



10 Critical Due Diligence Points When Acquiring A Port Container Terminal Facility

By **Steven I. Chung**

A long overlooked sector, container terminal facilities have been garnering strong media attention both in the U.S. and internationally, due to the political uproar related to DP World's March 2006 acquisition of the Peninsular and Oriental Steam Navigation Company (P&O), which owned several U.S. ports. Despite this cloud of politics hovering over port deals, container terminal facilities have been garnering strong interest from financial buyers, including investment banks and private equity firms, who have chosen to instead focus on the fact that many container terminal facility operators are profitable, highly cash-generative and asset-rich targets.

Container terminal facility operators run seaport facilities which are typically leased from local governments. Given the inherent security concerns that many governments have in securing their ports, when considering such a complex and politically sensitive acquisition, the importance of due diligence is magnified in determining the feasibility of making such an acquisition and properly valuing the asset.

The following are 10 key due diligence points that should be considered by any potential buyer of a container terminal facility:

1. **Potential CFIUS Review**

To the extent there are legitimate concerns that a potential acquisition of a U.S. port by a non-U.S. entity may be perceived as involving infrastructure critical to the national security of the U.S., it is advisable for the transaction parties to submit a voluntary notification to the Committee on Foreign Investments in the United States (CFIUS). A voluntary notification compels the U.S. Government to undertake an initial review of the proposed transaction within 30 days. At that time, CFIUS will either approve the transaction or continue its investigation for 45 additional days and submit a report and recommendation to the President, who has 15 days thereafter to decide whether or not to take any action. On the other hand, if the transaction parties elect not to submit a notification,

the transaction remains subject to investigation by the U.S. Government at any time, which could potentially result in the transaction being blocked at a later stage or issuance of an order by the President requiring that the transaction be unwound. By electing to file a CFIUS notification, an acquirer in effect can require the U.S. Government to analyze the substantive issues presented before consummating the transaction, and to the extent no concerns are raised by CFIUS, obtain a definitive “safe harbor” ruling.

2. Concessions

As container terminal facilities are typically leased from local governments, the underlying ground lease with the relevant local government is generally the most critical document in the due diligence process. This ground lease essentially serves as the license for the container facility operator to operate its business. As such, the terms of this ground lease, including the remaining term of the lease (with any options to renew), the rental obligation, any remaining capital improvement obligations of the operator and any change of control provisions are of particular importance. Given their strategic geographic importance, particularly in the United States due to security concerns related to terrorism, it should not be surprising that these leases will typically have strict change of control provisions. Accordingly, any acquisition will need to include discussions with the local governmental authority very early in the acquisition process. Further, a careful examination of the other permits and registrations needed by the port operator to operate its business should be conducted, including a detailed review of any stevedoring permits and space permits (for ground transportation of cargo, including

“ship to rail”) issued by the local government, the government-approved security plan and any general licensee registrations (e.g., in the U.S., registration with the US Nuclear Regulatory Commission is necessary for any X-ray machines, which are typically used by container terminal facility operators in examining containers).

3. Remaining Capital Improvement Obligations

When providing or renewing a ground lease to a port operator, the local governmental authority will also place the financial burden of constructing and/or improving the terminal on the operator. The most significant capital expenditure related to any container terminal involves the initial construction of the terminal and future expansions of the terminal which entails very costly capital improvements such as reinforcement of the berth to allow for additional dredging of the berthing area and the structural strengthening of the foundation. Consequently, it is essential in any container terminal facility acquisition to clearly define the remaining capital improvement obligations of the relevant operator and what portion, if any, of such capital improvements will be financed by the local governmental authority. The largest capital expenditure for container terminal facility operators apart from capital improvement projects to the container terminal involves the purchase of heavy industrial equipment used in the operation of the port, including straddle carriers, cranes and forklifts.

