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THE FEDERAL SHIP CONSTRUCTION LOAN GUARANTEE PROGRAM

HEARING

BEFORE THE

SEAPOWER AND EXPEDITIONARY FORCES SUBCOMMITTEE

OF THE

COMMITTEE ON ARMED SERVICES
HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

FIRST SESSION

HEARING HELD
MARCH 15, 2007

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THE FEDERAL SHIP CONSTRUCTION LOAN GUARANTEE PROGRAM

HOUSE OF REPRESENTATIVES,
COMMITTEE ON ARMED SERVICES,
SEAPOWER AND EXPEDITIONARY FORCES SUBCOMMITTEE,
Washington, DC, Thursday, March 15, 2007.

The subcommittee met, pursuant to call, at 2:26 p.m. in room 2212, Rayburn House Office Building, Hon. Gene Taylor (chairman of the subcommittee) presiding.

OPENING STATEMENT OF HON. GENE TAYLOR, A REPRESENTATIVE FROM MISSISSIPPI, CHAIRMAN, SEAPOWER AND EXPEDITIONARY FORCES SUBCOMMITTEE

Mr. TAYLOR. Meeting will come to order.

The committee today will meet to discuss the opportunities for Title XI loan guarantees for the shipbuilding industry for ship operators who choose to use that as a form of financing to try to revive the American shipbuilding industry.

This is nothing new. Those of us who have been around here a while have heard it under a number of different names, not to be limited to the National Shipbuilding Initiative. Both Democrats and Republicans have claimed to be its father, and I am for everyone who is for this.

I for one—and I think I can speak for my ranking member—remain concerned that a nation that can produce the world's greatest military, the world's largest economy and a nation that imports such a huge percentage of the world's goods continues to do so on foreign flag vessels. And we have taken what was once the world's greatest fleet and now become a nation that rarely builds a commercial ship. I am also reminded that we are a nation that is spending anywhere from $6 to $10 billion a month in another country helping them to build their infrastructure but gets amazingly stingy when it comes to taking care of our own.

The one that probably struck me the greatest with this Administration was, shortly after 9/11, the cancellation of the American classic line ships that were to have been built in Mississippi—were being built in Mississippi. They were sold for scrap when scrap was at an all time low, and then just a few years later our Nation turned around and chartered foreign flag cruise ships so that first responders in New Orleans and other folks who had lost their homes on the Mississippi gulf coast could have a place to live.

I am convinced that for what we spent to charter those vessels we could have gone a heck of a long way toward finishing those ships that were being built, had them in the inventory and then whatever the next catastrophe is, be it a weapon of mass destruc-

tion somewhere domestically, a typhoon in Guam, we would have had that housing available.

And so I happen to believe that was a very bad decision on the part of the Bush Administration. It struck me as more of a slap at the Clinton Administration than any sound business policy. But that is water under the bridge. But we just don't want to keep repeating those mistakes.

So, with that, I will yield to my extremely capable ranking member, Mr. Bartlett of Maryland.

STATEMENT OF HON. ROSCOE G. BARTLETT, A REPRESENTATIVE FROM MARYLAND, RANKING MEMBER, SEAPOWER AND EXPEDITIONARY FORCES SUBCOMMITTEE

Mr. BARTLETT. Thank you very much, and before I give my opening statement, I need to note that I will need to leave to go to the floor. I hope to be back before the hearing ends, but we will have the testimony to read.

Thank you, Mr. Chairman.

Good afternoon, ladies and gentlemen. I am pleased to be with you today to discuss the Maritime Administration's (MARAD) Title XI loan guarantee program. As many of you know, I am a strong advocate of improving our domestic shipbuilding capability. The Maritime Administration's Title XI loan guarantee program has in the past been a useful tool for spurring more investment in domestic ship construction. In particular, the Title XI has helped U.S. shipbuilders maintain the Jones Act fleet.

The purpose of today's hearing as I see it is to understand why the Title XI program no longer achieves its mission of promoting growth and modernization of the U.S. merchant marine and U.S. shipyards. I note that the President's budget request for fiscal year 2008 does not request funding for Title XI and that Mr. Connaughton's prepared statement notes that the Administration believes the program is a form of corporate subsidy.

According to MARAD, ship owners and shipyards should be able to obtain financing in the private sector without the help of Title XI. I would like to pursue this point further.

Does the private sector indeed support financing to ship owners and shipyards? My understanding is that some in the industry are able to obtain private sector funding while others are not. If you are constructing tanker vessels, for instance, commercial financing may be more easily obtained. I think Overseas Shipholding Group's recent contract with Aker Shipyards in Philadelphia is a good example of a ship owner using commercially obtained financing to build product tankers. Yet finding private sector funding for constructing roll-on/roll-off vessels or bulk carriers I am told is more difficult.

I am hopeful that our witnesses can help explain whether the commercial market is indeed capable or willing to independently, that is without Title XI guarantees, finance the projects of ship owners.

As an advocate for increasing domestic ship construction, this needs to be the critical question.

A related issue, Mr. Chairman, which demands our attention is whether the MARAD loan guarantee program operates efficiently

and provides industry with the right set of incentives. Even if the Title XI program was funded at a level that it could give out new loan guarantees, we still need to evaluate whether the Title XI is designed in a way that will make the program self-sustaining. My understanding is that, in the past, Title XI benefitted not only the ship owners and ship builders but also the U.S. Government. During this period, Title XI had a large, diverse pool of participants in the program that spread the default risk across all sectors of the industry. As a result, defaults were covered, indeed more than covered, by fees charged for the guarantee. Moreover, I am told that the program was even profitable.

The question I would like our witnesses to address is what it would take, in the event MARAD had the funding to give out Title XI loan guarantees, for the Title XI program to be once again self-sustaining.

Again, thanks to all of our witnesses for being here today. I look forward to your testimony.

Thank you, Mr. Chairman.

Mr. TAYLOR. Thank you, Mr. Bartlett.

I would like to introduce our first witness, Mr. Sean Connaughton, graduate of the United States Merchant Marine Academy. Being a graduate of that institution, he knows that, on an annual basis, hundreds of young men and women will graduate from an institution hoping to become ship captains, and I hope his remarks today will be to let us know that the Administration is willing to help us find a way to build some ships for those kids to work on.

But with that, we are pleased to have you here. We know your tight schedule. And we welcome you, and I would ask unanimous consent that the committee rule limiting witnesses to five minutes be waived for today.

Without objection.

So, Mr. Connaughton, please give us your thoughts.

STATEMENT OF SEAN T. CONNAUGHTON, ADMINISTRATOR, MARITIME ADMINISTRATION, DEPARTMENT OF TRANSPORTATION

Mr. CONNAUGHTON. Thank you, Mr. Chairman, members of the committee.

I appreciate very much the opportunity to be here today to discuss the Title XI program which is administered by the Maritime Administration. I have a prepared statement, Mr. Chairman. I would like to ask if I can enter that into the record and just do a summation.

Mr. TAYLOR. Without objection.

Mr. CONNAUGHTON. Thank you, sir. As most of you know, the Title XI program provides for a full faith and credit loan guarantee by the Federal Government of private sector debt incurred for the construction or reconstruction of ships in the United States—in the U.S. shipyards.

At present, we have an outstanding portfolio of around $2.9 billion in loan guarantees covering the modernization of American shipyards as well as a wide variety of vessels. Title XI is rep-

resented in just about every market segment in the maritime industry in practically every geographic area.

Although the Administration has not requested funding for new loan guarantees since 2001, Congress has periodically appropriated money for this purpose. The most recent project we approved was two passenger and vehicle ferries for the—also known as the Hawaii SuperFerry. We financed a similar vessel which began operating in Lake Michigan in 2004.

These ferries are state of the art and highly suitable for use on America's marine highway system. In choosing to finance the ferries MARAD is promoting a vessel type that can be used to relieve highway congestion by providing an attractive marine transportation alternative.

We are very proud of the fact that we have notably improved our management of the Title XI program since audit reports were issued in 2003 and 2004 by the General Accounting Office, and now the Government Accountability Office (GAO) and the Department of Transportation's (DOT) Office of the Inspector General (IG).

In addition to the steps MARAD itself has taken, the Department has instituted a Credit Council to provide financial oversight for all of the Department's credit programs including Title XI.

We are very pleased to report that our program improvements have been recognized. In his November 2005 report on the top management challenges facing the Department of Transportation, the DOT Inspector General stated that the Title XI loan guarantee program is functioning effectively.

In addition, the Title XI program went through a PART assessment last year as mandated by the Office of Management and Budget (OMB). Title XI received a final part score from OMB that indicates the program is considered to be moderately effective. The DOT Inspector General's comments and the PART score clearly demonstrate MARAD's diligence in implementing recommendations for improved program management. Moreover, I am confident that MARAD is now positioned to continue to administer the program in such a way as to maximize the benefit to our national and economic security while protecting the government's financial interests.

At this time, the Administration does not request funding for Title XI because it believes the program is a form of corporate subsidy and that ship owners and shipyards should rely on their own creditworthiness to obtain financing in the private sector. Furthermore, the taxpayers should not bear the risk of default by private companies. However, I want to emphasize at this point that our position on Title XI programs should in no way be misconstrued as a lack of support for the U.S. shipbuilding industry or U.S. ship owners. The Administration is on record as staunchly championing the Jones Act in order to protect their interests. We simply believe that the Title XI program is an unwarranted intervention in the credit market.

I want to thank the members of this committee, and I want to thank Chairman Taylor for holding this hearing on a very important issue, and I will be very happy to answer any questions you may have, sir.

[The prepared statement of Mr. Connaughton can be found in the Appendix on page 41.]

Mr. TAYLOR. Thank you, Mr. Connaughton.

Connaughton. Excuse me. Shame on me.

Chair yields to Mr. Larsen of Washington.

Mr. LARSEN. Thank you very much, and is it Connaughton?

Mr. CONNAUGHTON. Yes.

I get a little confused—well, it gets confused, although we are not related, the chairman of the President's CEQ council is Jim Connaughton, and I am Sean Connaughton.

Mr. LARSEN. He has never been before us. I want to get your name right. Like Larsen, I always get mispronounced with Larson with an O–N. Can't tell the difference.

In your opinion—I want to go back to what Mr. Bartlett said near the end of his opening comments. In your opinion, why does it seem to you that, in the market, it may be easier to get financing for something like tankers versus something like for containers or dry cargo or bulk?

Mr. CONNAUGHTON. I believe one of the issues that the private sector faces as well as we deal with when we are evaluating applications is, what is the market that the vessel is going to serve, what is the status of that market and what are the long-term possibilities in that market.

And my assumption would be that when they end up looking at different market sectors and for whatever the vessel itself is going to be built for and be used as, ends up making or having a big impact on the type of loans, the amount of loans and the type of creditworthiness requirements. So we deal with the same thing when we look at loan applications as well, sir.

Mr. LARSEN. I understand that, certainly the philosophical argument, and I don't want to get too much into a philosophical argument here because there may be plenty of space between that we are not going to meet on, but in your comments saying that it is a fundamental—not funding Title XI comes down to fundamental thought that it is an unwarranted intervention in the credit market, but there are other, I think, in my perspective and maybe others' perspectives, there are other things to take into account about having a shipbuilding industry, having a U.S. shipbuilding industry, being able to invest in that shipbuilding industry, and I think Title XI plays an important part in that. And I don't know how we bridge maybe that philosophical difference there, but I do want to certainly get that on the record.

But you note in your testimony that if it is functioning well, Title XI is functioning well, then why wouldn't you fund it? Separate from the philosophy, if it is functioning well and if it is moderately effective, you know, why is there no money included in the budget for it?

Mr. CONNAUGHTON. Well, the position of the Administration is one that actually has been held by this Administration, actually, and also the Clinton Administration.

Mr. LARSEN. And the Clinton Administration was wrong as well on that point.

Mr. TAYLOR. Will the gentleman yield? I do think, in fairness, that after the Clinton Administration fought us every step of the

way on the National Shipbuilding Initiative, he did call it the President's Shipbuilding Initiative when he signed the bill, so with that, I yield back.

To set the record straight.

Mr. CONNAUGHTON. The Administration's position is that, given the portfolio, given the current book of business that we are overseeing, we are going to run this—run the Title XI program as well and as effectively as possible to ensure that the taxpayers' interests are protected. However, the Administration's position is that if these loans are viable and if they are available in the commercial and the private sector, that that is where the carriers should be turning to, is the private sector.

Mr. LARSEN. There are 74 loans now outstanding; is that right?

Mr. CONNAUGHTON. Actually, I have a list, sir, but I know the total book value, but I am not sure how many we have.

Mr. LARSEN. Regardless of the total book value, how many have you, how many has this Administration done in the last—in the life of the Administration?

Mr. CONNAUGHTON. I am not sure. Do we have the—I can get you the exact information, sir. I don't have it with me.

[The information referred to can be found in the Appendix beginning on page 99.]

Mr. LARSEN. If you could for the record, if I can get the number of loans outstanding, I think the book value was $2.9 billion, if I am not mistaken. And if you could also get me the number of the loans that have gone through Title XI during this Administration as well. I am trying to get a better idea of maybe the Administration hasn't supported it, as the previous Administration hadn't either, but it seems to be being used and used well.

So, and then, finally, Mr. Chairman, just one more. Is it necessary—I note in your testimony about the Credit Council, that the DOT has established this Credit Council to provide financial oversight for all the department's credit programs, including Title XI. Is this an additional review on top of whatever review MARAD is doing for Title XI loans?

Mr. CONNAUGHTON. Yes, sir.

Mr. LARSEN. What value does it add that wasn't being added—that wasn't there before a Credit Council review was in place?

Mr. CONNAUGHTON. Probably the biggest thing is that it has been an extra set of eyes and ears and review of these applications. And adding a little bit different perspective on some of them because it is not just simply Title XI. There are actually other loan programs and programs in other modal administrations, and so the Credit Council has actually been very useful in actually getting maybe a little bit different perspective, getting there to be a, you know, some other, essentially eyes and ears in making sure that the applications are going to be ones that are going to be as low a risk as possible. So I have not at least personally seen them to be a hindrance or a burden. They have actually been helpful in actually you know taking a look and getting some better ideas.

Mr. LARSEN. Do you know how much time is added on to review of Title XI loans? If the Credit Council review wasn't there, what was the average time for Title XI loan review, and now Credit Council review is there, how much extra time?

Mr. CONNAUGHTON. I don't know, sir. I have not dealt with any loans since I have been in the office for six months now, but I can find out how much time. But I don't believe it is that much. The Credit Council meets fairly regularly, and when other loans—I have seen loans or other types of program applications from other programs, we get those applications on a fairly timely basis, and then we meet fairly regularly and deal with them. But I can actually get you how much between.

[The information referred to can be found in the Appendix beginning on page 99.]

Mr. LARSEN. And just conclude on the same head scratcher, if, for me, if you're saying things are functioning well and things are moderately effective—certainly we want things to be effective or supremely effective, whatever the highest rank is on that list—that we need to add an additional layer of review for something that is functioning pretty well. Understanding this is a DOT initiative and not necessarily a MARAD Title XI initiative, but it just does seem to be, you know, for some people around here, an extra eyes and ears means more bureaucracy as well so, thank you, Mr. Chairman.

Mr. TAYLOR. I thank the gentleman.

The Chair recognizes the gentlelady from Guam, Ms. Bordallo.

Ms. BORDALLO. Thank you, Mr. Chairman. I just want to reiterate what Mr. Larsen covered. He asked a question. And I don't think I really was able to comprehend your answer very directly, and that was, if the program is successful, then why would the Administration not request funding for it? I don't think I remember directly what you said.

Mr. CONNAUGHTON. Ma'am, the Administration's position is that when we are dealing with these types of applications, this program, it is the taxpayers who are essentially backing up, assuming the risk of what is a private relationship between a shipyard and a carrier and that, if these projects are viable, that financing should be obtained through the private financial markets. And so the Administration's position is that, since the private financial markets are available, that the government should not be involved in these types of loan guarantees.

Ms. BORDALLO. On the other hand, do you agree with the fact that if these partnerships continue, isn't it a more efficient way of building ships?

Mr. CONNAUGHTON. Well, it is just a different way of doing it, in that Title XI loans have some different parameters than a private sector loan would. Probably one of the biggest differences is that Title XI loans are for 25 years and that there is only a requirement that 12.5 percent be put up forward by the applicant. So, when you look at the fact that not as much equity is necessary up front, and the fact that the loan itself is actually for a very extensive or an extended period of time, much longer than most commercial loans in the private market, it makes—it makes it more attractive to utilize the Title XI. But, again, the Administration's position is that this is something that should be worked out in the private sector and between private parties.

Ms. BORDALLO. Thank you.

Thank you very much, Mr. Chairman.

Mr. TAYLOR. I thank the gentlelady.

Mr. Connaughton, there are a couple of inconsistencies in my mind that I would like the Administration to, and if you could on behalf of them, straighten out.

I would think the primary beneficiaries of this program would be what we refer to in Washington as the big six. Seems like our second tier yards are doing fine mostly because the Jones Act protects them, and they are only competing against other Americans and therefore can remain competitive.

Who is the only customer—or I take that back. 99 percent of the ships that are produced by the big six are purchased by whom?

Mr. CONNAUGHTON. The United States Government is the primary customer of these yards.

Mr. TAYLOR. Is it fair to say that the laws of economies of scale are just as true for shipbuilding as any other industry, that the more you build of something, your fixed costs go down and the cost per unit produced will go down?

Mr. CONNAUGHTON. In fact, sir, just recently being up in the Aker yard, you can see quite clearly the differences when you do have a series construction and the amount of—or the cost of overhead per vessel goes down dramatically.

Mr. TAYLOR. I know it is not your job, but I have got to believe you read the papers. And I would presume in the course of reading that, you have heard the general's lament, the slow delivery time on things like up-armored Humvees, on things like the mine-resistant ambush-protected vehicle that we are trying to field for the Marine Corps and the Army, the delays we had in building other Defense needs that are built of steel or else fabricated of steel. Are you aware of that?

Mr. CONNAUGHTON. Yes, sir.

Mr. TAYLOR. With that in mind, and since the commander in chief is regularly reminding the American people that we are a Nation at war, why then is there this reluctance on the part of the same Administration to rebuild that industrial might that would result in economies of scale when we build our Navy ships, would provide the sort of industrial capacity that we have so that the armor we need for the MRAP or up-armored Humvees, would be more readily available?

I really find an incredible disconnect on the part of the Bush Administration. And I realize that you are the messenger. But my question is, is anyone at MARAD trying to get the Administration to, as Secretary Rumsfeld used to say, connect the dots and figure this out?

Mr. CONNAUGHTON. Sir, we, since I have been in office, I have had the opportunity to visit yards, to meet with the shipyard executives as well as their representatives. And, obviously, we understand there are some very serious challenges being faced by the shipyard industry as well as in general in the carrier community in the United States.

I have asked the yards what it is that we can be doing to make them more competitive. What do we need to be doing to look at what types of hurdles and barriers may exist that we can end up taking some action on? And we put that in writing to the yards. I know that they are actually coming back to us on that. We want

to foster the shipyard industry. It is an important driver in employment. It is an important aspect of, obviously, our economy and specifically in various parts of the country, very, very large employers, as well as part of our National Defense Foundation.

The issue really is, though, how do we get to that? And whether the programs like this are adding or potentially even being detrimental to that. And I don't have all the answers, sir, but we are going to try to work very closely with them, within the obvious confines of the very difficult fiscal and financial challenges being faced by us in the government. But the thing is that we need to have a better idea about what can be done to make those yards more competitive. And this is something that we are talking to the yards about, asking the yards about, and we will raise it within the Administration.

