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ONE HUNDRED NINTH CONGRESS

Congress of the United States

House of Representatives

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October 20, 2005

The Honorable Michael Chertoff
Secretary of Homeland Security
Department of Homeland Security
Washington, DC 20528

Dear Secretary Chertoff:

I wrote to you on September 23 about my concerns about the \$236 million contract between FEMA and Carnival Cruise Lines to provide housing for hurricane evacuees aboard three Carnival ships for six months.¹ Since then, I have obtained new information about the operating expenses of the three Carnival ships involved. A comparison of this information to the federal contract raises serious questions about whether the Carnival contract is a responsible use of taxpayer funds.

The information I have obtained comes from an internal "Financial Review" prepared by Carnival in January 2002 that discloses the revenue received and expenses incurred for Carnival Cruise Lines and the three Carnival ships now under federal contract: the Sensation, the Ecstasy, and the Holiday. This financial data reveals that the federal government appears to be paying Carnival significantly more under the federal contract than the ships earned on their own, while Carnival's expenses appear to be significantly less under the federal contract than the ships normally incur. The net result is a contract that looks lucrative for Carnival but exceptionally expensive for the taxpayer.

In the first two months of fiscal year 2002, the period covered by the financial review, the revenue for the three ships was approximately \$25 million per month. Extrapolating to six months, the duration of the federal contract, the total revenue would be just \$150 million, substantially less than the \$236 million the company will receive under the federal contract, even after taking inflation into account. At the same time, there will be over 800 fewer Carnival employees working on the ships under the federal contract, further boosting Carnival profits. For example, Carnival's expenses in the internal financial review included salaries and accommodations for 175 bar staff, 110 entertainers, 99 casino staff, 31 "Camp Carnival" staff, 28

¹ Letter from Rep. Henry A. Waxman to Secretary of Homeland Security Michael Chertoff (Sept. 23, 2005).

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employees in photo labs, and 25 shore excursion staff. None of these expenses is being incurred under the federal contract.

Even if the federal contract were more fairly priced, its merits would be dubious. Under the contract, the taxpayer is required to compensate Carnival for lost revenues from services that have nothing to do with the relief mission, such as millions of dollars in gambling proceeds and liquor sales. Moreover, it is not clear that Carnival would have been able to earn its usual revenues during the period covered by the federal contract. One of the ships (the Sensation) is based out of New Orleans, and a second ship (the Holiday) operates from Mobile, Alabama. Given the devastation wrought by Hurricanes Katrina and Rita, Carnival would certainly have needed to make costly schedule adjustments and may not have been able to maintain an ordinary cruise schedule.

Your Department does not have a good record on federal procurement contracts. As investigative reports and government audits have identified, the Department has squandered billions on poorly designed and ineptly managed homeland security contracts. The nation cannot afford to repeat such mistakes in the relief and recovery efforts following Hurricanes Katrina and Rita. I therefore urge you to release additional information about this contract and the basis on which it was negotiated.

The Carnival Contract

Under its contract with FEMA, as negotiated and managed by Military Sealift Command, Carnival Cruise Lines has docked three of its ships — the Sensation, the Ecstasy, and the Holiday — in the Gulf Coast for use as temporary living arrangements for evacuees, emergency workers, and others.

Carnival provides three meals per day to each person on the ship, as well as weekly laundry and cleaning service.² Many of the expenses ordinarily incurred by Carnival, however, are not being incurred under the federal contract. These include the costs of providing entertainment, gambling, and bar services, as well as the maintenance and wear and tear on ship engines experienced when the vessels are at sea.

The passenger capacity of the three ships is 7,116, and the contract cost is \$236 million for six months, with one optional three month extension.³ On a per-person basis, the cost to the federal taxpayer would be about \$5,500 per month if the ship were kept at full capacity. To house a family of five for the full six months of the contract, the cost would be over \$165,000.

² Military Sealift Command, Contract No. N00033-05-C-5611 with Carnival Cruise Lines (awarded Sept. 2, 2005).

