are mathematically correct. An audit includes additional substantive procedures not performed under this agreement and thus does not meet the requirement of the contract.

RECOMMENDATION:

JDDA SSP should provide audited annual Statements of Gross Sales to HAS.

JDDA SSP MANAGEMENT RESPONSE:

“...Although Concessionaire interprets Section 6.6.1 of the Agreement differently, Concessionaire is willing to provide audited statements in the future...”

⁷ Emphasis added

4. INADEQUATE INSURANCE COVERAGE

BACKGROUND:

The Agreement between JDDA SSP and HAS, details the minimum insurance requirements for JDDA SSP and its Subcontractors in Article 11.1 as:

TABLE 2 – Insurance Requirements	
COVERAGE	LIMIT OF LIABILITY
Worker’s Compensation	Statutory for Worker’s Compensation
Employer’s Liability	Bodily Injury by accident \$500,000 (each accident) Bodily Injury by Disease \$500,000 (policy limit) Bodily Injury by Disease \$500,000 (each employee)
Commercial General Liability: Including Broad Form Coverage, Contractual Liability, Bodily and Personal Injury, and Completed Operations	Bodily Injury and Property Damage, Combined Limits of \$1,000,000 each Occurrence and \$2,000,000 aggregate
Excess Liability	Bodily Injury and Property Damage, Combined Limits of \$2,000,000 each Occurrence and \$4,000,000 aggregate
ALL RISK covering Concessionaire Improvements, Fixtures, Removable Fixtures, and Equipment (including fire, lighting, vandalism, and extended coverage perils)	(Replacement Value)
Automobile Liability Insurance (for vehicles used by the Concessionaire in the course of its performance under this Agreement, including Employer’s Non-Ownership and Hired Auto Coverage)	\$500,000 combined single limit

Other relevant information includes:

“Article 11.1.5 Insured Parties. Each policy, except those for Workers Compensation and Employer’s Liability, must name the City (and its officers, agents and employees) as Additional Insured parties on the original policy and all renewals or replacements.

Article 111.1.11 Subcontractors. Concessionaire shall require all Subcontractors carry insurance naming the City as an additional insured and meeting all of the above requirements except amount. The amount shall be commensurate with the amount of the subcontract or joint venture agreement, but in no case shall it be less than \$2,000,000 per occurrence. All Subcontractors selling alcoholic beverages shall carry liquor liability insurance coverage of at least \$2,000,000 per occurrence, \$3,000,000 aggregate. Concessionaire shall provide copies of such insurance certificates to Director.”

FINDING:

Our testing of the current insurance certificates revealed the following exceptions:

- Two of 16 entities did not have Excess Liability Bodily Injury & property damage combined limits of \$2mm each occurrence; \$4mm aggregate;
- One of 16 did not have all risk covering Operator improvements, fixtures, removable fixtures, & equipment (including fire, lighting, vandalism, & extended coverage perils) Replacement Value;
- Three of 16 did not have adequate Workers Compensation - Statutory;
One of 3 restaurants selling liquor did not have the Liquor Liability Insurance;
- Fifteen of 16 did not have COH named as Additional Insured.

RECOMMENDATION:

JDDA SSP should provide proof of insurance coverage to verify the minimum requirements are met.

JDDA SSP MANAGEMENT RESPONSE:

“...Concessionaire will provide proof of insurance coverage to verify that the minimum requirements of the lease are met...”



RELATED PARTY ORGANIZATIONAL STRUCTURE

While related parties involved in contractual relationships are not uncommon, the complexity and underlying benefits to the parent corporation(s) warrant the readers' understanding.

