# Memorandum

MIAMI-DADE COUNTY

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| Date: | July 1, 2008 |
| To: | Honorable Chairman Bruno A. Barreiro and Members, Board of County Commissioners |
| From: | George M. Burgess<br>County Manager |
| Subject: | Resolution Authorizing Execution of Terminal Operating Agreement between Miami-Dade County and Terminal Link (Miami) LLC; and Execution of Termination, Release and Reservation of Rights Agreement between Miami-Dade County and Maersk, Inc. |

Supplement to
Agenda Item No. 8(Q)1D

On June 10, 2008, the Office of the Inspector General ("OIG") issued a memorandum (attached) to the Mayor and the Board regarding their observations, review, and comments on the proposed Terminal Operating Agreement ("Agreement") between Miami-Dade County ("County") and Terminal Link (Miami) LLC ("TLM"); and Termination, Release and Reservation of Rights Agreement ("Termination Agreement") between the County and Maersk, Inc., ("Maersk"). Although the OIG mentions that the proposed Agreement fosters fair and balanced competition, which may be a catalyst towards attracting new business and eventually increasing growth in container business at the Port of Miami ("Port"), the OIG also expresses concerns, primarily regarding the following four issues.

1) A NEW AGREEMENT WITH A NEW ENTITY - The proposed Agreement with TLM is a new agreement with a newly formed entity, which was not the result of a public procurement process but through negotiations involving the current lessee, Maersk, even though Maersk is no longer a party to the agreement. The OIG is also concerned that the newly formed entity does not have the financial strength of its parent company and, thus, recommend that the parent company serve as the guarantor of the agreement.

2) FINANCIAL TERMS – REFRIGERATED CONTAINER REVENUE LOSSES - While it appears that the financial terms of the proposed Agreement significantly increase near-term revenues, the OIG is concerned about the true value of land rent.

3) CAPITAL IMPROVEMENT AND DEVELOPMENT – A review of the projects listed in the Agreement indicate that the main beneficiary of the upgrades would be TLM. The OIG believes that the Port should not commit capital contributions to the extent proposed in the Agreement.

4) SIDE-LETTER AGREEMENT – The OIG is concerned about a 1995 Side-Letter Agreement valued at $1.2 million that was never brought to the attention of the Board for approval, and is troubled by the proposed $65,000 settlement which would, in effect, retroactively authorize the $1.2 million credit and, thus, void a $879,812 account receivable.

In response to the first issue, we concur with the OIG's observation that the proposed Agreement with TLM represents a new agreement – not an assignment of an existing agreement. We likewise agree that the proposed Agreement was the product of direct negotiations, not a public bidding process.

Port staff negotiated for nearly a year with representatives from the first and third largest cargo shipping lines in the world - AP Moller-Maersk and CMA CGM, respectively, after they decided to form a partnership for purposes of operating a cargo terminal at the Port. We considered the process to have been part and parcel of the realities of our marketplace, and fully compliant with and supported by State law. Thanks largely to the latitude granted to Florida ports under State Statute F.S.125.35, we were able to bring this complex deal to fruition.

In fact, one of the *Whereas* clauses is particularly instructive in understanding how this deal was constructed. The clause reads:

*WHEREAS, Maersk a party to the Original Agreement, is only willing to surrender and terminate its remaining rights and interest in the Original Agreement if the County approves the instant superseding Terminal Agreement, under which certain Maersk affiliates may derive indirect benefits through or in connection with the above-referenced cargo terminal operator joint venture between OPERATOR and Universal Maritime Service Corporation, a New York Corporation and a wholly-owned subsidiary of AP Moller-Maersk affiliate APM Terminals North America, Inc.;*

As indicated above, the Port could not bid out the acreage covered under this terminal operating agreement, as Maersk retains certain contractual rights to the terminal for the next several years which they were unwilling to surrender. Maersk conditioned the surrender of its rights on the Board of County Commissioners approving this superseding Agreement.

With regard to the concern of the newly formed entity not having the financial strength of its parent company and the recommendation of the parent company serving as guarantor; Port staff negotiated a very solid backstop whereby Terminal Link, a wholly owned subsidiary of CMA CGM, guarantees all of TLM's payments and performance obligations to the County as set forth in the Agreement. Specifically, Terminal Link shall continue to serve as guarantor of all of TLM's payment, performance and other obligations for the later of the expiration or termination of the initial term of the Agreement or, if applicable, the properly exercised renewal term(s) of this Agreement plus six (6) years. Terminal Link shall provide the County with:

i. On an annual basis, by August 30 of each fiscal year of the initial term and applicable renewal term(s), (i) Terminal Link's audited annual financial statements and (ii) a written certification prepared by its outside auditors certifying that its net worth for the immediately preceding year, calculated in accordance with United States generally accepted accounting principles ("GAAP"), is not less than USD $45 million which threshold shall increase annually on October 1 of each fiscal year during the initial term and applicable renewal term(s) by 3% compounded annually ("Net Worth Floor"); and

ii. On a quarterly basis during each fiscal year during the initial term and, if applicable, the renewal term(s), a written certification from Terminal Link's CFO certifying that the company's net worth for the immediately preceding quarter, calculated in accordance with GAAP, is not less than the above-defined Net Worth Floor.

If either of the above-required annual or quarterly certifications is not timely provided to the County, or, if timely provided, any such certification ever indicates that Terminal Link's net worth for the applicable period, calculated in accordance with GAAP, is or was less than the then-applicable Net Worth Floor, then in such event TLM shall within ten (10) calendar days therefrom provide the County with supplemental security by delivering (and then maintaining) either (i) a USD $30 million irrevocable letter of credit, from an institution and in a form acceptable to the County; or (ii) an irrevocable written guarantee from CMA properly executed in a form acceptable to the County.

