

ISSUE 1

Changing the Historical Balance of Interests (Public v. Licensee v. Landlord)

Many duty free shops are currently located on land owned by a third party. Current landlords include a diverse group of entities ranging from The Crown, Federal Bridge Commissions, Municipal Government, Foreign or Canadian private landowners, and a Native Band. In these cases, the duty free operator leases the property where their stores are located. Some operators have short-term (5 year) leases, while others have long-term (30 year) leases.

CBSA appears to want to vacate its' historical role of selecting the licensee through a public Request for Proposals involving a business plan and financial assessment, both for licensing and re-licensing of sites. Public communications by CBSA to date have already alerted landlords of a potential change in their relative power in their relationship with duty free licensees. This has already emboldened some landlords, who sense they may be able to determine the lessee/licensee in future, subject only to CBSA site and criminal background review requirements. Given an already established site, the landlord's preferred duty free licensee could be anyone who can pass a criminal background check, and could perhaps even include the landlord as possible licensee.

No indication has been given that countervailing laws, regulations and policies will be put into place to recognize the private business rights and interests of historical licensees. For all intents and purposes this change would amount to an expropriation of the private business investments and interests of historical licensees, in favour of other private parties (landlords). It will create two classes of duty free licensee, based solely on land ownership. At some of the largest sites the proposed system would clearly open the door for the landlord to seize the business value of existing duty free shops for themselves: either through a landlord-run tender for the site or through an outright landlord takeover of the site (directly or through a newly chosen third-party licensee). In these situations the expropriated value would be to the benefit of The Crown, Federal Bridge Commission or other land owner.

The proposed change therefore raises questions of transparency and public policy fairness, since the existing licensees suffered the industry start-up risks and made ongoing investments. These were made based on reasonable reliance on the historical business model.

The proposed change will result in a myriad of unintended negative side effects:

- It will have unintended negative consequences in terms of public oversight costs, border security and compliance risks.
- The resulting market uncertainties created will stifle long-term industry investment and employment at land border locations.
- It will result in an unreliable system for control over the selection of licensees and/or effective control over the ownership and operation of shops.
- It will destroy the historical balance of interests implicit in duty free licensing involving three stakeholder groups: Canadian public, licensee and landlord interests.
- It would cede control over 'who gets the license' to an uncontrollable assortment of entities: federal bridge commissions, federal government departments, municipal government landowners, foreign landowners, private Canadian landowners and native bands.
- It would result in controversy and eventually significant litigation potentially involving historical licensees, landlords and the federal government.

Scenarios of Concern to FDFA Members

1. Breakdown of lease negotiations:
 - a) Landlord and existing Licensee commence with normal negotiations, for renewal of lease on property.
 - b) Landlord demands a significant increase in rental rate from duty free shop, based on a belief that under the SR changes it can select another suitable candidate who will pay the higher rent, if the incumbent will not agree to the unreasonable demands.
 - c) Negotiations grind to a halt and the shop either closes down when the lease expires, or the incumbent duty free licensee goes on a month-to-month rental basis. Investment and new employment stagnate.
 - d) Landlord approaches CBSA with a license application for its newly selected prospective licensee (or perhaps itself). The prospective licensee need only pass a criminal background check, as the site is already deemed acceptable to CBSA since it is an existing duty free shop location.
 - e) CBSA has no basis to turn down the new duty free license applicant. The historical licensee loses the business he/she started and developed. Litigation ensues involving the federal government, CBSA and historical licensee.

2. Landlord Initiated Site tender:
 - a) Based on SR changes, a Landlord is emboldened and notifies the incumbent duty free operator that they will have to compete in a landlord run tender process against other interested parties, to retain the right to operate the duty free business that they put up initial risk capital and effort to start and develop. In essence, the landlord is now running a duty free license tender, rather than a tender for the highest and best use of the property between the federal government's chosen duty free licensee, and other potential highest and best uses (e.g. McDonald's franchise, Gas station, etc.)
 - b) Incumbent licensee will either refuse to participate on the basis that the landlord has no right to run the tender for a duty free business, or he/she might feel forced to participate in the tender, but in the process loses the business that he/she started and developed. Another option would be the landlord deciding to apply for the license and run the shop themselves.
 - c) In this process the landlord will have virtually total control, and ability to extract the majority of financial benefits from the duty free operation. This would weaken the businesses, and over the long term kill investment, employment and most importantly entrepreneurship.
 - d) CBSA has no basis to turn down the new duty free license applicant if it is not the historical licensee. The historical licensee loses the business he/she started and developed. Litigation ensues involving the federal government, CBSA and historical licensee.

Historical System - Private Market Dispute Resolution Mechanism

Under the historical system, where a dispute has arisen between an operator and landlord, CBSA has traditionally encouraged the parties to negotiate a mutually acceptable outcome.