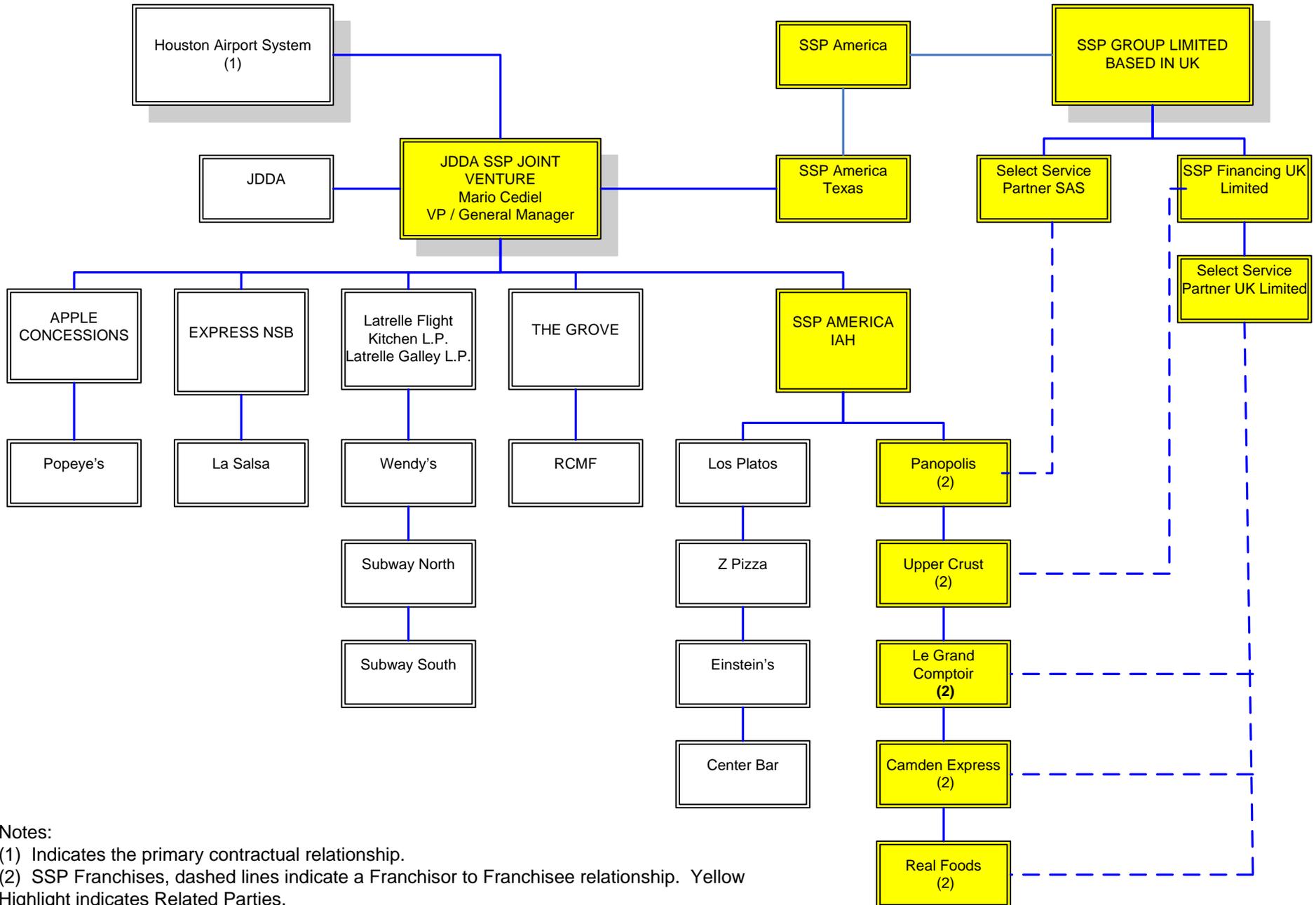
SSP has a complex global organizational structure with many branches and subsidiaries throughout the world. They have strategically created the structure that, within the context of the Agreement yielded them distinct advantages.

From January 1 through December 31, 2010, JDDA SSP reported gross sales of \$20,533,442. **Table 3 illustrates the percentage of gross sales from related parties.** When taken into consideration with Detailed Findings #1 & 2, this shows the structure, magnitude and impact.

TABLE 3 JDDA SSP RELATED PARTY GROSS SALES Calendar Year 2010				
	SSPA AMERICA Gross Sales Reported	Other JDDA SSP Restaurants Gross Sales Reported	Total Gross Sales	Percentage of Gross Sales from related parties
Total	\$14,292,481	\$6,240,961	\$20,533,442	70%

NOTE: The Organizational relationships that impact the scope of our audit is shown in the Chart on the following page:

JDDA SSP and RELATED ENTITIES ORG CHART



Notes:
 (1) Indicates the primary contractual relationship.
 (2) SSP Franchises, dashed lines indicate a Franchisor to Franchisee relationship. Yellow Highlight indicates Related Parties.