³ *Id.*

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At present, the ships are significantly below full occupancy. The Sensation and Ecstasy are currently docked in New Orleans. As of October 12, the Sensation had about 2,000 registered guests and the Ecstasy had about 2,100 guests. The Holiday is docked in Mobile and had about 1,400 registered guests on board.⁴ If this level of occupancy were to continue for the next six months, the cost to the taxpayer to provide housing aboard the ships for a family of five would be \$214,500. For this price, the taxpayer could purchase or build a permanent home for the family.

Carnival's Internal Financial Review

Carnival Cruise Line representatives have stated repeatedly that this contract will enable the company to earn as much profit as it would have earned had it operated normally, replacing lost revenues and covering increased expenses. A recent letter from Carnival Cruise Lines CEO Bob Dickinson to members of Congress states that the contract is "profit neutral" and based on "good faith estimates of vessel costs."⁵

I have obtained an internal "Financial Review" from Carnival that calls these assertions into serious doubt. This internal financial review reveals the revenues Carnival received from the Sensation, the Ecstasy, and the Holiday during a two-month period at the start of the 2002 fiscal year. This review shows that the ships earned \$25 million in one month, which is equivalent to \$150 million over a six-month period.⁶ The \$236 million being paid by the federal government is 57% higher than the revenue earned by the three ships four years ago.

Since 2002, inflation has increased by 2.6% annually, a cumulative increase in the cost of living of 8%.⁷ Even taking this into account, the federal contract price is \$74 million more than Carnival's revenues from four years ago.

Avoided Expenses

The 2002 financial review also provides a breakdown of Carnival's operating expenses for the three ships. It reveals that these expenses will be much lower under the federal contract

⁴ Email from Kenneth Allen, Military Sealift Command, to Government Reform Committee Minority Staff (Oct. 14, 2005).

⁵ Letter from Bob Dickinson, President and CEO Carnival Cruise Lines, to Members of Congress, (Oct. 3, 2005).

⁶ Carnival Cruise Lines Operating Company, Financial Review (Jan. 2002). Data for the Holiday and the Sensation are from January 2002. The Ecstasy was in operation for only one week in January 2002; data for this ship is from December 2001.

⁷ Bureau of Labor Statistics, *Consumer Price Index, All Urban Consumers (Current Series)* (2005).

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than they are when the ships are providing actual cruises. Yet it does not appear that these reduced expenses were taken into account when the federal contract was negotiated.

One significant reduced expense is the reduction in necessary staff. Under the federal contract, Carnival has no need for entertainment, bar, casino, and shore excursion staff and should not be incurring the expense of these employees' salaries, food, and lodging. Based on a comparison of the most recent crew counts on the three ships with January 2002 staff counts, it appears that the ships have reduced their crew by about 865 employees during the period of the federal contract.⁸

The 2002 data provides some insights into the specifics of these savings. In January 2002, there were 175 bar staff, 110 entertainers, 99 casino staff, 31 "Camp Carnival" staff, 28 employees in the photo labs, 25 shore excursion staff, and 25 cruise staff on the Sensation, the Ecstasy, and the Holiday.⁹ Using Carnival data, it appears that these nearly 500 employees would have been paid more than \$3 million over the course of six months.¹⁰ Pay for entertainers alone on these three ships over six months is estimated to have been more than \$1.5 million.¹¹ Moreover, Carnival does not need to provide food or lodging to these employees, further increasing its cost savings.

There are a number of other expenses relating to the operation of a cruise ship that Carnival will not be required to pay while the ships are under charter to the federal government. In its 2002 financial documents, Carnival lists entertainment expenses per operating day that averaged \$989 for its "fantasy class" ships, including the Sensation and the Ecstasy, and \$700 for the Holiday. These avoided entertainment expenses could equal almost \$500,000 over six months for the three ships. In addition, the pools, bars, and casino areas do not require daily maintenance, the engines are not enduring the same wear and tear, and there are no navigational expenses. Yet none of these savings appear to be accounted for in the contract.

⁸ Carnival Cruise Lines Operating Company, *Financial Review*, p. 60 (Jan. 2002); Email from Kenneth Allen, Military Sealift Command, to Government Reform Committee Minority Staff (Oct. 14, 2005).

⁹ Carnival Cruise Lines Operating Company, *Financial Review*, p. 60 (Jan. 2002).