Mr. TAYLOR. Mr. Connaughton, one of the things that I would hope the Administration would consider is being more supportive of this program, particularly for vessels that have a military utility. And I will give you one, for instance, that has come out in open testimony in this subcommittee. There are five Navy oilers in the entire Pacific. The vessels that escort our nuclear-powered carriers are all oil fired. If I were a potential foe of the United States, by a series of means, my first strike would be, in a war in the Pacific, my first strike would be to get rid of the oilers.

My, for instance, question is, would the Administration be more supportive of using Title XI to build a next generation of double hull oilers if they could be built in a way that they would be capable of refueling Navy ships? If we tied it down a little closer to a proven military vulnerability, a proven military need and something that we could turn to the private sector to augment things that, again, I have to believe any chief petty officer and any potential foe of the United States has already figured out, is a vulnerability of ours?

Mr. CONNAUGHTON. Sir, obviously, it is something that has not been broached to me or as far as I am aware of anyone else in the Administration. But, however, I will point out that where the military is currently looking more and more to rely on private commercial parties to support a lot of their efforts, they are again looking—they are looking to the domestic carrier fleet. And they are even looking at, and I think the vessels you are talking about, some of those are obviously reaching the point where they need to be replaced. And I know the military is actively looking at the potential of utilizing vessels being built in Aker, and those vessels that are being built are being built without Title XI right now. And so it is something that I think, at least if those types of examinations show that as utility, I think there is a point there that maybe the Title XI is not necessary to provide those types of assets.

Mr. TAYLOR. Mr. Connaughton, again, I know that you are in the uncomfortable position of having to defend some bad decisions.

Mr. CONNAUGHTON. I didn't say that, sir.

Mr. TAYLOR. And I know you can't for the record note that there was no movement on the part of his head yes or no. Again, I have—I for one was outraged when this Administration proposed to send troops to Colombia to protect the Occidental Petroleum Pipeline. And this Administration described that as a critical Na-

tional Defense Infrastructure that the Colombians needed to protect. It is with great irony that this Administration would turn around and object to you trying to improve the yards and the U.S. Merchant Marine. If he is willing—if this President is willing to do it for the Colombians, then I would hope he would be willing to do it for his fellow Americans. Any other questions?

And again, I know that you are the messenger. I hope that we can work on this. I have to say that for the record because I really believe that to be true. I think this is something of great importance to our Nation that we have been ignoring for far too long. I think we have an opportunity to do something, and we hope we can work with you along those lines.

Mr. CONNAUGHTON. Thank you, Mr. Chairman, did you have something for me before the hearing?

Mr. TAYLOR. Chairman Ortiz of the Readiness Subcommittee contacted me shortly before the hearing to express his concern that MARAD was moving toward allowing the American reserve fleet—those that are going to be scrapped—to be scrapped overseas. And I would like to share his concerns with you and also my concerns.

We both know that the price of scrap steel is comparatively high, may well be even at an all time high. I think we are both aware that if a vessel is scrapped in this country, it is going to be done in an environmentally sensitive manner that doesn't run up the cost. I think we are also aware, if it is done overseas, it will probably be done in an environmentally unfriendly manner.

And so, on behalf of Chairman Ortiz and myself, if there is a move at MARAD to scrap these ships overseas, I would like to voice his objections and my objections to that. I think we can afford to do it domestically. I think it is going to provide jobs domestically, and we know this can be done in an environmentally responsible manner here. And I can't make that guaranty for overseas.

Mr. CONNAUGHTON. Mr. Chairman, the use of foreign scrap yards is something that grew up or grew out of, I believe, some legislation several years ago that requested or mandated that the Maritime Administration look at that. Given our experience in that, I can tell you that I would be very reluctant ever again to see the Maritime Administration utilize a foreign yard.

Mr. TAYLOR. I will pass that word to Chairman Ortiz, and I know he will be pleased to hear it.

Mr. CONNAUGHTON. Thank you, sir.

Mr. TAYLOR. Thank you for sharing your limited time with us. We look forward to working with you.

Mr. CONNAUGHTON. Thank you, sir. Thank you, sir.

Mr. TAYLOR. The chair will now call Ms. Cindy Brown, the President of the American Shipbuilding Association; Mr. Roy Bowman of Thompson Coburn, Attorneys at Law; Mr. Martin Gottlieb, the Managing Director of the Argent Group; Mr. Charles Raymond, Chairman and CEO of Horizon Lines; and Mr. H. Clayton Cook Jr., of Seward & Kissell, Attorneys at Law.

We appreciate all of you being here. We apologize in the delay in getting started. My mother would haunt me if I didn't recognize the ladies first, so we are going to start with Ms. Brown.

STATEMENT OF CYNTHIA L. BROWN, PRESIDENT, AMERICAN SHIPBUILDING ASSOCIATION

Ms. BROWN. Thank you, Mr. Chairman, Congresswoman Bordallo, Congressman Larsen, thank you very much for having this hearing today on the importance of the Title XI ship loan guarantee program in facilitating commercial ship construction in the United States.

The American Shipbuilding Association (ASA) is a national trade association of the six largest shipbuilders in the United States to build all the capital ships for the United States Navy and have a long history in building large ocean going commercial ships. We also represent more than 70 companies engaged in the manufacture and design of ship systems and components. And my membership list is attached to my statement.

Today, Title XI is urgently needed for small- and medium-sized U.S. ship owners and operators to secure affordable financing, over 25 years, for the purpose of replacing their aging Jones Act fleets with new ships built in our shipyards.

Without Title XI, the majority of the Jones Act owners will not be able to invest in new tonnage, and thus desperately needed commercial shipbuilding work will not materialize for our industry.

The Jones Act fleet numbers 105 oceangoing ships which carry oil and dry cargo between U.S. ports. The average age of the fleet is 22 years, when the average economic useful life of a tanker is 20 years and a dry cargo ship is 25 years. And many of these ships in the fleet are well over 30 years of age. These ships need to be replaced to ensure the United States has the ships necessary to meet our coastwise commercial needs, our energy transportation needs, and these ships need to be replaced to ensure that we have safe tonnage for our water-born commerce. The construction of oceangoing commercial ships in the United States made possible by Title XI has many benefits for the Nation.

Number one, it helps American shipyards retain and grow our highly skilled engineering and production workforce, which is vital to building ships for the United States Navy and Coast Guard.

Second, increased ship production provided by commercial orders reduces the cost of U.S. Navy and Coast Guard ships because it allows the U.S. shipyards to spread their overhead costs over a greater universe of ships. These are costs that would otherwise be totally covered by the United States Government.

The coast of ships built for the U.S. Government is also reduced by stabilizing our workforce. Persistently low and unstable rates of Navy ship construction have resulted in large costly swings in our workforce.

When government shipbuilding orders are delayed or reduced, we have to lay off our highly skilled workers, then to later higher, retrain or train a new workforce. Just as an example, it takes a minimum of $50,000 to train a welder to minimum proficiency standards.

The huge cost and time required to train our workforce is stabilized when we have a mix of both Navy and commercial orders to allow us to avoid these swings.

Third, building commercial ships facilitates the introduction of best commercial building practices which can also increase our efficiencies and reduce our cost.

Fourth, commercial and oceangoing ships built for American ship owners are available to the Department of Defense in time of war and National emergency. For example, the six tankers financed by Title XI in the late 1990's and built by Newport News Shipbuilding were called into service for DOD in the Iraq war to transport jet fuel to our deployed services. Commercial roll-on/roll-off and container ships are also needed by DOD. Without American built and owned ships, the U.S. is dependent upon foreign ships for the resupply of our troops.

Fifth, commercial ships built in the U.S. are built to the highest safety standards in the world. Just one example are the double hulls we have built in the post-OPA 1990's time frame where these ships have been built not only with double hulls but with redundant propulsion systems, controls. In the case that there would ever be a mechanical failure that would also result in an oil spill, these ships have redundancy designed and built into them.

The Title XI program was established to give ship owners and operators an access to long-term affordable financing that they could not otherwise find in the commercial market without a loan guarantee.

The program was designed to ease the risk to the commercial lending institutions, with the government assuming the risk in order to facilitate financing for smaller and medium-sized companies comparable to that available to large corporations.

If all ship owners and operators were huge corporations with deep pockets, there would be no need for Title XI. The program was designed to address financing needs of the companies where there is some risk.

ASA strongly supports minimizing the government's risk exposure. A default is not in the program's interest nor is it in our industry's interest. However, in the name of risk reduction, there have been multiple regulatory restrictions imposed on the program by this Administration making it very difficult for any applicant to be approved. In light of these regulatory handcuffs, ASA asked the subcommittee for its support in not only funding the program but also amending the program to establish a priority category for certain ship loan applications and an accelerated review process for these applications.

No money has been appropriated for Title XI since fiscal year 2003 when Congress provided $25 million in the emergency war supplemental. Without funding, no loan guarantees can be issued. As stated earlier, without Title XI guarantees, the majority of Jones Act ship owners will not have the financial means to replace their fleets. If ship owners don't have access to affordable financing to introduce new modern tonnage in the Jones Act trade, there will be increased pressure to repeal the Jones Act to allow foreign tonnage to carry American's coastwise commerce. Should that happen, there will be no commercial shipbuilding market left for American shipyards in the absence of a commercial shipbuilding subsidy program to offset years of subsidies provided to foreign shipyards in Asia. These subsidies have allowed those shipyards to corner the

commercial shipbuilding market. Without commercial work, the risk increases for losing more U.S. shipyards that comprise the core shipbuilding industry upon which this Nation depends for its defense. Furthermore, the cost of naval ships will rise.

The American Shipbuilding Association encourages Congress to authorize and appropriate $60 million for the Title XI program in fiscal year 2008. This funding would generate more than $1.2 billion in ship construction in the economy.

In addition to funding, there is a need to add to the statute priority review and approval process for traditional applications to expedite the financing for replacement tonnage serving the Jones Act. I ask the subcommittee to consider an amendment which would add a new priority for loan guarantees for replacement vessels.

For an applicant to receive priority under this proposed new category, the applicant would have to be an established vessel owner and/or operator in a proven Jones Act market. The application would have to be for the construction of replacement tonnage for vessels over 20 years of age. And the replacement vessels would have to be militarily useful to augment dedicated DOD sea lift assets in times of war and National emergency.

Our recommended amendment, which is attached to my statement, proposes that applications under this new priority category be evaluated and processed by the Maritime Administration without the additional review of the Department of Transportation Credit Council. This recommendation is made to expedite the review process while still minimizing risk exposure of the government.

The reason the risk is minimized is because these owners will be applying for guarantees that are established ship owners in established proven trades where the Maritime Administration has extensive knowledge and familiarity with the cargo demands. This amendment further recommends that the Maritime Administrator be directed to develop and apply to applications under this priority category a more broadbased financial evaluation other than the current regulatory strict 2-to-1 debt-to-equity criteria alone.

ASA recommends that the broader-based financial evaluation also take into account an applicant's cash flow performance and collateral assets in determining an applicant's creditworthiness. This amendment is needed because the Credit Council review has added many months to an application review and approval process that heretofore took 60 days.

More disturbing is the appearance that the role of the council is to deny new loan guarantees in reflection of this Administration's opposition to the program. The Department reportedly put the Credit Council in place to guard against applications being potentially approved that had high risk of default. Given that the applications under this priority category would be traditional applications from proven owners in proven trades, the risk of default is low.

The Maritime Administration would still be required to follow and apply all the statutory risk assessments and supplemental security provisions to avoid default in reviewing these applications.

Mr. Chairman, members of the committee, thanks again for having this hearing on the importance of the Title XI ship loan guar-

antee program and sustaining the defense shipbuilding industry of this country. Your favorable consideration of my industry's recommendations for program funding and improvements is appreciated.

[The prepared statement of Ms. Brown can be found in the Appendix on page 44.]

Mr. TAYLOR. Thank you, Ms. Brown.

The Chair now recognizes Mr. Roy Bowman.

STATEMENT OF ROY G. BOWMAN, THOMPSON COBURN LLP, ATTORNEYS AT LAW

Mr. BOWMAN. Good afternoon, Mr. Chairman, members of the committee. I want to just start by saying I am appearing here only to express my own views developed over some 35 years or so in this industry, including my first introduction to Title XI as General Counsel of the Maritime Administration in the 1970's. Rather than read my testimony, I would like to the submit it for the record and just summarize.

Mr. TAYLOR. Without objection.

Mr. BOWMAN. A few points particularly taking off on what Mr. Bartlett said. Mr. Bartlett mentioned the availability of the Aker—commercial financing in the Aker transaction, which I think is a marvelous illustration of commercially available financing, but I think one has to put it in context. If you look at the world of shipping today, the international shipping community is flush with profits. World trade is at the highest level. The emergence of China has meant that every sector of international shipping community is prospering. That goes for the tankers to carry the oil, the ore carriers for the iron, and steel and the liner carriers to bring the products back to the United States.

At the same time, what has happened is that the appetite for risk among the banks is very high. The premiums for risk are at a low, as low as they have ever been. So what does this mean? It means, it is not going to stay this way. There is going to be a change coming, and when that change comes, the opportunity for Title XI to function as a back stop will be very useful and very worthwhile. So the mere fact that we can do some things today—which I absolutely applaud—nevertheless doesn't mean that it will be always this way.

The second point I would like to make is that there is a problem with financing American ships. And it is a problem that anybody who has been around this industry knows for years and years and years. American built ships are very expensive. In fact, they may often be twice the cost of an internationally built ship.

The significance of this is that the international financial community is going to be reluctant to finance any but the very best credits because the ability to redeploy the American built ship in the international trade is going to be very limited. And I think that may be why there is part of the difference between the liner and the tanker industry that Mr. Bartlett alluded to, but maybe Mr. Raymond will address that further. So I think there is a role for Title XI, notwithstanding the availability of commercial financing, for those reasons.

The second point I would just like to make is that I think, unlike the approach that Ms. Brown takes, I think we need to broaden the program. You know this program becomes more and more limited to fewer and fewer customers. The risk profile is enhanced. It is increased. And even the GAO report pointed to the concentration of loans, for instance, in the AMC situation. One area where U.S. shipyards are still competitive is the offshore drilling industry and the offshore service boat industry. These participants in the program, these customers if brought into the program could spread the risk.

Finally, I would like to just agree with the comments on the Credit Council and the other steps that need to be taken to expedite this process. Title XI has now become so cumbersome that only applicants who have limited access to other financing will resort to it. In order to broaden the program and thus allay the risk, it needs to be brought into a more streamlined and more responsive kind of agency without narrowing the profile of participants.

Finally, I can't resist just referencing here the members of the Credit Council perhaps everybody has looked at this, but if one just reads the list of the Credit Council, I think it is clear that the addition of expertise to MARAD is very limited. For instance, just from DOT's press release, the Assistant Secretary for Budget of DOT, the Under Secretary of Transportation for Policy, the General Counsel, the Assistant Secretary for Transportation Policy, Federal Highway Administrator, the Federal Transit Administrator, the Federal Railroad Administrator, the Maritime Administrator—that is nice—and the Director of Office of Small and Disadvantaged Business.

These are the experts that are going to add to MARAD's judgment. I think these kinds of overly bureaucratic responses to risk need to be changed. So my testimony speaks to other things. I will be happy to amplify it if anyone has any questions.

[The prepared statement of Mr. Bowman can be found in the Appendix on page 59.]

Mr. TAYLOR. Thank you, Mr. Bowman.

Chair recognizes Mr. Charles Raymond.

STATEMENT OF CHARLES G. RAYMOND, CHAIRMAN AND CEO, HORIZON LINES, INC.

Mr. RAYMOND. Thank you, Mr. Chairman. I also would like to enter my testimony into the record, and I will not read that, with your permission.

Mr. TAYLOR. Without objection.

Mr. RAYMOND. I would like to take a few minutes and recap and focus on a few of the more important points of my testimony. First of all, I started out, like Secretary Connaughton, as a cadet at Kings Point. In my case, I started in 1961 and had been in this industry one way or the other—as a student, as a vessel officer, as a manager of Sea Land's international business—for 32 years, and now as chairman of Horizon Lines, for 45 years.

The origins of our company: Horizon Lines go back to Sea Land in 1956 when Malcom McLean and I believe Representative Bentley sailed the Ideal X from New Jersey down to Texas with containers on board using our marine highway.

I think we are coming full circle on that need and that opportunity. And I also want to address that in my testimony.

Today, Horizon Lines is our Nation's leading liner operator. It is the largest Jones Act carrier but also is the largest American flag liner operator. Our company is publicly held. Our market capitalization is about $1 billion. It is not a large corporation by definition. It is a small cap. Our management and our boards of directors are populated with some very patriotic individuals and successful business people, including General Privatsky, who is the former head of Military Traffic Management Command; John Handy, who you are familiar with serving as our Executive Vice President; Secretary Mineta, who served both as Transportation Secretary and Commerce Secretary, also esteemed Member of this House for many years; and most recently, recently retired Chief of Naval Operations Admiral Vern Clark.

We have a fleet today of 16 Jones Act vessels, every one of which was built here in the United States, crewed by American crews and owned by U.S. citizens. Those vessels have an average age today of 31 years. They range from 20 years of age to 38 years of age. Two of the older vessels that we have in fact were deployed out of the Puerto Rico trade, out of Operation Desert Storm in order to move materiel to support our troops in the war zone at a time when foreign crews of Denmark and Japan refused to go into the war zone.

These vessels had been militarily useful, and what I am going to propose to you in terms of our need for the program going forward would include military usefulness of the vessels that we would build.

We have a unique opportunity, I believe, to put in place a systematic replacement of not only our own fleet but of the other Jones Act operators with whom we compete. We will also have, in many cases, vessels close to the same age as our own. This would be a multi-year program which would be predictable, would hopefully be funded and would be very efficient under Title XI. In our own case, our company is operating today eight different types of ships that have been acquired over the years. They are vessels of maritime designations C–6s, C–7s, C–8s, lash vessels that have been converted, SL–18s that were bought in 1972 and diesel ships that were built in the Lakes back in 1985.

We have a menagerie of vessel classes if you will. And in order for us to be more efficient, we want to go to a standard class of ships which our existing models that are being built overseas and vessels that we can take those designs and, through technology transfer with U.S. shipyards, put in place a long-term building program that will build a long series of vessels.

With that, the unit cost, as you point out, Mr. Chairman, will come down. The startup costs, which involve new architecture fees, organizing computer-driven protocols for cutting and for welding and other technologies in the shipyards will be very efficient and will bring the unit costs down and, as Ms. Brown pointed out, would take the overhead costs for the entire shipbuilding community and spread that across a much broader base.

The vessels that would be replaced in this program would be freed up to serve our marine highway, something that is getting

more and more attention—and should get the attention of not only the Department of Transportation but the Maritime Administration per se. These are vessels that can carry up to 600 to 700 containers each at speeds of 21 knots or better, and connect the deep water ports of our Nation with ports that are not quite as fortunate enough to have the water that deep water ports do.

These vessels, as I say, would be militarily useful. They are of the speed and draft and tonnage capability that the U.S. Transportation Command has identified as being militarily useful and the commanders in the field as well.

It would provide a predictable and systematic work flow for our Nation's shipyards, enabling us to approach young people that it costs $50,000 to train and weld and show them a career going forward, not one that is going to be populated with layoffs and then rehiring that has characterized the business in past years. It would provide a series of identical ships which not only serves the shipyards well but also would serve our very valued customers, both the commercial customers and the military customers, effectively taking the unit costs of those assets down and therefore helping to maintain inflation in the markets that we serve which in many cases don't have any choice but to ship; certainly the cases of Puerto Rico, Hawaii and, in many cases, Alaska and certainly Guam.

All of these factors support the need for a multiyear authorization, something that is predictable, that we can go to our shareholders and get their votes to approve something that fits our economic models, enables us to build the vessels in a way that sustains the high speed, the reliability that the Jones Act requires but also that is required by our military forces going forward.

Mr. Chairman, I appreciate the opportunity to address the committee, and I hope that this is a hearing that will help us keep the Title XI program from continuing to run aground.