JDDA SSP, a Texas Joint Venture
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Lansdowne, VA 20176
(703) 729-2333 (Tel)
(703) 729-4414 (Fax)

June 20, 2011

Via Email Only

Mario Diaz, Director
Houston Airport System
16930 JFK Boulevard
Houston, Texas 77032

Re: Audit of Contract C30046
Managing Agent Agreement for Food and Beverage Services
Amendment No. 4 (the "**Agreement**")

Dear Mr. Diaz:

The purpose of this letter is to provide the response of JDDA SSP ("**Concessionaire**") to the undated Final Draft of the report for the Audit received with your June 10, 2011 email (the "**Audit Report**"). By agreement, the deadline for submission of this response was extended through close of business on June 20, 2011.

With additional time we can provide further backup information.

1. FRANCHISE FEES AND RELATED PARTY TRANSACTIONS

A. The Subject Five Concessions Satisfy the Requirements of Section 3.1.13

The Audit Report asserts that five of the restaurants do not meet the Agreement's definition and terms of 'Nationally Branded.' As a result, it is recommended that Concessionaire should reclassify the five franchises to non-branded (increasing the applicable payment percentage from 12% to 14%), and remit to HAS the 2% difference (approximately \$294,500) as a cumulative and retroactive adjustment. Concessionaire respectfully disagrees.

Section 3.1.13 of the Agreement defines "Nationally Branded" to include the following three elements:

- (1) Nationally or internationally recognized food and beverages;
- (2) Sold by Concessionaire, its joint venture partners or subcontractors;
- (3) Where a royalty or franchise fee is charged by a franchisor and paid by Concessionaire, its joint venture partners or subcontractors for the privilege of selling such food and beverages from the Facilities.

By applying the three elements to the facts in this case, it shows that all of the elements of "Nationally Branded" are satisfied with respect to the five franchises at the Airport in Houston. In the same order as above:

(1) The five concessions are all operated under nationally and internationally recognized food and beverage brands. In the aggregate, these brands are operating in 144 restaurants across 15 countries, including the United States. With the public exposure gained in international airports and train stations, the five brands are being exposed to hundreds of millions of people each year. Please see the attached Exhibit 1 for breakdowns by brand, country and site.

(2) In satisfaction of the second element above, the food and beverages from these five restaurants at IAH are being sold by a subcontractor, SSP America IAH (a joint venture comprised of SSP America Texas, Inc., Imperial Concessions, Inc., and Charles Bush Consulting, LLC) ("**Subcontractor**").

(3) Subcontractor pays a royalty and/or a franchise fee to the respective franchisors for the privilege of selling such food and beverages from the five restaurants at the Airport, thus satisfying the third element.

Nothing in the Audit Report finds or concludes that any of the Section 3.1.13 required elements are missing in the present case. To the contrary, the Audit Report bases its Findings and Reconciliation on entirely different factors that are not included within the definition of "Nationally Branded," and are not otherwise supported by the Agreement.

As a result, the five franchises satisfy the requirements of the Agreement for the 12% Percentage Rent classification as "Nationally Branded food/non-alcoholic beverage." (*Agreement Section 8.4.1, page 28*).

B. The Five Franchises Constitute Commercially Independent Transactions

In the Audit Report Finding for Section 1 (page 5), it is concluded that the Percentage Rent Rate should be increased to 14% because the “activity reflects a related party transaction, not of arms length.” As a basis for this conclusion, the Audit Report relies on three factors, which are not included in the Agreement with respect to the definition of “Nationally Branded” or the calculation of Percentage Rent.

“Franchise fees are being deducted by the five sub-contracted restaurants owned by the parent company and partner to the joint venture.”¹

“The franchise fee agreements that support the designation of ‘Branded’ products were dated subsequent to the audit request.”²

“The franchise fees paid to the franchisor were adjusted based on costs incurred by the franchisor and not the percentage specified in the agreements.”³

In Section 1, page 5 of the Audit Report, and in the diagram attached as **Appendix 1** to the Audit Report, the franchisors of the respective five brands are accurately identified (“**Franchisors**”). It is also correct to say that the Franchisors are affiliates of the SSP companies that own portions of Concessionaire and Subcontractor. However, both Concessionaire and Subcontractor also include owners who share no ownership interest or affiliation with the Franchisors.