With respect to the OIG's concern of the true value of the land rent (once the existing refrigerated container revenue ceases), we assert that this was a trade-off during negotiations which will ultimately benefit the Port. The OIG is correct in its report stating that the Port will lose revenues due to the shifting of the refrigerated container revenues to TLM. However, as stated by the OIG, a substantial portion of this revenue is recaptured with the additional $0.25 per square foot out of the total 1.25 per square foot open ground rental rate. This proposed revenue structure affords the Port a greater revenue guarantee with annual compounded increases throughout the entire term of the Agreement averaging 4.7%. It

should be noted, that under the existing revenue generating structure, revenues from refrigerated containers can increase or decrease at any time depending on the volume and types of cargo that shipping lines import and/or export through the Port; providing no guarantee to the Port.

Additionally, as the terminal becomes more automated and the need for additional space to accommodate future growth becomes imminent, it is likely that TLM may choose a different way of providing refrigerated outlets to its customers and ultimately cease using the existing refrigeration units, whose layout occupies significantly more space than new high density refrigerated container racks capable of providing refrigeration to containers stacked vertically and more densely. Under this scenario, TLM would pay for the improvement and ultimately collect the revenues for the provision of the refrigerated outlets; leaving the Port without any revenue from this source. Thus, we strongly favored structuring the Agreement in this fashion.

In response to the capital improvement and development concerns, we concur with the OIG in its comments related to TLM being the primary beneficiary of the upgrades. However, the Port also stands to benefit from these improvements as the terminal's throughput capacity will be increased; thus potentially increasing the Port's TEU throughput revenue from TLM. It is also worth noting that these types of improvements are not uncommon for landlord ports to make; particularly when the tenant is paying significant rent for the use of the facility. Notwithstanding the above, TLM will also be contributing a significant amount of funds to improve the Port's infrastructure.

As stated previously, the OIG's fourth concern is a May 1995 side letter agreement entered into by the then Port Director; providing credits to Maersk from future terminal charges for $1.2 million. As described in the memorandum of the accompanying agenda item, this arrangement caused an accounts receivable balance of approximately $870,000. Although the Port did not have the legal authority to grant the credit nor was this issue addressed nor ratified through the subsequent 1995 Agreement between the County and Maersk, we are recommending that the Board approve the removal of this receivable from the Port's financial books, as the limited available evidence reflects a commitment by the then Port Director.

Maersk has been at the Port of Miami since 1982 and has been an outstanding customer throughout its tenure at the Port. Its current account balance is clear, and should the Board approve this Agreement, its long outstanding receivable of approximately $870,000 will be removed.

CMA started calling Miami in the 1990s and since 2001, has increased its throughput figures significantly. Their account balance is also current.

Assistant County Manager

# Memorandum

19 West Flagler Street ◆ Suite 220 ◆ Miami, Florida 33130
Phone: (305) 375-1946 ◆ Fax: (305) 579-2656
visit our website at www.miamidadeig.org

To: The Honorable Carlos Alvarez, Mayor, Miami-Dade County

The Honorable Chairman Bruno A. Barreiro
and Members, Board of County Commissioners, Miami-Dade County

From: Christopher R. Mazzella, Inspector General

Date: June 10, 2008

Subject: Memorandum of OIG Observations, Review and Comments on the *Proposed Terminal Agreement between Miami-Dade County and Terminal Link (Miami) LLC;* and *Execution of Termination, Release and Reservation of Rights Agreement between Miami-Dade County and Maersk, Inc.*, Ref. IG07-74

As part of the Miami-Dade Office of the Inspector General's (OIG) continuing oversight of Seaport Department (Seaport) operations, the OIG has been monitoring the contract negotiations process and reviewing the current and proposed agreements with the current terminal operators (Operators) serving the Port of Miami (POM). The three Operators serving the POM are Maersk, Inc. (Maersk), Port of Miami Terminal Operating Company, L.C. (POMTOC), and Seaboard Marine, Ltd. (Seaboard).

This memorandum sets forth the OIG's observations and comments with respect to the proposed agreement for the parcel of terminal land currently leased to Maersk on the Transit Committee's Agenda for June 11, 2008.

The OIG would again like to express its gratitude to the Seaport and the Operators for their cooperation and assistance during this process. In particular, the Seaport ensured that the OIG was kept informed of all meetings, provided it with copies of correspondence and documentation, and, in general, provided information on cargo terminal operations.

## SUMMARY OPINION

While there are certain terms of this agreement that we believe could be improved upon, overall we believe that it does foster fair and balanced competition, which may be a catalyst towards attracting new business and eventually increasing growth in container business at the Port of Miami. The aspects of the agreement, however, that the OIG has concerns about are:

1. A NEW AGREEMENT WITH A NEW ENTITY - The proposed Terminal Agreement with Terminal Link (Miami), LLC (TLM) is a new agreement with a newly formed entity, which was not the result of a public procurement process but through negotiations involving the current lessee, Maersk, even though Maersk is no longer a party to the agreement. The OIG is also concerned that the newly formed entity does not have the financial strength of its parent company and, thus, we recommend that the parent company serve as the guarantor of the agreement.

2. FINANCIAL TERMS – REFRIGERATED CONTAINER REVENUE LOSSES - While it appears that the financial terms of the proposed Agreement significantly increase near-term revenues, the OIG is concerned about the true value of land rent.

3. CAPITAL IMPROVEMENT AND DEVELOPMENT – A review of the projects listed in the Agreement indicate that the main beneficiary of the upgrades would be TLM. The OIG believes that the Seaport should not commit capital contributions to the extent proposed in the Agreement.