Thank you.

[The prepared statement of Mr. Raymond can be found in the Appendix on page 70.]

Mr. TAYLOR. Thank you, Mr. Raymond.

The Chair now recognizes Mr. Graykowski.

STATEMENT OF JOHN E. GRAYKOWSKI, PRESIDENT, MARITIME CONSULTING

Mr. GRAYKOWSKI. Thank you, Mr. Chairman, and members of the subcommittee, and I, too, would like to include my full statement in the record.

Mr. TAYLOR. No objection.

Mr. GRAYKOWSKI. I kind of find myself feeling like the Ghost of Christmas Past here because a lot of the controversy and the discussion related to the Title XI program occurred while I was at the Maritime Administration. And in large part, the last 13 or 14 years of my life have been spent involved in commercial shipbuilding at MARAD as deputy and acting administrator, as a private attorney representing clients trying to get Title XI, and as general counsel of Aker Philadelphia shipyards, so I am bringing a number of perspectives here.

Mr. Larsen, if I could just kind of correct an impression that was left by Mr. Connaughton, who is a great guy and good friend, and

I value him as someone who is a leader in the industry. I am a bit confused at the comment that the Clinton Administration opposed the program because I was there from January 20, 1994, until the end of the Administration. It is true we had fights within the Administration on funding. Mr. Taylor, you were a major leader in the effort to sustain this program.

By way of history, the National Shipbuilding Initiative in my recollection was sourced in a speech that candidate Clinton gave at NASSCO in San Diego in May of 1992 when he told the workers there that, if I am elected, I will revitalize commercial shipbuilding. He said that in response to the decline in the Soviet Union and the inevitable reduction in Navy shipbuilding.

Following his election, I think, Mr. Taylor, you were here, you worked on it. Mr. Batemen, who is a terrific leader, enacted the National Shipbuilding Initiative, which was a five-part shipbuilding initiative aimed at revitalizing the commercial shipbuilding industry in the country. The major tool that was contained in that act was an expansion of the Title XI program, an expansion in funding and an expansion in authority to fund shipyard modernization and also export projects.

By any measure of success, Mr. Chairman, and members of the committee, I believe that program was a success. Within seven months following enactment, we had regulations issued; the Maritime Administration had partnered with the U.S. shipbuilding industry to actually market our ships and our shipyards to foreign customers. And by the end of the fiscal year 1994, we had done seven deals. And by the end of the Administration, 80 deals had been completed, generating $6 billion—$6 billion in shipyard activity in the country, big vessels, small vessels, barges, tower barges. The money went to all sectors of the country, all shipyards, large and small. Some 400 vessels of all types were built in that time period.

I think it bears, you know, at least some mention. There were defaults. The defaults were—are a tragedy to the country in terms of the financial impact. They are a tragedy of the applicant who does lose money. It may be 13.5 or 12.5 of the deal, but 12.5 of $100 million is a lot of money by any measure. But the impact that really is lasting and long tailored the consequences of the agency because what it says to the people there, all of the work you put into this deal, where you thought, at the end of the day, it was the right thing to do, and let's go, turned out to be wrong. And they are left to pick up the pieces. And so what it does is, in effect, demoralizes staff and makes it harder and harder for the next deal and the next deal to be done.

With respect to where the program is today, Mr. Larsen, you asked how many deals had been done, and I think Mr. Connaughton is in an exceedingly difficult position because of the funding profile and philosophical view of the Administration that this program is wrong and somehow supports a bad thing. I happen to believe shipbuilding is really good for this country for what it does for jobs, what it does for the economy, what it does for our National security.

But in the last three years, Mr. Chairman, MARAD—in 2003, three deals were completed; 2004, two deals were completed; 2005, one deal was completed; and in 2006, no deals were completed.

Now they have certainly made the program I guess more secure. But they are not building any ships.

And the one message of the National Shipbuilding Initiative to me at MARAD was: Build ships; we need them.

I think what I would like to, you know, sort of associate myself most strongly with are the comments with respect to the Credit Council. I used to tell people when we were marketing the program—and we really tried to build a partnership. And I left the program I think in a good shape, MARAD's reputation intact, and you can ask any shipbuilder and most ship owners in this country what they thought of Title XI, and you would get a positive response. But it took—I used to tell them it would be 9 to 12 months to complete an application and around $100,000 in transaction costs for attorneys through closing; 100 and a quarter, 90 whatever, depending on the complexity of the deal. MARAD did not approve every application. For the 80 that we approved, just on a back-of-the-envelope calculation, probably 250 deals we didn't approve.

We turned down the Quincy shipyard deal. Told the guy no. Congress enacted a law that told MARAD to waive economic soundness criteria. The guy comes back and applies. MARAD does the deal. Default occurs. But that was the direct result, I believe, of the congressional enacting law which took the major tool out of MARAD's toolbox. MARAD's due diligence process, which no one ever talks about, the most persistent complaint I got from applicants everywhere in the Title XI practice, many of whom are in the room, is, John, you are taking too long; you are asking too many questions; you are imposing too difficult conditions.

So where I stood at the program, I felt we were complying with congressional intent, meeting the intent of the public policy which is to generate shipyard activity, and we did the best we could to make sure every deal, before it was approved, had the protections necessary for the government. Any loan program has risk in it. Ask Chase Manhattan. Ask Eximbank. Ask Sallie Mae. There are going to be defaults, and I am not trivializing them, but they are an essential and intrinsic part of the lending program, and you do your best to mitigate the risk. AMCV. 9/11 completely cut the legs out from that company and its business plan, and it had a 30-year monopoly on the trade in Hawaii. Shipyard costs increased. You have got a lot of factors that are difficult to foresee in the beginning, and remember, Title XI is a 25-year program. You are trying to project out there that this deal is going to work. So the basic point from where I sit—and I know I may sound defensive to you—is we tried very hard to do what we were supposed to do both to build ships but to do it in a responsible fashion.

Where things sit today, this Credit Council—and I am just angry about it, actually. Mr. Larsen, you hit the nail on the head. Logically, how can you add another layer of review and increase the efficiency of the program? As Roy Bowman pointed out, the people reviewing these applications are not maritime experts. They know nothing about the industry, either its history or its importance or

its value or any of the other things, and yet, they are making people delay. The cost goes up. Frustrations increase, and it is all done in secret. There is no transparency. There is no accountability, which offends me as someone who has spent 25 years in government. You know, if you are making decisions that affect me, you ought to look a person in the eye and tell him why. In the case of the Credit Council, as I understand the process, the council tells MARAD to tell the applicant what the problems are, and then the applicant goes back to MARAD and back to the Credit Council. That is intrinsically wrong and unfair. So, if I made any changes in this program, if I sat where you did, I would eliminate the Credit Council, and if you cannot do that, then make it transparent and make it accountable; put some regulations and some boundaries on it because you have to—I would hope we could return to the Title XI program that was welcoming. It would have told anybody who had a vessel they needed to replace, a market they wanted to enter, a new design they wanted to sort of look at, come in and we will talk to you. Short sea shipping, which Mr. Raymond is involved in, in which everybody is talking about—get trucks off the highway—it is inherently a high risk project. It is a new market with a new company with new cargos, high capital requirements, and you are supposed to get that from the commercial lending sector?

I will close with this. The Merchant Marine Act of 1936, which is kind of our Holy Grail in this industry—and MARAD operates under it. We all live by it—says it is necessary for the national defense and the development of the foreign and domestic commerce of this country to have a Merchant Marine, composed of the best equipped, safest and most suitable types of vessels constructed in the United States and supplemented by efficient facilities for shipbuilding and ship repair. Now, if that is our national policy and we have a Title XI program that is broken and in disrepair, there is a disconnect that needs to be fixed.

Thank you.

[The prepared statement of Mr. Graykowski can be found in the Appendix on page 75.]

Mr. TAYLOR. I thank the gentleman, and I thank him for the refresher in history. To the extent that I should be—to the extent I should stand corrected, I do stand corrected.

Mr. GRAYKOWSKI. You do not need to be corrected, Mr. Chairman.

Mr. TAYLOR. The Chair now recognizes Mister—I hope I say this correctly—Mr. Gottlieb.

STATEMENT OF MARTIN E. GOTTLIEB, MANAGING DIRECTOR, ARGENT GROUP LTD.

Mr. GOTTLIEB. Yes, Mr. Chairman.

Mr. Chairman, distinguished members of the committee, I am Martin Gottlieb, the Managing Director of Argent Group, Limited. Argent specializes in arranging and structuring financing for U.S. Flag vessels. Since the beginning of 2000, Argent has raised financing for 35 of the 41 U.S. flag oceangoing vessels built to order during that period. The total cost of those vessels is approximately $4.5 billion, but 85 percent of that cost was commercial financing,

and 15 percent of that cost was Title XI financing. Since 2003, as Mr. Graykowski talked about, six projects have been approved by the Maritime Administration. Argent was involved in three of those projects, which include the only five oceangoing vessels that have been approved for Title XI by the Maritime Administration since 2003.

As I am sure all of you know, commercial financing is readily available for foreign built ships, but it is much more of a challenge for U.S. Ships, largely because the volume of the commercial ships built in the U.S. is just too small to come anywhere near the economies of scale for foreign vessels. Foreign built vessels are viewed as commodity assets because they can be readily deployed or sold. U.S.-built assets are viewed as purpose-built assets that cannot be readily sold.

The Title XI program addresses this challenge through four principal benefits. First, it enables shipowners to obtain construction financing for U.S.-built ships in much the same way that guarantees backed by export credit agencies of foreign countries do so for foreign built ships.

Next, Title XI provides financing for up to 87–1/2 percent of the cost where commercial financing would be 40 to 70 percent of the cost. Title XI provides a financing term of up to 25 years. Commercial financing is 7 to 10 years.

Last, Title XI carries a lower interest rate than commercial debt, making the acquisition of U.S.-built vessels more affordable. We should not forget about the fact, though, that the Maritime Administration charges a guarantee fee. The guarantee fee on top of the Title XI interest rate significantly increases that rate, still more attractive than commercial financing, but it is not so much lower as many people think when they look just at the interest rate.

Now some recent experiences with the Title XI program. Argent's experience with the program dates back to the 1970's, when it was transforming from an insurance program to a credit program. It also spans the before, during and after effects of the DOT Credit Council, which we have heard a lot about already, and to answer one of Mr. Hanson's questions, for one of the projects of which I was involved in 2003 for an established operator in a proven trade route, we made a Federal XI application in 2003, and we had the approval in three and a half months. Approximately one year later, as the Credit Council was being formed for that identical company for an identical vessel, the amount of time took nine and one half months. Significantly additional conditions were imposed which, from my observation, came through the Credit Council.

In terms of the Credit Council, which you have heard a lot about already, since the formation of that Credit Council there has been an attempt to run this program on a risk-free basis. While I believe that is a laudable objective, it is just not consistent with the policy objectives. It also appears to us that the industry expertise that resides in MARAD, which, by the way, is every bit as comparable to that in the commercial sector, is just being diluted in the process. I believe that this industry expertise is essential to an effective evaluation of applications and the implementation of the appropriate terms and conditions for any given project.

A couple of suggestions I have to make the program operate more efficiently. First, the financial test and the regulations should be updated. They are actually out of date at this stage, in my view. For a vessel operated by an established carrier on an existing trade route, a debt-to-cash-flow-type test should replace some artificial debt-to-equity test. Similarly, the working capital test should be replaced with an earnings or a coverage test. These tests would be exactly in line with commercial financing. I also recommend that approval of projects for established operators on existing trade routes not require the Credit Council or outside consultant review and to be put back in the hands of MARAD.

In closing, I believe a strong and well-functioning Title XI program is vital to our country, our Merchant Marines and our domestic industrial base. If Title XI is not revitalized, in my view, there will be vessels that just will not be built for the U.S. flag. With proper funding, appropriate revisions, updates and proper oversight, the Title XI program can be revitalized to perform the functions that Congress intended that are necessary to rejuvenate our Merchant Marine.

Thank you, Mr. Chairman and members of the committee. I will be happy to answer any questions you have.

[The prepared statement of Mr. Gottlieb can be found in the Appendix on page 85.]

Mr. TAYLOR. Thanks to the gentleman.

The Chair now recognizes Mr. Cook.

STATEMENT OF H. CLAYTON COOK, JR., COUNSEL, SEWARD & KISSELL LLP, ATTORNEYS AT LAW

Mr. COOK. Thank you.

Chairman Taylor and committee members, thank you for inviting me here this afternoon. My name is Clayton Cook. I am counsel to Seward & Kissell, a New York City-based law firm that was founded in 1890. It was internationally recognized as a leader in U.S. flag vessel finance. I served as General Counsel of the Maritime Administration from 1970 through 1973. I am working with Roy Bowman, who was responsible for the legal aspects of the implementation of the Merchant Marine Act of 1970 and for the drafting of the Federal Ship Financing Act of 1972, which governs MARAD's current Title XI program.

These two acts ushered in the most successful period of commercial shipbuilding in U.S. history. The Title XI program was critical to the shipbuilding success. The Title XI program, properly funded and managed, could play a similar critical role today in the successful financing of container and railroad vessels that we need for our American marine highway.

I was interested in Administrator Connaughton's comments with respect to the availability of commercial financing. They are comments that I have heard for at least the last decade, perhaps longer, and in some instances from Maritime Administrators. I think it is true that commercial financing is available for new vessel construction, for vessels in the petroleum trades, and this has been true for at least 30 years because, professionally, I have dealt with long-term financing for petroleum vessels for at least 30 years, but it is not true when it comes to new container and Roll

on/Roll off (Ro/Ro) vessels that we need today, and these vessels cost and will cost in the range of $150 million to $250 million.

In some situations where we are looking not at established carriers but possible new carriers and even old established carriers, there are no long-term charters. These vessels are being built with the hopes of "the customer will come" situations, and there is no 20- or 25-year financing apart from a Maritime Administration credit support or perhaps, in some cases, with a very strong parent company guarantee.

Before coming over today, I went to my desktop computer and went to a Web site that Tim Colton, who is a Marine consultant, runs. On that Web site, he has a list. He maintains a list of vessels built in the United States, and there is one list of all of the container ships that have been built in the United States since World War II and another list of all of the Roll-on/Roll-off vessels that have been built during that period. Each of those lists is between 40 and 50 vessels long. With the container ships, every one of those vessels was built with Title XI credit support except two, and those were two very recent vessels built for Matson Navigation, which has a very strong parent in place in Alexander & Baldwin. So that is two vessels out of over 40, and I often wonder if someone has found a new means of credit support that I have not heard of or that I have not seen.

Turning to Ro/Ro vessels, every one of the Ro/Ro vessels built in the United States since World War II except vessels that were built for U.S. Government military use was financed with the Title XI program. Now, where we go without the program I am not sure.

I would like to end my comments here. I thank the committee, and look forward to receiving questions.

[The prepared statement of Mr. Cook can be found in the Appendix on page 90.]

Mr. TAYLOR. I thank the gentleman.

The Chair now recognizes the gentlewoman from Guam.

Ms. BORDALLO. Thank you. Thank you very much, Mr. Chairman. I have been very impressed with the panel's comments, and before I make my short statement, I just want to say that both military and commercial ships are the lifeline to the territory of Guam, so I want to see the industry continue building ships.

Mr. Chairman, you and I and Mr. Bartlett toured shipyards in the Far East, and we saw the activity going on in these shipyards, and we were told that their governments subsidized them, many of them, and I do not know how you felt, Mr. Chairman, but I just kept thinking about our U.S. shipyards and hoping that we certainly could keep up and not supersede them in their work, and I want to see our U.S. shipbuilders/shipbuilding companies succeed, so I support the Title XI loan program.

I want to say this. Ms. Brown mentioned the amendment. I looked over that amendment regarding the experts, the so-called "experts," on the Credit Council. In my lifetime, I have dealt with large committees and small committees. You get far more done with a smaller committee, and certainly, from all of those different fields of expertise, I do not know how anyone would ever come to a consensus, and I think the thing that really brought light to my eyes was the possibility that they could deny new loan guarantees

just to reflect the Administration's position, and I think that is something we have to look at very carefully.

Mr. Chairman, I want to go on record as saying that I support the Title XI loan program. Thank you.

Mr. TAYLOR. I thank the gentlewoman. I want to open this up to the panel.

Years ago when the Clinton Administration had just been elected and we were going to have a Democratic House and a Democratic Senate, I remember asking a friend who was in the shipbuilding industry but did not know government work what could we do to get things going, and his answer was very, very similar to yours. I do not know if he had read it in a publication, but he said Title XI—which I had never heard of at the time—with the help of Bill Anderhase and others, certainly was not as easy as any of us wanted, I think in fairness, but we were able to do something, and as you mentioned, we were able to do some good things.

Aside from Title XI, what is this committee or this Congress or this Administration missing that we could do to try to revitalize the shipyards because, of all of the things I have pointed to, the lack of industrial base on the vulnerability—I very much remember the national embarrassment of this Nation having to rent something like 85 foreign flag vessels to resupply our troops in Desert Storm. Many of those troops just—I am sorry. 85 foreign ships—and many of those ships were flying flags that just a few years prior to that were in the Warsaw Pact, something unthinkable, something incredibly lucky for us but something we certainly could not have counted on.

So, besides Title XI, what opportunities do you see, and if you were to have the opportunity to speak to the President of the United States and get his support for this, what would you say? I will open this up to the panel. How about if we go by seniority since I am getting to be one myself?

Ms. BORDALLO. Mr. Chairman, would you yield for a moment——

Mr. TAYLOR. Absolutely.

Ms. BORDALLO [continuing]. For a correction on my statement?

I kept referring to it as "Title X." I am sorry, gentlemen. Please go.

Mr. TAYLOR. We will start with Mr. Cook.

Mr. COOK. Mr. Chairman, part of the 1970 act package was a tax deferral program called the Capital Construction Fund. That is a program that has been enormously beneficial and which deserves the committee's attention at this time. That program should be extended to cover ocean coastwide traffic. It now applies to our noncontiguous trades and our Great Lakes trades. It was used by Matson Navigation in the purchase of its four container ships and was, I believe, one of the reasons that it was able to purchase the final two ships without Title XI. It is a program that is widely used, is enormously beneficial, not well understood but a program that we should try and extend now. Thank you.

Mr. GRAYKOWSKI. Mr. Chairman, and I agree, and Mr. Connaughton did ask the industry. He did have a caveat when he sent the letter to the industry and said without costing any money, but if we take that limitation off of it, I will tell you what—I represent Aker Philadelphia Shipyard, and I am involved with the

Shipbuilders Council, and I think you will hear this from Ms. Brown as well that the persistent and chronic and very scary problem is labor, to me, losing guys, men and women really, and it is both in numbers and it is training, and I think there is a function—it is partly a function of the cyclical nature of the business. A lot of the folks that were the stable labor supply in the Gulf were decimated by Katrina in a number of ways or disrupted and either dispersed to other geographical regions or they got jobs elsewhere, but I think on the labor side it is almost a ticking time bomb. The average age at the shipyard in Philadelphia is about 46, and you know, it seems to me that if this government could put together a training program to address not only the basic skills that Ms. Brown talked about but almost a continuing education program—because training is not just a one-day, one-time thing, and all of us, I think, in the industry have our training programs, but there is no comprehensive sort of umbrella organization, standards.

I have looked at the Employment and Training Administration at Department of Labor (DOL), and I do not believe I can find the word "shipbuilding," and in a sense, welders are welders, but in another sense, I think we should try to develop a professional class of shipbuilders. We are doing it at Aker. We have a four-year program, and we want to train the guys and keep them for their whole lives, but I think there would be a valuable investment in focusing on attracting and bringing people in, and it is not just peculiar to shipbuilding. The entire industrial base in this country is suffering sort of a labor shift, but you know, that certainly comes to mind as an area that would be very fruitful and profitable to put together.

