

ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECT FILES 8672
1538 SCOMM 57: SENATE SPECIAL COMMITTEE ON OIL & GAS, 1987-1988 1335

Mr. Eric Holmberg, Governor, Alaska, Washington, D.C.
FROM: Mayor Herbert Petroski, Anchorage, Alaska
SUBJECT: CDS Tankers
DATE: April 2, 1987

Our June 1985 analysis showed that CDS tankers could save 45% on average shipping costs over non-CDS tankers. This amounted to \$1.25/bbl for Gulf Coast shipments and \$0.57/bbl for West Coast shipments. Since repayment we have seen average tanker rates to destinations east of Panama drop 75 cents.

The three CDS tankers now engaged in AMS trade are moving oil to the U.S. Gulf Coast, and can carry 60 million barrels of AMS per year.

The losses to the State from removal of these tankers would accrue from lower wellhead values due to higher transportation costs. We estimate these losses to be a minimum of \$10 million and as much as \$50 million annually:

Royalty Effect

$$60 \times 1.25 \times .125 = \$9.4$$

Severance Tax Effect

$$60 \times 1.25 \times (1 - .125) \times .15 \times .84 = \$8.3$$

TOTAL \$17.7 million

(The severance tax is levied on non-royalty oil. The severance tax rate is 15 percent. The economic limit factor (ELF), which reduces the effective severance tax rate as well productivity declines, is estimated to be 0.84 over the near term.)

This can be considered a conservative estimate. The reduced competition from removal of the tankers (the tanker market is tight now) could raise transportation cost for all AMS, in which case the State could stand to lose over \$50 million annually if tanker rates on all shipments to the Gulf Coast returned to the previous level:

Royalty Effect

$$300 \times 0.75 \times .125 = 28.1$$

Severance Tax Effect

$$300 \times 0.75 \times (1 - .125) \times .15 \times .84 = 24.8$$

TOTAL \$52.9 million

March 18, 1987

The Honorable Elizabeth H. Dole
Secretary
Department of Transportation
400 Seventh Street S.W.
Room 10200
Washington, D.C. 20590

STANDARD OIL

Dear Secretary Dole:

The Standard Oil Company is the major shipper of Alaskan crude oil. Two of the three VLCC class CDS vessels that were "sanitized" in 1985 are in our service under long term charter. In fact, any action which affects the supply and demand for Jones Act tonnage is of concern to us. As a result, we are closely following the Department's response to the U.S. Court of Appeals' decision in First Attransco Tanker Corp. vs. Dole which vacated the Department of Transportation's ruling on the payback rule.

It is our view that the outcome of this case may also impact an earlier court ruling regarding the Department of Transportation's rule for allowing CDS ships to enter Jones Act service temporarily under six-month waiver. That rule specified that the Secretary need only consider the impact on Jones Act vessels of over 100,000 DWT prior to issuing a waiver for temporary entry of CDS ships into the Alaskan trade. However, the Court held that the Secretary must also consider the impact on smaller Jones Act ships and directed the Secretary to reconsider the present rule.

Standard believes that the need for these ships is quite evident. CDS ships were routinely employed in Alaskan trade prior to the sanitization of vessels under the payback rule. In the meantime, production from Prudhoe Bay and Kuparuk has increased, the Lisburne field has begun production, and the Endicott field is expected to begin production in the fourth quarter of 1987. If the two rules were overturned, it is difficult to see how Alaskan oil flow could be maintained without a significant economic penalty. Essentially all available ships will be required all of the time to satisfy normal coastwise trade and move the Alaskan oil.

Given the current situation, I urge you to take the following actions. First, reduce uncertainty in the marketplace by issuing your proposed new rule on payback in a timely fashion relative to the July 16, 1987 date after which the sanitized ships would otherwise be obliged to exit Jones Act service. Second, use the rulemaking to clarify the status of the Bayridge, a vessel sanitized earlier whose status remains unclear. Third, do not join the CDS payback issue with the CDS waiver issue in the context of the proposed rulemaking. The CDS waiver issue is best considered separately after the outcome of the sanitization issue is known.