4. SIDE-LETTER AGREEMENT – The OIG is concerned about a 1995 Side-Letter Agreement valued at $1.2 million that was never brought to the attention of the Board of County Commissioners for approval, and we are troubled by the proposed $65,000 settlement which would, in effect, retroactively authorize the $1.2 million credit and, thus, void a $879,812 account receivables.

Each of these issues will be discussed in further detail.

**BACKGROUND**

In July 2007, the Seaport Director advised the OIG that the Seaport was about to begin terminal operating negotiations with the Operators at the POM. Due to the complexity of simultaneous negotiations with the Operators and the future implications of any or all of those agreements, the Seaport Director requested that the OIG observe and comment on the negotiation processes.

Since that time, OIG activities have included attendance at all scheduled negotiation meetings with the Operators and review of all existing terminal operating contracts, their amendments, Port tariff, historical statistical and financial data, current financial data, and two independent studies of POM operations.[1] OIG staff also made numerous site visits to observe cargo operations and facility conditions. Meetings and interviews

[1] *Port of Miami Tariff Analysis*, Planning and Economics Group, May 24, 2006, and *Port of Miami Cargo Terminal Capacity Analysis*, TranSystems, October 26, 2007.

were held with various Seaport staff members representing the Administration, Finance, Maritime, and Marketing divisions. Thus far, the OIG has issued a final report relative to the Seaboard Marine Terminal Agreement.

With respect to the TLM proposed Agreement, OIG comments have been forwarded to the Seaport Director and his staff since November 2007. Our comments on the most recent terms of the proposed agreement were presented to the Seaport Director in the form of a draft memorandum dated May 2, 2008. His written response to the OIG is attached. (Appendix A) The OIG has taken the Seaport's response into consideration and made revisions to our draft memorandum as appropriate. The following "final" memorandum discusses the agreement as "proposed" for the upcoming June 11th Transit Committee Meeting.

1995 AGREEMENT WITH MAERSK, INC.

On July 11, 1995, the Miami-Dade County Board of County Commissioners adopted Resolution R-944-95, which authorized the current agreement with Maersk, Inc. (Maersk) for terminal operations at the Port of Miami. This agreement provided for an initial term of 5-years with three 5-year options for Maersk but is silent on the methodology for exercising renewal options. The agreement is mid-way through the second renewal period and the entire agreement will expire in 7 years in the year 2015.

The Seaport Director informed the OIG that since Maersk did not take affirmative action to renew the agreement for an additional 5-year term, he had placed them on notice as having a month-to-month agreement.

## OIG AREAS OF CONCERN

### 1. A NEW AGREEMENT WITH A NEW ENTITY

The OIG is concerned that the process of terminating the current agreement with Maersk and entering into a new agreement with the newly created entity, TLM, was not done with the benefit of an open public procurement process to ensure that the County is receiving the best possible terms.

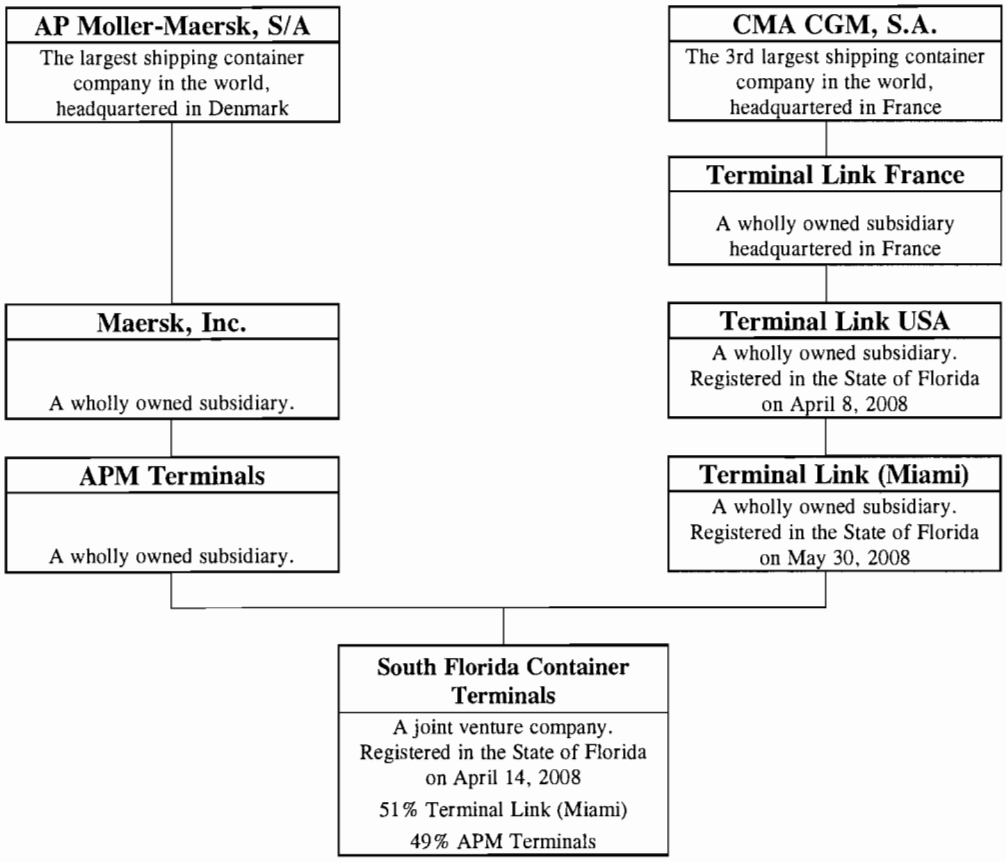
At the first Maersk negotiation session attended by the OIG on September 5, 2007, the Maersk representative stated that Maersk would like to propose a joint venture with CMA CGM[2] (CMA) to provide terminal operating services and requested that negotiations continue on that basis; the Seaport agreed and negotiations continued. At a later meeting in January 2008, the OIG requested further clarification of the identities