Mr. TAYLOR. This is a modification of a question posed by Mr. O'Rourke. His question would be has anyone been able to quantify the savings that resulted from the investments that were made at Avondale and NASSCO as far as the reduced price to the Navy for the ships that were built there. I would think that that would be a powerful point to be made if anyone has ever made—yes, ma'am.

Ms. BROWN. Let me say, Mr. Chairman, I do not have those figures here with me, but we will get back to you for the record if I could, but could I also expand on that as you just opened the question up that, other than Title XI, what could be done to rebuild our shipyards, our Merchant Marine in this country? I am going to go back to something that you know very well, and it is how do you get more volume of ships into your shipyards.

Mr. Bowman talked about not narrowing the field of giving a priority category under Title XI. I think that, you know, we need to look at that. There is a Jones Act. We need to hold that. That is what Title XI can help to do, but if we are going to expand the universe, if you look out internationally, there are 2,000 ships every year being ordered, oceangoing ships. If we could increase the percentage of our market share—and you do not have to take a large part. We do not have to go back to the 9 percent before the construction differential subsidy was eliminated—but if we could get 4 percent, just think about how many ships that would equate to of being built every year in this country. But we are never going to capture that market from standing still to get there unless there is a subsidy program of some nature put into place so that we can

attract equal—the lowest price because the commercial market chases the lowest priced bidder, and we have got to be able to have a subsidized price to equal the Chinese cost because they are dictating the market, and that is an unpopular thing to say, but it is the reality of expanding the marketplace.

Mr. TAYLOR. Mr. Bowman.

Mr. BOWMAN. May I add to that and say—look, it is really not rocket science. We have done it before, and here I may sound a little apologetic, but if you go back to the 1970 act, if we had had a coordinated program that involved a construction differential subsidy to make the price of a ship equivalent to the international market price, an operating program, a guarantee program that financed the ship, and a tax program that Mr. Cook alluded to today. That worked for 10 years, and in that time—I just happen to have some old data with me—in 1969, we built 10 ships for the international trade markets in the United States. Those programs built ships and took up the slack when the military program was not in effect, but now what happened.

In 1980, the Reagan Administration cut the connection with the construction program. All of the yard capacity was dedicated to military programs, and now that the military programs are winding down, we do not have the mechanism in place to penetrate the international market. So it can be done if you want to. Maybe there is not enough money to do it, but——

Mr. TAYLOR. Mr. Bowman, the Chair has noted on previous occasions the irony of the Reagan Administration's taking our shipyards from some government dependence to total government dependence——

Mr. BOWMAN. Precisely.

Mr. TAYLOR [continuing]. Lessening the dependence on the taxpayer.

Mr. RAYMOND. Mr. Chairman, if I might add just one thing, that is on the maritime security program, I believe if more true U.S.-owned companies were participants in the MSP program that the ability to build a common-sized vessel for the international support of our fleets and for the Jones Act would ultimately make the shipyards more efficient as well.

Mr. TAYLOR. I want to throw this open to the panel because, again, I have been fortunate enough to serve for a while. I know that there will be people—the Wall Street Journal comes to mind; the Financial Times comes to mind; the Administration comes to mind—that would say, "Well, here they go again," and they undoubtedly will point to the American classic lies. My memory, which is far from perfect, is that at the time that that program was abandoned, which was shortly after 9/11, people looked at a snapshot or this Administration looked at a snapshot—and when I say "snapshot," just for a matter of months—of the downturn in the cruise ship industry, which had been growing astronomically prior to that, and said this is not a viable business deal. They not only chose to pull the plug on it in addition to Mr. Zalpo's pulling the plug on it, but our Nation still could have finished them, and if my memory is correct, they sold the ships for scrap at a time when the price of scrap steel was at rock bottom even with just—if they had waited just a few years to sell them for scrap, the price would have

gone up dramatically, but it has always been my opinion that if they had finished the ships then within two or three years of the events of 9/11, the cruise ship industry would have recovered, and they could have sold those ships almost for the value of the cost of building them.

You are the experts. I would like to hear your thoughts on that because that question is going to get asked, and I would like to hear your answer to that question.

Mr. COOK. Well, Mr. Chairman—and all of us here on the panel, I think, can agree—that those two ships are, in fact, operating today in the Hawaiian Islands as cruise vessels. They were sold abroad; they were completed abroad and then brought back, and if that is not the proof of the pudding of your proposition, I do not know what is.

Mr. TAYLOR. If my memory is correct, they were finished in Germany——

Ms. BROWN. Correct.

Mr. TAYLOR [continuing]. Which is not a low-wage nation.

Ms. BROWN. No. They were towed—one was towed to Germany for completion, and then the parts for the second one that were sold to the same were taken also to Germany.

Mr. TAYLOR. Okay.

Mr. Larsen.

Mr. LARSEN. Thank you, Mr. Chairman. Just a few points, one point and one question. I want to clarify my comments as well.

Mr. Graykowski clarified the past history. I was only trying to make a point about the reference to the Clinton Administration because it is usually everything bad that happened around here happened in the 1990's unless it helps someone's argument, and my only point is whatever happened in the 1990's happened in the 1990's. I do not care. We have a problem now, and we have to be focusing on that problem.

Mr. Cook, I apologize I had to step out, but while I was stepping out to meet with a constituent, you were just talking about financing for shipping in the petroleum industry, and one of the questions I had had earlier from Mr. Connaughton is, is there a difference between and why is there a difference, if there is, between financing shipbuilding in the petroleum industry versus other elements of the shipping industry?

Mr. COOK. Well, there is an enormous difference, and there are several reasons for it.

One is if you have vessel users in the petroleum industry or investment grade credits. Whereas, our U.S. flag carriers in our foreign and coastwide trades are generally not investment grade credits.

The other element is that, in the petroleum industry, many of the vessels are financed with long-term charters. I have done petroleum financing now for over 30 years, and I was doing financing in the mid–1970's in the petroleum industry without Title XI, and if you look at the Aker Philadelphia transactions that are being done now, the vessels that are being turned out—the first four vessels that were turned out—are on charter to Shell Oil Company and British Petroleum (BP). When you have that sort of credit available and you have long-term charters available, you do not

need Title XI. When you are building container ships and Ro/Ro's and serving an uncertain market without long-term charters, you do.

Thank you.

Mr. GOTTLIEB. I agree with what Mr. Cook said.

Within the petroleum industry, the ultimate sponsors for those vessels are the major oil companies. When the major oil companies will contract for those vessels under long-term contracts, whether it be three years or five years or seven years, the financings are based on the strength of those oil companies and those contracts.

Mr. LARSEN. Is that function essentially kind of creating a vertical integration because they are contracting for the ship, itself, on a long-term basis as opposed to in the container industry? In the container industry, the person shipping the container does not own the ship as well usually.

Mr. GOTTLIEB. Well, the difference, sir, is the fact that in the petroleum industry the trades are really point to point. The oil is not where it needs to be. The oil coming out of the ground is not where it is being refined. The oil where it is being refined is not where it is being consumed. So these are point-to-point type trades. They tend to be the contracts of long-term charters. In a liner trade, as Mr. Raymond can say, the ship leaves the dock every Tuesday at this time whether it is full of containers or whether it is half full of containers or whether there are no containers on it. So it is a whole different kind of a trade with the economics supporting the underlying asset. It is either by contract or by expectation. I think that is really where the difference is. In the oil trade, it is really just basically, they say, by contract with very strong counterparties at the other end of the contract.

Mr. LARSEN. Ms. Brown.

Ms. BROWN. It gets back to the fact that it is not the product that the vessel is carrying. It is the pockets, the wealth of the owner-operator, to the money that is financed or who has access to the financing of the product. Independent tanker operators who are small, independent companies that do not have a long-term charter with a major oil company are not going to have the same difficulties getting financing in the commercial market, just like a container ship operator. So it really comes down to the strength, the financial strength, of the owner, the buyer, that company, rather than the type of vessel being financed.

Mr. GRAYKOWSKI. The first deal—again, the voice of history here. The first deal we did, as I recall—yes, probably the first was American Heavy Lift, which was, as I recall, the first company, oil transportation company—product tankers—that was going to be eliminated and made extinct by OPA 90, and we did a deal, an innovative deal in my view, and Avondale Shipyard put four bodies on an existing power plant. The ships are still in operation, are paid off, have continued to pay off. The next tanker deal we did was with what is called the Elliottson Corporation, which was going to be an export deal to a very prominent Greek oil transportation company, through a number of evolutions. One of the ships went to Mobil Oil. Another went to—right now Sea-Bulk owns it. Those are Title XI transactions.

As Ms. Brown alluded to, the market shifted, the oil market. Back in the 1990's, there was a predominance of spot trading, and very few—companies were not going long because they could shop around, and you would get the best price out of operators. That has slowly and finally flipped. So, in recent years, more of the majors—Shell, BP, Chevron, and such—will go long, and you can use that charter to finance construction in the private market, but if you are operating in the spot environment, I would have to—I mean I believe Title XI is a lot more attractive financing than a commercial if you are on the spot basis.

Mr. LARSEN. Do you mean to say in the U.S. market?

Mr. GRAYKOWSKI. Yes, sir. The Jones Act.

Mr. LARSEN. Yes, the Jones Act.

Thank you, Mr. Chairman.

Mr. TAYLOR. The Chair recognizes the gentleman from Maryland if he has any questions.

Mr. BARTLETT. I want to apologize for my absence. Things are not traditional on the floor today, and I did my 25th one-hour on a problem which will involve you all probably more than almost any other element of our society, and that is energy and oil and so forth since we use a lot of it in our big ships, and so forth. So I apologize for having to go to the floor to do that.

Is it going to be feasible in the future to have enough participants and a big enough program that there will be enough assurance that we are not going to lose money on the guarantee? Almost everywhere else—I am on the Committee on Small Business. We have lots of loan guarantees in Small Business and various programs in Small Business, and usually we are talking about cutting the rate. We have pretty low rates to begin with, but the recovery of those loans is so efficient that we are talking about, gee, we need to cut the rate because this is not supposed to be a money maker for the government. We are supposed to help spread the risk, which is what these things are supposed to do.

Is there a reasonable probability that we can have a big enough base and we can supervise the risk so that this can be a defensible program again?

Mr. COOK. Mr. Chairman and Mr. Bartlett, I can say that if past history is a guide the answer is yes. The Title XI program as administered during the 1970's and really right up until the last ten years or so has been, by and large, a money maker for the United States Government, and it should be. It is essentially a mortgage insurance program. You purchased an insurance policy. You paid the Maritime Administration a fee, and that fee for many years was sufficient to pay for the Administration of the program and to cover the defaults and to return a profit to the government. To do that, you need volume. It is hard to predict the future with volume, but we have a situation where if we do not do something it is not going to make money, and it perhaps may go away. If we put the program back into operation, if we have leadership from this Congress, we should be able to get a volume of transactions that will be such that that program will not cost the taxpayers but will be run at a profit.

Mr. RAYMOND. Mr. Congressman, if I could just add my comments on that from my line of perspective. We are operating 16

vessels today. With our competition between Alexander & Baldwin and the Saltchuk Group and Crowley, they have approximately another 18 container ships, so that is about 34, 35 ships. There are only four of those that have been built within the last 15 years. So there is a very defined market there. The vessels that will have to replace those ships will be used in the noncontiguous offshore trades serving Alaska, Hawaii, Puerto Rico, and Guam. Those markets depend upon efficient ocean transportation. We are their lifeline. Our company alone carries about 37 percent of all of the cargo that moves between the lower 48 States and Hawaii, Alaska and Puerto Rico. So you could almost look at this business as a utility. The difficulty in getting financing is that the cost of the American ships is very high. For us to replace five ships today would be on the order of magnitude almost equal to our market capitalization. The issue comes out that if a commercial bank were financing our ship and for whatever reason we were to default, then they would only have two or three customers to go to try to place those vessels, and they would not be fungible on the international markets, as was pointed out earlier, so the lending institution would take a heck of a hit, and that is why the numbers of basis points that you pay for commercial lending without Title XI adds up to significant dollars over time when you are talking about a 25-year financing. When you are talking about vessels that cost in the range of $125 million to $200 million and for the series that we are talking about, there is a lot of money that the residents of Hawaii, Puerto Rico, Alaska, and Guam and also the consumers in the U.S. who are buying the products that are shipped from there are going to have to pay for no good reason.

Mr. BOWMAN. Could I just add to that?

I think in order to get a true diverse profile, though, you need to go beyond the Jones Act trades. I mean that is one of the problems. In the past, we had a wide diversity because we had penetration in the international shipping markets which was made possible by the Construction Differential Subsidy Program. Now, certainly, there is a wide market in the Jones Act, but it still is limited American trade with, by international standards, a small number of ships. You really have to try and expand the shipping program, the shipbuilding program, beyond the Jones Act and include the offshore services industries—it is the same shipyards—and you have got to broaden the base and the shipyards. The shipyards have to do some of their part, too. They have got to address this cost issue because it has been a problem we have struggled with, as I said, for 100 years, but as long as the ships are two and even more times as expensive, you are not really going to get any penetration in the international market.

Mr. RAYMOND. Mr. Chairman, on that point if I might add just an observation. I was the Chief Operating Officer at Sealand Service for about 12 years, and at the time that we sold the company to the international piece, we were operating about 110 ships. We had bought them all over the world. In my view, there is absolutely no reason why American shipyards cannot be competitive absent the issue of subsidies from foreign governments that was pointed out, I believe, earlier.

What is going to be necessary, though, is for there to be a stream of construction projects that build vessels of a like kind and that enable the shipyards to apply technology in a way that the foreign yards do. That is why when you went to Korea you saw a Hyundai or a Hanjin building vessels in series. We are building ships right now for an international trade that are being built in 133 days from keeling to delivery. They are the 30th, 31st and 34th vessels of that series, so they have it down. It is like buying a suit off the rack. When somebody has already built 1,000 of those, they have got the dimensions right. The buttonholes are right. Whereas, if you go build one of a kind, then you have a huge learning curve. You have the risk during construction as well as the risk after construction that we did not get it right, which makes it very difficult for the shipyards.

I think that the best example of what the shipyards can do in the U.S. is look at the automotive industry and look at what happened when we partnered the U.S. manufacturers and the U.S. labor with foreign entities that had it down, with the Toyotas, with the Hyundais and others, that today are building cars in the United States. We are building them in Marysville, Ohio, and we are shipping cars out of Marysville and selling them in Korea. There is no reason we cannot tackle that, but the answer is going to be that you are going to have to apply the techniques that they use in the international yards, partner with labor to get that done, but be able to show labor a stream of construction projects that, to them, makes sense.

Thank you, sir.

Mr. BARTLETT. Mr. Raymond, thank you for your answer.

The chairman and I have gone to shipyards all over the world—in Europe, in Asia and in this country—focusing on the challenge just as you presented it, and the reason for my question was, obviously, if the only commercial ships we ever build are Jones Act ships, that is probably not going to be a big enough base to justify this program, and we represent a fourth of the world's economy, and we represent a tiny fraction of the world's commercial shipbuilding, and if we can compete with foreign—if we can compete in heavy equipment and if we can compete in auto manufacturing, why can't we compete in shipbuilding? I think we can, and I appreciate your counsel as to the kinds of things we need to do to get there.

We went to the big yards. We went to Hyundai. Is it the biggest in the world? Yes. I was stunned. They build their own engines. You could live in one of those engines. They were three stories high. You know, you have a big living room, kitchen, dining room, and several bedrooms inside one of those big engines, and I think—what?—40 percent of all of the screws in the world are made there in Hyundai heavy industry, and we hope that we can do something so that we can become competitive, and for a large number of reasons we need to. That is for national security reasons we need to do that, and I think that this commercial shipbuilding, if we can exploit this appropriately, will bring down the cost of our military ships, and we have got to do that. Just everywhere we look there are challenges in that, and we have got to do that, and if everybody is focused on it, I think we can.

Mr. Chairman, there is something that we might explore, and that is another hearing in which we have experts in who do not have a vested interest so that we can get counsel as to whether or not we ought to reestablish this Title XI program. We certainly need the capability to build these ships, and if the loan market out there will not make the loans without the guarantees, then, you know, we have got to make the guarantees.

Mr. TAYLOR. Mr. Chairman, if you have a suggested list of witnesses——

Mr. BARTLETT. I will ask our panel if they have suggestions of witnesses of whom nobody could argue they are honest brokers.

Mr. GRAYKOWSKI. Well, I am confused by—you know, you want to hear from people who actually are involved in shipbuilding, and I mean I have worked in a yard; I have been a lawyer, and I have worked in the government, and that is a perspective. I mean, am I biased? Yes, I am biased for U.S. shipbuilding, but you know, there are a lot people who you could find out at OMB who would have a distinctly different view than I do of this program. I can assure you of that. They were there when I was there at MARAD. So I do not know who the, quote, "honest brokers" would be. I mean you have to accept the premise that shipbuilding is important, essential, critical, and any other adjective you want to say, to this country.

Mr. BARTLETT. Congressional Research Service (CRS), Government Information Office (GIO), as examples, and obviously, we have to use our judgment because you can get different stories, as many as you want.

Mr. GRAYKOWSKI. But, Mr. Bartlett, I do not mean to quarrel with you. It is just that in the policy world shipbuilding is an anomaly, the Jones Act. There is not an economist in the world or in this country who is going to tell you the Jones Act is good, but the chairman knows it. I know it. Everybody here knows it, not just because it is good for business, but it is good for the country, but you know, you could have that type of a debate, but you know, off the top of my head, I do not know where you are going to find people who are not involved in the shipbuilding industry or in the ship finance industry who will sit here and say this is a good thing to do because it is good for the country, the world, people or whatever.

Mr. BARTLETT. I understand the Administration has zeroed this out. If we are going to fight for it, we just need as much support as we can in fighting for it.

Mr. COOK. Mr. Bartlett, I believe when you were out I made part of my presentation, and I pointed out that I had gone to my computer this morning and printed out a list of all of the container ships and all of the Roll-on/Roll-off vessels that have been built in this country since World War II, and what I said after having reviewed that list was that, in terms of Roll-on/Roll-off vessels, every vessel built in the United States since World War II, except for vessels that were built for the U.S. military, was financed with Title XI financing, and when I looked at the container list, I found that every vessel, every container ship that had been built in the United States since World War II with the exception of two very recent vessels from Matson Navigation, which has Alexander & Baldwin

as a parent that can provide parent company guarantees—every one of those ships was built with Title XI financing. So while I think it is very interesting that the Maritime Administrator can talk about the availability of commercial financing, I do not know where it is. Perhaps there is something secret that these other people are unaware of.

Mr. GRAYKOWSKI. Can I say just one other thing? I know I have been talking more than anybody.

Mr. Bartlett, when I was at MARAD, we did 400 different vessels. We financed 400 different types of vessels, and sometimes people just think of big ships, which are important and, frankly, great things to watch and be part of building, but sort of the bread and butter of this program, in my view, are all of the barge guys, guys in your district and along the coast who are, in large part, family-owned companies who need new equipment or they keep the old stuff going way longer than they should or they are folks with catamarans; it is drill rigs; it is oil service vessels. So, in terms of spreading the risk, there were 80 projects in seven years, big yards, small yards, big vessels, small vessels. The portfolio was spread, and I really believe that the market here is sufficient, if you include these types of vessels, to support the program and meet your objectives of minimizing the risk.

Certainly, getting back to the export market, in fact, we did export vessels and do today certain types—oil service being a good example—and we did export deals under Title XI, but the issue, as Mr. Taylor knows full well, of why we are where we are as a shipbuilding industry and as a shipbuilding nation, that is the subject of a long hearing and, in a sense, a philosophical debate. There are a lot of problems that got us where we are today, and it is going to take a lot of different activities to get us out of the hole we are in today.