Specifically, in each of the five subject restaurants, the franchisee is a joint venture comprised of SSP America Texas, Inc., Imperial Concessions, Inc., and Charles Bush Consulting, LLC. In other words, two of the three owners of the Subcontractor are entirely independent from, and unrelated to SS. Because Imperial Concessions, Inc., and Charles Bush Consulting, LLC have no relationship with the Franchisors, these five franchises at the Airport are commercially independent of the Franchisor, and these franchise relationships constitute arms length transactions.

Attached to this letter as Exhibit 2 is a letter from SSP’s accountants, KPMG LLP, dated April 29, 2010. Although this letter is addressed to an airport in Greece, it confirms the bona fide arms length nature of SSP’s worldwide franchise relationships. If given the time, SSP will provide a letter to the same point with respect to this audit.

¹ The SSP parent company does not own the five restaurants – they are owned by the Subcontractor (SSP America IAH).

² The Agreement (Section 3.1.13 and otherwise) does not say anything about when franchise agreements must be dated. It only requires the payment of royalties or franchise fees, and these payments were made.

³ Section 3.1.13 does not prohibit adjustments to the royalties and/or franchise fees, and it does not require the payment of any minimum amount of franchise fees or royalties.

Because the five brands are licensed to a wide array of affiliated and unaffiliated franchisees/licensees and are recognized worldwide (independent of SSP), the Franchisor companies and/or their franchise rights may be sold at any time, thus severing all affiliation with SSP.

C. Conclusion

The Finding and Recommendation in Section 1 of the Audit Report rely entirely on factors that are not expressed in Section 3.1.13 or Section 8.4.1 of the Agreement. As a result, there is no basis to reclassify the subject franchises to non-branded concessions, or to require any remittance of additional license fees.

2. DEDUCTIONS OF 14% MIXED BEVERAGE TAX

For the reasons summarized below, we also respectfully disagree with the Finding and Recommendation regarding the Mixed Beverage Gross Receipts Tax (“**MBT**”).

A. Interpretation by Performance

The MBT fits within the exclusion from “Gross Sales” described in Section 3.1.11.1 of the Agreement.

“Any and all retail sales taxes, and any related direct taxes upon the consumer and collected by the Concessionaire on such sales.”⁴

When parties perform an agreement over a period of time with knowledge of the nature of the performance and without objection, that performance will control the meaning of the relevant provisions of the contract. In the performance of the Agreement between the City and Concessionaire since 2007, the MBT has consistently been treated as a deduction from Gross Sales before calculation of Percentage Rent. These four years of consistent performance fully and accurately expressed the intent of the City and SSP with respect to the interpretation of Section 3.1.11.1.

This performance is also consistent with other airports in Texas.⁵ In these other Texas airports, sales taxes and MBT are treated the same – as exclusions from Gross Receipts. Even the Audit Report acknowledges that “...the deduction of MBT from Gross Sales has been common”

⁴ The sentence structure of the above-quoted exclusion addresses two categories of taxes. First, it addresses “**Any and all retail sales taxes,...**” Next, it addresses “**any related direct taxes upon the consumer and collected by the Concessionaire on such sales.**” The first bolded phrase is not limited to one type of sales tax. To the contrary, it specifically includes “any and all” such taxes. Such an all-inclusive phrase would not be needed if the two bolded portions of the sentence were to be read together. Additionally, the comma after “Any and all retail sales taxes,” specifically shows that the two segments of the sentence are to be read separately. If the intent was otherwise, the quoted sentence would not have included the comma.

⁵ In the airports at San Antonio and Midland, it is SSP’s experience that MBT is treated as an exclusion from Gross Sales, just as in Houston.

practice.” (Audit Report, page 7 footnote 6.) Yet, the Audit Report attempts to re-write years of past performance at the Airport with a retroactive and entirely new interpretation.

B. MBT Falls Within the Exclusion

The MBT is a form of sales tax, and thus fits within the first part of the exclusion from “Gross Sales” described in Section 3.1.11.1 of the Agreement (i.e., “Any and all retail sales taxes”).

The MBT and the sales tax defined in the Texas Limited Sales, Excise, and Use Tax Act, Section 151.051 *et seq* are both (1) imposed by law, (2) calculated in the same manner, (4) paid by Concessionaire at the same time each month, and (4) paid directly to the same state agency, the Office of the Texas Comptroller.

