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Public Utilities Commission

BEFORE THE PUBLIC UTILITIES COMMISSION

IN RE:	REVIEW OF POLA SALES AGREEMENT AND INTERIM MAINTENANCE AGREEMENT	PAG DOCKET 12-01 ALJ REPORT

INTRODUCTION

This matter comes before the Guam Public Utilities Commission (the "PUC") pursuant to a Petition filed by the Jose G. Leon Guerrero Commercial Port, Port Authority of Guam (hereinafter referred to as "PAG" or the "Port") on June 19, 2012, whereby PAG requests review and approval of the Sales Agreement, and the Interim Maintenance Agreement, related to the acquisition of certain Port of Los Angeles (hereinafter referred to as "PoLA" or "POLA") cranes owned by Matson Navigation Company, Inc. ("Matson") and Horizon Lines, L.L.C. ("Horizon").

BACKGROUND

I. Enabling and Special Legislation

On September 11, 2009, Public Law ("P.L.") 30-57 was enacted, which approved the implementation of "Phase I, First Stage 1-4 (2010-2012) and Second Stage I -B (2011-2013) of the Jose D. Leon Guerrero Commercial Port Master Plan Update 2007 Report."[1] In addition, the public law established a debt ceiling of $54,500,000 for the Port Modernization Program, to be used "exclusively in the implementation of the portion of this Master Plan."[2] Moreover, the

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1 P.L. 30-57, Section 2, p. 2 (Sept. 11, 2009).
2 *Id.* at Section 3, p. 3.

public law required PAG to purchase or lease to own "*at least* two (2) Gantry Cranes," "*no later than* December 31, 2012."[3]

On March 11, 2010, P.L. 30-100 was enacted, which reiterated the requirement that PAG "acquire, either through purchase or lease-to-own, *at least* two (2) Gantry Cranes *no later than* December 31, 2012."[4]

On November 21, 2011, P.L. 31-145 was enacted, which amended P.L. 30-57. Under this public law, the Guam Legislature expressly found the following:

> [T]here are five (5) cranes currently on the Port's commercial docks, and that through a license agreement executed in December 2007 between the Port and Matson/Horizon, Inc. or its successor (the Carriers), three (3) of these cranes, referred to as POLA Cranes 15, 16 and 17, were purchased and refurbished by the Carriers and placed on the Port's rails. Additionally, the Port currently maintains and operates two (2) older and smaller Gantry Cranes, referred to as Gantry 2 and Gantry 3, to service non-Matson/Horizon, Inc. or its successor vessels, and that due to their age and material condition are more expensive to maintain and provide less reliable service. Retirement of these cranes is overdue.[5]

The Guam Legislature additionally found that "the acquisition of the POLA Cranes by the Port has the potential to present a singularly unique opportunity and value to Guam given their presence on the rails, record of operational reliability, and the elimination of disruption to ongoing operations."[6] Moreover, the Guam Legislature further found that "it would be prudent to explore acquisition of the POLA cranes through direct purchase or lease-to-own, and that further to this exploration, acquisition should be authorized, provided that this unique opportunity and value can be realized through independent assessment of material condition, and

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3 *Id.* at Section 4, p. 3 (italics in original).
4 P.L. 30-100, Section 2, pp. 2-3 (Mar. 11, 2010) (italics in original).
5 P.L. 31-145, Section 1, p. 2. (Nov. 21, 2011).
6 *Id.* at Section 1, p. 3.

fair and reasonable value, and follow-on negotiation of acquisition terms is uniquely and demonstrably favorable to Guam."[7]

Pursuant to P.L. 31-145, PAG was required to perform, among other terms, the following: obtain, through purchase or lease to own, at least two (2) gantry cranes by December 31, 2012; create a negotiating team authorized "to engage in the negotiations with the Carriers"; engage the services of an independent consultant to obtain an assessment of the condition and life expectancy of the PoLA cranes, provide an "as is" valuation assessment, and determine a range of fair and reasonable value of the PoLA cranes; review the acquisition terms, and ratify such terms.[8]

In addition, PAG is required to procure the services of "a Performance Management Contractor (PMC) to manage the performance, operation and maintenance of the newly acquired POLA Gantry Cranes, and other Gantry Cranes used in support of Port operations."[9] "During the interim period that the Port is procuring the PMC contract, the previous owners of the Cranes *shall* continue to provide maintenance of the cranes, on account of the Port."[10] Finally, P.L. 31-145 also required the PUC to perform its regulatory review and dispose of the matter in a timely and expeditious manner.[11]

II. PAG Board Ratification

On June 5, 2012, PAG's Board of Directors approved the Sales and Interim Maintenance agreements, by way of Resolution No. 2012-05. Additionally, by way of Resolution No. 2012-04A, PAG's Board of Directors also approved a crane surcharge fee, of up to $125 for loaded container and $5 per tonnage for non-containerized cargo, to fund the debt

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7 *Id.*
8 *Id.* at Section 3, pp. 4-6.
9 *Id.* at Section 3, pp. 6-7.
10 *Id.* (italics in original).
11 *Id.* at Section 3, p. 6.

service, repairs, and maintenance for the PoLA cranes, as well as to establish a sinking fund to plan for replacement cranes in the future.

