# KINGSTON PREPARES FOR EXPANSION VIA PPP

**FOR ONE CARIBBEAN PORT, THE PLANNING PROCESS IN RESPECT OF THE PANAMA CANAL EXPANSION LED TO THE DECISION TO UTILISE A PUBLIC-PRIVATE PARTNERSHIP MODEL TO ATTRACT INVESTMENT AND ACCOMPLISH THE NECESSARY CAPITAL IMPROVEMENTS. BY JOE SELIGA, PARTNER AND JEROMY CANNON, COUNSEL, MAYER BROWN.**

As of June 2016, after nearly nine years of construction and more than US$5bn of investment, the expanded Panama Canal, with its new and larger locks, was completed and opened for operations. The expanded locks can accommodate container ships with capacities of up to 13,000 twenty-foot-equivalent (TEU) units and with draught requirements of up to 50ft. This represents a near-tripling of the capacity of the container ships that can be accommodated through the Panama Canal.

Shipping lines around the world have been preparing their fleets for this expanded capacity at the Panama Canal by commissioning additional larger-capacity ships and deploying a greater number of larger-capacity ships to Panama Canal service.

Another potential longer-range impact of the expansion of the Panama Canal may be the gradual shifting of containerised shipping import activity from Asia away from the West Coast of the United States to the East Coast and Gulf Coast.

The potential for East Coast and Gulf Coast ports to capitalise on the Panama Canal expansion has spurred major capital investments to dredge and deepen channels, to improve dockside capacity and to upgrade intermodal connectivity.

Over the last decade, each of the Port of New York-New Jersey, the Port of Baltimore and the Port of Miami have deepened their channels to 50 feet. The Port of Virginia already had the requisite channel depth for the neo-Panamax ships. Likewise, Savannah now has a 47-foot channel while Houston and Philadelphia have dredged to 45 feet. It is expected that Charleston will have a 52-foot channel within a few years.

The United States East Coast and Gulf Coast ports have not been the only places where preparation for the Panama Canal expansion have been a major focus of investment by government and private business. Yet another region of opportunity in the wake of an expanded Panama Canal may be the Caribbean. Ports of call in the Caribbean could serve shipping lines effectively as significant transshipment hubs with the capacity to handle the largest of the ships that can now come through the Panama Canal.

Whether on the East Coast, the Gulf Coast or in the Caribbean, many of the various port authorities operating container terminals have been faced with a fundamental issue in respect of the Panama Canal expansion. The expansion represents a significant opportunity for growth of a particular port and may, indeed, be immensely important to the overall health and vitality of the maritime business community that the port serves.

However, the capital investment for dredging and other capacity enhancements necessary to compete with other ports will be steep. Traditional funding and financing sources often have proved to be inadequate for the task. Additionally, the anticipated inter-port competition to win and maintain shipping business following the expanded Panama Canal opening is likely to be strong. As a result, an added emphasis has been on being ready as soon as possible to start to attract the post-expansion business.

For one Caribbean port, the planning process in respect of the Panama Canal expansion led to the decision to utilise a public-private partnership model to attract investment and accomplish the necessary capital improvements.

The Port Authority of Jamaica owns and had operated the Kingston Container Terminal in Kingston, Jamaica since the facility’s inception. Boasting one of the world’s largest and most well-protected natural harbours, the Kingston Container Terminal had already become an established operation, focusing on transshipment and containerised cargo generally. And in the context of the expanded Panama Canal, Jamaica’s location vis-à-vis the United States, Central America and South America allows the Kingston Container Terminal to be very well-positioned to serve as a strategic transshipment hub.

Notwithstanding that the Kingston Container Terminal was so well-positioned by geography and natural features, significant impediments stood in the way of capitalising on the opportunity. Estimates for the dredging and other capital necessary to accommodate the largest vessels were more than US$500m. Juxtaposed against the necessary capital investment was a government-wide imperative in Jamaica to reduce indebtedness pursuant to arrangements with the International Monetary Fund, among others.

Faced with the need for investment and limitations on the incurrence of debt, the Port Authority of Jamaica pursued a public-private partnership arrangement, specifically a concession of the Kingston Container Terminal. After an informal process that sought expressions of interest, the Port Authority released a request for qualifications on April 3 2013 for potential proposers to manage, develop and expand the Kingston Container Terminal.

The Port Authority sought global terminal operators and/or shipping lines to participate in the procurement process. Following the receipt of responses to the request for qualifications, three firms were shortlisted and invited to participate in the request for proposals round.

