

Statement of

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Before the

United States House of Representatives
Select Bipartisan Committee To Investigate the Preparation
For and Response to Hurricane Katrina

On

Military Sealift Command / Federal Emergency Management Agency
Charter of Three Passenger Vessels in Support of Relief Efforts
Associated With Hurricane Katrina

November 2, 2005

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Introduction

Mr. Chairman and members of the Committee, thank you for the opportunity to appear before you today regarding the charter by the federal government of three of Carnival Cruise Line's (Carnival) passenger vessels in support of relief efforts associated with Hurricane Katrina.

America will long remember the utter devastation wrought by that hurricane between August 28 and August 29, 2005. This storm destroyed a significant number of homes, businesses, and infrastructure in the Gulf Coast region, resulting in the displacement of many thousands of American citizens. Residents of the Gulf Coast immediately found themselves living like refugees. The basic necessities of life – food, water, clothing, shelter, and medical care were gone. To assist in the recovery process, Carnival, at the request of the federal government, made available for charter three of its vessels, each capable of immediately moving to the disaster areas and providing much needed shelter, food, water, and medical care.

Testimony Goals

Mr. Chairman and members of the committee, my appearance here today has three goals. First, I would like to describe the process that led to the charter of our vessels. Secondly, I would like to correct and clarify certain persistent errors in the reporting and interpretation of our relief efforts. Lastly, we believe that these and future hearings will be observed by American businesses that

the government may again need to call for help in future disasters. Our government must send the right message to private enterprise that may be crucial to future responses. The information you are gathering today can improve our government's readiness to better handle these catastrophic events in the future. We would like to make some recommendations in this regard.

Background Information

Carnival Corporation & plc, the parent corporation of Carnival, operates a fleet of 79 modern passenger vessels, making it the largest cruise company in the world. The parent corporation's 12 widely recognized cruise brands serve markets in North and South America, the UK and mainland Europe, providing cruises to vacation destinations worldwide. The corporation's Carnival Cruise Lines brand operates a fleet of 21 modern passenger vessels, seven of these operating from the Gulf Coast ports of New Orleans, Galveston, Mobile and Tampa. Because of this presence, Carnival was able to quickly respond to the government's requests in the aftermath of Hurricane Katrina.

The Chronology

Early on the morning of Wednesday, August 31, at approximately 7:30 a.m.,¹ David Forney, Chief of the Vessel Sanitation Program for the Center for Disease Control (CDC) contacted Carnival by email on behalf of the Secretary of Health and Human Services and inquired as to whether Carnival would be willing to make passenger vessels available to house displaced residents and federal, state, and local relief workers. (See Exhibit A) Late that

¹ All times stated are Eastern Standard Time.

evening, the President and CEO of Carnival Cruise Lines, Mr. Robert Dickinson, was called at home by Mr. Brad Gair, a FEMA official, who was again inquiring as to the availability of Carnival vessels for Katrina relief purposes. The next morning, Carnival was contacted by and submitted to FEMA an indication of general terms upon which vessels might be available. Carnival was advised to expect contact from the Military Sealift Command (MSC), a branch of the U.S. Navy, and the government agency that would charter any vessels needed for Katrina relief. According to press reports, the Military Sealift Command approached 75 companies and shipbrokers seeking competitive proposals for vessels.²

The chartering of vessels to the U.S. government for domestic service was very new to Carnival. Carnival is essentially a private sector business. These were, in fact, our first charters to the U.S. Government, and it should be remembered that the federal government sought us out. Carnival responded to the government's inquiries, advising that it could assist in the hurricane relief efforts and requested more details regarding the government's specific needs.

On Thursday evening, September 1, 2005, at approximately 8:00 p.m., the Military Sealift Command issued, via e-mail, a Request for Proposals (RFP) to Carnival and other vessel operators. To be eligible for award of a contract or "charter," any potential offeror had to provide a vessel within 10 days that would meet the Military Sealift Command's minimum set of written requirements.³ Specifically, the Military Sealift Command required vessels capable of providing:

- The carriage, berthing, and feeding of a minimum of 1,000 passengers;

² Ken Silverstein and Alan C. Miller, Under the Waterline of Cruise Ship Deal, Los Angeles Times, Oct. 5, 2005, at A-22. Carnival is unaware of the specific number of owners and operators approached by MSC.