III. Regulatory Review

Under 12 G.C.A. §12004, the PUC must expressly approve any contractual agreements or obligations which could increase PAG's rates and charges. In addition, under PAG's Contract Review Protocol, "[a]ll professional service contracts in excess of $1,000,000" and "[a]ny contract or obligation not specifically referenced above which exceeds $1,000,000" "shall require prior PUC approval under 12 G.C.A. § 12004."[12]

DISCUSSION

I. Petition for PUC Approval of Sales and Interim Maintenance Agreements

On June 19, 2012, PAG filed a Petition requesting that the PUC approve the Sales Agreement and the Interim Maintenance Agreement related to PAG's purchase of certain PoLA cranes owned by Matson and Horizon. The Petition contains the proposed Sales Agreement between PAG, Matson and Horizon, the proposed Interim Maintenance Agreement between PAG and Matson, and is supported by resolutions issued by PAG's Board of Directors, condition and evaluation reports related to the PoLA cranes, as well as a financial model depicting a crane surcharge to service the debt from the purchase of the cranes.

A. The Sales Agreement

The Sales Agreement contains provisions regarding the purchase of cranes and their spare parts by PAG from Matson and Horizon. The essential terms of the agreement involve the sale of the following cranes, including spare parts, for the sale price of $12 million:

12 Contract Review Protocol, PAG Docket 09-01, p. 1 (June 20, 2011).

"4 Hitachi container gantry cranes located at the Port of Guam," which include cranes identified as G-3, 14, 16, and 17.[13]

The Sales Agreement also contains provisions related to condition of assets, warranties, closing, insurance, and release and indemnity provisions. The agreement also contains a provision requiring Matson to "perform, at its sole cost and expense, each of the Critical Repairs identified in Exhibit D" "within twenty seven (27) months following the Effective Date of this Agreement."[14]

B. The Interim Maintenance Agreement

The Interim Maintenance Agreement contains provisions regarding Matson's maintenance of the cranes during the "interim period before a Performance Management Contractor can be retained by PAG for crane maintenance services."[15] The essential terms of the agreement involve Matson's provision of "repair and maintenance services, including paint and corrosion work, for the Cranes in accordance with the maintenance standards prevailing in the industry," which also include the provision of "a supervisory crane mechanic who will oversee a maintenance and refurbishment program for the Cranes, purchase material and replenish spare parts, provide repair and maintenance services.[16]

The Maintenance Agreement also contains provisions regarding reimbursement of costs, the term of the contract, indemnification, insurance, and independent contractor relationship. Finally, also included in the Maintenance Agreement is a provision regarding arbitration.

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13 Sales Agreement, p. 10 (Exhibit A).
14 Sales Agreement, p. 6.
15 Maintenance Agreement, p. 1.
16 Maintenance Agreement, p. 1.

C. Condition Survey

In its Final Detailed Condition Survey ("Condition Survey"), Casper, Phillips & Associates ("Casper") maintains that the PoLA cranes "can be put in good enough condition to merit their direct purchase from Matson/Horizon and provide operational and economic advantages over purchasing two new cranes through competitive bidding on the open market."[17]

Casper summarized that "[s]ignificant findings as a result of the inspection are that (a) Gantry Crane #3 is in very good condition and likely worth retaining on the dock in the event that PAG wants an inventory of at least 3 and possibly 4 quality Gantry Cranes during the 20-year planning horizon, (b) the best mix of cranes to fill out that inventory would be POLA's 16, and 17 and Gantry #3 for a total of three cranes (adding POLA 14 if the total desired is 4 cranes) assuming that recommended non-recurring retrofits are accomplished near-term (sequentially one crane at a time) and that a structured recurring (annual) maintenance program (properly established parts inventory and preventative maintenance regimen) be implemented and followed, and (c) with the proper maintenance, all four cranes should remain in good serviceable condition throughout the planning horizon."[18]

Casper further summarized that the cranes were "well designed, well constructed," and that the upgrades have "an estimated useful service life that exceeds the number of years (beyond the current 20 year planning horizon) that it will take for the cranes to become operationally obsolete."[19] Casper, however, observed that "the maintenance performed on the POLA cranes since they arrived on Guam, has been unsatisfactory" and is "significant enough that unless this is corrected, it will not be long before the cranes suffer more damage than PAG can afford to repair." Condition Survey, p. 3. Casper expressed that it was "confident that

[17] Casper, Phillips & Associates' Final Detailed Condition Survey, p. 3 (January 5, 2012).
[18] Condition Survey, p. 1.
[19] Condition Survey, p. 3.

the POLA cranes will serve the Port's needs through the current 20-year planning horizon if the cranes and supporting wharf structures are well maintained."[20]

D. Crane Valuation Report

In Casper's Final Crane Evaluation Report ("Crane Valuation Report"), Casper maintains that the "acquisition of the POLA cranes based on known performance characteristics and condition and having the Port control their 'end condition' by executing the corrective actions recommended in the Valuation Report would put the Port in a comparable or better position than would result from a new crane procurement process."[21] Casper observes that "[b]ased on the funding limitation of $14 million, such a procurement would have inherent uncertainty as to whether or not the low bid would be within the budget, and if so, what compromises to quality of components and construction might need to be made to keep the bid within budget."[22] Casper further observes that there "is the potential risk of bid protest in the solicitation process, which may result in delays to the procurement, fabrication, and delivery of the cranes."[23]

Casper concludes that "the most the Port should pay for acquiring POLA Cranes 16 and 17 is approximately $8 M," but that "approximately $6 M needs to be spent on the correction of deficiencies for POLA Cranes 16 and 17 to bring them to the point where they are in a condition comparable to new cranes and ready to be subjected to a future sustainable maintenance program that will safeguard their continued service life beyond the current 20-year

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20 Condition Survey, p. 4.
21 Casper, Phillips & Associates Final Crane Valuation Report, p. 2 (May, 2012).
22 Crane Valuation Report, p. 2.
23 Crane Valuation Report, p. 2.

planning horizon."[24] Casper excluded from the report the valuation of PoLA Crane 14, and Gantry Cranes 2 and 3.