4. Key Customer Contracts

The primary revenue source for container terminal operators are the relevant stevedoring and terminal services

agreements with their cargo customers, as well as the harbour charges paid by the relevant shipping companies docking in such port operator's facility. In evaluating the customer agreements, several issues should be thoroughly analyzed including the diversification of the customer base, the term of such customer contracts, the payment obligations under such agreements and whether such customer contracts include volume guarantees. Further, in evaluating the harbour charges collected by a port operator, it should be determined what portion of such charges must be shared with the relevant local governmental authority.

5. Labor/Unions

The majority of port operators, particularly in the U.S., have a unionized workforce. In the U.S., when a workforce is unionized, the relationship is generally governed by a collective bargaining agreement (CBA). Virtually all CBAs have "no strike" clauses and discipline/grievance procedures, both of which can provide important stability to the workplace. Even with these provisions, however, difficult labor relations can be a distraction to management and a drain on resources. For this reason, it is essential to review all grievance/arbitration/litigation files of a port operator. In addition, for a U.S. port acquisition, particular attention should be paid to files containing National Labor Relations Board (NLRB) documents and documents relating to pending or concluded employee complaints, grievances and arbitration matters. The NLRB is the federal government agency that has primary jurisdiction over labor issues, including disputes between the port operator and its unions that cannot be resolved through, or do not come within jurisdiction of, the grievance dispute provisions of the CBA. These documents

should be carefully examined to determine the presence of any serious disputes.

6. Employee Benefit Plans

Given the sheer number of employees that are needed to operate a port facility, a detailed review of the port operator's benefit plans are essential to evaluating the financial condition of the business. Specifically, special attention should be given to any pension plans which the port operator may have in place and the amount of underfunding of any such plan.

7. Environmental Concerns

Due to the type of cargo typically handled by port operators, port operations do not generally require air or waste water permits or involve the use of chemicals in amounts that trigger environmental permitting and reporting requirements for chemicals used onsite for maintenance operations. Although many port operators will employ an environmental consultant, other than indirectly through substances discharged by their heavy industrial equipment, port operators generally do not handle hazardous materials on a day-to-day basis, and hence port operators do not have significant environmental issues.

8. Importance of Technology as Ports Have Become Automated

As port facilities have become automated, technology has taken on greater importance for port operators. Strong attention should be paid to the port operator's key software licenses and related software for manipulating and monitoring cargo, yard space, vessel and workflow information.

9. Litigation/Government Investigations

Due to the size of its workforce as well as the nature of their business of handling large amounts of expensive cargo, port operators are party to numerous litigations ranging from work-related injuries to employees to damage to their customers' cargo. Generally, these suits are settled or dismissed and should not be of material concern to a potential acquirer, particularly if the container terminal is operated by a strong operator. An area of particular concern, particularly for U.S. operators, however, involves any investigations by governmental authorities into the activities of an operator or its employees. In particular, particular attention should be paid to any subpoenas of employees or any formal investigations that have been made by governmental authorities into an operator's business activities.

10. Security Plan

As ports serve as an entry point into a jurisdiction, security is an issue of particular importance for port operators. For example, in the U.S., under the supervision of the Department of Homeland Security

(DHS), the U.S. Customs and Border Protection has overall responsibility for preventing terrorists and terrorist weapons from entering the U.S. by eliminating potential threats before they arrive at U.S. borders and ports. The U.S. Coast Guard routinely inspects and assesses the security of U.S. ports in accordance with federal laws. *Every regulated U.S. port facility is required to establish and implement a comprehensive security plan that outlines procedures for controlling access to the facility, verifying credentials of port workers, inspecting cargo for tampering, designating security responsibilities, training, and reporting all breaches of security or suspicious activity, among other security measures.* Accordingly, particular attention should be given to reviewing the approved security plan binding on the port operator. In the U.S., working closely with the local port authority and law enforcement agencies, the Coast Guard regularly reviews, approves, assesses and inspects these plans and facilities to ensure compliance. Failure to comply may result in suspension or revocation of plan approval, making the facility ineligible to operate in waters subject to the jurisdiction of the U.S.



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