[2] CMA CGM is the third largest shipping company in the world, headquartered in France.

and relationships of the various entities relative to the Agreement. The CMA representative stated that the proposed joint venture between CMA and Maersk would provide the terminal services. When prodded further by the OIG as to *"Which entity would sign the agreement or hold the lease?"*, the response from the CMA representative was *"CMA."* It was further explained that CMA would create a wholly owned subsidiary called Terminal Link that would enter into the Agreement with the Seaport. In addition, a joint venture between CMA and Maersk would be created to provide the actual daily terminal services; the joint venture would be 51% CMA CGM and 49% Maersk.

As negotiations neared closure, it was further clarified that Terminal Link USA would create a new subsidiary named Terminal Link (Miami) LLC (TLM) that would actually sign the Agreement. Further, it was stated that the joint venture to provide the terminal services would be named South Florida Container Terminals (SFCT). Maersk would not be a signatory to the Agreement.

For clarity, below is an illustration containing a brief description and relationships of the new entities involved:



In his response of May 23, 2008 (see Appendix A), the Seaport Director concurs that the proposed agreement is a new agreement resulting from direct negotiations and not a public bidding process. Furthermore, he added that Florida Statutes §125.35 provides the authorization and latitude to conduct these types of negotiations. While the OIG concurs that F.S. §125.35 may provide the authorization to conduct these types of negotiations, the OIG believes that conducting negotiations in this manner may not provide the Seaport with an appropriate forum for determining the true value of the Port of Miami land for terminal operations.

The Seaport Director explains in his response to the OIG that *"POM had no ability to bid out this terminal operating agreement as Maersk retains certain contractual rights to the terminal for the next several years which they were unwilling to surrender."* However, it is the OIG's contention that the Seaport did not fully pursue negotiations with Maersk to determine if a renewal could be agreed upon, but rather proceeded directly to what was thought to be a joint negotiation with Maersk and CMA. In fact, early in the process, it was unclear since one individual represented both Maersk and CMA. Moreover, the door opener for a new round of negotiations was the Seaport's position that since Maersk did not take affirmative action to renew the agreement for an additional 5-year term and, thus, was on a month-to-month agreement, the Seaport required renewal renegotiations. The end result was not a renewed agreement with Maersk but a completely new agreement with a new entity—Terminal Link (Miami)—which was incorporated in Delaware two months ago and registered to do business in Florida less than a month ago.

This issue ties with another OIG concern over who is the "guarantor" of the agreement. While this issue has been recently resolved by the parties to the agreement, the OIG is still concerned about whether the guarantor, Terminal Link France, is substantial enough to provide a meaningful guarantee. The Seaport originally requested that CMA be the guarantor. However, CMA was unwilling and insisted that Terminal Link France should be sufficient since it is a wholly owned subsidiary of CMA.

In addition to the Terminal Link corporate and financial information provided by CMA, the Seaport obtained additional information from Dunn & Bradstreet.[3] Based on this information, the Seaport was still not comfortable with the financial strength of Terminal Link to act as the sole guarantor to the Agreement and, as a result, requested additional assurances. These assurances would be in the form of submitting annual financial statements showing a net worth of not less than $45 million with regular quarterly updates and certification that its net worth has not fallen below that threshold for any quarter. Should Terminal Link fail this requirement, CMA would then be

[3] According to the Dunn & Bradstreet report obtained by the Seaport in April 2008, the Dec. 31, 2006 Net Worth for Terminal Link France is reported as €17.5 million (US $27 million). See footnote 4, regarding the retroactive shareholder loan.

required to submit either an irrevocable Letter of Credit for $30 million or an irrevocable guarantee from CMA.

The OIG believes that a more substantial guarantor would be CMA directly, as the Seaport initially requested. Furthermore, having CMA, as the guarantor, would eliminate the need for the Seaport to timely follow up and review one annual report and three quarterly financial reports during each of the 25 years of this Agreement to ensure that the shell company, Terminal Link, has the required minimum net worth.

The BCC, in reviewing this proposed Agreement, should ensure that the County's financial interests are adequately protected by the most substantial guarantor available, namely CMA, and not a wholly owned subsidiary with limited liability that has received artificial infusions of cash to enhance its appearance of net worth.[4]

2. FINANCIAL TERMS – REFRIGERATED CONTAINER REVENUES LOSSES

Although it is stated in the County Manager's Memorandum that this Agreement will generate approximately $15.3 million in revenues, it must be emphasized that $3.9 million would be new revenues to the Seaport due entirely from the land rent component at $1.25 per square foot. Furthermore, the OIG notes that the Seaport's new revenue gain is inclusive of an $850,000 loss due to the Seaport turning over the refrigerated container operations to TLM. Currently, the Seaport charges Maersk a contracted daily rate for each refrigerated container that is connected to the Seaport's electrical infrastructure. The Seaport nets in excess of $850,000 annually after paying for maintenance and electric costs. Under the proposed Agreement, TLM would reimburse the Seaport only for the cost of electricity used.