The only difference between the MBT and the Section 151.051 sales tax is the mandatory vs. non-mandatory charge to the customer. With sales tax, the retailer is required to add the tax to the sales price (Section 151.052). With MBT, the retailer elects whether or not to collect the tax from the customer. If the retailer does elect to collect the MBT from the customer, the retailer is required to label the MBT on the sales receipt as a “reimbursement.” Otherwise, the process and result of the two taxes are identical.

C. Conclusion

For the reasons stated above, we submit that the past performance of the City and SSP should continue with respect to the deduction of the MBT from Gross Sales.

3. AUDITED STATEMENTS OF GROSS RECEIPTS

Although Concessionaire interprets Section 6.6.1 of the Agreement differently, Concessionaire is willing to provide audited statements in the future.

4. INADEQUATE INSURANCE COVERAGE

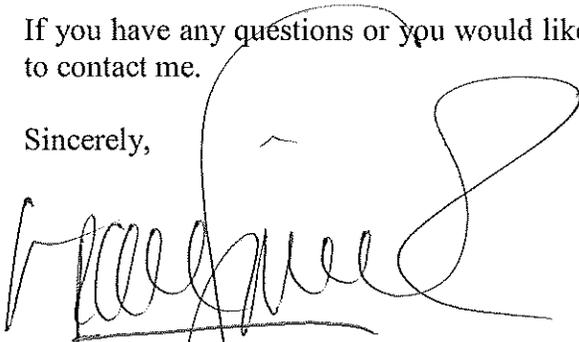
Concessionaire will provide proof of insurance coverage to verify that the minimum requirements of the lease are met.

Please note that nothing in this letter is intended to waive any rights, and we reserve the right to raise new and additional issues with respect to this matter.

Mario Diaz, Director
Houston Airport System
June 20, 2011
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If you have any questions or you would like to discuss this matter further, please do not hesitate to contact me.

Sincerely,



Mario F. Cediel
JDDA SSP
George Bush Intercontinental Airport
(281) 233-7619 - Office
(713) 851-8867 - Cell
(281)233-7444 - Fax

cc: David Schroeder, CPA, CISA

City of Houston, Office of the City Controller's Audit Division Note:

Exhibits were attached as supporting detail to this letter and were not included in the report, but are available upon a specific request:

- 1 - Listing and locations of subsidiary concessionaires;
- 2 - Letter affirming the existence of payments reported as franchise fees.

ADDITIONAL NOTE: On July 21, 2011, subsequent to the signature date of the Audit Report, SSP America submitted additional comments. This information sought to further support their disagreement with the first two issues originally identified. Because: (a) these documents were remitted after the signature date; (b) because they don't substantively change SSP's position, and (c) because they totaled 54 pages, we refer to them here and make them available upon request.

Per **GAGAS 8.33**, "*When auditors receive written comments from the responsible officials, they should include in their report a copy of the officials' written comments, or a summary of the comments received....*" **GAGAS 8.34** further states that "*Auditors should also include in the report an evaluation of the comments, as appropriate. In cases which the audited entity provides technical comments in addition to its written or oral comments on the report, auditors may disclose in the report that such comments were received.*"

CITY OF HOUSTON

INTEROFFICE CORRESPONDENCE

TO: Ronald C. Green
Controller

FROM: Director of Aviation
Houston Airport System

DATE: July 5, 2011

SUBJECT: 11-06 HAS Concession Contract
Audit – Final Draft

The following is Houston Airport System's follow-up to our memo dated June 22, 2011 (attached) regarding the audit of the contract agreement between HAS and JDDA SSP ("Audit") received June 20, 2011. Additional time was requested and approved to further research Audit Recommendation 1 and 2.

Recommendation 1 – Franchise Fees and Related Party Transactions:

JDDA SSP should reclassify their SSP franchises to non-branded and remit 2% difference (approximately \$294,500) to HAS (12% of Gross Sales for Nationally Branded and 14% of gross sales for Non Branded)

In the June 22, 2011 memo HAS requested additional time to review and research 1) the franchise agreements with SSP Financing UK Limited, and 2) the joint venture agreement between SSP America Texas, Inc., Imperial Concessions, Inc., and Charles Bush Consulting, LLC to more fully understand the exact nature of the relationship to JDDA SSP.

Review of franchise agreements and joint venture agreements:

The Managing Agent Agreement for Food and Beverage Services is between the City of Houston and JDDA SSP, a Texas joint venture.