Sincerely,



FEM:drc

Repayment of Construction Differential Subsidies (CCS)
(also called "CCS Sanitization")

DISCUSSION ISSUES:

The following information should be noted in discussion of CCS Sanitization:

- This is a significant economic issue for Alaska. Removal of the four large efficient ships will require using nearly all the smaller ships available, driving the market price for all shipping up by \$.25 to \$1 per barrel. Netback values on the crude oil will decline accordingly. Each \$.50 per barrel reduction in netback represents roughly \$75 MM per year in lost state revenues.
- Alaskan oil production has increased significantly in the last year, highlighting the need for efficient transportation. The Lisburne field (40-50 MBD) began commercial production in early 1986. Prudhoe Bay production increased with natural gas liquid (NGL) recovery in early 1987 (50 MBD). Kuparuk has reached peak production, and Endicott field is expected to begin production in the fourth quarter of 1987 (up to 100 MBD).
- Largely because of the increased Alaskan production the four large, efficient VLCC vessels in question have been in continuous service since repayment of their remaining subsidy: the BROOKLYN and the BAYBRIDGE under charter to EXXON, and the ARCO INDEPENDENCE and the ARCO SPIRIT under long term charter to Standard Oil.
- Larger vessels make the transport of crude oil to the West Coast and Gulf Coast more economically efficient than smaller vessels. This is especially true to the Gulf Coast, which accounts for a substantial portion of the Alaskan oil delivered.

Repayment of Construction Differential Subsidies (CDS)
(also called "CDS Sanitization")

On January 16, 1987, the U.S. Court of Appeals decision in First Attranco Tanker Corp. vs. Dole vacated a Department of Transportation ruling under which three very large crude carrier ships (VLCC's) repaid the remainder of their construction subsidies in 1985/86 and thus became Jones Act ships, rather than just U.S. flag ships. The Court ruled that the Secretary of Transportation was well within her authority to permit this repayment, but that procedural defects in not adequately explaining the effect of this action on other Jones Act ships rendered the rule unjustified. The decision requires all three ships to exit Alaskan service on July 16, 1987, unless the Department of Transportation explains the effect on other Jones Act ships to the court's satisfaction.

Prior to repaying the subsidy these three large, efficient U.S. flag ships were not allowed to carry Alaskan oil unless there were no suitable Jones Act ships available. Even under those circumstances these efficient ships could only be used part time (no more than six months out of the year). A fourth ship which entered Jones Act trade under generally similar circumstances in 1983 is also vulnerable to the ruling. In total these four ships are currently moving 200,000 barrels of Alaskan oil to market every day. If they are taken out of the fleet then a large number of much smaller, less efficient and more expensive ships must take their place if the Alaskan oil is to get to market. This increased demand will raise the market price for all Jones shipping, by an estimated \$.25 to \$1.00 per barrel.

Any action which affects the supply and demand for Jones Act tonnage is of concern to Alaskan oil producers and to the State of Alaska. An increase in the cost of transportation not only reduces oil company income and incentives in Alaska but also reduces the netback value of all Alaskan production. For example each \$.50 increase in per barrel transportation costs would reduce state income by roughly \$75 MM per year.

Given this situation, the State of Alaska should support the DOT's intention to issue a new rule in a timely fashion relative to the July 16, 1987 deadline. The DOT should use the rulemaking to clarify the status of the BAYRIDGE, the fourth vessel referred to above, as well as confirming that the three other vessels at issue (ARCO SPIRIT, ARCO INDEPENDENCE, and the BROOKLYN) should remain as Jones Act vessels.

1 IN THE SENATE

BY FAHRENKAMP

2

SENATE JOINT RESOLUTION NO. 43

3

IN THE LEGISLATURE OF THE STATE OF ALASKA

4

FIFTEENTH LEGISLATURE - FIRST SESSION

5

Relating to the shipping of Alaska oil.