The Port Authority released the request for proposals on January 15 2014. Following the release of the request for proposals, the Port Authority engaged with each of the shortlisted proposers through a series of meetings to discuss the project and the terms of a proposed concession agreement.

In the end, only the consortium of Terminal Link and CMA CGM tendered an offer to the Port Authority for the Kingston Container Terminal concession. After review and evaluation of the proposal, the Terminal Link/CMA CGM consortium was named the provisional preferred bidder under the request for proposals. Negotiations with Terminal Link/CMA CGM continued throughout the remainder of calendar year 2014 and into February and March of 2015, with intensive negotiations being held in Paris and Kingston.

Upon the culmination of negotiations, Terminal Link/CMA CGM was named the preferred bidder, and a special purpose entity affiliate named Kingston Freeport Terminal Limited (KFTL) was formed by the Terminal Link/CMA CGM consortium.

On April 7 2015, the Kingston Container Terminal Concession Agreement was executed. At the most basic level, the concession agreement obligates KFTL to operate the Kingston Container Terminal, to undertake certain capital projects and to finance those capital projects. While the Concession Agreement called for a no-more-than nine month period for KFTL to secure the necessary initial financing and to reach financial close, financial close was ultimately achieved as of July 1 2016.

Approvals by KFTL's financing partners proved more difficult to achieve than initially expected. In addition, intervening events such as a significant acquisition by CMA CGM of a competitor shipping line and the change of government in Jamaica caused some degree of uncertainty for the transaction as it progressed from commercial close to financial close. KFTL ultimately secured financing from several sources, including the Inter-American Development Bank, among others.

The concession agreement has a 30-year term that is subject to further extension at the agreement of the parties or in connection with subsequently approved expansion plans. As of the operational handover date, the existing equipment of the Port Authority used for the operations of the Kingston Container Terminal was sold outright to KFTL in exchange for US$75m, paid over the first several months of the term.

While KFTL is an affiliate of CMA CGM and CMA CGM expects to utilise the facility as a strategic transshipment hub for the shipping line's operations, the concession agreement requires that the facility be an open facility available for use by multiple users and shipping lines. KFTL is entitled to set service rates with its customers, subject to a general anti-discrimination obligation, and retain revenues derived from the operations of the facility. A combination of general and specific operational standards govern the day-to-day operations of the facility by KFTL with periodic reporting and compliance oversight contemplated from the Port Authority.

In addition to the upfront payments in respect of the equipment acquisition, KFTL is obligated to make annual fixed payments of US$15m, subject to inflation escalation, and a variable revenue-sharing payment based on activity. The revenue share is equal to 8% of KFTL's gross revenues.

Perhaps most importantly, KFTL is obligated to undertake the type of significant capital improvement works that are needed to prepare the Kingston Container Terminal to compete for the large-ship business expected to materialise following the opening of the expanded Panama Canal.

Specifically, the concession agreement contemplates capital works in two phases. Phase I is expected to cost approximately US$259m and includes two major components: (1) capital dredging to 14.2m draught and (2) investment to optimise the existing facilities to increase the potential capacity to 3.2m TEUs. The Phase I dredging work must be completed within the first five years while the capacity optimisation work has been incentivised to be completed within the first six years of the term.

Phase II is expected to cost approximately US$250m. Phase II contemplates further dredging to a draught of 15.5 metres and capacity expansion to 3.6m TEUs. KFTL is obligated to submit a plan in respect of this Phase II work by the tenth year of the term, with work incentivised to be commenced by the twelfth year of the term. Based on the plans submitted by KFTL for the Phase II work and the approval of the parties, the overall term of the concession may be extended in connection with completion of the Phase II work. Further Phase III expansion of the facilities may be discussed and agreed upon by the parties.

Shortly after the financial close and operational handover, KFTL commenced contracting for and actual construction work relative to the Phase I works.

While the overall long-term success of the project cannot yet be assessed, the concession of the Kingston Container Terminal has allowed the Port Authority of Jamaica to be poised to deliver on Jamaica's goal – prompted by the possibilities and opportunities presented by the expansion of the Panama Canal – to establish Jamaica as a global transshipment hub and to position Jamaica to be a major logistics hub in the global supply chain.

By deploying a public-private partnership model, Jamaica has made substantial progress in achievement of those goals despite severe economic and fiscal constraints. As other governments grapple with their own plans and strategies in light of the Panama Canal expansion, others may find the potential use of concessions and public-private partnerships more generally to be an effective tool. ■