II. Slater Nakamura Report

Pursuant to a request by the PUC, the consulting firm of Slater, Nakamura & Co., L.L.C. ("Slater Nakamura") reviewed the proposed acquisition of the PoLA cranes. On August 9, 2012, Slater Nakamura transmitted a draft of its report to PAG and the Administrative Law Judge of the PUC (the "ALJ") detailing its evaluation, assessment, findings, and recommendations related to PAG's acquisition of the PoLA cranes. On August 24, 2012, Slater Nakamura transmitted another draft of its report to the ALJ; and on August 27, 2012, it transmitted its final report (hereinafter referred to as the "Report") to the Chairman of the PUC, and the ALJ.

A. Capacity Analysis

The consultants submit that "[t]here is no known rule related to the recommended crane capacity a port should maintain."[25] However, they assert that "[a]s a real world test, when Matson and Horizon purchased and installed the three POLA cranes at PAG, it was assumed that there would be a significant increase in the cargo throughput in the harbor. If three cranes could have handled the projected throughput requirements for the military buildup, common sense would indicate that three cranes can also handle the reduced cargo demands."[26]

The consultants have indicated that "[d]uring the period of January 2012 to June 2012, PAG had a total of 58 container ships call on Guam," and observed the following: "59 container ships called at the Port of which 36 were Matson owned ships"; "[t]he other 23 vessels are operated by the Mariana Express Shipping Line (MELL)"; "[o]nly on one occasion were two

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24 Crane Valuation Report, p. 1.
25 Report, p. 21.
26 Report, p. 21.

container ships pier side at the same time"; "[c]ontainer vessels were planned to be pier side a total of 1,677 hours"; "[t]he inter-island vessel, Super Shuttle, received and transferred cargo 27 times during the same six month period"; "[t]he average in port stay for the Super Shuttle was 15 hours," "[t]he median stay was 11 hours."[27] The consultants thereafter concluded that:

> "PAG must decide if it requires and can afford to operate four cranes based upon the forecast demand. By not purchasing one of the POLA cranes, PAG will still acquire Crane 3 and will save $4M in acquisition costs alone. This savings will allow PAG to address the maintenance requirements in the two POLA cranes that it does purchase without exceeding the budget."[28]

Based upon its analysis, the consultants determined that: "Three operational cranes will give PAG excess capacity ranging from 190% in FY13 to 153% in FY27; Four operational cranes will give PAG excess capacity ranging from 280% in FY13 to 230% in FY27."[29]

B. **Total Cost of Ownership**

In the Report, Slater Nakamura conducted some market research on new and available used cranes that either meet or exceed the current capabilities of the PoLA cranes. The consultants examined new cranes manufactured by ZPMC and Kalmar; as well as used cranes manufactured by ZPMC at the Virginia Port Authority, used cranes manufactured by Kone at the Virginia Port Authority, and used cranes manufactured by Hitachi at the Port of Los Angeles.

1. **New ZPMC Cranes**

According to the consultants, these cranes can be built similar to the specifications of the existing PoLA cranes. The acquisition cost of the ZPMC cranes appears to be $8 million each. There are no repair costs since the cranes will be furnished brand new; and

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27 Report, p. 21.
28 Report, p. 23.
29 Report, p. 23.

shipping is apparently included in the cost of the cranes. The consultants estimate that $512,407 would be required per crane for installation, with costs of other pier upgrades unknown. In addition, there is an initial spare parts inventory in the amount of $133,333 per crane. These cranes also would not require any major maintenance or upgrades.[30]

2. New Kalmar Cranes

According to the consultants, the Kalmar cranes can be built according to the specifications of the existing PoLA cranes. The acquisition cost of these cranes, however, is quoted at $8.5 million each. There will be no repair costs since the cranes will be furnished brand new; but shipping would be an additional $500,000 per crane. The consultants estimate that $512,407 would be required per crane for installation, with costs of other pier upgrades unknown. Again, there is an initial spare parts inventory in the amount of $133,333 per crane; and these cranes would not require any major maintenance or upgrades as they are brand new.[31]

3. Used ZPMC Cranes from the Virginia Port Authority

According to the consultants, the acquisition cost related to the ZPMC cranes from the Virginia Port Authority is estimated at $23,750,000, which includes retrofitting, transportation, installation, parts and training. The consultants submit that these cranes may require day-to-day maintenance at the same level as the existing cranes, but since these cranes are relatively new, any major maintenance or upgrades would be significantly less when compared with the PoLA cranes. The consultants estimate the shipping cost at $6.6 million, assuming that three cranes can be shipped on one vessel. The consultants further estimate that some pier modification may be required, and that such costs are unknown. In addition, installation and minor retrofits are estimated at $600,000 per crane; training, spare parts, and

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[30] Report, pp. 28-29.
[31] Report, p. 29.

other costs associated with bringing these cranes into service are estimated at $800,000; with operating expenses over a fifteen year period estimated at $45,977,399 for the three cranes.[32]

