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International Transport Workers' Federation
Federación Internacional de los Trabajadores del Transporte
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Internationale Transportarbeiter-Föderation
Международная федерация транспортников
التنظيم عالمياً، النضال من أجل حقوقنا

International Container Terminal Services, Inc. (ICTSI): PROXY ADVISORY NOTE

This *Proxy Advisory Note* further outlines the reasons for voting AGAINST the re-election of Directors Stephen A. Paradies and Jon Aboitiz at ICTSI's 2018 Annual Stockholders' Meeting on April 19th 2018.

1. Insufficient number of independent directors

The Nomination Sub-committee is charged with evaluating the qualifications of prospective members of the Board. It is our view, that as Chair of the Nomination Sub-committee Director Paradies bears substantial responsibility for the dearth of independent Directors on the Board.

Proxy advisor ISS recommends that Boards in the Philippines have the greater of 30% or three independent directors. Similarly, the ASEAN Corporate Governance Scorecard recommends that firms have a minimum of three independent Directors. Moreover, the Philippines Securities and Exchange Commission recommends that firms have at least three or 30% independent directors.¹ Out of seven directors ICTSI management classifies only Mr. Higdon and Espiritu as independent.

The lack of board independence is of particular concern given that, through ownership in two different classes of shares, the Razon family holds over 60% of the voting rights at the Company. ICTSI's own documents highlight this as a risk to outside shareholders:

"...the Razon Family exercises control over or has significant ability to influence major policy decisions of the Company, including its overall strategic and investment decisions, dividend plans, issuances of securities, adjustments to its capital structure, mergers, liquidation or other reorganisation and amendments to its Articles of Incorporation and By-laws. If the interests of the Razon family conflict with the interests of other shareholders of the Company, there can be no assurance that the Razon Family would not cause the Company to take action in a matter which might differ from the interests of the other shareholders."

We believe that directors that are independent from Mr. Razon and other ICTSI managers may help to lessen the risk of a divergence in interests, and ensure that minority shareholder interests are safeguarded.

2. Entrenchment of current Board members

It is our view that ICTSI managers and shareholders may also benefit from a refreshed Board. The average tenure on the ICTSI Board is now 22 years. Several members have long-standing social, business and/or professional ties to Mr. Razon.

The Securities Exchange Commission of the Philippines suggests that directors with more than nine years of board membership should not be considered independent, although a company may seek to justify continuing to designate them as independent. If this recommendation was rigorously enforced at ICTSI, none of its directors would qualify as independent without additional justification and shareholder approval.

We believe refreshing the pool of Board members raises the likelihood that ICTSI's senior management will benefit from diverse business experiences and perspectives. This might help management better navigate some of the firm's current operational problems and future challenges.

¹ To see ISS standards please refer to: <https://www.issgovernance.com/file/policy/2017-asia-pacific-regional-voting-guidelines.pdf>. To see ASEAN Scorecard see: http://www.sec.gov.ph/wp-content/uploads/2015/10/ASEAN_CG_SCORECARD_20_april_2015.pdf page 28. Also see the standards from the SEC see <http://www.ictsi.com/admin/images/download/1005201703032803302017091838ICTSI%20-%20PSE%20Corporate%20Governance%20Guidelines%20for%20Listed%20Companies%202016.pdf> Item 2.3 or SEC Memo Circular 19 -2016.

Director	Board Member Since	Tenure
Enrique K. Razon Jr.	1987	31 years
Joseph Higdon (I)	2007	11 years
Jon Ramon Aboitiz	2008	10 years
Stephen A. Paradies	1987	31 years
Oscar Victor R. Espiritu (I)	2002	16 years
Andries Soriano III	1992	26 years
Jose C. Ibazeta	1987	31 years

It should be the role of Nomination Sub-committee to monitor Board tenure and guard against entrenchment. As Chair of the Sub-committee we believe that Mr. Paradies bears substantial responsibility in allowing the Board to reach this point. His own long tenure is a factor shareholders might take into account in considering his suitability both to perform this role, and for re-election. Additionally, as described in ICTSI's disclosures, Mr. Paradies is the brother-in-law of Mr. Razon, which raises question about whether he would upset the current entrenchment of the Board of Directors.

3. Conflicts on the Related Party Transaction Committee

ICTSI shares Enrique Razon, its CEO and Chairman with Bloomberry Resorts, the parent company of the Solaire Casino. Additionally Senior Vice-President Christian Gonzalez, Assistant Corporate Secretary Silverio Benny J. Tan and other ICTSI executives also have roles at Bloomberry Resorts. At present ICTSI provides limited disclosure to shareholders about the degree that resources are shared between with Bloomberry Resorts. At a minimum ICTSI splits the time of Mr. Razon, Mr. Gonzalez, and Mr. Tan; uses space at the Solaire Casino; shares sports sponsorship and advertising; and there are substantial questions that should be raised about how plane use, travel expenses, and perquisites for executives with joint responsibility are shared between the firms.