A substantial portion of this loss ($776,675) is recaptured in the land rent component with the addition of $0.25 per square foot. For comparative purposes, Seaboard Marine's new agreement requires the payment of $1.00 per square foot for land that is acknowledged by all (including the Seaport) to be less desirable. Conversely, TLM will pay $1.25 per square foot for land that is much more desirable. However, when discounting the land rent by the loss of refrigeration revenues, the effective rent for each of the two yards of $1.00 per square foot is the same. We believe that the Seaport Department could have obtained a much higher premium land rental price, especially in light of added third party rights in the Agreement.

[4] On April 7, 2008, the OIG received a copy of letter, dated July 17, 2007, by Pricewaterhouse Cooper Audit, the independent auditor for CMA, addressed to the Directors of CMA CGM S.A. stating that the Year ended December 31, 2006 Net Worth of Terminal Link is US $89,516,865. The letter further states ***"Net worth amounting to 89,516,865 US Dollars as at December 31, 2006 reflects on a pro forma basis, the effect of the amendment of the 50,000,000 euros (US $75 million) shareholders loan dated July 17, 2007."*** (Emphasis added by OIG.)

3. CAPITAL IMPROVEMENT AND DEVELOPMENT – MAINTENANCE, DRAINAGE, AND RUBBER TIRE GANTRY (RTG) PADS

The Agreement requires the Seaport to make phased capital contributions of up to $16 million towards the implementation of a Rubber Tire Gantry (RTG) infrastructure. TLM is required to share in the infrastructure costs by providing up to $12.5 million. The OIG believes that the Seaport should not commit as large a financial contribution as outlined in the Agreement for the following reasons:

- The minimum throughput guarantee of 2,750 TEUs[5] per acre does not justify a Seaport investment in RTG infrastructure.

- The projected cargo volume is 4,206 TEUs per acre.
  - Maersk cargo volume has been steadily declining and is projected to be 2,804 TEUs per acre.
  - CMA cargo volume is projected at 1,402 TEUs per acre. This projected volume is not new cargo to the POM but instead is cargo transferred from one operator to another.

The OIG believes that the proposed financial structure of the development plan is not in the best interest of the POM; however, certain considerations may make it more palatable, such as:

- Increasing the minimum throughput guarantee to a level that justifies the need for RTGs;
- Reducing terminal acreage that would result in a higher throughput per acre for the projected cargo volume; or
- Decreasing the Seaport's financial contribution towards the RTG upgrades.

In his May 23, 2008 response, the Seaport Director states that the projected volume of 4,200 TEUs is at the Sustainable Practical Capacity threshold for considering upgrades to RTGs as recommended in the TranSystems Report and, therefore, justifies the capital upgrades. As previously stated, the OIG does not question the need for the infrastructure upgrade, but is concerned about the amount to be paid by the Seaport since fully one-third of the projected volume (100,000 TEUs) is being transferred from another terminal yard, thus causing the threshold to be attained. This business arrangement fully benefits TLM and not the Seaport. The OIG stands by the three alternatives suggested above, of increasing the minimum TEU throughput guarantee,

[5] TEU = Twenty Foot Equivalent Unit – an industry measure for shipping containers; e.g. a 40-foot container is counted as 2TEUs.

reducing the leased acreage, or decreasing the Seaport's financial contribution towards the improvements.

As a point of reference, in the recently approved amendment to the Seaboard Marine Agreement, the terminal operator agreed to a minimum throughput guarantee of 4,000 TEUs per acre without the benefit of or requirement for RTGs. Seaboard's TEU throughput minimum guarantee is 45% higher than the minimum guarantee proposed in this agreement.

## 4. SIDE-LETTER AGREEMENT (ARREARAGE)

On November 13, 2007, the OIG advised the Seaport that a Seaport financial report titled *Analysis of Outstanding Customer Balances* (as of 10/24/07), reported a total outstanding balance of $1,023,881.64 in excess of 90-days for Maersk, of which $879,812.31 (86%) relates to "Electric Cont"[6] and is dated between 1997 and 1999, as shown below:

| Category | >90 Days |
|---|---|
| Maersk/Sealand | $24,725.84 |
| P&O Nedlloyd | $27.15 |
| **Electric Cont** | **$879,812.31** |
| Late Document | $13,094.95 |
| Late Payment | $103,465.57 |
| Misc. Rev | $1,763.60 |
| Released Cargo | $987.80 |
| Undefined Section | $4.42 |
| | **$1,023,881.64** |

As a result of the OIG's intervention and review, Maersk has since issued two payments totaling $53,267.29 towards the outstanding balance. At that time, Maersk also advised that they do not owe and will not pay the $879,812.31 in *Electric Cont* and the related $103,465.57 in *Late Payment* (interest) charges because it represents the remainder of a "refrigerated container credit" that was owed to them as part of a 1995 side-letter agreement for a $1.2 million operational credit with the Port Director at that time, Carmen Lunetta.[7]

### $1.2 MILLION CREDIT

From interviews with various individuals and review of certain documents, the OIG was told that in 1995 former Port Director Lunetta gave Maersk a $1.2 million credit against future terminal expenses to be paid by Maersk to the Seaport. The OIG was

[6] Electric Cont refers connecting refrigerated containers to the Seaport's electrical system.
[7] Carmen Lunetta, Seaport Director, resigned May 1997

advised that the rationale for the credit was that a terminal operating agreement was verbally agreed to in 1993; however, at the request of Lunetta, it was delayed for 2 years before being brought to the BCC for approval in 1995. During that time Maersk claimed that they lost the benefit of the lower contract prices, hence the $1.2 million credit.