CBSA will not allow the landlord to put forward a new prospective licensee while a valid duty free license is in effect at the border crossing. CBSA informs the landlord also that failure to reach a private negotiated agreement with their chosen licensee will result in site closure and loss of revenue for an indeterminate amount of time since:

- The historical licensee will be given time to review potential options for relocating the duty free business to another suitable site.
- The landlord cannot run a tender for a duty free license. Only the federal government can select a licensee through an RFP process. Therefore the landlord runs the risk of not having their chosen new operator selected by the federal government, if they fail to negotiate a lease with the incumbent licensee.
- Due to the lag time involved in giving the historical licensee an opportunity to relocate, and CBSA time to determine if a new RFP is warranted, CBSA informs the landlord that the site may be without a duty free operation for a lengthy period of time, until the completion of a competitive proposal process.

In this manner CBSA does not become embroiled in the private commercial negotiations between its' selected licensee and the landlord. Market pressures (the desire to earn revenue, and the desire to avoid a loss of revenue in the event of a site closure) bring both parties together to arrange a lease renewal. This process has worked without incident for 25 years, except in one location where the courts intervened based on a Native land claim.

RECOMMENDATIONS

Over the past 30 years, the current system has successfully resolved, and in many cases successfully prevented, disputes between operators and landlords in all but one case where the courts intervened based on a native land rights claim.

FDFA believes that CBSA should maintain the competitive RFP selection process and remove subsection 8(a) from the *Duty Free Shop Regulations* (SOR/86-1072) as it pertains to land border locations. Subsection 8(a) provides that the Minister may cancel a licence where the licensee no longer owns or leases the place that is licensed as a duty free shop. Removing subsection 8(a) would help ensure that all parties negotiate in good faith, as a failure to negotiate a lease would not result in the cancellation of a licence. It would also make section 8 more consistent with sections 9 and 12 of the regulations.

In exchange for this needed change brought about by the Strategic Review, FDFA members would support the creation of a new provision to allow the Minister to suspend or cancel a licence if an operator 'abandoned' their licence. This would prevent any operator from unreasonably refusing to provide the services under their licence.

For FDFA members, the only other reasonable and fair solution to this issue would be compensating new laws or regulations that enshrine and confer more long-term security over their license, and that would prevent the above-noted scenarios from occurring. Failing one of these two approaches, the FDFA and its' members will strongly oppose current vision for the future of the land border duty free program.

ISSUE 2

Adequate Range of Goods and Services, Multiple Licenses at One Crossing

CBSA has noted an initial vision that would remove subsection 3(6)(e) from the Regulations on the basis that it does not want to make a determination about whether adequate services or goods are being offered. Moreover, if the competitive tender process is also eliminated, a second licence could conceivably be awarded to anyone who approached CBSA. The absence of any safeguards would create devastating instability in the industry, and put at risk the historic investments made by existing operators.

If multiple duty free stores are permitted at each land border crossing, certain landlords might seek their own duty free licence or select a friendly third party to apply for a second duty free licence on an adjacent property. If and when the second licence was obtained, the landlord could offer the second duty free licensee lower lease rates, or, alternatively, refuse to renew the lease of the existing duty free operator. In either scenario, the historic investments of the existing duty free operator would be imperilled.

Of further concern to the above noted points, CBSA's vision would significantly reduce the facilities and services required in the laws and regulations -- that together with the comprehensive RFP process -- determined the high level of investment and standards of operation. The investments and lease terms of current operators were based on the provisions regarding 'reasonable range of goods and services' and facilities standards.

The proposed SR recommendations could allow new sites to be licensed with a limited range of goods and services (much lower investment), at rents that differ dramatically from those paid by existing operators. This would create great uncertainty in the industry which could hamper future investment and employment, and unfairly advantage landlords and new site operators.

Scenario of Concern to FDFA Members

- a) An existing duty free store has operated at a given land border duty free crossing for more than 25 years; the investment, facilities and services having been determined by past high standards.
- b) The operator leases or owns their land, in an area where there are other secure lots which could be developed. The other lots could potentially even be owned by their existing landlord.
- c) At some point during the lease period, their landlord or some other land owner decides to apply for a second duty free shop to be licensed at their crossing, either for themselves or an allied third party.
- d) The new duty free shop is given more favourable lease conditions and requires significantly less investment in facilities and services, thereby giving the new operator an unreasonable competitive advantage. This could even be accomplished by the existing shops landlord, to affect a new level of control over duty free operations, and extract almost all the profits from the historical licensee.
- e) If CBSA fails to license new shops on relatively comparable locations, there will likely be controversy and legal challenges from groups that feel disadvantaged or not given fair consideration. The most likely challenges would come from rural areas where many potential suitable duty free properties could exist; particularly on Native lands where another interest group may seek to obtain a license on an adjacent property.

Historical System – Facilities and Services Standards

Under the historical system, subsection 3(6)(e) of the *Regulations* provides that the Minister shall not issue a licence for a duty free shop unless an adequate range of goods is not available in, or adequate service is not provided by, any duty free shop already located in the area in which the proposed duty free shop is to operate. If that pre-condition is met, CBSA would then be required to use a competitive proposal process to identify who should be awarded the second licence.