6 BE IT RESOLVED BY THE LEGISLATURE OF THE STATE OF ALASKA:

7

WHEREAS on January 16, 1987, the United States Court of Appeals for the District of Columbia vacated a United States Department of Transportation rule under which three very large crude oil carrier ships, the Arco Independence, the Arco Spirit, and the Brooklyn were allowed to operate in the United States domestic shipping market; and

12

WHEREAS the court decision would require all three ships to stop domestic shipping of Alaska oil by July 16, 1987, unless the United States Department of Transportation adopts another rule to allow the ships to continue their domestic shipping; and

16

WHEREAS a fourth ship, the Bayridge, that is used in Alaska oil shipping may also be affected by the court decision; and

18

WHEREAS Alaska oil production has increased significantly in the last year, and these four ships currently move 200,000 barrels of Alaska oil to market every day; and

21

WHEREAS if the four ships are prohibited from engaging in domestic shipping, a large number of much smaller, less efficient and more expensive ships will be required to take their place to transport Alaska oil to market, and this change would raise the cost of transportation for all Alaska oil shipped in these smaller ships by an estimated \$.25 to \$1.00 per barrel, and netback values on the oil would decline accordingly; and

27

WHEREAS if the Arco Independence, the Arco Spirit, and the Brooklyn are not allowed to engage in the domestic shipment of Alaska oil, the direct economic loss to the state will be between \$18,000,000 and

1 \$150,000,000 annually; and

2 WHEREAS if the United States Department of Transportation fails to
3 adopt a rule by July 16, 1987, allowing these four ships to operate in the
4 domestic shipping market, the transportation of Alaska oil may be disrupt-
5 ed, the transportation costs will increase dramatically, and the state and
6 the federal government will lose a significant amount of revenue; and

7 WHEREAS the substitution of a large number of smaller ships could
8 disrupt the transportation of Alaska oil because the smaller ships are
9 often older, less well-equipped, and less safe, and because the increased
10 number of ships could cause congestion at docking facilities; and

11 WHEREAS the best-equipped and safest ships should be used for the
12 transportation of oil in order to protect the environment and communities
13 through which the ships pass;

14 BE IT RESOLVED that the Alaska State Legislature respectfully urges
15 the Secretary of the United States Department of Transportation to adopt
16 before July 16, 1987, a rule that would enable the Arco Independence, the
17 Arco Spirit, the Bayridge, and the Brooklyn to continue to operate in the
18 United States domestic shipping market without interruption.

19 COPIES of this resolution shall be sent to the Honorable Elizabeth H.
20 Dole, Secretary of the U.S. Department of Transportation; and to the Honor-
21 able Ted Stevens and the Honorable Frank Murkowski, U.S. Senators, and the
22 Honorable Don Young, U.S. Representative, members of the Alaska delegation
23 in Congress.

5-1050A
Bannister
4/15/87

1 IN THE SENATE

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20 market every day; and

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24 market, and this change would raise the cost of transportation for all
25 Alaska oil shipped in these smaller ships by an estimated \$.25 to \$1.00 per
26 barrel, and netback values on the oil would decline accordingly; and

27 WHEREAS each \$.50 per barrel reduction in the netback value of the oil
28 formerly transported by these four ships would represent roughly \$7,500,000
29 per year in lost revenue to the state; and

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2 adopt a rule by July 16, 1987, allowing these four ships to operate in the
3 domestic shipping market, the transportation of Alaska oil may be disrupt-
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APR 20 1987

Billing Code No. 4910-81

DEPARTMENT OF TRANSPORTATION
Maritime Administration

[Docket No. 110]

Construction-Differential Subsidy Repayment

AGENCY: Maritime Administration, Department of Transportation.

ACTION: Notice of Proposed Rulemaking.

SUMMARY: This rule would allow four vessels that repaid their construction-differential subsidy (CDS) in exchange for the right to operate in the domestic trade to remain in that trade. Three of those vessels have been operating in the Alaska oil trade after repaying their CDS under a 1985 Department of Transportation rule. A recent court decision vacated that rule, but delayed the effective date of its order to July 16, 1987. The fourth vessel was approved to repay its CDS by an administrative decision in 1980 under conditions of an interim rule that was subsequently vacated by the court. However, the court allowed the vessel to remain in the domestic trade pending agency reconsideration of the rule. In response to those court decisions, this proposed rule would allow those four vessels to remain in the domestic trade in furtherance of the purposes and policies of the Merchant Marine Act, 1936, as amended.

DATES: Comments must be received by May 14, 1987, 1987.

ADDRESS: Submit comments to James E. Saarl, Secretary, Maritime Administration, Room 7300, 400 Seventh Street, S.W., Washington, D.C. 20590. The Maritime Administration requests that commenters send six copies of their comments.

FOR FURTHER INFORMATION CONTACT: Lynne Adams-Whitaker, Chief, Division of Regulations, 400 Seventh Street, S.W., Washington, D.C. 20590, Tel. (202) 366-5181.