4. Used Kone Cranes from the Virginia Port Authority

The cost for acquiring these used cranes is estimated at $21,350,000, which includes retrofitting, transportation, installation, parts and training. The consultants submit that these cranes are likely to be in the same condition as the existing PoLA cranes, and therefore the day-to-day and long-term maintenance are estimated to be the same. The consultants estimate the shipping cost at $6.6 million, assuming that three cranes can be shipped on one vessel. The consultants further estimate that some pier modification may be required, and that such costs are unknown, though installation and minor retrofits are estimated at $600,000 per crane. In addition, training costs are estimated at $800,000; with operating expenses over a fifteen year period estimated at $59,961,163 for the three cranes.[33]

5. Used Hitachi Cranes from the Port of Los Angeles

The cost for acquiring these used cranes is estimated at $15,750,000, which includes retrofitting, transportation, installation, parts and training. Since these cranes are identical to the PoLA cranes, any costs associated with necessary repairs and maintenance would mirror the costs related to the repair and maintenance of the existing PoLA cranes. The consultants estimate the shipping cost at $5.2 million. They do not, however, anticipate any pier upgrades or training costs. The consultants further estimate the operating expenses for over a fifteen-year period at $37,955,134 for two cranes.[34]

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32 Report, p. 30.
33 Report, pp. 30-31.
34 Report, p. 31.

6. The PoLA Cranes (Crane 14, 16 & 17)

Based on Slater Nakamura's analysis, the cost for acquiring these cranes is $4,000,000 each, which includes existing spare parts, and totaling $12.35 million with the addition of $350,000 for the parts and parts room modification. Repair costs are estimated at $9 million; and there would be no shipping costs, pier upgrades, or training costs associated with these cranes. Slater Nakamura estimates that the operating expenses over a fifteen-year period will be $63,072,545 for the three cranes.[35]

Slater Nakamura's summary of the crane options described above is illustrated below, and is identified as "Figure 29" in the Report.

Crane option	Acquisition costs	Operating costs	TCO for 15 years
POLA cranes 14,16,17	$12,350,000	$56,084,095	$68,434,095
VPA used ZPMC Cranes	$23,750,000	$46,571,925	$70,321,925
New ZPMC Cranes	$27,587,220	$50,209,373	$77,796,593
POLA Hitachi Cranes	$15,750,000	$37,955,134	$53,705,134
VPA used Kone Cranes	$21,350,000	$59,961,163	$81,311,163
New Kalmar Cranes	$30,587,220	$52,576,923	$83,164,143

The consultants expressed that a number of factors limit PAG's ability to acquire cranes, which include the following: PAG's $14.5 million budget that limits their ability to spend significant dollars up front; PAG's current agreements with Matson/Horizon relative to the PoLA cranes that do not expire until 2014, which complicates the transition of non-PoLA cranes since

35 Report, p. 28.

under these agreements Matson and Horizon are entitled to use the existing PoLA cranes and collect any crane surcharge through 2014.[36]

In addition, the consultants also expressed that the purchase of new cranes would likely take two years for delivery "so the timing might work well with the terms of the Matson/Horizon agreement" and that "PAG also has piers which may not support heavier and taller cranes. Therefore, additional engineering analysis is required and additional costs may be incurred in the installation of other cranes."[37]

Based on its analysis, Slater Nakamura determined the following: that "[t]he only option which meets the PAG's budget of $14.5 M for upfront costs is the acquisition of the POLA cranes which can only be achieved if required maintenance is deferred"; that "[t]he lowest [total cost of ownership] is also the acquisition of the existing POLA cranes"; that "the TCO for the used ZPMC cranes is relatively close to the POLA cranes and the ZPMC cranes are substantially newer (20 years) and would have fewer mechanical and maintenance issues and a longer life expectancy"; and that the acquisition of "newer cranes would result in lower long-term operational costs."[38]

C. <u>Slater Nakamura's Findings</u>

Based on its investigation, Slater Nakamura made the following findings. With respect to financing, the consultants found that PAG has $14.5 million for the purchase of cranes, and that the purchase of three PoLA cranes and deferring "needed maintenance to future years" would satisfy PAG's budget of $14.5 million.[39] The consultants add, however, that PAG must

[36] Report, p. 41.
[37] Report, p. 41.
[38] Report, p. 42.
[39] Report, p. 43.

"include the cost of demolition of Crane 2 in its costs," and that "[b]ased upon historical numbers, this could be as much as $500 K."[40]

With respect to throughput capacity, the consultants found that PAG's acquisition of two PoLA cranes would meet its annual capacity demands.[41] The consultants conclude that the acquisition of three (3) cranes would "provide substantial excess capacity" that would "result in a need to increase fees per container to cover operational and acquisition costs."[42] The consultants disfavor this scenario as "[t]here is no known plan to bring larger ships to Guam which would drive the need for larger cranes."[43]

Finally, with respect to total cost of ownership, Slater Nakamura expressly found that the "lowest acquisition cost identified is for the purchase of the POLA cranes 14, 16 and 17," and that the "lowest Total Cost of Ownership (TCO) is for the acquisition of the POLA cranes 14, 16 and 17."[44] However, the consultants maintain that while "[t]he TCO for the acquisition of the VPA's ZPMC cranes is slightly more than the TCO for the POLA cranes," "these cranes are 20 years newer than the POLA cranes," and therefore such "new or newer cranes will result in lower long-term operational costs and will provide more flexibility for servicing larger vessels in the future."[45]