Mr. BARTLETT. Well, we believe that the more ships our country builds, the cheaper we will be able to get our military ships. Anything that helps us build more ships we think moves us down the right road.

Thank you, Mr. Chairman.

Mr. TAYLOR. Thank you, Mr. Bartlett.

I want to thank all of our panelists for being here. I hope you know that we want to make this happen, and I hope—so my last question would be—Ms. Brown was the only one to actually throw a target figure before the committee when she said $60 million would create $1.2 billion worth of loan guarantees. I feel like, with the cooperation of Mr. Bartlett, that that would be an achievable goal coming out of this subcommittee.

My question is—and I would open it up to the other members of the panel—is that a realistic goal to shoot for? Is that something for which we know we would have to have the cooperation of the Appropriations Committee as well? I would like to open it up to your thoughts as to what that number should be given the PAYGO rules of this Congress and of the situation that exists.

Mr. RAYMOND. Mr. Chairman, one thing I would mention is I do not know if $60 million is right or wrong. I think it is a very, very significant number in terms of what that can generate, but I believe we are talking about a multiyear program here that is very

essential for our company, and I know for the other Jones Act carriers that they can talk to their customers; they can talk to their investors and explain to them that there is an ability to replace this fleet and also talk to the U.S. military that there is an ability to replace this fleet with the appropriate kinds of ships. So, you know, taking advantage of a flash-in-the-pan program for 1 year versus 2, 3 or 4 years does not allow that stream of vessels of a like kind to be planned for which translates into a tremendous benefit for the shipyards so that they can gear up for a long-term plan and get the economies to scale and be competitive perhaps on other types of vessels.

Mr. TAYLOR. The other question I would pose to you is if you were to adjudicate—well, if you were to dispense this money, how would you do so in comparison to the ship acquisition versus yard modernization, because the one thing that the chairman's trips to Maersk and Hyundai left me with is that at least of the American yards I have seen we are decades behind them.

Mr. RAYMOND. I believe they go hand in hand, but I will pass that to Ms. Brown.

Ms. BROWN. May I just add?

Of the Title XI loan guarantees in the 1990's after your shipbuilding initiative with Herb Bateman that initiated, there were guarantees for shipyard modernization. The Avondale Steel fabrication facility that they called the "factory" was financed with Title XI. In NASSCO, there was a facility to enhance pre-outfitting capability there. So, of Title XI, those are the examples that I am personally aware of because of my familiarity and of who I represent.

I will say that today, though, since those shipyards are no longer independently owned, they probably would look to other—they can still use Title XI, but I would say that they may still look more internally to their corporations, but it is a factor.

Mr. TAYLOR. Mr. Graykowski, to answer my own question, should that discussion be left entirely to MARAD? Because my heartburn is that MARAD is apparently not supportive of this idea at all.

Mr. GRAYKOWSKI. Number one, in terms of the amount of money, Mr. Chairman, do not put a dollar into Title XI without changing the way the applications and the Credit Council and the other nonsense works, okay? Please, and that is a statement against interest, you know, because I love the program, but do not do it. I ask you.

Number two, originally back in the 1990's we funded it, at least in part if not in whole—I cannot remember the exact split—with 050 money, and I know that there are problems in the DOD budget, but we crosswalked it over because of the recognition of DOD, you know, the intersection of Navy shipbuilding and this, so that was part of the funding.

Number three, in terms of Capital Expenditure (CAPEX), it is a crying need as you have identified. Two years ago, in H.R. 3506, they passed the Small Shipyard Assistance Act, which is a CAPEX program—Ted Stevens did it—which contains grants. Grants would be a great way to do it because you can leverage against it, but I think, given the way that MARAD sometimes blows hot and cold, if you will, or is somewhat ambivalent at times on where they are

going on this program and the more direction they receive from the Congress, perhaps that would be better. I know I was responsive when I read legislation on perhaps putting the split in, but you know, we need to leave flexibility to the agency because we beg people for shipyard modernization all the time. We got NASSCO. We got Avondale. I did the deal with Dick Fortman, but not a lot of guys took advantage of it at that time, and so the money would flow. So, you know, I am a little leery of actually putting a wall and a fence between the two.

Mr. TAYLOR. Okay. Mr. Gottlieb, Mr. Bowman and then you if you do not mind, sir.

Mr. BOWMAN. Yes. I would like to take a little different view.

I think, in today's PAYGO world you have so little flexibility in terms of the money that you are not going to get shipyard modernization unless they see a real market, unless they see the throughput, the customer there to buy the ship. To the extent you take this money and divide it among modernization and throughput, you are not going to get enough applicants, and the result is that the modernization is going to be done but it will get done for the benefit of the Navy, really, who will use the same facilities for the Navy.

Ms. BROWN. It will not be there to build ships.

Mr. BOWMAN. Right. So I think a small amount of minimized yard modernization because, as Ms. Brown says, people who see a market—these people, the big shipyards, have plenty of wherewithal to build the markets, but they have to see a market.

Mr. TAYLOR. Mr. Gottlieb.

Mr. GOTTLIEB. Mr. Chairman, back to your question on the numbers, $60 million is a lot of money, but in some of my calculations—and maybe Mr. Raymond can help me here—I look at the dry cargo fleet over the next 10 years or so, the Jones Act dry cargo fleet, and I see 15 to 20 replacement vessels. If you think that the average cost of that in today's dollars is $150 million, you are talking about a $3 billion requirement. $60 million really does not get you to $3 billion.

The other thing is I would get back to Ms. Brown. Historically, the multiple factor for Title XI versus the amount of subsidy was 20 to 1. We have not seen that for a while, Mr. Chairman. As for the most recent program that was approved by the Maritime Administration—the ferries for Hawaii—the subsidy factor was a fraction of that 20 to 1.

Ms. BROWN. That was because of the Credit Council.

Mr. GOTTLIEB. Well, that was because of the Credit Council, and that was because of OMB. OMB came in with a new subsidy calculation, as I understand it, and the multiple factor was in single digits, not 20 to 1.

Mr. TAYLOR. Mr. Bartlett, the Chair recognizes in the room—and I do not recognize everyone—but two experts in the field, one being Mr. Ronald O'Rourke, who works with the Congress, and Mr. Jerry Lamm, who is a shipbuilder, and I would like, with your permission, to ask unanimous consent that they be allowed to submit additional comments since we did not have an opportunity to have them as a part of the record. Again, I think what they have to say is worth hearing with your approval. It would be for the record.

Mr. Bartlett, without objection?

Mr. BARTLETT. Oh, absolutely.

Mr. TAYLOR. Okay.

Anything else? Again, we very much appreciate all of you being here. We regret the late start, but I certainly think it was worth hearing, and I very much appreciate your attendance.

The committee stands adjourned.

[Whereupon, at 4:25 p.m., the subcommittee was adjourned.]

A P P E N D I X

March 15, 2007

PREPARED STATEMENTS SUBMITTED FOR THE RECORD

MARCH 15, 2007

DEPARTMENT OF TRANSPORTATION

STATEMENT OF MARITIME ADMINISTRATOR

SEAN T. CONNAUGHTON

BEFORE THE

SUBCOMMITTEE ON SEAPOWER AND EXPEDITIONARY FORCES

OF THE

COMMITTEE ON ARMED SERVICES

UNITED STATES HOUSE OF REPRESENTATIVES

ON THE

TITLE XI PROGRAM

MARCH 15, 2007

Good morning, Mr. Chairman and Members of the Committee. It is indeed a pleasure to be here today to discuss the Title XI program, which is administered by the Maritime Administration (MARAD).

As most of you know, the Title XI program provides for a full faith and credit loan guarantee by the federal government of private sector debt incurred for the construction or reconstruction of ships in United States shipyards. Loan guarantees can also be issued for the modernization of American yards to make them more competitive. The Government can provide a guarantee up to 87 ½ percent, depending on the type of project. Companies must provide equity for the remainder and security to the Government. The company has to meet strict financial requirements and the project has to be economically sound.

The Title XI program was created to promote the growth and modernization of the U.S. merchant marine and U.S. shipyards by enabling eligible companies to obtain long-term financing on terms that would otherwise be available only to the most creditworthy concerns. The term of a Title XI loan guarantee can extend to 25 years and the Government backing of the financing makes it possible for a company to lock in an attractive interest rate for this period.

At this time, the Administration does not request funding for Title XI because it believes this program is a form of corporate subsidy, and that shipowners and shipyards should rely on their own creditworthiness to obtain financing in the

private sector. Further, the taxpayers should not bear the risk of default by private companies.

However, I want to emphasize at this point that our position on the Title XI program should in no way be misconstrued as a lack of support for the U.S. shipbuilding industry or U.S. shipowners. This Administration is on record as staunchly championing the Jones Act in order to protect their interests. We simply believe that Title XI is an unwarranted intervention in the credit market.

Although the Administration has not requested funding for new loan guarantees since 2001, Congress has periodically appropriated money for this purpose. In implementing Congressional direction, we have used these funds to finance projects that we believe will yield the greatest benefits to our economic and national security. The most recent project we approved was two passenger and vehicle fast ferries for Hawaii SuperFerry. The total cost was $180 million for both with Title XI guarantees at $140 million. The ferries are under construction at Austal Shipyard in Mobile, Alabama. The first will be delivered at the end of this month and the second in February of 2009. We financed a similar vessel, which began operating in 2004 across Lake Michigan.

These ferries are state of the art and highly suitable for use on America's Marine Highway system. In choosing to finance the ferries, MARAD is promoting a vessel type that can be used to relieve highway congestion by providing an attractive marine transportation alternative. The ferries are also militarily useful and TRANSCOM has expressed an interest in them. The Hawaii SuperFerry vessels will be offered for enrollment in the Voluntary Intermodal Sealift Agreement, or VISA, program.

At present, we have an outstanding portfolio of $2.9 billion in loan guarantees covering the modernization of American shipyards as well as a wide variety of vessels: ferries, tankers, drill rigs, passenger vessels, dredges, supply vessels, tugs, RO/ROs, containerships, tugs and all kinds of barges. Title XI is represented in just about every market segment in the maritime industry.

We are very proud of the fact that we have notably improved our management of the Title XI program since audit reports were issued in 2003 and 2004 by the General Accounting Office, now the Government Accountability Office, and the Department of Transportation's Office of the Inspector General. MARAD has taken the steps we believe are necessary to address the audit recommendations. Let me highlight some of the major areas of improvement:

- We have established requirements for an independent outside application review when necessary;

- We have instituted a formal financial monitoring process with a credit watch report for regular financial monitoring of Title XI borrowers;

- We have developed a regular physical condition report system for Title XI vessels;
- We have revised our credit risk methodology;
- We have tightened our fund disbursement procedures; and
- We are in the process of implementing an electronic financial monitoring system, which will significantly enhance management of the existing portfolio and future financing activities in the Title XI program.

In addition to the steps MARAD itself has taken, the Department of Transportation has instituted a Credit Council to provide financial oversight for all of the Department's credit programs, including Title XI. This has provided another valuable avenue of review for loan guarantee applications, significant financial transactions with existing borrowers, and portfolio monitoring.

We are very pleased to report that our program improvements have been recognized. In his November 15, 2005 report on the top management challenges facing the Department of Transportation, the DOT Inspector General stated that the "Title XI loan guarantee program is functioning effectively." He went on to note that MARAD now systematically monitors its loan portfolio and that creditworthiness overall has improved.

In addition, the Title XI program went through a PART assessment last year, as mandated by the Office of Management and Budget. PART stands for Program Assessment Rating Tool, and is a stringent diagnostic process that OMB uses to assess the performance of Federal programs. Title XI received a final PART score from OMB that indicates that the program is considered to be moderately effective.

In conclusion, the DOT Inspector General's comments and the PART score clearly demonstrate MARAD's diligence in implementing recommendations for improved program management. Moreover, I am confident that MARAD is now positioned to continue to administer the program in such a way as to maximize the benefit to our national and economic security while protecting the Government's financial interest.

I want to thank the Members of this Committee and Chairman Taylor for holding this hearing today. I will be happy to answer any questions you might have.

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Statement of

Ms. Cynthia L. Brown

President

American Shipbuilding Association

Before the

House Armed Services Committee

Subcommittee on Seapower and Expeditionary Forces

March 15, 2007

Thank you, Mr. Chairman, Members of the Subcommittee, for the opportunity to testify on the importance of the Title XI Ship Loan Guarantee Program in facilitating commercial ship construction in the United States.

The American Shipbuilding Association (ASA) is the national trade association of the six largest shipbuilders in the United States that build all of the capital ships for the U.S. Navy, and which have a long history in the construction of large oceangoing commercial ships. ASA also represents more than 70 companies that design, manufacture, and service major ship systems and components. A membership list is attached.

The Federal Ship Financing Program was established pursuant to Title XI of the Merchant Marine Act of 1936. As amended, the Act provides for a full faith and credit guarantee by the U.S. Government of commercial loans issued to U.S. or foreign ship owners for the purpose of financing the construction or reconstruction of vessels in U.S. shipyards. The program also guarantees debt obligations of U.S. shipyards for the purpose of financing advanced shipbuilding technology and facility modernization.

Following enactment of the Federal Credit Reform Act of 1990, appropriations to cover the estimated costs of a project are required prior to the issuance of any Title XI financing guarantee. Title XI guarantees 87.5 percent of a commercial ship financing loan for a period of 25 years. The program has a 20 to

one multiplier – meaning that for every $1 million appropriated for the program $20 million in ship construction is generated in the U.S. economy.

The Maritime Administration (MARAD) of the Department of Transportation charges a number of fees to applicants. There is a non-refundable filing fee of $1,000 when an application is filed. Prior to MARAD issuing a letter of commitment, an investigation fee of one-half of one percent on obligations to $10 million, and 1/8 of one percent on all obligations in excess of $10 million is charged to the applicant.

Today, this program is urgently needed for small and medium-sized U.S. ship owners and operators to secure affordable financing over 25 years for the purpose of replacing their aging Jones Act fleets with new ships built in our shipyards. Without Title XI, the majority of Jones Act ship owners will not be able to invest in new tonnage, and thus, desperately needed commercial shipbuilding orders will not materialize for our industry.

The Jones Act fleet numbers 105 oceangoing ships, which carry oil and dry cargo between U.S. ports. The average age of this fleet is more than 22 years when the normal economic useful life of an oil tanker is 20 years and a dry cargo ship is 25 years. Many of the ships in this fleet are well over 30 years of age. These ships need to be replaced to ensure that the United States has the ships necessary to meet our energy distribution and economic needs. Modern tonnage is also needed to ensure the safety of domestic waterborne transportation.

Benefits of Commercial Shipbuilding Made Possible by Title XI:

The construction of oceangoing commercial ships in the United States made possible by Title XI loan guarantees has many benefits for the Nation:

First, it helps American shipyards retain and grow our highly skilled engineering and production workforce, which is vital to the building of ships for the U.S. Navy and Coast Guard.

Second, increased ship production provided by commercial orders reduces the cost of U.S. Navy and Coast Guard ships because the shipyards are able to spread their overhead costs over a larger universe of ships -- costs which would otherwise be covered exclusively by the U.S. Government. The cost of ships built for the government is also reduced by stabilizing our workforce. Persistently low and unstable rates of Navy ship construction have resulted in large, costly swings in the workforce in our industry. When government shipbuilding programs are delayed or reduced, the shipyards are forced to layoff their highly skilled workforce to later recruit and train or retrain a workforce when an order arrives. It takes three years and a minimum of $50,000 to train a ship welder, for example, to minimum proficiency levels. The huge costs and time required to train a skilled workforce increases the cost of every ship we build. Stabilizing our workforce with a mix of Navy and commercial orders allows us to avoid these costs and greatly enhances our efficiency in building ships by being able to retain our experienced workforce.

Third, building commercial ships facilitates the introduction of best commercial building practices into Navy and Coast Guard programs, which can equate to increased production efficiencies and reduced costs.

Fourth, commercial oceangoing ships built for American ship owners are available to the Department of Defense in time of war or national emergency. For example, the six tankers financed by Title XI and built by Newport News Shipbuilding in the late 1990's were called into service for DOD in the Iraq war to transport jet fuel to our forward deployed forces. Commercial roll-on/roll-off and containerships are also needed by DOD. Without American-built and –owned ships, the U.S. is dependent upon foreign ships for the re-supply of our troops.

Fifth, commercial ships built in the U.S. are built to the highest safety standards in the world. As one example, the double hulled tankers that U.S. shipyards have built subsequent to the Oil Pollution Act of 1990 are the most environmentally safe in the world. These ships were designed and built with redundant propulsion plants, controls, and other equipment to guard against a mechanical failure that could also result in an oil spill.

Recommendations for the Title XI Program:

The Title XI program was established to give ship owners and operators access to long-term, affordable financing that they could not otherwise find in the commercial market without a loan guarantee. The program was designed to ease the risk of commercial lending institutions with the Government assuming that risk

in order to facilitate financing for smaller and medium-sized companies comparable to that available to large corporations. If all ship owners and operators were large corporations with deep pockets, there would be no need for Title XI. The program was designed to address financing needs of companies where there is some risk. ASA strongly supports limiting the Government's risk exposure. A default is not in the program's interest, nor in the industry's interest. However, in the name of risk reduction, there have been multiple regulatory restrictions imposed on the Program by this Administration making it very difficult for any applicant to be approved.

In light of these regulatory handcuffs, ASA asks the subcommittee for its support in not only funding the Program, but also in amending the Program to establish a priority category for certain ship loan applications and an accelerated review process for these applications.

No money has been appropriated for the Title XI Program since fiscal year 2003 when Congress provided $25 million in the Emergency War Supplemental. Without funding, no loan guarantees can be issued by the Maritime Administration. As stated earlier, without Title XI guarantees, the majority of Jones Act ship owners will not have the financial means to replace their fleets. If ship owners don't have access to affordable financing to introduce new, modern tonnage in the Jones Act trade, there will be increased pressure to repeal the Jones Act to allow foreign tonnage to carry America's coastwise commerce. Should that

happen, there will be no commercial shipbuilding market left for American shipyards in the absence of a commercial shipbuilding subsidy program to offset years of subsidies provided to foreign shipyards in Asia, which have allowed those shipyards to corner the commercial shipbuilding market.

Without commercial work, the risk increases for losing more U.S. shipyards that comprise the core shipbuilding industry necessary for the Nation's defense. Furthermore, the cost of naval ships will increase. The American Shipbuilding Association encourages Congress to authorize and appropriate $60 million for the program in fiscal year 2008. This funding would generate more than $1.2 billion in commercial ship construction.

In addition to funding, there is a need to add in the statute a priority review and approval process for traditional applications to expedite the financing for replacement tonnage serving the Jones Act. ASA asks the subcommittee to consider an amendment, which would add a new priority for loan guarantees for replacement vessels under section 53743 of the Merchant Marine Act. Section 53743 of the statute was added in the Oil Pollution Act of 1990 to govern priority applications for Title XI guarantees for replacement vessels due to changes in operating standards as a result of double hulls. For an applicant to receive priority under this proposed new category, the applicant would have to be an established vessel owner and/or operator in a proven market; the application would have to be for the construction of replacement tonnage for vessels over 20 years of age, and;

the replacement vessels would have to be militarily useful to augment dedicated DOD sealift assets in time of war or national emergency.

Our recommended amendment, which is attached to my statement, proposes that applications under this new priority category be evaluated and processed by the Maritime Administration without the additional review of the Department of Transportation Credit Council. This recommendation is made to expedite the review process while still minimizing risk exposure to the Government given that the owners applying for guarantees under this category would be established ship operators in proven trades where the Maritime Administration has extensive knowledge and familiarity with the cargo demands. This amendment further recommends that the Maritime Administrator be directed to develop and apply to applications under this priority category a more broad-based financial evaluation other than the current regulatory uniform two-to-one debt-to-equity criteria alone. ASA recommends that the broader-based financial evaluation also take into account an applicant's cash flow performance and collateral assets in determining the applicants credit worthiness.