SUPPLEMENTARY INFORMATION:

Background

The Jones Act (46 U.S.C. 883) generally provides that all cargo transported in the domestic trade between points in the United States must be carried on vessels built in the United States, documented under United States law and owned by United States citizens. While United States vessels in the domestic trade operate under the protection of the Jones Act (46 U.S.C. 883), vessels operating in the foreign trade do not have such protection. Thus, vessels operating in the foreign trade must compete with foreign-flag vessels that have lower operating and construction costs. To offset these higher U.S. construction costs, Congress passed Title V of the Merchant Marine Act, 1936, as amended ("the Act"), which authorized the payment of construction-differential subsidy (CDS) for the purpose of building ships in U.S. shipyards to be operated in foreign

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commerce. 46 App. U.S.C. 1151 et seq. The Secretary of Transportation, through the Maritime Administration (MARAD), may pay as much as half the construction costs of vessels used in the U.S. foreign trade. 46 App. U.S.C. 1152. There is no corresponding subsidy program for vessels constructed by U.S. owners exclusively for use in the domestic trade. In 1970, Congress expanded the scope of the Act to include bulk (i.e., tanker or dry bulk) vessels. Merchant Marine Act of 1970, Pub. L. 91-469, 84 Stat. 1018.

In addition, Title VI of the Act authorized the payment of an operating-differential subsidy (ODS) for U.S.-flag vessels manned by U.S. citizens and operated in accordance with U.S. safety standards. 46 App. U.S.C. 1171. By a policy decision, ODS was not paid to CDS-built bulk-vessels over 100,000 DWT. Because of the large economy of scale of these vessels, labor costs, which are the essential subsidized item under the ODS program, are relatively small in terms of the overall project cost.

CDS-built vessels are subject to certain restrictions. Under section 506 of the Act, vessels constructed with CDS "shall be operated exclusively in foreign trade or on a round-the-world voyage. . . ." 46 App. U.S.C. 1156. Section 506 of the Act allows CDS vessels to be operated in the domestic trade in the following limited circumstances: (1) on a round voyage from the

west coast of the United States to European ports which includes Intercoastal U.S. ports; (2) on a round voyage from the Atlantic coast of the U.S. to the Orient which includes Intercoastal ports of the U.S.; (3) on a foreign voyage including a stop in Hawaii or an island possession or territory of the U.S. In addition, CDS vessels may be operated in the domestic trade with the consent of the Secretary of Transportation for up to six months in any year under authority of section 506 with the requirement that the vessel owner repay the subsidy on a pro rata basis. All domestic trading restrictions for each CDS-built vessel lapse at the end of the vessel's statutory life. Section 9 of Pub. L. 86-318 (74 Stat. 216) sets a 20 year economic life for tankers.

The overall objectives of the 1970 amendments to the Act were to encourage U.S. shipbuilding, thus enhancing the U.S. merchant marine fleet, and to serve the needs of national commerce and defense. The specific goal of the 1970 amendments was to build 30 ships per year over ten years, with emphasis on building bulk carriers, including tankers, for operation in the foreign commerce.^{1/} Prior to the 1970 amendments, the direct subsidy programs of the Merchant Marine Act had been confined to liner vessels, which operated scheduled services in foreign commerce under the regulatory supervision of the Federal Maritime

^{1/} In fact, only 34 petroleum tankers were built with CDS authorized by the 1970 amendments.

Commission. The Congress, in extending the reach of these programs to the unregulated bulk trades, specifically recognized the need to make these vessels "competitive" with foreign flag ships. See H. Rep. No. 1073, 91st Cong., 1st Sess., 38 (1969); Merchant Marine Act, 1936, 603(b), 46 U.S.C. 1173(b). There was however, no guarantee that even with these subsidies U.S.-flag vessels could compete in the U.S. foreign commerce.

Unfortunately, the governmental subsidy programs offered to U.S.-flag very large crude carriers ("VLCCs", i.e., tankers over 160,000 DWT) has not enabled them to be competitive in the foreign trade. In 1970, Congress did not foresee, and perhaps could not have foreseen, the drastic changes that would occur in the world oil market. The decline in export of crude oil from the Middle East, in addition to an oversupply of world tankers built since 1970, has been financially devastating for the world tanker market. Further, the gap between foreign construction costs and U.S. construction costs widened beyond the level Congress authorized under the CDS program. As a consequence, the two ultra large crude carriers and nine VLCCs constructed with CDS under the 1970 amendments were left with no significant competitive opportunities in the foreign commerce.