Additionally, Slater Nakamura has made these added findings. First, the consultants maintain that the VPA cranes may potentially be "acquired for $100 K," which would result in a lower total cost of ownership than the purchase of the PoLA cranes. The consultants further maintain that "[o]nly by deferring maintenance on the three POLA cranes is it

40 Report, p. 43.
41 Report, p. 43.
42 Report, p. 43.
43 Report, p. 43.
44 Report, p. 43.
45 Report, p. 43.

possible to acquire the cranes within the PAG's budget."[46] The consultants also note that Crane 3 "is in better material condition than the three POLA cranes."[47] The consultants further note that "[i]f PAG acquires three cranes it will be absorbing the cost of additional idle cranes and will need to adjust rates appropriately to recover those costs"; but where "PAG acquires only two cranes, Matson will likely pass on costs for the additional time spent in port to the shippers (and ultimately Guam consumers)."[48]

D. Areas of Risk

Slater Nakamura has identified the following risks.

1. Cargo Throughput Analysis

a. Cargo Throughput May Be Less

The first area of concern is that the cargo throughput may be less than what has been forecasted. This risk was indicated as a high level risk. Slater Nakamura remarks that should this event occur, the result would be "even greater excess crane capacity for the Port and less revenues to support the crane acquisitions."[49]

b. Cargo Throughput May Be More

Similarly, the cargo throughput may be more than what has been forecast. However, this risk was indicated as a low level risk, and that "[g]iven the excess capacity based upon the forecast, the impact on PAG should be minimal even if the number of vessels calling on Guam doubles over the next 15 years."[50]

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46 Report, pp. 43-44.
47 Report, p. 44.
48 Report, p. 44.
49 Report, p. 48.
50 Report, p. 49.

2. Maintenance

The next area of concern is that the cranes may require maintenance greater than what has been forecasted. This risk was indicated as a medium level risk. Slater Nakamura remarks that since "the environmental conditions on Guam are some of the harshest in the world for cranes," and since "the cranes have not been properly maintained during their time on Guam," "it is imperative that a preventative maintenance program be fully funded and executed."[51]

3. Funding

The final area of concern is that PAG may not be able to fully fund the debt and provide maintenance of the cranes.[52] This risk was indicated as a medium level risk.[53] Slater Nakamura remarks that "PAG will need to create a tariff funding model that will fund the debt, replacement costs for the cranes and the ongoing maintenance," which should require annual review "to determine if adjustments to the tariff are required."[54]

F. Slater Nakamura's Recommendations

Based on Slater Nakamura's investigation, it issued the following recommendations. First, the consultants recommended that the PUC authorize PAG's acquisition of PoLA cranes 14, 16 and 17.[55] Second, it recommended that the PUC direct PAG to repair PoLA cranes 14, 16 and 17, as well as Crane 3 to meet the recommendations indicated in the reports by PAG's consultants.[56] Next, it recommended that the PUC authorize PAG to fund the demolition of Crane 2 from its $14.5 million fund.[57]

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[51] Report, p. 49.
[52] Report, pp. 49-50.
[53] Report, pp. 49-50.
[54] Report, pp. 49-50.
[55] Report, p. 45.
[56] Report, p. 45.
[57] Report, p. 45.

In addition, Slater Nakamura recommended that the PUC direct PAG to develop a tariff recommendation that would fully fund the acquisition, financing, maintenance, and ultimate replacement of PoLA cranes 14, 16, and 17, as well as Crane 3, within 15 years.[58] The consultants also recommended that PAG "develop a more accurate projection for cargo throughput that can be used to forecast revenues from tariffs."[59] And finally, it recommended that PAG consider "placing one crane in layup pending an increase in cargo throughput demand."[60]

III. PAG's Response

A. Operations

On August 16, 2012, PAG submitted its response (hereinafter referred to as the "Response") to the draft Slater Nakamura Report, transmitted to PAG on August 15, 2012. In the Response, PAG maintains that it is presently "preparing for sustainable operations, operations that address island organic growth, and operations that support an expanded military presence on Guam." Accordingly, PAG further maintains that this preparation requires the following: the simultaneous offloading of cargo of at least two ships at berth; the offloading of cargo within industry time standards; capacity to handle cargo volumes that peak at two to three times the current steady-state volume levels; cranes on standby in the event of emergencies; downtime for crane maintenance.[61]

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58 Report, p. 45.
59 Report, p. 45.
60 Report, p. 45.
61 Response, pp. 1-2.

PAG submits that "[t]hese requirements were analyzed within the context of the approved Master Plan and subsequent Terminal Operations Planning with the outcome of both calling for 4 Operational Gantry Cranes."[62]

B. "Means to Desired End"

PAG asserts that the policy underpinning the special legislation of P.L. 31-145 was to "enable sole source negotiation and potential purchase of the PoLA cranes" since the Guam Legislature recognized that there was some "unique value" to acquiring the PoLA cranes so long as such cranes were "in good condition and being transferred to PAG at a fair and reasonable price."[63]