HOW IT WORKED[8]

There is a letter from former Seaport Director Lunetta, dated May 30, 1995, agreeing to give Maersk a credit of $1.2 million.[9] The letter contains a credit schedule showing how the credit would be applied against future terminal expenses from October 1995 to December 1996. Apparently, the credit schedule, as proposed in the Lunetta letter, was not immediately implemented. By March 1997, additional correspondence proposed that the $1.2 million credit be applied towards future refrigeration rates in that the Seaport would invoice only 50% of the contract rate until $1.2 million had been reimbursed to Maersk as a result of the reduced charges. Because the Seaport's application of the credit was effected by discounting the invoiced contract rate, the payment of those invoices would show payment in full and, thus, would be cleared from the Seaport's accounting records. Through review of other correspondence, we believe that this occurred from March 1997 to November 1997.[10]

Following the resignation of Lunetta in 1997, the Seaport Transition Team issued instructions to immediately cease the practice of using the discounted rates and that the full contracted rates were to be applied.[11] We believe these instructions were issued in November or December 1997. Nevertheless, Maersk, in a March 24, 1998 letter to the then new Port Director, Mr. Charles Towsley, informed him that since the Port stopped issuing the 50% invoice credits on its monthly invoices, Maersk would continue paying future invoices as if the credit was being provided, until the entire $1.2 million credit had been obtained.

The OIG's review of the invoices, payments and financial reports of balances show that Maersk then began paying 50% of future electrical connection (i.e. refrigerated containers) invoices. Because only partial payments were made, the unpaid invoiced

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[8] Many of the correspondences referenced herein were provided to the OIG by Maersk. Oftentimes, the Seaport did not have copies of the relevant correspondences, and also were provided copies by Maersk.
[9] May 30, 1995 Letter from Carmen Lunetta, Port Director, to Jorgen Palmbak, General Manager – APM Terminals, Subject: *Miami Terminal Agreement - Sideletter*
[10] While our search for pre-November 1997 invoices in storage was unsuccessful and we were unable to confirm whether the 50% reduction in unit price was actually applied to the invoices, subsequent correspondence from Maersk reveals that significant amounts credited during this period did take place.
[11] March 26, 1998 Memorandum from John Ballestero, Chief of Operations to Charles Towsley, Port Director, *Subject Maersk Lines*

amounts remained open and, as a result, $879,812.31 appears in the Seaport's accounts receivable records for Maersk.

SIDE-LETTER AGREEMENT AND SUBSEQUENT TERMINAL AGREEMENT

The OIG has reviewed the July 11, 1995 County Manager Recommendation Memo accompanying the *Terminal Agreement with Maersk, Inc. for Shipping Terminal Operations at the Port of Miami,* Resolution R-944-95 authorizing the Agreement, and the Agreement itself. Not one of these three documents references either a side-letter agreement or a $1.2 million credit towards future terminal charges.

In the current agreement with Maersk, Section 20 entitled *Entire Agreement*, states:

> *This Agreement, including all exhibits, codes, or tariff attached hereto or referred herein, contains the entire agreement of the County and Maersk with respect to the matters stated herein, and may not be modified except by way of a written instrument and approved by the Board of Dade County Commissioners. Any oral or written representations or agreements regarding the subject matter hereof made prior to the execution on this Agreement are hereby merged into and superseded by the Agreement.*

This agreement was signed by both Philip Connors, Executive Vice President, and Jorgen Palmbak, General Manager Operations for Maersk. The OIG notes that the Lunetta "side-letter agreement" was dated May 30, 1995 and was also signed by Jorgen Palmbak on behalf of Maersk.

According to the dates listed above, the Lunetta "side-letter agreement" is superseded by the execution and approval of the Terminal Agreement, which does not mention or include by reference the "side-letter agreement." Furthermore, the OIG notes that any responses from Maersk as to its reliance on the apparent authority of the Port Director is clearly nullified due to the clause which states "*and approved by the Board of Dade County Commissioners.*" Jorgen Palmbak signed both documents on behalf of Maersk and should have been familiar with the contents of those documents.

In addition, the OIG is also concerned that if the Seaport Transition Team was aware of the "side-letter agreement" in 1997, and ordered the discount to cease, why was no action taken against Maersk for unilaterally applying the credit in the form of a 50% discount. Years later, this large account receivables (arrearage) have remained on the Seaport's financial statements, as they do now. Since November 2007, the OIG has been telling the Seaport that this is still an outstanding issue that needs to be brought to

the attention of the BCC for action and resolution prior to the assignment, renewal, or termination of any agreement involving Maersk, Inc.

In his May 23, 2008 response, the Seaport Director stated:

> *We are pleased with your Office's assistance in unraveling a complicated outstanding financial issue with Maersk . . .*
> *Nonetheless, the arrearage issue and "side letter agreement" from a decade ago that your office researched, is an important issue for our Board . . . we intend to fully inform the Board on this issue. In this regard, I believe it best that we reserve our recommendation for resolving this issue for the County Manager's memorandum.*

The OIG is pleased that the results of our research and analysis were of assistance to the Seaport in resolving an issue that has been outstanding for thirteen years. According to the proposed termination agreement, the BCC is being asked to approve a settlement amount of $65,000 to be paid by Maersk. In essence, the settlement only applies to credits claimed by Maersk that exceeded the $1.2 million side deal. The $65,000 settlement is only a compromise between a $35,964 arrearage as acknowledged by Maersk versus $97,142 as calculated by the OIG exceeding the $1.2 million credit. As worded in the proposed agreement, the $65,000 settlement would nullify the $879,812 arrearage for non-payment of electrical connections invoices as shown in the chart on the previous page. Wiping out the $879,812 arrearage would essentially retroactively approve the former Port Director's 1995 side-letter agreement.