³ RFP N00033-05-R-561 at 7 (modifying PASSTIME charter paragraph XI). Per subparagraph (b), each proposal, to be eligible for award, must be "in conformance with the terms of [the] solicitation..."

- Three meals per day per person, with availability between meals of water, coffee/tea, soda, juice, and light snacks;
- Cleaning services for rooms and laundry services for not only ship linens but also the personal laundry of refugees and relief workers;
- Security services for the vessel;
- Office space for 10 government personnel;
- Medical facilities and related services; and
- Pharmacy services and prescription refill capabilities.

Because of the emergency nature of the circumstances, the Military Sealift Command required all potential offerors to submit proposals no later than 11:00 a.m. on Friday, September 2, the following day.

To meet these needs, Carnival employees submitted a proposal – for the charter of three passenger vessels – the next morning. In the course of these negotiations, it became apparent to us that performance of the contract would involve a number of issues such as immigration, employment, tax, and Customs concerns that would have to be resolved following deployment of the vessels. The urgency of the situation demanded fast action. The government and we moved forward in good faith in promptly assisting victims of the Katrina disaster.

On the morning of Friday, September 2, the Military Sealift Command received proposals covering 13 vessels.⁴ The Military Sealift Command subsequently offered charters for four of these vessels – Carnival’s *Ecstasy*, *Holiday*, and *Sensation* and the *M/S Scotia Prince*, operated by Scotia Prince Cruises. In accepting Carnival’s proposal, the Military Sealift Command advised Carnival that the terms of the charters had to be negotiated by the end of that day. Following all day discussions, binding agreements, called “Fixtures” in the maritime

⁴ Leslie Wayne and Jeremy Alford, Cruise Ships, Spurned by Evacuees, Are Home to Displaced City Workers and Families, New York Times, Sept. 16, 2005, at A-17.

industry, were concluded very late that Friday evening, permitting Carnival to order the movement of its three vessels to the ports of Mobile, Alabama and Galveston, Texas.⁵ The Fixture process, also new to Carnival, is used by the government to quickly obtain a binding commitment for a vessel to enable the vessel to begin to move into position for delivery to the charterer or to reach a port of loading or embarkation. Negotiation of the detailed terms and conditions follows when there is more time.

Carnival was in the position of learning the detailed provisions of the Military Sealift Command PASSTIME standard charter party agreement and trying to understand the complexities of being a government contractor between the time it received the Request for Proposals and the execution of the Fixture approximately 26 hours later. We learned that a Fixture and the Fixture process of negotiating a charter were well suited to the emergency conditions prevailing during the hectic days following Katrina.

The next day, on September 3, 2005, Carnival brought in extra staff and reservation agents to begin canceling the scheduled cruise vacations for over 120,000 of our customers on the three ships, an action that resulted in our having to provide full refunds. The company paid the travel agents their full commissions on those bookings. We lost some number of these individuals as customers to other vacation options including competing cruise lines. Canceling these cruises enabled Carnival to deliver the *Ecstasy* and *Sensation* to the government in Galveston on Monday, September 5, 2005, and the *Holiday* in Mobile on Thursday, September 8, 2005. Both the *Ecstasy* and the *Sensation* were subsequently relocated, at the Military Sealift Command's direction, to the port of New Orleans, where they arrived on Sunday, September 11, 2005. At the time of delivery to the government, Carnival dispatched Special Assistance Teams

⁵ The Fixtures, per industry custom, were subject to further negotiation regarding detailed charter terms and conditions. Final charters were completed and executed on September 30, 2005.

and senior staff to help with the registrations and embarkation of the displaced people who would be sheltered and cared for on these vessels.

Clarifications and Corrections

Against this background, let me correct and clarify the record of these events.

First, The Charters Were Competitively Bid. The Process was Established by MSC using Established Procurement Procedures under Admittedly Extraordinary Conditions.

Contrary to reports in the press, on the talk shows, and the web, the charters were, in fact, competitively bid. MSC contacted a reported 75 vessel owners and operators to provide suitable vessels, and requested a response to a very detailed Request For Proposal (RFP). This is a standard bidding procedure. Clearly there were multiple sources to fulfill the government's needs. Single source contracting may have been used for other assets and services, but the acquisition of vessels was accomplished through a competitive bidding process.