The domestic market, however, has not fared as poorly. With the opening in 1977 of the Trans-Alaska Pipeline System, the demand for U.S.-flag tanker tonnage has increased and that demand has

not been completely met by the existing Jones Act (domestic) fleet. To alleviate the shortage of suitable Jones Act tanker vessels, MARAD has allowed CDS-built tankers to enter the trade for up to six month periods after repaying the subsidy pro rata under section 505 of the Act and in accordance with 46 CFR Part 250.2/ Since 1977, MARAD has approved 43 such applications for CDS-built tanker service in the Alaska oil trade (of those approvals, 37 were for VLCCs). However, because of the limited duration and availability of these temporary permissions and the depressed market conditions confronting tankers in the foreign trade, several CDS tanker owners (predominantly those owning VLCCs) applied for permission to enter the domestic market on a permanent basis in exchange for the total repayment of any unamortized CDS received plus interest.

Prior to 1978, requests for permanent repayment were handled ad hoc. No hearings were held on these requests and notice of the proposed determinations was not given to the public. However, after MARAD admitted the VLCC STUYVESANT (operated by Seatrain Lines) to the domestic trade, competitors in that trade

2/ 46 CFR Part 250 establishes procedures by which MARAD may temporarily waive (i.e., for no more than six months in any twelve month period) the domestic trade restrictions on CDS-built vessels over 100,000 deadweight tons (DWT) in the Alaska-Panama Canal trade. Applications for such waiver must be accompanied by information showing that suitable vessels (i.e., those over 100,000 DWT) of a competitor would not be available for the prospective voyage.

brought suit challenging MARAD's action. The ultimate disposition of the suit was that, on writ of certiorari, the Supreme Court held that the Secretary's broad contracting powers and discretion to administer the Act encompass the authority to grant permanent release to vessels under CDS restriction.

Seatrail Shipbuilding Corp. v. Shell Oil Co., 444 U.S. 572 (1980).

In 1978, MARAD issued a notice of proposed rulemaking (NPRM) that would have set guidelines for permanent CDS repayment. Charterers and owners of six CDS-built vessels applied for CDS repayment. On October 15, 1980, MARAD adopted and made immediately effective an interim rule to govern applications for CDS repayment. Under the interim rule, MARAD retained greater discretion than proposed in the (NPRM) to determine whether to grant or deny CDS repayment applications. Approvals would be granted only for vessels of at least 100,000 DWT and only in exceptional circumstances, after a determination that no favorable opportunities existed for viable employment of the vessel in foreign trade during a protracted period. MARAD was to consider a number of factors in determining whether exceptional circumstances existed.

On November 13, 1980, through an adjudicative decision, MARAD approved the CDS repayment application for the BAY RIDGE, another

Seatrail vessel. MARAD deferred action on the other pending CDS repayment applications. On November 25, 1980, the Independent U.S. Tanker Owners Committee filed a complaint in the U.S. District Court for review of the interim rule and the BAY RIDGE decision, alleging substantive and procedural defects in connection with both actions. The District Court granted summary judgment for defendants on all counts. An appeal was taken.

The Court of Appeals considered the alleged substantive and procedural defects of the interim rule. The Court concluded that MARAD was not legally obligated to issue regulations limiting its discretion and that the interim rule itself did not constitute an abuse of MARAD's statutory discretion. Nevertheless, the Court vacated the interim rule on procedural grounds. It concluded that the rule lacked a general statement of basis and purpose, as required by the Administrative Procedure Act (5 U.S.C. 551 et seq.), to explain MARAD's position on the various issues raised during the rulemaking proceeding. The Court also found that adjudication allowing the BAY RIDGE repayment was procedurally and substantively flawed.