Existing operators made significant investments to adhere to this standard.

RECOMMENDATION

FDFA strongly recommends that CBSA retain the language found in subsection 3(6)(e) of the Regulations, and refrain from issuing a duty free licence for any land border crossing where there is already a duty free operation unless it can be demonstrably justified.

It is not clear why CBSA would seek to change the existing system which has sustained our industry and benefited the Crown and Canadians for more than a quarter century. Any change could only increase the risks to CBSA and complicate oversight and enforcement. It would also weaken the industry in the face of intense competition in their export sector, from US duty free shops and retailers.

Elimination of the RFP cannot be justified on the basis that CBSA is not competent to evaluate business proposals and financial aspects of prospective licensees. The diverse range of land owners at the land border have no more expertise in this regard, and CBSA has, in the past, easily been able to overcome any lack of financial or retail expertise through use of expert third-party consultants in the RFP evaluation process.

ISSUE 3

Licensing of New Duty Free Shops

Landlord owners at potential new locations [at major crossings] must be subject to the same rights in the duty free licensing process as at existing locations. If the government attempts to institute a licensing system for new sites that would give landlords more control over selecting the licensee, than rights given to landlords of existing sites, controversy and litigation will inevitably result as the latter group attempts to obtain the same right and privileges as new landlords.

On the other side, if the federal government makes changes that will in effect expropriate the business value of existing duty free businesses from historical owners, in favour of another private interest group (landlords), challenges and litigation will surely result, but this time they would come from existing licensees who feel unfairly treated versus their landlords (another private party).

The most transparent and best course – especially in light of the historical investments and success of the program – would be to preserve the historical balance of interests between the public, duty free licensees and land owners. The FDFA strongly supports maintaining the historical RFP process that set a clear and accepted set of rules for duty free licensing; that for 25 years has been accepted by both landlords and licensees, who each benefitted from the system.

Scenario of Concern to FDFA Members

At present, the vast majority of land border crossings have a duty free store. In the future, however, it is possible that CBSA will be asked to licence new duty free operations at crossings where none currently exist or, alternatively, at new crossings. The two most likely contenders for new duty free licences would be Cornwall, Ontario and the possible additional crossing in Windsor, Ontario. The question to be determined is how CBSA will process requests for new licences.

Current Licensing System

Under the current system, if CBSA is approached about a potential new duty free operation it first considers whether it has the resources in place at the crossing to monitor and enforce compliance. If so, and if it determines there is a need for a new duty free operation, it will then issue a competitive Request for Proposal to identify the preferred candidate to become a licence holder. Once the preferred applicant is selected, and once they have a right of access to the designated site, the license is issued.

Proposed System under Strategic Review

Under the proposed system, where a potential new site has been identified, it is not clear that CBSA would continue using a competitive proposal process. It seems that CBSA would only consider potential licensees who have already negotiated some form of lease arrangement with the landlord/landowner at the crossing. CBSA will examine whether the site in question is secure, does not impede traffic flows and does not pose an enforcement risk. CBSA will also ensure it has adequate resources at the crossing to monitor and enforce compliance, and that the license applicant has no criminal history.

RECOMMENDATIONS

FDFA strongly recommends that CBSA maintain the competitive tender process for new sites, a process which has enhanced the security and viability of the land border duty free industry for more than a quarter century. By eliminating the competitive tender process, CBSA will effectively be giving landlords/landowners at border crossings the right to select their own duty free operator – a ‘rubber stamping’ which would exacerbate the power imbalance which already exists between landlords and duty free stores. CBSA would also be creating a new situation that would inevitably be vehemently opposed by either licensees or landlords.

The success and stability of the land border duty free industry can be attributed to the fact that CBSA has always selected prospective licensees through a comprehensive process which evaluated both the financial viability and the security risks of potential applicants. Landlords/landowners at border crossings were always given the *option* to have a duty free store at their crossing, as opposed to the *right* to select a duty free operator. Abandoning this model would create undue risk for CBSA and the industry as a whole.

CBSA should select and certify the preferred duty free shop location as a first step in the licensing process for new sites. This process could include a requirement that the landlord commit to negotiating for a lease with the preferred licensee selected by CBSA in a competitive RFP process. This would reduce the potential for challenges of the RFP outcome in future, and firmly establish the right of the crown to select the duty free licensee at each crossing.

New sites and ferry ports along the US border have far more characteristics in common with land border sites, than with airports or other forms of duty free. They should be subject to the Canadian ownership requirement, due to the unique economic and security benefits this offers, and the tourism component as the 'last point of contact with departing travelers'. Failure to use a consistent ownership requirement could result in undue and undesired scrutiny and controversy, due to the lack of sound reasoning for employing a different set of criteria versus land border.