PAG submits that one such "unique value" includes the "impracticality of pursuing purchasing for alternative 'used' cranes."[64] PAG maintains that pursuing an open solicitation under Guam's procurement law and regulations would provide the following options: "One solicitation whereby an 'offeror' submits a turnkey proposal to acquire, retrofit, ship, and commission the desired number of cranes"; "Multiple solicitations whereby PAG buys cranes 'as is' and 'where is' and then issues follow-on solicitations to address remaining requirements (retrofit in place, retrofit at alternate site, ship, and commission)"; and finally, that "[u]nder no circumstances would PAG be in a legal position to negotiate (on a sole source basis) for the direct purchase of cranes from VPA or PoLA . . . without a determination . . . that one of those Port Authorities is the only one that can meet PAG requirements."[65]

62 Response, p. 2.
63 Response, p. 2.
64 Response, p. 2.
65 Response, pp. 2-3.

C. "Unique Value" of the PoLA Cranes

PAG further asserts that "[t]he cranes are on the rails and are a proven commodity."[66] In addition, the parts and maintenance regime of the PoLA cranes are familiar to PAG. Moreover, PAG argues that if it were to purchase "new cranes," attendant to such purchase would be a "2-year timeline associated with the solicitation, fabrication, and commissioning of the cranes assuming no protests."[67]

PAG also asserts that there will be "no operational disruption if the acquisition involves just a transfer of ownership."[68] PAG submits it is likely that acquiring "outside cranes" would be several million more than $19 million and would include the added stress of government procurement.[69]

Finally, PAG adds that it should "have the opportunity to get the fourth required crane and the flexibility to deal with buildup spikes, casualty response, and structured maintenance at an initial purchase price of $4 [million]."[70]

D. All or Nothing Deal

PAG submits that it has been advised that the agreement with Matson and Horizon "is an 'all or nothing' offer."[71] Thus, it appears that either PAG purchases the three cranes or the deal is off.

E. Financing

PAG has requested Parsons Brinkerhoff and sub-consultant Sarandipity, L.L.C. to develop a Structured Maintenance Program for all of its gantry cranes, which will include budget

66 Response, p. 2.
67 Response, p. 3.
68 Response, p. 3.
69 Response, p. 4.
70 Response, p. 4.
71 Response, p. 5.

estimates for the cost of maintaining four ship to shore (STS) cranes over the next fifteen (15) years.[72] This estimate will include the cost of scheduled preventative maintenance, planned corrective maintenance, and unscheduled and unplanned corrective maintenance.[73] "PAG intends to use $12 million loan to purchase the cranes and implement a $105 surcharge on loaded containers and $5 on break bulk cargos to service this loan and address all other crane related expenses."[74] PAG's projected $4.9 million annual revenue from the crane surcharge will be used to fund the debt service of $1.3 million per year, the maintenance program, the demolition of the Gantry 2 crane, the stocking of spare parts, and a reserve fund.[75]

PAG submits that "[t]he implementation of the crane surcharge and the resulting accumulation of funds in the reserve fund should put the Port in position to react to the unexpected loss of a crane in the event of an extraordinary typhoon, earthquake or operational accident, and also fulfill the PUC Consultant's recommendation to procure crane placement as early as 15 years into the future."[76]

F. Capacity Throughput

PAG argues that it "has always maintained that 4 gantry cranes is the right composition to support the service needed in its operations."[77] PAG asserts that it requires "3 cranes working on vessels and 1 crane to be down for maintenance at any one time, and for Port operations to have the flexibility to move vessels in other berths when there is construction on the wharf," and that it normally has two (2) vessels at berth."[78]

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72 Response, p. 5.
73 Response, p. 5.
74 Response, p. 5.
75 Response, p. 5.
76 Response, p. 6.
77 Response, p. 6.
78 Response, p. 6.

In support of its position, PAG makes reference to two intra-island vessels that arrive to Guam weekly and biweekly. PAG submits that "[t]he traditional operation assigns 2 cranes to the Matson vessel and 1 or 2 cranes to the connecting or feeder vessels," but that there have been "occasions when one of the cranes breaks down and the Operations Manager would need to pull other cranes being used on another vessel or in interruptible maintenance status to be able to continuously work on the domestic carrier vessel to meet the productivity needed to complete the operations."[79]

PAG therefore maintains that "[l]imiting the number of cranes to three would reduce the Port's capability to efficiently work on the vessels and complete its operations in a timely manner," and that "crane deployment, flexibility to deal with casualties and scheduled major maintenance, flexibility to work around construction, and capacity to deal with cargo volume spikes double and triple normal volumes all trump the individual crane capacity analysis measured against normal or organic growth cargo projections."[80]

G. Total Cost of Ownership

1. PoLA Cranes

PAG estimates that the total acquisition cost for three (3) cranes is $12,350,000, which reflects the $12 million negotiated price for the three (3) cranes, and $350,000 for spare parts.[81] PAG further estimates that the total operating cost per PoLA crane for fifteen (15) years is $16,173,369.[82] This includes about $5,714,781 for annual maintenance, $2,303,681 for

[79] Response, p. 6.
[80] Response, p. 6.
[81] Response, pp. 7-8.
[82] Response, pp. 7-8.

financing costs, and $1,937,500 for the Performance Management Contract. [83]Accordingly, PAG maintains that the total cost of ownership for three (3) used PoLA cranes is $60,870,106.[84]

2. Recommended Cranes

PAG submits that the total cost of ownership for the PoLA cranes is significantly lower than the costs associated with owning the cranes listed in the Slater Nakamura Report as examples.[85] Specifically, PAG asserts that the total cost of ownership for the PoLA cranes is $22.3 million lower than the new Kalmar Cranes, and $16.9 million lower than the new ZPMC cranes.[86] PAG further asserts that when compared with the used ZPMC Cranes, the total cost of ownership for the PoLA cranes is lower by $8.9 million.[87]

H. Sole Sourcing

Finally, PAG maintains that it currently lacks authority to engage in sole source purchasing. [88]

RECOMMENDATION

Based on the evidence submitted, the ALJ hereby finds that the Sales Agreement and the Interim Maintenance Agreement are fair and reasonable, and therefore, recommends that the PUC approve these contracts pursuant to 12 G.C.A. §12004 and PAG's Contract Review Protocol, PAG Docket 09-01.