The JDDA SSP JV is between SSP America, Inc., (formerly known as Creative Host Services, Inc.,) and JDDA Concession Management, Inc. ("JDDA"). SSP America, Inc., and JDDA are collectively referred to hereinafter as the "Principals I".

The Principals I have rights and obligations in the JDDA SSP Joint Venture in proportion to their share of ownership. JDDA owns fifty-one percent (51%) and SSP America, Inc. owns forty-nine percent (49%).

JDDA is responsible for managing the day-to-day administrative operations of the Joint Venture, including without limitation, collection and payment of rents, preparation and distribution of rental reports to the City and SSP America, Inc., accounting for depository and payment accounts. Additionally JDDA is responsible for monitoring and administering maintenance and repairs to the facilities by the subcontractors.

SSP America, Inc. is responsible for managing the day-to-day operational affairs of the Joint Venture including, without limitation, customer satisfaction, quality control and audits, brand relations and

contracting, cash flow and financial, procurement, and general supervision of the operations on behalf of and in the name of the Joint Venture of any kind necessary and desirable to the operational affairs Joint Venture's business.

The franchise agreements are between Select Service Partner UK Limited, a company incorporated in England whose registered office is at 1 The Heights, Brooklands, Weybridge, Surrey KT13 ONY, United Kingdom ("Franchisor") and SSP America IAH, a Texas joint venture with its offices at 19465 Deerfield Avenue, Suite 105, Landsdowne VA United States ("Franchisee")

SSP America IAH is a Joint Venture Agreement between SSP America Texas, Inc., formerly known as Creative Host Services of Texas, Inc., a Texas corporation ("SSPT") and Imperial Concessions, Inc., a Texas corporation ("DBE Principal") and Charles Bush Consulting LLC ("CBC"). SSPT, DBE Principal and CBC are collectively referred to hereinafter as the "Principals II". Principals II have rights and obligations in the SSP America IAH Joint Venture in proportion to their share of ownership. Based on SSP America IAH Joint Venture's initial estimated cost to develop the concessions in Terminal C ownership is: SSPT 70%, DBE Principal 26%, and CBC 4%.

The purpose of the SSP America IAH Joint Venture is to enter into one or more purveyor agreements and to own, develop and operate food and beverage concessions in a portion of Terminal C at IAH, and such other activities directly related thereto as may be necessary or advisable to further such business.

HAS Response to Recommendation 1:

We agree that JDDA SSP should pay the 2% on all past gross sales that it deducted for "franchise fees" based on:

- 1) In the JDDA SSP Joint Venture, SSP America, Inc. owns less of the Joint Venture (49%) than JDDA (51%) however SSP America, Inc. is responsible for managing the day-to-day operational affairs of the Joint Venture including, without limitation, brand relations and contracting, cash flow and financial, procurement, and general supervision of the operations on behalf of and in the name of the Joint Venture.
- 2) In the SSP America IAH Joint Venture, SSP America Texas, Inc. is a 70% owner of the Joint Venture.
- 3) SSP America, Inc., SSP America Texas, Inc., and Select Service Partner UK Limited all appear to an extension of one or the other.

If JDDA SSP is able to produce more convincing documentation that a bona fide franchise exists between Select Service Partner UK Limited and SSP America IAH, and that the parties involved in the franchises are not a subsidiary, entity or extension of Select Service Partner UK Limited, then the extra 2% in fees may not be due.

Recommendation 2 - Deductions of 14% Mixed Beverage Tax:

JDDA SSP should cease deducting the MBT from Gross Sales and remit the total amount to HAS.

In the June 22, 2011 memo HAS requested additional time to review and research the practice in the airport industry for allowing or not allowing the deduction of an alcohol tax (such as the MBT) for the purpose of determining concession fees paid based on a percentage of gross revenues. We believe it will be helpful to review concession contracts at other airports and the interpretation made in practice around similar language.

HAS Response to Recommendation 2:

HAS agrees that JDDA SSP should cease deducting the MBT from Gross Sales for the purpose of calculating percentage fees on alcoholic beverage sales. Notwithstanding, we may wish to consider the option of a compromise settlement of this issue, with material consideration from JDDA SSP.



For Mario C. Diaz

MCD: mcd

cc: David Schroeder
Andy Icken
Randy Rivin
Kirk Rummel
Ian Wadsworth
Randy Goodman