Second, Carnival Agreed to Profit Neutral Contract Terms;

From the outset of the charter negotiations, Carnival informed the government that its objective was to charge only what it would have otherwise earned from the vessels operating in a post Katrina marketplace. The RFP required all offers to be based on the Military Sealift Command's standard Passenger Time (PASSTIME) Charter Agreement, which compensates the vessel owner based on two factors: a *per diem* rate for the full use of the vessel and related services and reimbursement for certain listed expenses. However, in Carnival's case, the charters provide:

Owner, intending that the services it is providing to the United States Government under this Charter Party inure to the good and welfare of the American people while at the same time intending to protect its interests shall within six months following the completion of the Charter period,

including the option term if exercised, present Charterer a payment reflecting the surplus, if any, between the net profit Owner earned from the Charter after taxes and the expected net profits Owner would have earned on the cruise operations scheduled during the Charter period as estimated in good faith by Owner, which surplus shall be applied as a credit against Owner's final invoice to the Charterer. Any price adjustment made pursuant to this clause shall constitute a voluntary reduction to the fixed price per diem payments and shall not in any way be deemed to change the firm-fixed price nature of this Charter Party.

Some media stories, while correctly stating that the clause was inserted in the agreement after the Fixture was signed, erroneously stated or implied that Carnival put the clause in the final agreement in response to public criticism of the pricing of the charters. The fact is that this clause was discussed at length before the Fixtures were executed. However, MSC was not sure such a clause could be included in the charters. The clause is both novel and unprecedented, and so it was left to the further negotiations of the detailed terms and conditions of the charters following execution of the Fixtures, when time would allow for working out the details and final language of the provision. Proceeding in this manner allowed the vessels to move to the affected disaster areas without delay. If the government has any concerns about the implementation of this profit neutrality provision, Carnival would welcome any review by the Defense Contract Audit Agency that is requested by MSC.

Our public statements following the completion of the Fixtures evidence our early intentions in regard to the foregoing. On September 5, 2005, Carnival Corporation issued a press release reporting the expected financial impact of Hurricane Katrina and the charters of the three vessels on our projected fourth quarter earnings. In the press release, Carnival informed our shareholders, financial analysts and media that:

While it is difficult to determine the full financial impact resulting from the above hurricane related events, the company currently believes that these events will reduce earnings by between \$.01 and \$.03 per share ...

In other words, we reported that the hurricane related events, including the vessel charters, could slightly decrease our earnings for the fourth quarter – essentially a negligible or neutral impact.

Further, on September 19, 2005, our Chief Financial Officer said the following in our quarterly conference call/webcast to financial analysts and shareholders regarding the expected earnings from the three vessels for the period from September through November 2005:

So in giving guidance for the 4th quarter, we have based our guidance as if we had operated these three ships normally. Since we are expecting the charter to be earnings neutral, that should not affect our EPS guidance for the 4th quarter. When we ultimately report those charter results in our 4th quarter results, it may affect individual line items such as revenues or expenses, **but it should not affect the bottom line.** (emphasis added)

The foregoing public statements are subject to the scrutiny of the Securities and Exchange Commission.

Additionally, claims that the federal government appears to be paying Carnival more under the charters than these vessels would otherwise earn based on Carnival's revenue figures from December 2001 to January 2002, are also inaccurate.⁶ Such claims rely upon revenue figures that reflected the devastating negative impact on the economy from the events of September 11, 2001. The cruise industry in particular, as well as the entire tourism industry, were hard hit at that time. It was one of the worst periods in the history of the cruise and travel industry. Carnival's operating revenues have increased significantly since that point.

Claims that normal revenue levels would not have been achieved by Carnival during the MSC/FEMA charter period are likewise inaccurate. On August 31, 2005, prior to the call from

⁶ Alan C. Miller and Ken Silverstein, A Democrat Says Data Show Carnival Got a Lucrative Contract for Providing Post-Katrina Lodging, Los Angeles Times, Oct. 21, 2005 at A-27.