It is our contention that shareholders have not received sufficient disclosure about the nature, extent or degree of sharing resources. For example, if Mr. Razon travels and does business on behalf of both ICTSI and Bloomberry are the costs split? Is there an accounting of how his time was divided? Are shareholders from one company subsidizing those of the other company? We believe it is necessary for shareholders to be informed about these potential issues and others that may exist.

Director Aboitiz currently oversees the Related Parties Transactions Committee, he is also a Director of Bloomberry Resorts. Mr. Aboitiz's loyalties are thus divided. His judgements regarding the fair allocation of costs and resources between the two firms can not be made solely based on the best interests of ICTSI shareholders. Additionally, his role as Chair of the Committee contravenes the recommended practices of ASEAN Scorecard for Corporate Governance.

4. Protracted disputes at multiple terminals

In October 2017, the ITF published a report that detailed how operational failures across the ICTSI network had resulted in a pattern of labour violations and had called into question ICTSI's ability to ensure productive industrial relations across its global network. These violations had led to protracted disputes that directly affected multiple port stakeholders, including governments, global brands and shipping lines. Since the release of that report, other disputes have hit ICTSI operations, including at their flagship Melbourne terminal, global brands and shipping lines.

In Melbourne, Australia, ICTSI has committed more than \$450 million to the operation of a major new terminal. However, on-going disputes with labour unions and other port stakeholders threaten the success of the terminal. In quarterly calls with analysts and investors, ICTSI claims that they need contracts with three shipping lines to break even at the Port of Melbourne. To date, the

company has only contracted with one shipping line to provide a regular service through the terminal.² ICTSI's failures to resolve issues with the union may impact of ICTSI's ability to contract with new shipping lines, as shipping lines seek terminals with more stable relationships with port stakeholders.

In 2017, ICTSI raised tariffs at the Port of Toamasina, Madagascar. These hikes occurred despite the terminals' ongoing poor performance under the management of ICTSI, which has led to severe delays for both shipping lines and road hauliers.³ In November 2017, the main users of the Port of Toamasina, including shipping lines and freight forwarders, formed a business group to protest the tariff hikes and major delays in the servicing of vessels and trucks.⁴ This escalated to a strike by carriers and freight forwarders in December following ongoing delays due to maintenance failures at the terminal.⁵ In January 2018, Madagascar media reported vessels were stranded for up to 2 weeks, unable to berth at the terminal, due to alleged mismanagement by ICTSI.⁶

These protests by port clients follow-on from concern by global clothing brands using the Port of Toamasina. In April 2017, the Levis, Esprit and the Ethical Trading Initiative, contacted the Government of Madagascar regarding the unfair dismissal of dock workers at ICTSI's Port of Toamasina.

ICTSI's managers have ambitiously grown the company over the last decade. However, we believe that their growth has not been accompanied by sufficient managerial oversight and appropriate internal controls to ensure productive industrial relations, compliance with local laws and international labour conventions, and even fail to ensure compliance with ICTSI's own internal policies and Codes of Conduct. These are issues that seem to be squarely among the responsibilities of the Board Risk Oversight Committee.

It is our view that the Board Risk Oversight Committee, chaired by Mr. Paradies, has failed to ensure that ICTSI's internal controls are sufficient to avoid some major operational issues including; major port disputes and relationships with censured regimes. The Charter of the Board Risk Oversight Committee charges the members with overseeing management activities including, "managing credit, market, liquidity, operational, legal and other risk exposures of the corporation. This function includes regularly receiving information on risk exposures and risk management activities from Management." Perhaps even more pointedly, the Charter charges the Committee with finding ways of reducing these risks. The Charter describes the responsibilities as follows, "[The Committee] Reports of the Board on a regular basis, or as deemed necessary, ICTSI's material risk exposures, the actions taken to reduce the risks, and recommends further action or plans, as necessary."⁷

5. Operational risk from transactions with censured regimes

ICTSI has become one of the largest terminal operators in the world. In that process, the company has partnered with regimes implicated in crimes against humanity, including Syria and the Democratic Republic of Congo (DRC). At present forty percent of the company's (12 out of 30) ports are operated under regimes that are either censured or under investigation, including for crimes against humanity.⁸ ICTSI has also expanded into countries where an individual's ability to exercise human and labour rights is severely curtailed and often fraught with danger.

² https://www.porttechnology.org/news/ictsi_reveals_all_about_australias_fully_automated_terminal

³ ICTSI (2017). *International Container Terminal Services, Inc. PSE:ICT FQ2 2017 Earnings Call Transcripts*, <https://finance.yahoo.com/news/edited-transcript-ict-ps-earnings-153345500.html>

⁴ Antsa R. (2017), Madagascar: Port de Toamasina - Alerte rouge des opérateurs pour défaillance de MICTSL, 23 November 2017 <http://fr.allafrica.com/stories/201711230476.html>

⁵ Riana, R. (2017), 'Toamasina Port: Freight Forwarders and Carriers on Strike', 27 December 2017, <http://www.newsmada.com/2017/12/27/port-de-toamasina-les-transitaires-et-les-transporteurs-en-greve/>; Antsa R. (2017), 'Madagascar: Port de Toamasina - La tension monte entre MICTSL et les usagers', 11 December 2017, <http://fr.allafrica.com/stories/201712110597.html>