The Court of Appeals remanded the case to the District Court with instructions to vacate the interim rule and to order new rulemaking procedures, and to vacate the approval of the BAY RIDGE application, but to allow the BAY RIDGE to continue in

domestic operation pending reconsideration of the BAY RIDGE adjudication. The Court left to MARAD's discretion whether the new BAY RIDGE decision should await publication of a permanent rule regarding CDS repayment. The Court also left to MARAD's discretion whether to adopt a permanent rule similar to the interim rule so long as the justification for the rule adopted was "clearly and thoughtfully presented in a statement published contemporaneously with the rule". Independent U.S. Tanker Owners Committee v. Lewis, 690 F.2d 906, 920 (D.C. Cir. 1982) [hereinafter referred to as ITOC v. Lewis].

The Department of Transportation published a new NPRM on January 31, 1983, 48 FR 4408. That NPRM, which was issued by the Secretary, proposed to permit total CDS repayment for all U.S. tanker vessels. The notice reviewed the entire history of this issue since the MARAD first accepted total repayment on the VLCC STUYVESANT and reviewed the comments received on earlier MARAD rulemakings pertaining to total repayment in return for domestic trading privileges. It invited further comment on these issues and assessed the economic impact of allowing the owner/operators of these vessels to determine on their own whether to repay their CDS. The rulemaking concluded that the Government was not in a position to assess, on its own, which vessels should, and which should not, be allowed to meet the needs for additional capacity

in the domestic trade. For example, it pointed out that only allowing operators in financial jeopardy to repay their CDS was not consistent with the objectives of the 1936 Act. 48 FR at 4412.

The Department concluded that the marketplace decisions of individual operators would best serve the needs of the fully deregulated domestic tanker trade, provided that those operators that repaid were placed on an equal competitive cost footing with the existing Jones Act fleet. Id. at 4409-4410. Accordingly, the proposed rule would require repayment of an additional amount consisting of compound interest on the unamortized subsidy from the date of its original receipt. The addition of this amount, which frequently would exceed the unamortized subsidy itself, would duplicate the financial conditions inherent in a private sector decision to commit any comparable new asset to the domestic trade, with an allowance only for its age, by allowing the amortization of the subsidy pursuant to its statutory useful life of 20 years. See 48 FR 4408-4414. Since the Government does not otherwise regulate entry of new capacity in the domestic trade, duplicating the conditions ordinarily governing such entry was deemed the most appropriate approach.^{2/}

^{2/} Similarly, damaged foreign-built vessels may be acquired and reconstructed for use in the domestic trade under the Wrecked Vessels Act without prior government approval, provided a specific amount is expended in the reconstruction (i.e., three times their salvage value). 46 App. U.S.C. 14.

Shortly after the close of the comment period on the NPRM, the Congress took action to prevent the Secretary from promulgating a final rule. The DOT FY 84 Appropriations Act (Pub. L. 96-78, August 15, 1983) prohibited the enforcement of any rule with respect to the repayment of CDS until 60 days following the promulgation of any such rule. Thereafter, the Commerce Department's FY 84 Appropriations Act (Pub. L. 98-166, November 28, 1983) imposed an additional restriction that prohibited DOT from enforcing any CDS repayment rule until after June 15, 1984. In August of 1984, the FY 85 Appropriations Act for Commerce, Justice and State, which provides appropriations for MARAD, imposed yet another restriction. That Act prohibited the Department from enforcing any CDS repayment rule until May 15, 1985 (Pub. L. 96-411, August 30, 1984). Thereafter, Congress considered, but did not extend, these prohibitions.

On May 7, 1985, the Department published in the Federal Register a final rule which allowed any owner or operator of a tanker built with CDS to repay its subsidy (with interest) and consequently obtain a permanent removal of domestic trading restrictions. The amount of repayment included the unamortized CDS on the vessels plus compounded interest on that amount. The interest rate, to be used for computational purposes, was the rate at which the original Title XI obligation was made or the

Title XI long-term bond rate at the vessel's delivery. The final rule included a one-year time limit after the rule's effective date during which total CDS repayment had to be made irreversibly.

That time limit was from June 6, 1985 to June 6, 1986. During that time, three VLCCs repaid their CDS: the ARCO INDEPENDENCE (262,400 DWT), ARCO SPIRIT (262,400 DWT), and the BROOKLYN (226,200 DWT). The total amount of CDS repaid by these ships was \$105.8 million. Those ships are now operating in the domestic trade.