CDC, arrangements had already been made to move *Conquest* and *Sensation* departures from New Orleans to Galveston (the *Ecstasy* was already operating out of Galveston). As passengers fly or otherwise travel to the port of embarkation, it is a simple matter to change such travel arrangements for Galveston. Indeed, the *Conquest* continued with its full schedule with its projected occupancy and earnings after relocating to Galveston. The *Holiday*, saw only one five day cruise canceled and resumed normal operations from its home port of Mobile, which received minor hurricane damage, on September 3, 2005.⁷

The Carnival Vessels are Being Utilized

The government, as charterer, decides how to best utilize the vessels' services. The Military Sealift Command initially ordered the *Ecstasy* and *Sensation* to Galveston, but found that hurricane refugees preferred to remain on land, in local shelters.⁸ After determining that conditions allowed for safe passage back into New Orleans, the Military Sealift Command redirected these two vessels to New Orleans where today they are sheltering primarily New Orleans police personnel, firefighters, and relief workers along with their families. There were, as of October 31, 2005, 5,859 passengers aboard these ships.⁹ Based on two persons per cabin, the *Holiday*, which this past weekend was relocated to Pascagoula, Mississippi, was at 94% capacity and the *Ecstasy* and *Sensation* exceeded 100% capacity, meaning that some cabins held more than two persons. Based on the total contract berths (7,116), and the total payment provided in the charters of \$236 million (the *per diem* payments and the estimated allowed

⁷ For a copy of a Carnival Press Release containing this announcement, visit: http://www.carnival.com/CMS/Articles/mobile_return.aspx

⁸ Chris Adams, Gary Estwick, and Martin Merzer, Mayor Orders Holdouts to Leave New Orleans; Efforts to Relocate Katrina Victims Were Complicated by Many People Who Refused to Leave Their Homes in New Orleans or Shelters Elsewhere, The Miami Herald, Sept. 8, 2005, at A-1.

⁹ The three vessels possess 2,778 cabins accommodating 5,556 persons using industry standard of two passengers per cabin; 7,116 total berths; and 7,366 berths, including 250 additional available crew berths.

reimbursable payments), the government is paying an average per person cost of \$184, a cost which includes all meals, laundry service, and medical care. If an additional 250 unoccupied crew berths are utilized, this cost will decrease to \$178.

To put these amounts in perspective, back during the first Gulf War, the Military Sealift Command chartered the *Cunard Princess*, a 425-cabin vessel, for six months to house troops and to provide recreational facilities at a cost of \$145,000 per day.¹⁰ The cost per person for that charter, assuming 2-person per cabin occupancy, was \$170 per day in 1990 dollars, or approximately \$259 per day in 2005 dollars.

Carnival management, our employees, shareholders are proud of our participation in the enormous humanitarian effort in support of Hurricane Katrina victim relief. The value of passenger vessels that have the capability to quickly bring food, shelter, water, and medical care to localities in emergency situations has now been demonstrated.

Recommendations

It has also been demonstrated that there is room for improvement in the issuance of future disaster related cruise ship charters. We have two recommendations:

1. Given the need to address emergency situations as they unfold, and given the speed at which the MSC-Carnival charters had to be entered into, the federal government should enter into contingency agreements with willing vessel operators before future emergencies occur. Alternatively, the government should at least have the form and agreements tailored to disaster relief and proper procedures in place so companies willing to make vessels available will know

¹⁰ At the time, Cunard Lines was not owned by Carnival Corp. and Carnival plc.

in advance what to expect. This approach would both streamline the process and reassure taxpayers that funds are being spent appropriately and under proper supervision.

2. FEMA or another appropriate federal disaster relief agency should maintain an inventory of prescreened and vetted Owners willing to make vessels available on extremely short notice to avoid Carnival's experience. Crucial issues can be addressed earlier and also be better explained in public. Some of these issues include:

- Foreign-flag vessels providing disaster relief in U.S. waters,
- Different payment and reimbursement systems, and
- Immigration, labor, tax and tax credit issues, and customs questions and procedures.

The goal is to improve understanding and reduce risks that these companies will have to accept to make vessels available in the compressed time frames imposed by disasters and catastrophes. Taking the steps necessary to assure the availability of large cruise vessels will be an important readiness ingredient in the success of future disaster relief efforts.

We appreciate the opportunity to discuss these issues with you, as well as the opportunity to assist with the Katrina relief efforts.

November 1, 2005 6:00pm