⁶ Rakotobe, H. (2018) 'Port of Toamasina – Paralysis threatens the country', 29 January 2018, <http://www.lexpressmada.com/blog/actualites/port-de-toamasina-une%E2%80%88paralysie%E2%80%88menace%E2%80%88le%E2%80%88pays-2/>

⁷ See Items 8&9 here: [http://www.ictsi.com/admin/images/download/121420170109593a%20-%20BROC%20Charter_revised_proposal_5_4_17%20\(Clean\).pdf](http://www.ictsi.com/admin/images/download/121420170109593a%20-%20BROC%20Charter_revised_proposal_5_4_17%20(Clean).pdf)

⁸ At present ICTSI operates ports in the Democratic Republic of Congo, the Republic of Honduras. In 2013, ICTSI entered into port management agreements with the Republic of Sudan. The United Nations Security Council has extensive sanctions in place regarding activity in the Democratic Republic of the Congo, these sanctions date from 2004, and have most recently been extended until August 1, 2018. See: <https://www.un.org/press/en/2017/sc12883.doc.htm>. The Organization of American States has called for the rerunning of elections in Honduras due to

Given that workers in almost all ICTSI terminals face limitations on their access to labour rights at a country level, ICTSI must do more to mitigate against the risk of human rights violations at an enterprise level. The United Nations Guiding Principles clearly state that enterprises have a responsibility to mitigate against human rights risks – including potential labour rights violations – directly related to the company’s operations in the countries where they are located.

ICTSI’s responsibility is particularly acute, given that ICTSI has explicitly stated that it may in expand into countries that are subject to global sanctions:

“In the future, the Company may acquire ports in other jurisdictions or from governments that are the target of U.S. economic sanctions. Furthermore, the Company’s ability to operate in the United States may be limited by concerns related to its operations involving jurisdictions or parties that are targets of U.S. economic sanctions.”

This has financial implications for shareholders, if ICTSI’s dealings with sanctioned regimes impact on future expansion in countries that sanction dealings with regimes known for human rights abuses. Expansion to ports in Europe, the United States, Canada, Australia, or New Zealand maybe challenging given ICTSI’s current partnership agreements. Furthermore, under the UN Guiding Principles, the responsibility to mitigate against human rights abuses falls to the enterprise level, and firms have a financial responsibility to remedy human rights abuses directly related to their operations.

In January 2018, ICTSI announced that it had bid for the South Port Container Terminal (SPCT) in Port Sudan.⁹ Although the Sudan is no longer sanctioned, ICTSI engaged with a government implicated in genocide, war crimes and crimes against humanity, during a period when sanctions were in place. In 2013, ICTSI signed a contract with government entities in Sudan for the management of two container terminals in the Port of Sudan.¹⁰ At the time the contract was signed, in October 2013, the Government of Sudan was the subject of US and UN sanctions. President Omar Al-Bashir was subject to warrants by the International Criminal Court (ICC) for crimes against humanity, war crimes and genocide committed in 2009 and 2010.

ICTSI’s 2013 Annual Report fails to disclose the contract with the Sudan Port Corporation. We note similar absences in ICTSI’s disclosures to the Philippines Stock Exchange. In failing to disclose this contract, ICTSI failed to inform shareholders that it was doing dealings with Sudanese government entity, at the time when United States and United Nations sanctions severely restricted such dealings.

In our view, oversight by an independent and empowered Board, with an active and thorough Board Risk Oversight Committee may help to ensure that managers are limiting engagement with governments, entities, and individuals that are likely to face international sanctions in the future.

Given the overwhelming majority of voting rights maintained by Mr. Razon and his family, we are under no illusion that we will prevail in this vote. However, we wish to sharply signal to Mr. Razon and other Board members, that there is a need for change at ICTSI. While shareholder value at the company has increased over the last five years, we believe it is critical that governance and operational changes be made to position the company for further growth, and to attract the support of outside investors, lenders, and joint-venture partners.

Recommendation:

At ICTSI’s 2018 Annual Stockholders’ Meeting on April 19th 2018, the ITF recommends voting AGAINST the re-election of Directors Stephen A. Paradies and Jon Aboitiz.

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irregularities. The OAS has yet to recognize the results of the November 2017 elections. See: <https://www.telesur tv.net/english/news/Almagro-The-OAS-Hasnt-Recognized-Hernandez-as-Honduran-Pres.-20180213-0024.html>.

⁹ Port Strategy, (2018) ‘Seeing the bigger picture in concession bids,’ <http://www.portstrategy.com/news101/port-operations/planning-and-design/seeing-the-bigger-picture-in-concession-bids>

¹⁰ World Bank Group, (2013). *Republic of the Sudan Diagnostic Trade Integration Study – Update*, Report No: ACS10972, World Bank Group, Massachusetts; Sudan Sea Ports Handbook 2016-18