This amendment is needed because the Credit Council review has added months to an application review and approval process that heretofore took 60 days. More disturbing, is the appearance that the role of the Council is to deny new loan guarantees in reflection of this Administration's opposition to the Program. The Department purportedly put the Credit Council in place to guard against

applications being potentially approved that had high risk of default. Given that the applications under this priority category would be traditional applications from proven owners in proven trades, the risk of default is low. The Maritime Administration would be required to follow and apply all of the risk assessments, supplemental security provisions for default, and guarantee fees in the statute in its review and process of the priority replacement category applications.

In closing, thank you for having this hearing on the importance of the Title XI Ship Loan Guarantee Program in sustaining the defense shipbuilding industry of the United States. Your favorable consideration of my industry's recommendations for program funding and improvement would be appreciated. Thank you.

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Chesapeake, VA

Westwood Corp.
Tulsa, OK

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Winchester, NH

W & O Supply Inc.
Jacksonville, FL

York International
York, PA

NATIONAL DEFENSE AUTHORIZATION ACT FOR FISCAL YEAR 2008

DIVISION C—DEPARTMENT OF ENERGY NATIONAL SECURITY AUTHORIZATIONS AND OTHER AUTHORIZATIONS

TITLE XXXV—MARITIME ADMINISTRATION

SEC. 35XX. APPROVAL OF LOANS AND GUARANTEES APPLICATIONS.

(a) APPROVAL OF TRADITIONAL APPLICATIONS—Traditional applications under Loans And Guarantees (46 U.S.C.A. Chapter 537) shall not be subject to additional review or approval by any council, panel, board, group, or similar entity, or by an individual, beyond the scope of the Maritime Administration. For purposes of this section, any such application shall be considered traditional provided it involves a market, technology, and financial structure of a type that has been approved with applications in past instances by the Maritime Administration as of the date of the enactment of this Act, as determined by the Maritime Administrator. Any such application shall also be considered traditional if submitted for a vessel in accordance with 46 U.S.C.A. 53706(c) and 53734, as amended by this Act.

(b) Section 46 U.S.C.A. 53706(c) is amended—

(A) by striking Section 53706(c)(2)and (3) and inserting the following:

"(2) after applying paragraph (1), a vessel that is otherwise eligible for a guarantee and is a replacement vessel under section 53734 of this title, and

"(A) the applicant for the guarantee or commitment is an established vessel owner and operator in a proven market;

"(B) the vessel will be constructed in a United States shipyard, and

"(i) will facilitate commercial activities in the shipyard through efficiency gains associated with increased volume, or;

"(ii) will preserve shipbuilding assets essential in time of war or national emergency, and

"(C) the vessel will be militarily useful and could be used in time of war or national emergency;

"(3) after applying paragraphs (1) and (2), a vessel that is otherwise eligible for a guarantee and that the Secretary of Defense determines—

"(A) is suitable for service as a naval auxiliary in time of war or

national emergency; and

"(B) meets a shortfall in sealift capacity or capability.".

(c) Section 46 U.S.C.A. 53734 is amended—

(A) by striking Section 53734(a)(2) in its entirety and inserting the following:

"(2) the construction or reconstruction is necessary —

"(A) to replace a vessel that cannot continue to be operated because of a change required by law in the standards for the operation of vessels, and the applicant for the guarantee or commitment would not otherwise legally be able to continue operating vessels in the trades in which the applicant operated vessels before the change; or

"(B) to replace a vessel that is over twenty (20) years of age, and the applicant for the guarantee or commitment would not economically be able to continue operating the vessel in the trades in which the applicant operated vessels;

(B) by adding "or the age of the vessel" at the end of Section 53734(a)(3);

(C) by striking Section 53734(a)(4) in its entirety and inserting the following:

"(4) the capacity of the vessels to be constructed or reconstructed under this section will not substantially increase the cargo capacity in any of the applicant's existing trades;

(D) by striking Section 53734(c) in its entirety and inserting the following:

"(c) Applicability of other provisions.—A guarantee or commitment to guarantee under this section is also subject to sections 53701, 53702(a), 53704, 53705, *53706(c),* 53707(a), 53709(a), 53710(a)(1), (2), *and* (4) *and* (c), 53711(a), 53713, 53714, 53717, *and 53721-53725 of this title. The Administrator shall establish relevant metrics for measuring debt leverage in comparison to cash flow performance and collateral values of the applicants and shall not apply a fixed debt to equity ratio under this section.".*

Testimony of Roy G. Bowman

Before the Subcommittee on Sea Power and Expeditionary Forces
Of the

House Armed Services Committee

Federal Ship Financing Guarantee Program

March 15, 2007

R.G. Bowman
Testimony
March 15, 2007

Good afternoon, Mr. Chairman and members of the subcommittee. It's an honor to appear here today to comment on the Federal Ship Financing Guarantee Program contained in Title XI of the Merchant Marine Act, 1936. My comments here this afternoon reflect only my own views, formed over a number of years of observing the Title XI program and the shipping industry. My introduction to the Title XI program came in my capacity as General Counsel of the Maritime Administration in the period 1969 – 1971. After my service at MarAd, I practiced law in Washington, D.C. for the many years between then and now. I also served recently as Vice President for Government Affairs of American President Lines Ltd., a large international container operator that operates 11 U.S. flag vessels in the transpacific trade of the United States. I am now a partner in the law firm of Thompson Coburn LLP.

In my capacity as a practicing lawyer I have represented both shipyards and shipowners and have been involved in numerous vessel financing projects using both Title XI and loans made by commercial lenders. In addition, I was very substantially involved in the amendments to Title XI in 1995 which introduced the availability of Title XI guarantees for vessels built in the United States for export to shipowners outside the United States.

It's worth taking a moment to put the Title XI program in the historical context of world events during the 1970's through this first decade of the 21st century. For instance, when I first dealt with Title XI in the 1970's oil was $3 a barrel. As a result, consumption soared and the tanker market was at all time highs. VLCCs were paid for in one or two voyages from the Persian Gulf. In the U.S., there were thirteen subsidized lines in the foreign trade of the United

States running 250 or more U.S. flagships serving U.S. trade around the world. Most of these U.S. flagships were financed with the aid of Title XI.

With the Arab oil embargo of 1973, the tanker market collapsed and many a tanker was laid up. The United States, however declared a drive for energy independence and shipyards turned to the construction of LNG ships, drilling rigs and oil industry service vessels. Again, most of the projects were financed with Title XI.

During the 70's and 80's Title XI was critical to U.S. ship finance. Title XI was created because it was generally thought that shipping was highly risky and therefore not suitable for commercial loan financing. Most commercial banks would not readily accept the risks inherent in shipping. Bond investors seeking long term fixed returns were even more reluctant to take a chance on shipping. Title XI was originally created to address this problem to ensure that the foreign trade of the United States and the shipbuilding industry would continue to make the United States a force in world trade.

The 1970 Merchant Marine Act expanded various maritime promotional programs to all sectors of the U.S. fleet. Programs were available to defray the cost of operating and constructing U. S. flag ships which were then financed at fixed rates for periods of 20 to 25 years. During this period U.S. yards constructed 4-8 large ocean going ships a year. Title XI was also used for drilling rigs and service boats. As a result, the Title XI program had within its customer base a variety of vessel types and credits. This large base of ship types and customers assured that the Title XI default risk was spread among all sectors of the industry and among

various credit risks. During this period, the program was largely self-sustaining, that is defaults were covered by premiums charged for the guarantee.

As we will see, overarching economic events intervened to make the Title XI program vulnerable to high default rates just as the same events produced large losses in the commercial loan sector. For instance, in early 1980 the price of oil collapsed after a large run up following the Arab oil embargo. Because of the long lead time in ship construction, a number of projects in the drilling rig industry and service boat industry which were approved based on the higher oil price, were delivered after the price collapse and could not find employment at earnings level sufficient to avoid default. These defaults were not the result of inadequate credit judgment at MarAd but rather stemmed from MarAd's agreement with the widely held view of government and industry that demand for oil would steadily increase.

Although this system of promotion for the ship operating and ship building industry worked reasonably well in the decade of the 70's, the Reagan Administration terminated funding for construction differential subsidy in the early 80's with the result that increasingly fewer vessels were built in American shipyards for international trade. Unfortunately, since the use of wood gave way to steel in the construction of ships, U.S. yards have been largely priced out of the international ship building market. The significance of the end of U.S. vessel construction for foreign trade is that the number of vessels that are potential entrants in the Title XI program is far fewer than had previously been the case thereby limiting the ability to spread risks over a larger population of vessels.

With this background in mind, let us now turn attention to the events of the last ten years. The development of China as a major source of imports to the United States and the displacement of nearby suppliers such as Mexico and Latin America created an enormous increase in the ocean transportation required to satisfy America's appetite for imported goods. The computer that might have been assembled in Mexico ten years ago now comes from China or other far flung Asian factories. Similarly, the demand for raw materials and energy in China to supply these products and fuel China's domestic growth means more tankers and ore carriers are needed. Although this period was punctuated by the dot com collapse in 2000 and 9/11 in 2001, growth resumed with a remarkable intensity in the last four to five years.

As a result, the last several years have seen amazing growth and profitability in every sector of international shipping. Be it liner, tanker or dry bulk, every shipowner has experienced a level of profitability seldom seen in the last thirty years. In addition the price of oil is up to $60 a barrel which stimulates off-shore drilling activity and creates markets for the employment of drilling rigs and service vessels that can only be described as red hot.

During the last quarter of the 20th century, interest rates also displayed remarkable fluctuations. In the 1980's double digit interest rates on Treasury bonds were often found. Treasury bonds sold for 13%. Contrast that with today's 30-year treasury bond which carries a coupon rate of less than 5%. These remarkable fluctuations in interest rates impacted the market for shipping finance.

The growth and profitability in the shipping sector also had a remarkable impact on the financial community. Plenty of money is available today to finance sound new shipping projects

whether it be the issuance of initial public offerings of stock through the New York or Oslo exchange or bank or bond debt for every kind of shipping projects. Just last week a commentator on economic conditions stated that there has been an 18% compound annual growth in the global money supply over the last four years. A not insignificant portion of this money has found its way into the shipping industry. Under the current conditions, the international shipping community can readily obtain money for projects from the commercial markets.

Not only has the money supply increased but the willingness to accept risk has also substantially expanded. Paul Krugman, the economist and New York Times commentator, stated in his column of March 2, 2007 that the risk premium, as reflected in the difference between the interest paid on junk or risky bonds in comparison to safe bonds, has declined from 10% to a little more than 2 percentage points today. That is the interest cost of borrowing money for a risky credit was 10 percentage points more than the high credit quality borrower had to pay in interest in 2000. Thus we see a dramatic increase in the willingness of lenders to make loans to what would have been called risky credits. Indeed shipping can no longer be classified a high risk since good shipping credits can be financed in today's world at small margins over the London Interbank Offered Rate, or Libor, which is the base rate on which loans are quoted. Margins of ¾ - 1% over Libor for good credits are achievable.

The importance of this appetite for risk and the resulting lower spread is that the interest rate savings that can be achieved by using Title XI is lower and the cost of using the program comes close to offsetting any benefit achieved. Under these circumstances, borrowers will avoid the cumbersome Title XI program.

One need look no further than Philadelphia to find a fine example of the commercial financial markets rising to the needs of the shipping industry. I refer here to the Aker American Shipyards Project under which ten and perhaps 16 tankers may be built in the Aker Philadelphia Shipyard for charter to Overseas Shipholding Group. A recent news item stated that Aker American Shipping, the owner of the vessels, recently put in place a $770 million financing for the first 10 vessels in an amount of $80 million per vessel. These loans were arranged in the international markets through Fortis, an international bank. I understand that the interest rate on this loan is approximately 110 basis points over LIBOR and has been converted into a fixed rate loan at a little over 6% per year. This rate would be quite close to the effective rate of a comparable Title XI financing although the term, that is, the length of the loan is not nearly as attractive as the twenty year term that might have been available under the Title XI program. Just as with a home mortgage a longer term means lower annual payments.

This brings us to a crossroads in the Title XI program. There are at least two views. On the one hand some economists will say that the program has become unnecessary since commercial lenders are now willing to finance creditworthy projects. On the other hand an equally valid but opposite view would hold that guarantee programs are still required to provide a base support for construction of vessels in the United States and should remain in effect since risk premiums may rise once again as they have in the past. Just last week, the declining stock market produced an increase in the risk premium. The difference between high risk loans and high grade credit loans increased from about 210 basis points to about 250 basis points over the

last week. While not large, this increase is a reminder that risk premiums are not static and can easily revert to the conditions existing earlier in the decade.

There is also reason to believe that the existence of a robust financing market for international shipping may not translate in every case to the financing of U.S. built vessels. It is a sad fact that U.S. built ocean going vessels often cost twice as much as the same ship built in the international markets. While there is a huge international market for vessels of the type that might be built here for Jones Act employment, these ships cannot be readily deployed in international markets at rates necessary to repay the high cost of construction. Thus in the event of the deterioration of the Jones Act market, the ability to realize on the value of the vessels may be more limited than would be the case for a vessel built internationally. A vibrant Tile XI Guarantee program would provide a backup to the international finance markets.

The comments that follow address the actions that need to be taken if the Committee's conclusion is to retain and sustain the Title XI program. If the Committee wishes to see the program continued and see it accomplish the objective of providing financial support to shipbuilders that build vessels in United States shipyards, the Committee needs to do more than simply authorize appropriation of the necessary funds to permit MarAd to once again issue Title XI guarantees. While funding is a necessary condition to resuscitation of the program, it is not sufficient.

The Maritime Administration has recently been criticized for its administration of Title XI due to the significant defaults occurring in this decade. In my view, much of this criticism has been unfair. The defaults did not stem from MarAd's credit misjudgments but rather resulted

from overarching economic conditions such as the downturn in the cruise industry following the 9/11 attacks in early 2000, the collapse of oil prices in the 1980's resulting in extensive defaults through the drilling rig industry, or from the imposition of Congressional mandates to finance specific projects regardless of credit considerations. Unfortunately, these defaults have led to a series of recommendations by the GAO and others that have resulted in the imposition of extraordinary obstacles to the grant of Title XI guarantees. I refer to the use of the Department of Transportation Credit Council to review guarantee commitments proposed to be issued by MarAd. In addition, the authority granted MarAd to seek external advice when necessary in reviewing Title XI applications has become the rule rather than the exception. The result of these and other limitations on the Maritime Administration's exercise of judgment in granting Title XI guarantees has made the process so cumbersome, time consuming and expensive that any shipowner that can obtain financing elsewhere will do so. Witness the Aker transaction.

The result is that the program will become increasingly dedicated to high risk projects that can obtain funding from no other source. This will create a self-defeating premise in which defaults will continue to rise since the pool of projects from which premiums and guarantees are drawn will be the highest risk, most difficult projects. But even the GAO emphasized that spreading the risk among a number of different borrowers is necessary to a viable program. *See* Comments on Concentration of Risk at p. 29 of GAO Report 03-659, June, 2003. The guarantee program worked very well when it had many borrowers and a spectrum of different project types. As in any insurance program, spreading the risk allows the healthy projects to support the less healthy. To the extent that the Title XI application and administration process becomes so

cumbersome that good projects and good credits will go elsewhere, the program becomes increasingly risky. Thus, we have the perverse result that conditions imposed to improve credit judgement have in fact produced the reverse. Failure to broaden the program will only result in this panel reconvening in a few years to revisit the issue of defaults.

In order to achieve this broadening of customer base, it would be my suggestions that this Committee see that the following steps are taken:

1. Eliminate the Department of Transportation Credit Council. This Council is unnecessary and injects a layer of credit review by individuals having no understanding of the shipping industry and little incentive to promote the construction of vessels in United State shipyards. Indeed, they seem primarily focused on avoiding granting of any guarantees. The result is that the expertise that existed in MarAd has been supplanted by a committee with little knowledge and less interest in the program.
2. Return the use of the external consultant to its proper and limited role. The external consultant provisions contained in Section 53708(d) of Title 46 authorize but do not require the use of these consultants in every transactions. It can certainly be conceded that there will be projects in which the external consultant is necessary or advisable. However, the majority of projects coming before MarAd are well within the expertise of the Maritime Administration and indeed its knowledge base is generally greater than that of the outside consultants. Unfortunately the outside consultants have become the rule rather than the exception.

3. Provide MarAd with adequate funding for its administrative functions to rebuild the personnel and the expertise in the agency. Retirements and the lack of activity have taken its toll on the level of expertise at the Maritime Administration. Nevertheless, if the program is to continue there is no better place in which to rebuild the expertise that guided this program for many years.
4. The Committee should continue its oversight of the program at frequent intervals. As we all know legislative mandates to which the administration is not sympathetic are often implemented with less than vigor. Therefore, if the program is to be remodeled so as to be functionally effective the Committee will have to take a continuing interest in the administrative developments at the Maritime Administration.

Finally I cannot close without saying that the shipyards need to bring their construction costs closer to international standards and not use the Jones Act to perpetuate inefficient methods. The United States has struggled with this issue for more than a hundred years and we still do not have a solution to this disparity in costs. A healthy industry must keep striving for a solution.

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Statement of

Charles G. Raymond, Chairman and CEO,
Horizon Lines, Inc.

Supporting Improvement of and Funding for the Title XI Loan Guarantee Program

Before the

Subcommittee on Seapower and Expeditionary Forces
Committee on Armed Services
United States House of Representatives
Washington, D.C.
March 15, 2007

Mr. Chairman and Members of the Subcommittee:

I am Chuck Raymond, President and CEO of Horizon Lines. Horizon Lines is the nation's leading Jones Act container shipping and integrated logistics company. We operate 16 U.S.-flag vessels on routes linking the continental United States with Alaska, Hawaii, Guam, and Puerto Rico. All Horizon Lines vessels are U.S. citizen owned and crewed.

Our vessels are enrolled in the VISA program, which is a Marad run readiness program that makes private U.S.-flag vessel capacity available to the Department of Defense. We also proudly carry cargo for DOD, other government departments, and numerous commercial customers.

Horizon Lines appreciates the Subcommittee's invitation to discuss how the program of loan guarantees for ship construction, established by Title XI of the Merchant Martine Act, 1936, relates to our ability to construct new U.S.-flag vessels for use in commercial trades. The short response is that the Title XI program is critical to the long-term viability of the Jones Act fleet and the program could work far better than it does today.

Horizon Lines supports a well functioning and well funded Title XI program. A strong Title XI program will strengthen the national defense by strengthening the circumstances of ship operators, shipyards, maritime labor, and shipyard workers. New vessel construction means more modern U.S.-flag vessels and U.S. shipyards – both better able to face future challenges and assist DOD. To have these positive impacts, the program needs to be consistently funded and the terms and conditions of its use should be made less daunting to its private sector customers. It is not enough for the program to receive sporadic drips of funding. In recent years it has not received funding, period.

The current state of the Title XI program makes it difficult for shipyards or vessel operators like Horizon to plan commercial vessel construction programs. In the rest of my statement I will comment on these problems and suggest steps to improve this situation.

The Record Shows that Title XI is Very Important To the Jones Act Containerized Trades

Mr. Chairman, Title XI is very important to a commercially successful shipbuilding program for all Jones Act operators.

Title XI loan guarantees supporting a new vessel construction program provides a company like Horizon Lines at least three distinct benefits over commercial financing. First, Title XI provides a longer payback period better matched with new vessel life. Second, Title XI provides a higher advance rate, reducing the equity requirement to a manageable level. Finally, Title XI results in a lower interest rate.

At Horizon Lines, we put a lot of effort into business planning as well as execution. We are often looking at possibilities for new vessel construction. What we've found in our business modeling is that potential building programs will not work well for us without Title XI financing. Title XI financing would allow us to accelerate potential newbuilding programs and make any such programs more competitive.