The OIG does not condone the side-letter agreement made by the former Port Director but we recognize that the issue is over one decade old and that the Seaport must move forward. Nevertheless, the Board of County Commissioners must ultimately decide on what course of action should be taken to resolve this credit vs. arrearage issue. In conclusion, the OIG supports the Seaport in its efforts to promote competition thereby enhancing the Port of Miami's financial viability and regional standing. However, we do have our concerns, as noted above.

cc: George M. Burgess, County Manager
Robert A. Cuevas, Jr., County Attorney
Ysela Llort, Assistant County Manager
Bill Johnson, Director, Miami-Dade Seaport Department
Denis Morales, Mayor's Chief of Staff
Charles Anderson, Commission Auditor
Clerk of the Board (copy filed)

Attachments

# Memorandum

MIAMI-DADE COUNTY

MDC-OFFICE OF THE INSPECTOR GENERAL

2008 MAY 27 PM 12:43

**DATE:** May 23, 2008

**TO:** Christopher R. Mazzella
Inspector General

**FROM:** Bill Johnson
Port Director

**SUBJECT:** Response to OIG Draft Memorandum IG07-74 of Observations, Review and Comments on the Proposed Terminal Agreement between Miami-Dade County and Terminal Link Miami, LLC

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On May 2, 2008, the Office of the Inspector General (OIG) issued Draft Memorandum IG07-74 concerning a proposed terminal agreement between Miami-Dade County (County) and Terminal Link Miami, LLC (TLM). The OIG's memorandum presented four principal areas of concern, and a discussion of current arrearages. This memorandum serves to address the OIG's concerns and is intended to be included within the OIG's final report.

Prior to providing specific responses to the OIG's areas of concern, POM would like to state that it is extremely happy to have successfully navigated a long and complex negotiation process with two of the three largest cargo shipping lines in the world. The proposed agreement is a financial home run for POM and for the inland economy. Taken in combination with the Board of County Commissioners' recent approval of the Seaboard Marine Terminal Operating Agreement, the County has solidified its standing with its three most important cargo shipping partners, while adding over $7 million annually in new revenues to POM's bottom line. Similarly, these two agreements increase the annually guaranteed revenues to POM from approximately $6 million to approximately over $21 million. While this contract, like all contracts, was subject to significant give and take, we are absolutely excited to bring this deal to our Board.

I would also like to point out the importance of this agreement in our effort to reshape POM's cargo operations by reintroducing for the first time in nearly a decade true competition for third party business. Reintroducing the right to compete openly greatly increases the value of land to a terminal operator and thus our ability to charge substantial land rent. The contract calls for $3.9 million in new land rent revenues, which is a close approximation to the total positive net effect of this agreement on POM's finances.

In succeeding months, we hope to actively and productively re-engage POM's remaining terminal operator in negotiations, and we invite your Office to similarly observe and review that process for its business merit and overall fairness.

**APPENDIX A**

**ISSUES/RESPONSES**

***Issue 1:*** A New Terminal Agreement - The OIG believes that the Terminal Agreement with TLM is not an assignment of an existing agreement but the granting of a terminal operating agreement to a new entity without the benefit of a public procurement process.

***Response:*** POM concurs with the OIG's observation that the proposed contract with TLM represents a new agreement – not an assignment of an existing agreement; we likewise agree that the proposed contract was the product of direct negotiations, not a public bidding process.

POM negotiated for nearly a year with the first and third largest cargo shipping lines in the world - AP Moller-Maersk and CMA CGM, respectively – after they decided to form a partnership for purposes of operating a cargo terminal at POM. It is important to note, however, that CMA CGM approached AP Moller-Maersk to form a joint venture after AP Moller-Maersk had begun negotiations with POM for an extension of their existing contract. As noted in the Draft Report, the negotiations were complex. We considered the process to have been part and parcel of the realities of our marketplace, and fully compliant with and supported by state law. Thanks largely to the latitude granted ports under Florida Statute 125.35, we were able to bring this complex deal to fruition.

POM intends to make the Board of County Commissioners fully aware of the details of this important transaction in the County Manager's memorandum. We will be clear in our memorandum that this is a new terminal agreement and that it did not result from a public bidding process. In fact, one of the *Whereas* clauses is particularly instructive in understanding the circumstances under which this deal came into being. The clause reads:

> *WHEREAS, Maersk, a party to the Original Agreement, is only willing to surrender and terminate its remaining rights and interest in the Original Agreement if the County approves the instant superseding Terminal Agreement, under which certain Maersk affiliates may derive indirect benefits through or in connection with the above-referenced cargo terminal operator joint venture between OPERATOR and Universal Maritime Service Corporation, a New York Corporation and a wholly-owned subsidiary of AP Moller-Maersk affiliate APM Terminals North America, Inc.;*

As indicated above, POM had no ability to bid out this terminal operating agreement as Maersk retains certain contractual rights to the terminal for the next several years which they were unwilling to surrender. Maersk conditioned

the surrender of its rights on the Board of County Commissioners approving this superseding terminal operating agreement.

***Issue 2:*** Contract Term - The OIG could not find any sound economic, business, or financial reasons to consider entering into a 25-year non-negotiable agreement with TLM.

***Response:*** POM has conducted significant research into the customary lengths of cargo terminal operating agreements, finding that long-term contracts like the one proposed for TLM fall well within the industry norm. (Upon request, POM will provide its updated research to the OIG.)

POM was amenable to a contract of 25 years length (inclusive of options) for several reasons. First, the financial benefits to POM are extraordinary. With this contract, POM exchanged an agreement with a $3 million annual revenue guarantee of approximately $12 million annually, while net revenues to POM are expected to increase by approximately $3.9 million annually. For a port confronted with financial issues, this long-term pledge is of enormous value. We are aware of no similar or reasonably similar pledge anywhere in Florida. Secondly, as a condition of their extraordinarily aggressive financial pledge, the contracting parties made term length a key requirement. This is understandable, as these two dominant cargo entities are well poised to make use of the new and deeper Panama Canal channel. Combined with POM's commensurate plans to improve access to our port by deepening our shipping channel and adding a direct connection to the highway system via tunnel, we believe we have constructed the right agreement with the right parties.