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83 Response, pp. 7-8.
84 Response, pp. 7-8.
85 Response, p. 9.
86 Response, p. 9.
87 Response, p. 9.
88 Response, pp. 9-10.

I. Approval of the Sales Agreement

A. Legislative Mandate and Procurement of Other Cranes

With respect to the purchase of the PoLA cranes, it is clear that the Guam Legislature mandated PAG's acquisition of at least two (2) PoLA cranes by December 31, 2012. *See* P.L. 31-145. The Legislature specifically found that such acquisition presented a "*singularly unique opportunity and value to Guam* given their presence on the rails, record of operational reliability, and the elimination of disruption to ongoing operations."[89] Moreover, the Legislature required the authorization of the acquisition so long as an independent condition assessment was conducted, that the value was fair and reasonable and that the terms were "uniquely and demonstrably favorable to Guam."[90] Based on the evidence submitted, the ALJ finds that PAG has satisfied the statutory requirements.

The ALJ agrees with PAG that "[t]he cranes are on the rails and are a proven commodity"[91]; that the parts and maintenance regime of the PoLA cranes are familiar to PAG; and that there will be "no operational disruption if the acquisition involves just a transfer of ownership."[92] As expressed in Casper's Crane Valuation Report, the "acquisition of the POLA cranes based on known performance characteristics and condition and having the Port control their 'end condition' by executing the corrective actions recommended in the Valuation Report would put the Port in a comparable or better position than would result from a new crane procurement process."[93]

Slater Nakamura has expressed that a number of factors limit PAG's ability to acquire cranes, which include the following: PAG's $14.5 million budget that limits their ability

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89 P.L. 31-145, at Section 1, p. 3 (emphasis added).
90 *Id.*
91 Response, p. 2.
92 Response, p. 3.
93 Crane Valuation Report, p. 2.

to spend significant dollars up front; PAG's current agreements with Matson/Horizon relative to the PoLA cranes that do not expire until 2014, which complicates the transition of non-PoLA cranes since under these agreements Matson and Horizon are entitled to use the existing PoLA cranes and collect any crane surcharge through 2014.[94] In addition, Slater Nakamura has stated that the purchase of new cranes would likely take two years for delivery "so the timing might work well with the terms of the Matson/Horizon agreement" and that "PAG also has piers which may not support heavier and taller cranes therefore, additional engineering analysis is required and additional costs may be incurred in the installation of other cranes."[95]

Furthermore, the ALJ understands that procurement of new cranes would likely involve a "2-year timeline associated with the solicitation, fabrication, and commissioning of the cranes assuming no protests."[96] As Casper concluded, "[b]ased on the funding limitation of $14 million, such a procurement would have inherent uncertainty as to whether or not the low bid would be within the budget, and if so, what compromises to quality of components and construction might need to be made to keep the bid within budget." There indeed "is the potential risk of bid protest in the solicitation process, which may result in delays to the procurement, fabrication, and delivery of the cranes."[97] Hence, as PAG has asserted, attempting to acquire "outside cranes" would likely cost several million more than the cost of the PoLA cranes and would include the added stress of government procurement.[98]

B. Condition of the Cranes

Based on the evidence submitted, the ALJ finds that the PoLA cranes are in good condition. In Casper's Condition Survey, Casper maintains that the PoLA cranes "can be put in

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[94] Report, p. 41.
[95] Report, p. 41.
[96] Response, p. 3.
[97] Crane Valuation Report, p. 2.
[98] Response, p. 4.

good enough condition to merit their direct purchase from Matson/Horizon and provide operational and economic advantages over purchasing two new cranes through competitive bidding on the open market."[99] Specifically, Casper determined that (a) Gantry Crane #3 is in very good condition and likely worth retaining on the dock in the event that PAG wants an inventory of at least 3 and possibly 4 quality Gantry Cranes during the 20-year planning horizon, (b) the best mix of cranes to fill out that inventory would be POLA's 16, and 17 and Gantry #3 for a total of three cranes (adding POLA 14 if the total desired is 4 cranes) assuming that recommended non-recurring retrofits are accomplished near-term (sequentially one crane at a time) and that a structured recurring (annual) maintenance program (properly established parts inventory and preventative maintenance regimen) be implemented and followed, and (c) with the proper maintenance, all four cranes should remain in good serviceable condition throughout the planning horizon."[100]

According to Casper, the cranes were "well designed, well constructed," and that the upgrades have "an estimated useful service life that exceeds the number of years (beyond the current 20 year planning horizon) that it will take for the cranes to become operationally obsolete."[101] Thus, the ALJ finds that "the POLA cranes will serve the Port's needs through the current 20-year planning horizon if the cranes and supporting wharf structures are well maintained."[102]