We don't see this as any kind of aberration. A few years back, when the Title XI program was funded and loan guarantees were available, other major Jones Act carriers in the containerized trades acquired new vessels with Title XI support. We do not recall seeing, in recent years, any major vessel construction program in those trades that did not include Title XI support.

This pattern shows us that the availability of Title XI support is important to the future of the Jones Act containerized trades and our nation's ability to build large commercial vessels.

So, action should be taken to revitalize the Title XI program. Here are our suggestions.

A More User Friendly Program

In preparing for this hearing I took a look at the Marad website entry under the Title XI program. As of last Friday it set forth the following under the heading "Purpose of Program":

> The primary purpose of the Program is to promote the growth and modernization of the U.S. merchant marine and U.S. shipyards. The Program enables owners of eligible vessels and eligible shipyards to obtain long-term financing with attractive terms.

We need to get back to actually implementing that purpose. And, in saying that, I want to be clear that we recognize that Administrator Connaughton and Secretary Peters have

been in office only a short time and that the circumstances we are in as to title XI developed over a longer period of time.

One of the first steps in revitalizing the Title XI program should be an effort to make the program more user friendly. We all recognize that the government has a fiduciary duty to the taxpayers to run the program well and carefully. Accountability in the program is important. But it seems to us there is also a duty to help strengthen the merchant marine, the shipyards, the economy and the national defense. We must pursue those goals and can do so while being careful with the taxpayers' money. It is our sense that the Title XI program is now suffering from an overreaction to one program default in 2001.

In particular, we see a risk that applicants for Title XI support will face inflexible application of debt equity ratio and other unrealistic financial standards in the review of requests. The profitability of the company, its track record, and whether the line of business has been long established, rather than new, could receive inadequate weight. Applications from companies with a long standing track record of success and profitability, in established trade lanes and lines of business, should not get caught up in an application process that may be skewed towards risk avoidance to the point of loan guarantee avoidance.

We believe that applications for replacement of older, increasingly obsolete vessels of established operators, with terms that would protect against overtonnaging a market (to help limit default risk), do not present risks that warrant new or unusual review or review outside of Marad. Marad has many years of expertise and experience with the existing U.S.-flag vessel owners and operators to administer a program for replacement of old tonnage. Applications for Title XI support for such replacement vessels would represent a logical starting point for revitalization of the program; they should be given priority consideration under the Title XI program. Amending the law to specify that such applications would receive priority could do this. While Marad must review them carefully, they should not be subject to inflexible standards as to how a company must structure its finances. Replacement vessels for established Jones Act carriers of containers received Title XI support in the relatively recent past and do not present a meaningful default risk. Yet, in today's environment, it is not clear that comparable applications could be approved. We think that a new legislative priority provision, focused on established operators, in established trades, for the replacement of older, obsolete vessels, would be a prudent way to get the ball rolling and generate new construction at low risk. It would advance the program's goals of strengthening both vessel operators and shipyards.

Regular Funding for Title XI is Essential

Even if the Title XI program is made more user friendly, the defense and other benefits of the program will not be realized without regular funding at an adequate level.

Without annual funding for Title XI, effective planning and execution of vessel construction programs is close to impossible, at least in the containerized Jones Act

trades. It is not reasonable for the Federal Government to assume that U.S. shipyards can develop plans to build vessels, or series of vessels, not knowing when, if ever, the financial support will become available that will enable a carrier to place an order. A vessel operator like Horizon Lines needs to develop its acquisition plans carefully, with a close eye on marketplace conditions. We want to build when it makes sense to build commercially. We can't readily jump to sign contracts for newbuildings because, all of a sudden, Title XI money is available on a one shot basis. We need a program that is functioning regularly that carriers and shipyards can count on. That framework will encourage carriers to plan to renew their fleets and shipyards to invest in modernizing their infrastructure.

Defense Benefits

Before closing let me emphasize that there will be real benefits from making the Title XI program more user friendly and providing it regular funding.

Shipyards and shipyard workers are important components of the defense industrial base. They build and repair ships for the Navy. By building major vessels for the merchant marine, they expand the pool of vessels available to assist DOD. In addition, those operating ships provide an important pool of trained sailors and shipboard personnel, available for support of DOD. A more modern Jones Act fleet is able to support DOD more efficiently. A modernized fleet can give planners greater confidence that the merchant marine will be there for the long term to assist DOD.

A stronger Jones Act fleet for the long term provides a base of customers that will enable shipyards to modernize, both with respect to Navy and commercial buildings. In turn, more modern shipyards are better equipped to respond effectively to DOD's needs.

What we see, Mr. Chairman, in a decision by Congress on whether to fund and improve the Title XI program, is a choice between a descending spiral and an upward trend. Developments in the Jones Act fleet and in the shipyards interplay with each other. A step up can lead to other steps up. Failure to invest is another story altogether.

Vessel operators and shipyards, including their workers, are a tremendous resource to the national defense. We should strengthen them through revitalization of the Title XI program.

Conclusion

I have outlined today that Title XI support is very important to the renewal of the Jones Act container trades. The record shows that. Yet, today, the program is a proverbial ship that has run aground. We don't know if it will be there when it is needed.

To refloat the ship, we need to make the program less daunting to its customers and provide it regular funding. We can be careful with the people's money and still pursue Title XI guarantees that will revitalize both vessel operators and shipyards. Failing to

fund the program is not the answer. In particular, we see providing statutory priority to applications for replacement of older, increasingly obsolete vessels, by established operators, in established trade lanes, as an approach that can produce high benefits at low risk. This -- and funding -- is a logical first step to get the program going again.

Thanks again for the opportunity to appear. I'll be pleased to respond to any questions you may have.

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Statement of John E. Graykowski
On Behalf of the Shipbuilders Council of America
Before the Subcommittee on Seapower and Expeditionary Forces
House Armed Services Committee
March 15, 2007

Thank you Mr. Chairman and Members of the Subcommittee for giving me this opportunity to appear today in support of a revitalization and renewal of the Title XI loan guaranty program.

I appear today on behalf of the Shipbuilders Council of America, which is the largest national shipyard trade association representing approximately 38 shipyard companies that own and operate more than 75 shipyards on all three U.S. coasts, the Great Lakes, and Hawaii. SCA member shipyards build and repair the vast majority of commercial vessels that service the Jones Act market. SCA members also build small and mid-sized vessels for the U.S. Coast Guard, NOAA and other government agencies and maintain Navy combatant ships.

By way of background, I served as Deputy and Acting Maritime Administrator from 1994 through 2000 and was directly responsible for the implementation of the National Shipbuilding Initiative generally and the expansion of the Title XI program in particular. I have also represented clients in Title XI transactions and served as General Counsel of a shipyard, so I bring several perspectives to the table today.

I would like to begin with an understanding of what Title XI was as I knew it at MARAD. The program is governed by specific statutory and regulatory provisions that prescribe the terms, conditions and structure of the loan guarantees. Applicants are eligible to receive financing for up to 87.5% of the actual cost of the vessel at a fixed interest rate for a term of up to 25 years. No other financing -- commercial or otherwise -- can match these terms and that is

the principal attraction of Title XI for shipowners. Applicants must meet certain financial tests, among them 2 to 1 debt to equity ratios, positive working capital, operating history, verifiable economic projections, business plan, etc. which were all elements in the statutory "economic soundness" determination MARAD would have to make before approving a project. We would tell applicants that the process would likely take 9 to 12 months, involve negotiations and give and take with MARAD and cost them $100,000 or so in legal and support costs through closing. In all respects we attempted to present the program in a uniform transparent and collaborative way.

Title XI was not available to bad credit risks, MARAD was never a lender of last resort and if you look at the companies that utilized this finance they range from start-up family-owned entities to large publicly traded companies. Rather, companies sought Title XI because its terms implicitly recognize the need to keep debt service requirements low in order to amortize the cost of the new vessel over its useful life. By definition, vessels are long-lived assets that operate in markets where margins and returns are smaller than those found in other industries. In many cases, Title XI is the difference between an owner being able to afford new equipment, or having to maintain an older and less efficient fleet.

Title XI has been operating in its current form since the mid-1950's and until recently has been seen by U.S. vessel owners as a stable source of vessel finance that is not affected by changes in the finance markets that may favor maritime assets at one moment and turn to a more lucrative industry the next. While order books among many yards are full today, our industry knows well how quickly this can change, and as I recall the state of the shipbuilding industry in 1994 the industry was in desperate need of the stimulus Title XI provided.

The Title XI program I see today is not even a shadow of what it was seven years ago when I left MARAD. Its core constituents, the U.S. shipyards, perceive Title

XI to be broken, inaccessible, not worth the time, money or effort and basically beyond repair. The handful of deals that MARAD has completed in the last five years, and the ordeal recent applicants have endured have convinced many that Title XI has ceased to be a viable program.

Mr. Chairman, if the objective of this administration was to kill Title XI, then they appear to have succeeded, through lack of funding, and imposition of requirements and burdens that have caused it to fall under its own weight with no one on the outside really caring about the loss. What an ignominious end to a program that has done so much for our industry!

That, Mr. Chairman, is how I see the program today, and it greatly concerns me, because the entire Jones Act fleet needs recapitalization; as a nation we are years behind in the development of short sea shipping; and the full potential of the nation's waterways as our primary transportation network will never be realized without some means of assured finance for new vessel construction.

In contrast to the impression created by the Department of Transportation Inspector General (DOTIG), the Government Accountability Office (GAO) and others the Title XI program that I administered achieved the goals set by the Congress and was held in high regard by shipyards and shipowners alike.

Lost in the blizzard of misinformation, mischaracterization and unfounded charges by various investigative bodies, is the fact that between 1994 and 2000 – almost from a standing start -- MARAD approved over 80 projects that generated over $6 billion in shipyard activity in the United States![1] Put another way, but for the Title XI program and MARAD's aggressive marketing and implementation of the program, some 400 vessels of all types, barges, oil rigs, double hull product tankers; power barges, ferries, and on and on would not have

[1] FY 1994, 7 projects $403 million; FY 1995 14 projects $502 million; FY 1996 18 projects $1.4 Billion, FY 1997 11 projects $378 million, FY 1998 12 projects $860 million, FY 1999 11 projects $2.03 Billion, FY 2000 12 projects $1.064 Billion

been built and the overwhelming number of these projects are fully performing and servicing their debt. Mr. Chairman, we actually exported vessels from U.S. shipyards for the first time in a very long time and those foreign owners came to the U.S. yards specifically because Title XI was available.

If you measure success in terms of how long it takes between an idea and results, then you must conclude that Title XI was successful. In May 1992, Candidate Bill Clinton told a group of shipyard workers at NASSCO that he would revitalize commercial shipbuilding in the United States. In November 1993, Congress enacted, with strong bi-partisan support, the National Shipbuilding Initiative (NSI) whose central element was the expansion of the Title XI loan guarantee program to cover export vessels and shipyard modernization and increased funding. The NSI was an explicit statement by the Congress and the President that the shipbuilding industries were critical to the national security industrial base and that it was in the direct national interest to support these industries.

MARAD took this direction to heart and moved out, issuing interim regulations in March1994; attending a large international shipbuilding exposition in June where for the first time, MARAD and U.S. shipyards worked together to market our industry and use of Title XI in U.S. shipyards; and approving 7 projects by the end of the fiscal year.

One aspect of the program which has been obscured by all of the negative publicity is the due diligence process associated with each application. The review process MARAD employed had to strike a balance between thorough and effective due diligence and the need to process the application in a reasonable amount of time and actually build the vessels. The safest "no risk" answer in every application was always "no" and it is impossible to answer every conceivable "what if" question that the MARAD attorneys could devise; but then

no ships would be built and the program would not be achieving its statutory purpose.

Rather, as all banks do, you must reach a point where you are satisfied that you have analyzed the project; inserted contractual protections; imposed reasonable but strict requirements and you take that leap of faith and approve the deal, at the same time knowing that there is still an element of risk. That is the nature of lending, and the role I tried to play at MARAD was management of the process to arrive at that point and make the decision.

I find it ironic, given the impression created by certain reports that the most persistent complaint I received about the Title XI program from applicants was that MARAD was taking too long; asking too many questions; and imposing too many difficult conditions. Indeed, some of those questions also came from Members of Congress, whose constituents were either the ship owner seeking the guarantee, or the shipyards eager for the business.

I don't think it productive to rehash the major defaults that occurred during my tenure, but I am certainly willing to address any questions the Subcommittee may have. I feel it useful, however, to remind everyone that the vast majority of the projects that we completed between 1994 and 2000, are fully performing and are in no danger of collapse. It is also useful to recall that Congress was heavily involved in two of the more notorious projects, in one case granting an exclusive statutory license to operate in Hawaii, which formed the basis of MARAD's economic soundness determination and in the other directing MARAD to ignore economic soundness and fund the Quincy shipyard project, despite MARAD's stated objections and reservations about that project. As the senior political appointee at MARAD, I felt a responsibility to direct the Agency to be responsive to the clear mandates of the Congress.

Beyond this, Mr. Chairman –and I do not mean at all to minimize the consequences of defaults and know the painful impact those rare occurrences have on the Agency and the professional staff-- I must remind everyone that Title XI is a financing program and by its very nature there are risks inherent in each transaction. MARAD worked very hard to be right 100% of the time, but like all lending institutions, EXIM, Sallie Mae, Chase Manhattan, Bank of America, we knew that things can and do go wrong; shipyard costs rise; markets change; terrorist attacks occur; risks that could not be foreseen and mitigated in advance could jeopardize the projects.

The Title XI program of the last six years is a classic example of overreaction by the Congress and DOT, reacting to poorly documented and biased reports by the investigative agencies and no effort by MARAD whether by design or under orders, to defend itself. The result is that in addition to the baby and the bathwater, the entire nursery has been thrown out.

Since 2001, MARAD has approved 26 projects for a total of $1.9 billion in shipyard activity, but almost 50% of this amount occurred in FY 2001 when many of the projects that were pending when I left MARAD were approved. If you examine only the projects approved since FY 2002, following the imposition of the DOTIG procedures and the creation of the Credit Council MARAD's record declines from 8 projects in FY 2002, to 3 projects in FY 2003; 2 projects in FY 2004; 1 project in FY 2005; and to my knowledge no projects were approved in FY 2006.

To me, the most significant change to the Title XI program in these years, which has resulted in the collapse of the program; the loss of credibility and support among the maritime industry and an erosion in MARAD's role as an advocate for the shipbuilding industry has been the intrusion of the Credit Council in the Title XI process. What DOT did in creating this monster was to take a process that many perceived as already cumbersome, expensive, and lengthy and make it

unwieldy, twice as costly and unending The Credit Council is more than overseer, it dictates terms and conditions to MARAD, second-guessing the judgment of the MARAD professional staff and ignoring and disregarding their decades of specialized maritime finance knowledge and expertise.

To me, an essential element of "good" government is transparency and accountability in how decisions are made; applications reviewed and a consistent application of rules which will govern an outcome. Such transparency reduces uncertainty, assures fairness and engenders support for the agency and the program.

As I understand it, the Credit Council is essentially a group of non-maritime individuals, with strongly held opinions on things they basically know little or nothing about, who have the power and ability to kill, delay or warp transactions beyond the recognition of the applicants. And this is all done in a "Star Chamber" fashion, where the applicant has no voice; is not allowed to participate; hears only second or third hand what was discussed, and what problems were raised, and must then rely upon MARAD to plead his or her case.

Every delay or irrelevant demand issued by the Credit Council means more costs to the applicant, more delay to the start of the project which means higher costs; and no assurance that the end is in sight. This is beyond "bad" government; it is intrinsically unfair and arbitrary. Many of the Title XI applicants are small family owned businesses who can ill-afford to keep paying counsel to engage in fruitless paper exercises with no certainty of success in this or any other lifetime.

Mr. Chairman, if you consider one change to the Title XI program, return it to the professional staff of MARAD and forbid the Credit Council from having anything whatsoever to do with the projects. Or, if the Credit Council must remain and supplant all that MARAD does, then require the Council procedures to be transparent, subject to regulation; afford applicants a right of appeal and a right

to confront the Credit Council face to face. Let them see how hard small businesses struggle; how honorable people will meet their obligations and how giving shipyards new business and operators new vessels is actually good for this country.

We can never fully appreciate what the loss of Title XI has been in terms of opportunity cost to the nation. Many of the vessels we built in the 1990's would not have been constructed if Title XI had been in its present condition. What we did then was create a climate of relative certainty among shipyards and shipowners that Title XI represented a credible and reliable financing alternative. We fostered a reputation of openness, to owner and shipyard alike, and worked to improve the process with each project. And we were a real partner to the shipyards in working with them and their customers because we recognized financing is sometimes the largest constraint on new vessel purchases.

Mr. Chairman, today, you hear a lot of talk about short sea shipping, and movement in the Congress toward a national policy to remove trucks from the roads and move more cargo on the maritime highways. Europe has been successful in this effort but it has stalled in the United States, and we have been talking about it since the mid-1990's but have yet to initiate large-scale services. I believe that one of the greatest impediments to the development of these coastal services is the lack of a financing program, like Title XI, to construct the new generation of vessels that will be required.

Certainly there are issues relating to common design of the vessels; routes; ports and the like, but the financing risks associated with these projects are undeniable. These projects will likely involve a new vessel design, a start up entity; an entirely untested and new market, with new customers and new cargoes; a need to raise operating capital and make significant investment in

plant and equipment outside the vessel. These and other factors will combine, in my view, to make commercial financing difficult and maybe impossible to find.

Title XI is an ideal financing structure to analyze and accommodate this risk and achieve the public policy goals that are inherent to the short sea concept. The historical leveraging in the Title XI program creates an enormous potential to magnify the impact of relatively small federal appropriations throughout the industry in a very short period of time as we showed in the 1990's.

Without federal involvement, the financing of these projects will rely exclusively on the balance sheet of a particular project, and I agree that these should be the foundation of any financing. But where Title XI is different from private financing is the recognition that public policy objectives warrant the extension of credit or assumption of risk beyond that normally available in private capital markets and for reasons the private sector will not consider.

Finally, Mr. Chairman, in connection with a revitalization and renewal of Title XI, I would suggest that the Congress consider enactment of a new National Shipbuilding Initiative. The 1994 law, which enjoyed broad bi-partisan support, was not designed to be the last time Congress comprehensively addressed the needs of the U.S. commercial shipbuilding industries. It seems entirely appropriate to make an assessment of the state of our industry today and identify a number of areas where a modest investment of federal assistance or involvement could produce results equal or greater than those achieved by the original NSI.

Thank you, again, Mr. Chairman for this opportunity to share my thoughts and views and I want to thank you for your continuing support for our industry. I completely share your concerns about the future of shipbuilding in the United States, the fact that we cannot afford to lose more of this industry than we

already have and we will work with you and your staff on legislation to revitalize and renew Title XI and other shipyard programs.

Statement of

Martin E. Gottlieb, Managing Director
Argent Group Ltd.

Before the

Subcommittee on Seapower and Expeditionary Forces
Committee on Armed Services
United States House of Representatives
Washington, DC
March 15, 2007

Mr. Chairman and distinguished Members of the Subcommittee on Seapower and Expeditionary Forces:

U.S.-flag Ship Financing Background

I am Martin Gottlieb, a founder and Managing Director of Argent Group Ltd. Argent is a boutique investment banking firm that specializes in structuring and arranging financing for projects involving large-ticket assets such as ships. Since its inception in 1982, Argent has arranged financing for projects costing in excess of $25 billion, more than half of which has been in connection with ship financing transactions.

One of the more noteworthy transactions in which Argent has been involved is the $2.7-billion Maritime Prepositioning Ship and T-5 Tanker program that was completed in the 1980's. That transaction involved a total of 18 commercial ships that were newly-built or converted in U.S. shipyards and chartered by the U.S. Navy. Argent served as financial advisor to the Navy and for our role in that transaction a colleague and I were presented with "Distinguished Public Service" awards.