The financial terms agreed to by these entities reflect the fact that they are paying a premium today for access to assets that will not be available until roughly six years in the future. Insistence on a shorter-term contract would have cost the POM financially, and would have likely resulted in our losing these two valuable entities to competing Florida ports that would be very willing to offer long-term homes in exchange for such lucrative deals.

Thirdly, we are comfortable with the long duration of this agreement as it has several protections beyond the guaranteed revenue pledge. Importantly, the terminal operator will be on Tariff, excepting certain specific charges. This important concession by TLM helps protect a future director from incurring unanticipated new costs without an ability to derive new revenues. Additionally, the proposed agreement contains several other protections against inflation and a run-up in land values.

***Issue 3:*** Financial Terms – While the financial terms of the proposed agreement significantly increase the near-term revenues, the OIG is concerned about the

potential effect on the long term growth and development of the POM. In fact, it could also result in near-term chaotic operations between Operators at the POM.

***Response:*** Prior to entering into negotiations with its three terminal operators, POM created a preferred financial model for its cargo operations. The model was designed to achieve several financial and one operational goal. The financial goals were to increase revenue to POM, improve the minimum guarantees, and provide future directors with the ability to generate new revenues to offset new expenses. Our operational goal was to re-establish open competition for third-party shipping business. We are extremely pleased that a year of hard work and negotiations has resulted in new contracts that entirely match our initial goals.

When we created our model for negotiations, it was admittedly difficult to achieve the three financial goals listed above. Ultimately, we decided that the best path to achieving our financial and operational goals was through introducing a substantial land rent requirement and by creating a fee schedule for containers that effectively leveled the playing field for terminal operators competing for third party business and which was, as best as mathematically possible, revenue neutral to POM.

Increasing land rent was an important decision, as it will help end the practice of long-term land banking, which is the norm in the port industry. It likewise encourages terminal operators to efficiently use our assets. The new fee schedule for containers is as near to being revenue neutral as we can make it. The container fee model represents a slight increase to the present Maersk container rate and that of CMA, while various third party customers could experience slight increases or decreases, depending on their overall throughput levels and the terminal yard they elect to use. The modest variances in rates represent a small fraction of the fees paid by shippers at POM.

While the container rate schedule was purposefully designed to be as close as possible to being revenue and cost neutral for customers choosing between terminal operators, the overall deal was constructed to add substantial new net revenues and guarantees to POM. The total new net revenues to POM from this deal, irrespective of the movement of boxes from one terminal operator to another, are projected to be just over $3.5 million, which is the near equivalent to land rent component (adjusted downward for revenues relating to refrigerated container charges and upward for an increase in weighted-average crane fee rates).

In our remaining negotiations with our third terminal operator, POM will seek to continue to create a level playing field for competition for third party business.

***Issue 4***: Capital Improvement and Development - A review of the projects listed in the Agreement indicates that the main beneficiary of the upgrades would be TLM and so should be funded accordingly. The Seaport should not commit to any capital contribution.

***Response:*** During the course of this agreement, POM definitively believes that the terminal yard will require upgrades to accommodate higher levels of throughput that are achievable through use of a rubber tire gantry (RTG) system. Consequently, we were pleased to share these expenses with the tenant, rather than pay fully for the investment as is frequently the case with landlord ports. We were also pleased to cap our commitment of dollars for this purpose at $16 million. Despite the $16 million maximum commitment level by POM, we actually expect to fund less than this. Our recent engineering cost estimates fall below this figure, while we customarily attract grant funding for these types of investments.

POM disagrees with the assessment contained within the Draft Report that the upgraded terminal yard is not justified by projected cargo volumes. In the first full year of operations under this agreement, POM expects 291,000 TEUs to be moved through the terminal yard, which equates to over 4,100 TEUs per acre. According to POM's recent cargo terminal capacity analysis performed by Transystems of this terminal yard (and to other readily available information concerning cargo yard through-put capacities), we are exactly at the level indicated to begin conversion to RTG operations. Sustainable Practical Capacity (SPC) is the efficiency and cost yardstick used for determining when to invest in terminal infrastructure; for the terminal in question, the SPC is 4,200 TEU per acre.

From a financial perspective, these infrastructure improvements are self-financing. According to our cost sharing formula, with as little an increase as an additional 500 TEUs per acre annually owing to upgraded facilities, POM's anticipated infrastructure investment will be paid back through increased TEU revenues.

**ARREARAGES**

Regarding outstanding arrearages and disputed amounts, my office has long made it a practice that no deal moves forward to the Board of County Commissioners without resolving arrearages and disputed amounts. This has been the case in each new contract or contract amendment that POM has presented the Board during my tenure as Director. Prior to and during the time the OIG has attended negotiations, we have made it clear that no new terminal agreement could move forward without resolving outstanding financial issues.

We are pleased with your Office's assistance in unraveling a complicated outstanding financial issue with Maersk.

Nonetheless, the arrearage issue and "side letter agreement" from a decade ago that your Office researched, is an important issue for our Board. While I would like to speak to you personally prior to this proposed contract advancing to the Board, we intend to fully inform the Board on this issue. In this regard, I believe it best that we reserve our recommendation for resolving this issue for the County Manager's memorandum. Again, I am grateful for your staff's very professional and competent assistance in unraveling this matter.