C. **Value of the Cranes**

Based on the evidence submitted, the ALJ additionally finds that the value of the PoLA cranes is fair and reasonable. According to Casper's Condition Survey, "the most the Port

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99 Condition Survey, p. 3.
100 Condition Survey, p. 1.
101 Condition Survey, p. 3.
102 Condition Survey, p. 4.

should pay for acquiring POLA Cranes 16 and 17 is approximately $8 M." Indeed, Slater Nakamura determined that "[t]he only option which meets the PAG's budget of $14.5 M for upfront costs is the acquisition of the POLA cranes"; and that "[t]he lowest [total cost of ownership] is also the acquisition of the existing POLA cranes."[103] Thus, $4 million per crane is considered fair and reasonable, and is "uniquely and demonstrably favorable to Guam."[104]

Casper noted, however, that "approximately $6 M needs to be spent on the correction of deficiencies for POLA Cranes 16 and 17 to bring them to the point where they are in a condition comparable to new cranes and ready to be subjected to a future sustainable maintenance program that will safeguard their continued service life beyond the current 20-year planning horizon."[105] Slater Nakamura echoed the same sentiment.[106] As a result, the ALJ recommends that PAG complete its development of a Structured Maintenance Program for all of its cranes, which it has initiated with Parsons Brinkerhoff and sub-consultant Sarandipity, L.L.C.[107] Additionally, the ALJ further recommends that PAG begin repairs to the PoLA cranes indicated in Casper's Condition Survey, as recommended by Slater Nakamura.

D. The Purchase of Three PoLA Cranes

Slater Nakamura recommended that the PUC authorize PAG's acquisition of PoLA cranes 14, 16 and 17. The ALJ agrees. The Guam Legislature stated in its findings, related to P.L. 31-145, that PAG "is vested with the responsibility of developing its assets and the implementation of policies and strategies to enable the efficient loading and unloading of goods and materials destined for retail operations in Guam and Micronesia, and to facilitate a smooth transition to the military-induced expansion and anticipated population growth." P.L.

103 Report, p. 42.
104 P.L. 31-145, at Section 1, p. 3.
105 Crane Valuation Report, p. 1.
106 Report, p. 42.
107 Response, p. 5.

31-145, Section 1, p. 2. It further found that PAG "ownership or unrestricted access to all Gantry Cranes operating on its rails would improve operational efficiency and reliability in the movement of cargo through the Port and for transshipment to the neighboring islands in the region." P.L. 31-145, Section 1, p. 2.

Based on the legislative findings articulated above, PAG's acquisition of three cranes is not unreasonable under these circumstances. PAG has maintained that it is presently "preparing for sustainable operations, operations that address island organic growth, and operations that support an expanded military presence on Guam," which requires the following: the simultaneous offloading of cargo of at least two ships at berth; the offloading of cargo within industry time standards; capacity to handle cargo volumes that peak at two to three times the current steady-state volume levels; cranes on standby in the event of emergencies; downtime for crane maintenance.[108] PAG has also maintained that an added crane would provide PAG with "the flexibility to deal with buildup spikes, casualty response, and structured maintenance at an initial purchase price of $4 [million]."[109]

In addition, PAG has submitted that "4 gantry cranes is the right composition to support the service needed in its operations"[110] and that it requires "3 cranes working on vessels and 1 crane to be down for maintenance at any one time, and for Port operations to have the flexibility to move vessels in other berths when there is construction on the wharf."[111] PAG has also submitted that "[t]he traditional operation assigns 2 cranes to the Matson vessel and 1 or 2 cranes to the connecting or feeder vessels," but that there have been "occasions when one of the cranes breaks down and the Operations Manager would need to pull other cranes being used on

108 Response, pp. 1-2.
109 Response, p. 4.
110 Response, p. 6.
111 Response, p. 6.

another vessel or in interruptible maintenance status to be able to continuously work on the domestic carrier vessel to meet the productivity needed to complete the operations."[112] Therefore, PAG has shown that "[l]imiting the number of cranes to three would reduce the Port's capability to efficiently work on the vessels and complete its operations in a timely manner," and that "crane deployment, flexibility to deal with casualties and scheduled major maintenance, flexibility to work around construction, and capacity to deal with cargo volume spikes double and triple normal volumes all trump the individual crane capacity analysis measured against normal or organic growth cargo projections."[113] For these reasons, and based on the evidence submitted, the ALJ finds that the purchase of the three PoLA cranes is reasonable under these circumstances.

Based on the foregoing, the ALJ recommends the following: that the PUC approve PAG's acquisition of three PoLA cranes, specifically cranes 14, 16 and 17; that the PUC require PAG complete its development of a Structured Maintenance Program for all of its cranes, which it has initiated with Parsons Brinkerhoff and sub-consultant Sarandipity, L.L.C.; that the PUC require PAG to begin repairs on the PoLA cranes indicated in Casper's Condition Survey, as recommended by Slater Nakamura; that the PUC direct PAG to develop a tariff that fully funds the acquisition, financing, and maintenance resulting from the purchase of such cranes; that the PUC require PAG to develop a projection for cargo throughput that can be used to forecast revenues from its tariff, as recommended by Slater Nakamura; and, finally, that the PUC require PAG file a report with the PUC regarding the status, future plans, or demolition of Gantry Crane 2. Accordingly, the ALJ recommends that the PUC approve the form of the Sales Agreement contained in PAG's Petition.

112 Response, p. 6.
113 Response, p. 6.