¹⁰ See Carnival Cruise Lines Operating Company, *Financial Review* (Jan. 2002). The payroll estimates are based on the actual payroll and head counts across the Carnival fleet. No information regarding pay rates was provided for casino or shore excursion staff. These pay rates were estimated to be the same as food service staff.

¹¹ *Id.*

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Questionable Reimbursements

Even if the Carnival contract were more reasonably priced, its underlying premises would be questionable. The contract has been designed to require the taxpayer to compensate Carnival for both the revenues the company would have earned under normal operations and any additional expenses that Carnival incurs under the contract. This means that the taxpayer does not reimburse Carnival for just the services it actually provides. The taxpayer is also responsible for paying for revenues the company would have received from its casino operations, liquor and drink sales, and on-shore excursions, even those these costs have nothing to do with the primary relief mission.

The cumulative cost of these questionable reimbursements is significant. Extrapolations from the 2002 financial data show that Carnival could expect to receive approximately \$12.5 million in casino revenue and \$10.5 million in bar revenue from the three ships over six months.¹² When other extraneous revenue sources, such as on-shore excursions, are included, it appears that 20% of the cost of the contract can be attributable to reimbursements that have no connection to services actually provided by Carnival.¹³

Given our mounting federal debt and the devastation wrought by the hurricanes, few Americans would support compensating Carnival for lost gambling and liquor proceeds. Yet this appears to be exactly what the contract does.

The primary justification provided by Carnival executives for these reimbursements is that the company should recoup what the company would ordinarily earn from the three ships.¹⁴ However, it is doubtful that Carnival would have earned normal revenues from these ships in the aftermath of the hurricanes. One of the ships under charter (the Sensation) was operating out of the New Orleans port. Another (the Holiday) was based in Mobile. Hurricanes Katrina and Rita would surely have disrupted Carnival's operations even if the ships were not chartered to the federal government.

Yet another questionable reimbursement under the contract is the provision that Carnival will be paid \$35 million for reimbursement of federal taxes.¹⁵ The rationale for this reimbursement appears to be that Carnival traditionally uses legal maneuvers (such as sailing its ships under foreign flags) to evade U.S. taxes. Rewarding Carnival for successfully avoiding federal taxes in the past hardly seems like sound public policy.

¹² *Id.*

¹³ *Id.* Total onboard revenues over six months are estimated to be \$48 million.

¹⁴ "Katrina Contracts will be Reopened," *The Washington Post* (Oct. 7, 2005).

¹⁵ Military Sealift Command, Contract No. N00033-05-C-5611 with Carnival Cruise Lines (awarded Sept. 2, 2005).

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Conclusion

A provision was recently added to the federal contract requiring Carnival Cruise Lines to return any contract payments that create a surplus profit over what the company would have earned in normal operations as "estimated in good faith" by Carnival.¹⁶ The late insertion of the provision may be an admission of the flaws in the contract, but it does little to ameliorate my concerns. Under this provision, the responsibility for determining whether Carnival is overcharging the taxpayer has been turned over to the company itself, which offers the taxpayer scant hope of relief.

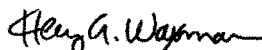
Instead of this meaningless provision, what we need to do is to restore transparency and accountability to federal contracting. Both Carnival and the Department need to justify to the Congress and the taxpayer why this contract is reasonable. And if an adjustment in the contract price is required, it should be made soon.

In order to assist in congressional oversight of this contract, I request that you provide the following additional information without delay:

- All documentation regarding the calculations of lost revenue provided by Carnival Corporation to the Military Sealift Command, FEMA, or other government agency to justify the cost of the contract;
- All documentation regarding the calculations of expenses incurred under normal operations and under the charter contract that were provided by Carnival Corporation to the Military Sealift Command, FEMA, or other government agency to justify the cost of the contract;
- All documentation regarding the decision to reimburse Carnival for federal taxes owed while under the charter contract; and
- Any documentation regarding the development of the provision calling for return of excessive profits by Carnival.

I would appreciate receiving these documents by November 3.

Sincerely,



Henry A. Waxman
Ranking Minority Member

¹⁶ Military Sealift Command, Contract No. N00033-05-C-5611 with Carnival Cruise Lines (awarded Sept. 2, 2005).