Over the years, Argent has been involved in many of the commercial ship financing projects for new-build U.S.-flag vessels that have been completed. In fact, since the beginning of 2000, Argent has served as the financial advisor on all but two of the U.S.-flag projects for deep draft, ocean-going vessels. In connection with these 2000-and-beyond projects, Argent has structured and raised financing for 35 vessels costing in excess of $4.4 billion using both commercial financing and Title XI financing.

Title XI Program Background

My experience with the Title XI program dates back to the early 1970's when the program changed from an "insurance" to a "guarantee" program and I have been involved with the program ever since.

Most recently, Argent served as financial advisor on three of the six projects that have been approved for Title XI loan guarantees by the Maritime Administration since the beginning of Fiscal Year 2003. These projects represent about 2/3 of the $637 million of Title XI loan guarantee commitments that were approved during that period. Of the six vessels, four were replacement vessels for established operators on existing trade routes and two were of a vessel type that is new to the U.S. market.

I appreciate the opportunity to testify before the Subcommittee about the Title XI program. My testimony will outline some of the benefits that the program affords a shipowner, draw some comparisons between commercial and Title XI financing, and identify some of the issues that I believe need to be addressed in order to revitalize the Title XI program.

Importance of a Robust Title XI Program

The Title XI program has been very successful, having been relied on, by some accounts, to provide assistance in financing over 90% of the new U.S. built ocean-going and Great Lakes fleets from the inception of the program in 1938 through the year 2002.

While commercial financing is readily available for foreign-built vessels, it is more of a challenge for vessels built domestically. The market for U.S.-built vessels is much smaller than that for foreign-built vessels. Consequently, the volume of ships built in the U.S. is too small to create the economies of scale that would lower the cost of these vessels to international levels. Because of their high cost and the small universe of users, commercial financing sources do not view U.S.-built vessels in the same way that they view foreign vessels. Foreign-built vessels are considered to be commodity assets that can be financed largely based on their asset value because they can be readily re-deployed or sold if the shipowner defaults on a loan. By contrast, U.S.-built vessels are viewed as purpose-built assets that cannot be so readily re-deployed or sold at a high enough price to support a significant loan against the vessel. Typically, a commercial lender will consider only the value of the vessel in the foreign market when lending based on asset value.

The Title XI program bridges this financing gap. Like the export finance programs of foreign countries, the Title XI program supports construction financing for ships built in the United States. It also supports permanent financing for U.S.-built vessels that is more closely aligned with the useful lives and values of vessels in the Jones Act market.

Attributes of Title XI Guaranteed Debt Financing

The Title XI program provides four principal benefits to U.S. shipowners:

- The program enables shipowners to obtain construction financing for U.S.-built vessels.
- The program provides financing for up to 87 ½% of vessel cost.
- The program provides for a financing term of up to 25 years from vessel delivery.
- The program provides lower-cost financing.

Construction financing for foreign-built vessels is generally supported by guarantees backed by export credit agencies. Lenders often require similar government support for U.S.-built vessels and the Title XI program, sometimes backed by performance bonds or corporate guarantees from U.S. shipyards, provides that support.

The Title XI program also provides financing for up to 87 ½% of the cost of a vessel, more than is available with commercial financing. Commercial lenders typically lend a maximum of 70-80% against the cost of a foreign-built ship. When those parameters are applied to higher-cost U.S.-built vessels, lenders will generally not provide more than 40-70% financing against the cost of the vessel. The remainder of the vessel cost must be financed with more expensive junior capital or equity. This overall higher financing cost makes the business case to support the acquisition of a U.S.-built ship very challenging.

By providing a financing term of up to 25 years from vessel delivery, the Title XI program better matches the financing term for U.S.-built vessels to their useful lives. Given their higher cost and purpose-built nature, U.S.-built vessels generally operate for a longer term than foreign-built vessels. The term of commercial financing is typically limited to between 7 and 12 years.

The debt issued under the Title XI program carries a lower interest rate than commercial debt. While the guarantee fees charged for the program can make it more costly for borrowers with high credit ratings, for all but the most creditworthy of borrowers, the Title XI program makes the acquisition of U.S.-built vessels more affordable.

Recent Experiences with the Title XI Program

In order for the Title XI program to be effective in supporting the construction and acquisition of U.S.-built ships, the program must be implemented on an efficient and predictable basis.

Argent's experience in assisting shipowners with the Title XI program spans the "before," "during," and "after" effects of the formation and functioning of the DOT Credit Council that was announced by the Department of Transportation in July 2004.

The Credit Council's formation was the outgrowth of a couple of significant defaults in the Title XI program following the events of September 11, 2001. Those events precipitated a review of the program by both GAO and the Department of Transportation Inspector General, which recommended some changes to the program. While some of these changes were helpful, the overall effect has been to create a program that attempts to be "risk free" – a laudable objective, but one that might also prevent the Title XI program from meeting its policy objectives of supporting shipbuilding in the United States. It is important to note that only one application has been approved since the formation of the Credit Council, perhaps due to the chilling effect on applications from the perceived bureaucratic red tape that is now part of the approval process.

Since the formation of the DOT Credit Council, the Title XI program operates on a less efficient and predictable basis than it has in previous years. The time between Title XI application and approval is longer, and our experience has been that additional conditions and requirements are placed on applicants as the approval process proceeds. It also appears to us that the industry expertise and experience that resides in the Maritime Administration is diluted in the current approval process. This industry expertise and experience, which is comparable to that in the commercial sector, is essential to the effective and efficient evaluation and implementation of appropriate terms and conditions for shipping projects. The appointment of consultants and the oversight of individuals who may not have the necessary depth of industry expertise can harm rather than enhance the program, and certainly slows it down. The industry expertise and experience of the Maritime Administration staff should not be lost in the current process and steps should be taken to take advantage of that expertise and experience.

Suggested Changes to make the Title XI Program more Robust

Having discussed the importance of the Title XI program and our recent experience with it, I'd next like to offer a couple of suggestions to make it operate more efficiently.

First, I suggest that the financial tests set forth in the Title XI regulations be reviewed and updated. As part of any update, I recommend that the Maritime Administration be given some latitude in setting the financial tests as projects are approved. For example, the debt-to-equity test that is currently in the regulations might be less appropriate for a vessel operated by an established carrier on an existing trade route than the debt-to-cash flow test that is commonly used in commercial financings. Similarly, the working capital test that is currently in the Title XI regulations might be replaced with an earnings test or a coverage test to more closely match commercial financing practice.

With regard to the Credit Council and the use of outside consultants to review Title XI applications, I recommend that the evaluation and approval of projects involving vessels for established operators on existing trade routes not require review by the Credit Council and outside consultants, and be put back in the hands of the Maritime Administration. Only those projects involving new technology or an unproven service where additional review and analysis might be warranted, should provide for the possibility of an outside consultant and Credit Council review. Following this approach, all Title XI projects would receive a more expedited review.

Conclusion

In conclusion, I believe that a strong and well-functioning Title XI program is vital to our country, vital to our merchant marine and vital to our domestic industrial base. With proper funding, appropriate revisions to the program and proper oversight, the Title XI program can be revitalized to perform the functions that Congress intended and that are badly needed to help rejuvenate our U.S. Merchant Marine.

Thank you, Mr. Chairman and members of the Committee, for the opportunity to share some of my views and experiences. I would be happy to answer any questions you may have.

SEWARD & KISSEL LLP

United States House of Representatives
Committee on Armed Services
Subcommittee on Seapower and Expeditionary Forces
Honorable Gene Taylor, Chairman

Testimony regarding
Federal Ship Financing Guarantee Program
Maritime Administration
Title XI Loan Guarantee Program
March 15, 2007

Submitted by
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United States House of Representatives, Committee on Armed Services, Subcommittee on Seapower and Expeditionary Forces -- Hearing on Maritime Administration Title XI program Testimony, March 15, 2007, by H. Clayton Cook, Jr., Counsel, Seward & Kissel LLP

Good afternoon, Mr. Chairman and Members of the Subcommittee. Thank you for inviting me to appear before you today to discuss the Maritime Administration ("MarAd") federal loan guarantee program administered under Title XI of the Merchant Marine Act, 1936, as amended (46 U.S.C. 53701). Your invitation stated that you were particularly interested in my views on the availability of Title XI program guarantees for vessel construction period financing, and more generally, with the Title XI program's desirability for long-term post-delivery vessel financing as compared with that which is available in the commercial market.

I plan to discuss these two subject matters in my oral testimony, and thereafter turn to a more general discussion of the Title XI program and my suggestions for several modest "course corrections."

1.0 Construction Period Financing.

The "shipyard risk" associated with a shipyard's successful completion of a vessel under construction is perhaps the most difficult financing problem that vessel purchasers face in any transaction. Financial institutions are loath to assume shipyard risk even when bonding may be available. In situations in which the shipyard has a sufficiently robust parent, the shipyard's parent may provide or guarantee this financing or bonding, and the purchaser's problem can be accordingly solved.

However, there are many excellent, small and medium sized United States shipyards that cannot provide this financing or obtain bonding, or find the impact of bonding on their vessels delivered price prohibitive. These shipyards should be participants in the construction of the Passenger and Ro/Pac ferries needed for transportation on our American Marine Highways. This is the very sort of problem -- for which no adequate private sector solution is available – which the MarAd Title XI program should address.

MarAd has provided these financing guarantees in the past. However, this is now a market from which MarAd, chastened by its many critics, has itself largely withdrawn. Congress should address this problem by directing MarAd to meet this need by making use of the Title XI program in some fashion. Perhaps this can be done by MarAd in a context of shipyard pre-certification, and MarAd assistance in whatever bonding or re-insurance arrangements may be required. But there is a clear role for a MarAd solution to this problem. It is needed. And, I would suggest that the solution to this problem should be addressed in connection with your Committee's current legislative efforts.

2.0 Long-Term Permanent Financing.

There is general agreement upon the need for a national transportation policy that will include the use of our Great Lakes and Ocean Coastal waters. But where are the Container and Roll-on /Roll-off ("Ro/Ro") vessels that will be needed? How is this to be achieved? Many of us believe that the principal problem is the absence of available financing.

In some circles today it is common parlance that there is adequate long term private sector financing available for new vessel construction such that there is no need for the MarAd Title XI program. This is true today, as it has been for many years, in financing new vessel construction for the petroleum sector. In my law practice, I have been professionally involved in such petroleum sector vessel financing for more than 30 years.

However, this is not true for the new Container and Ro/Ro vessels that are needed in our Great Lakes and Ocean Coastal trades. These vessels have and will cost in the range of $150 million to $250 million. The owners of these vessels will have no long term charters, but will be in "build the ships and customers will come" situations. There will be no 20 year or 25 year vessel financing without a Title XI or some similar government guarantee program (except in the very unusual situation of a strong parent company guarantee).

And, this is apparently also true for the less costly fast passenger and light vehicle ferries such as the Lake Express service across Lake Michigan and the HawaiiSuperferry inter-island project. HawaiiSuperFerry Chairman John Lehman, and Lake Express President Kenneth Szallai, have each publicly stated that the Title XI program was an essential element of their ferry vessel financing structure.

3.0 General Discussion: Current Problems & Solutions.

3.1 American Marine Highways.

I believe that everyone in this room today will agree that many of our major Interstate highways, and their bridge and tunnel connectors, are at or have already materially exceeded their design capacities. We will also agree that the major and ever worsening congestion problems that we are experiencing can no longer be solved by new highway, or bridge or tunnel construction. And, we see our Great Lakes and Ocean Coastal waterways, our American Marine Highways, empty of the passenger and cargo vessels that might provide a part of our solution. Where are the vessels and how are we to achieve a solution?

I am here today to testify to the essential role that the MarAd Title XI program has played during the past 35 years in financing Container and Ro/Ro vessels for our existing U.S. flag blue water fleet, and to suggest that with certain minor "course corrections" this same MarAd Title XI program can play a similarly important role in providing construction period and long-term permanent financing for the vessels that will be needed in the coming decades to transport our citizens and freight on our American Marine Highways.

We can see clearly before us these available empty "highways." But we also have before us a MarAd Title XI financing guarantee program that can facilitate the private sector financing for the needed vessels, once this program is redirected and refocused with leadership provided by this Congress.

3.2 History & Current Program Application.

The MarAd Title XI program was added to the basic Merchant Marine Act, 1936, package when the 1936 Act sponsors recognized that some form of U.S. government credit support would be essential to achieving the 1936 Act objectives. It has been an important clement in the financing of large ocean going U.S. flag vessels almost since its 1938 "Mortgage Insurance" beginnings.

Over the years, the Title XI program has been employed in the financing of Great Lakes and Non-Contiguous Trade vessels needed to provide essential national transportation services. As originally enacted in 1938, and as incorporated in the 1970 Act program, and redesigned in the Federal Ship Financing Act of 1972, the Title XI program was intended for use in financing vessels employed in essential transportation services in peacetime and that would be available to meet national defense needs in time of war.

It was only in 1972 that MarAd abandoned this policy, and that the Title XI guarantee authority was first used to finance the construction of drilling vessels and other non-transportation assets. I would suggest that your Committee should consider the return of the Title XI program to its original purposes. MarAd should administer the program in a fashion that will achieve the Congressional policy as stated in the 1936 Act and the 1970 Act, and limit the program use to new vessel construction and closely related objectives.

Consistent with these transportation objectives, Congress should maintain the use of the authority for assisting in the financing of vessel dry docks and shipyard modernization, and

Congress should authorize the expansion of the guarantee authority to include the terminal and dockage facilities that will be essential to the expanded Great Lakes and Ocean Coastwise Container and Ro/Ro services. The use of the Title XI program to finance any other non-transportation assets should be strictly limited to Congressionally mandated exceptions to these general rules.

3.3 Congressional Funding & Oversight.

I would suggest that the Committee consider a revised MarAd Title XI program that would be authorized and funded for a seven-year or similar period with monies adequate to provide guarantee authority and program administration sufficient to meet current and projected United States national transportation and national security needs, as these needs are identified and defined by Congress. The MarAd Title XI program should "course corrected" with financing guarantees limited to vessel types and services keyed to defined national transportation and national security needs.

MarAd should be directed to revise its "letter commitment" procedures to more closely conform to commercial practice, and should issue letter commitments that include Congressional funding as a condition to the issuance of the Government guarantee. This will greatly facilitate the financing of the new private sector Great Lakes and Ocean Coastal vessel services that are needed. This will also enable MarAd to come before Congress seeking funding for a list of qualified vessel guarantee projects rather than seeking a "blank check" in the annual authorization and appropriations process.

Congress could in this fashion oversee and control the use of the guarantee authority by means of the authorization and appropriations process. Congress should require that MarAd present to Congress the projects that MarAd has approved (conditioned upon Congressional appropriations) as a part of the MarAd yearly requests for Title XI authorization and funding. This would enable Congress oversight in assuring that the Title XI guarantee authority is being used to fulfill Congressionally mandated goals.

3.4 National Transportation "Start Up Services" & Lease Financing.

Title XI program financing regulations, such as those governing debt equity ratios and working capital, should be examined and revised to confirm their suitability to meeting the needs appropriate to a national transportation "Start Up Services" program. For many new ventures in the decade following the enactment of the 1970 Act, vessel leasing was the vessel financing

method of choice. Leasing is particularly attractive to vessel operators in many start up situations because of the need for working capital and the inability of such start ups to make full use of federal income tax vessel depreciation deductions. As a contribution to the process of developing the outlines for such a "Start Up Services"program, I will be submitting for the record a paper that I have prepared that explores the uses of the MarAd Title XI program, and of MarAd's capital construction fund ("CCF") tax deferral program, in this context.

4.0 Thank You & Concluding Thoughts.

I have appreciated this opportunity to appear before you to testify in response to your invitation of March 9th. My Seward & Kissel colleagues and I look forward to working with your Committee in any way in which we can assist your efforts to develop policies that will enable the United States to achieve and maintain:

> "a merchant marine (1) sufficient to carry its domestic water-borne commerce . . .; (2) capable of serving as a military and naval auxiliary in time of war or national emergency; (3) owned and operated as vessels of the United States by Citizens of the United States; (4) composed of the best-equipped, safest and most suitable types of vessels and manned with a trained and efficient citizen personnel; and (5) supplemented by efficient facilities for building and repairing vessels"

as mandated by Section 101 of the Merchant Marine Act, 1936, as amended (46 U.S.C. 50101).

Thank you for your time and attention.

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H. Clayton Cook, Jr. is a Counsel in the firm's Corporate Finance Group. Mr. Cook has been engaged in private law practice or U.S. government service since 1960. He joined Seward & Kissel in 2004 to assist the firm in building a Washington maritime practice.

Mr. Cook advises U.S. and foreign clients (financial institutions, shipyards and industrial corporations, private shipowners and ship operators) in the structuring and implementation of transactions involving the construction, ownership and financing of U.S. flag vessels, and in related dealings with U.S. government departments and agencies. During his service as Maritime Administration General Counsel, Mr. Cook was responsible for the drafting of the 1970 Act Capital Construction Fund (CCF) regulations, and the 1972 Act changes to the Title XI program. His client assignments have involved numerous Title XI financings and precedent setting CCF projects. CCF work has included: the program's first use of leveraged lease financing transactions; the first and only U.S. shipyard CCF award; and computer programs to measure CCF benefits in vessel purchases and in leveraged lease financing transactions. Mr. Cook has represented major oil companies and other non-citizen interests (including Bowaters citizens and 46 U.S.C. 12106(e) and (f) citizens) on Shipping Act, 1916 citizenship issues in the ownership, operation and chartering of U.S. vessels in our coastwise and Great Lakes trades and fisheries.

Mr. Cook graduated from Princeton University in 1956. He received his LL.B. from The University of Virginia in 1960, where he was Executive Editor of the Virginia Law Review and a member of the Raven Society and The Order of the Coif. Mr. Cook commenced practice with Sullivan & Cromwell in 1960. He joined Pepper, Hamilton & Scheetz in 1965, where he was elected to the partnership and served as Sun Oil Company's senior tax counsel before becoming General Counsel of the Maritime Administration in 1970. At the completion of his government service, Mr. Cook joined Cadwalader, Wickersham & Taft where he was the partner responsible for developing Cadwalader's Washington maritime practice.

Mr. Cook is a Life Member of The American Law Institute, a member of the Maritime Law Association of the United States (Maritime Finance Committee) and a member of the American and District of Columbia Bar Associations.

QUESTIONS AND ANSWERS SUBMITTED FOR THE RECORD

MARCH 15, 2007

QUESTIONS SUBMITTED BY MR. LARSEN

Mr. LARSEN. How many Title XI loan guarantees are currently outstanding?

Mr. CONNAUGHTON. 73.

Mr. LARSEN. How many loan guarantees have been approved during the Bush Administration?

Mr. CONNAUGHTON. 26.

Mr. LARSEN. How much time is added on to review of Title XI loan guarantees by Credit Council review? Before the Credit Council was established, what was the average time for a Title XI loan guarantee review and now that a Credit Council review is required, how much extra time is added?

Mr. CONNAUGHTON. There is no "average time" for review of a Title XI loan guarantee that would fairly represent the review process. Each application for a guarantee can vary greatly, from one that is from an established operator for a replacement vessel in an existing service to one from a start-up company for a vessel involving new technology in a new market. Clearly, the former will require far less time to review than the latter. Such factors as market volatility and the operator's financial condition also add to the review time of a particular application. The speed with which the applicant responds to the agency's requests for additional information is a further factor in the review time. Each application is unique and there is no one amount of processing time that can be said to be representative. There is only one Title XI application that has undergone the Credit Council review process and it was for a new operator with a new service. The Credit Council review process is intended to accompany the Maritime Administration's review process and should not add time.