On January 16, 1987, the Court of Appeals for the District of Columbia held that the Secretary of Transportation violated section 553(c) of the Administration Procedure Act by adopting a final rule on CDS repayment which did not contain a statement of basis and purpose giving an adequate account of how the rule served the objectives of the Act and why alternatives were rejected in light of them. Independent U.S. Tanker Owners Committee v. Dole, Civil Action Nos. 85-01555, 85-01740, 85-01752 and 85-1771. (D.C. Cir. January 16, 1987) [hereinafter referred to as ITOC v. Dole]. The court found that the Secretary's failure to provide an adequate statement of basis and purpose was arbitrary and capricious. The court vacated the rule, but withheld issuance of its mandate until July 16, 1987 "to avoid

further disruptions in the domestic market and to allow the Secretary to undertake further proceedings to address the problems of the merchant marine trade." Slip op. at 16. The court ruled that, as of July 16, 1987, the present rule will be vacated and conditions will be returned to the status quo ante, before the CDS repayment rule took effect, subject to any "further action" that the agency may have taken in the interim.

By letter dated March 10, 1987, counsel for the BAY RIDGE requested that a proceeding on the BAY RIDGE should be conducted independently of proceedings with respect to the three vessels which repaid CDS pursuant to the repayment rule that has been vacated by the Court of Appeals. The court in ITOC v. Lewis specifically left to MARAD's discretion whether or not the BAY RIDGE decision should await publication of a permanent rule governing repayment applications. MARAD has decided that it would be appropriate to consider the BAY RIDGE in this rulemaking, since it affects the same domestic trade as the other three vessels at issue.

The Proposed Rule:

This proposed rule would reaffirm the allowance of the repayment of CDS, with interest, and rescission of the domestic trading restriction for tankers that applied to and were approved by

MARAD between June 6, 1985 and June 6, 1986. The approved applications were for the ARCO INDEPENDENCE, ARCO SPIRIT and BROOKLYN. Further, this proposed rule would reaffirm the allowance of the repayment of CDS, with interest, and rescission of the domestic trading restrictions for the BAY RIDGE, which was approved to repay its CDS in November 1980. It would impose the same conditions on the BAY RIDGE that were imposed in 1980.

This proposed rule would differ from the 1985 CDS repayment rule in that it does not provide a one-year window for applicants to seek MARAD approval of their CDS repayment. This proposed rule would impose the same terms and conditions on the three tankers that repaid during the one-year window as were required in the 1985 CDS repayment rule.

Comments:

MARAD solicits comments on this proposed rule from all interested parties. In particular, MARAD seeks comments on the future of the Alaska North Slope (ANS) trade.

The Purposes and Policies of the Merchant Marine Act:

The preamble to the Merchant Marine Act, 1936, as amended, states that the intent of the Act is "[t]o further the development and maintenance of an adequate and well-balanced American merchant marine, to promote the commerce of the United States, to aid in

the national defense. . . . The specific goals of the Merchant Marine Act, 1936, as amended, as set out in section 101 of the Act, are to foster the development and encourage the maintenance of an American merchant marine that is

(a) sufficient to carry its domestic water-borne commerce and a substantial portion of the water-borne export and import foreign commerce of the United States and to provide shipping service essential for maintaining the flow of such domestic and foreign water-borne commerce at all times, (b) capable of serving as a naval auxiliary in time of war or national emergency, (c) owned and operated under the United States flag by citizens of the United States, insofar as may be practicable, (d) composed of the best-equipped, safest, and most suitable types of vessels, constructed in the United States and manned with a trained and efficient citizen personnel, and (e) supplemented by efficient facilities for shipbuilding and ship repair.

46 App. U.S.C. 1101.

MARAD believes that this proposed rule, which would allow the four CDS-built very large crude carriers ("the four VLCCs") to remain in the domestic trade, would benefit the domestic water-borne commerce by providing vessels that are the "most suitable" for the Alaska-Panama oil trade, which would result in a "well-balanced" American merchant marine. Although originally built to operate in the foreign trade, these VLCCs are not competitive in that trade. If not allowed to operate in the domestic trades, the four VLCCs would likely be unemployed and possibly scrapped.

The balance of this statement discusses how this proposed rule would fulfill the objectives of the Act. The suitability of these vessels for the Alaska-Panama trade is discussed in more

detail in Section I. Section II discusses the effect of this proposed rulemaking on the U.S. tanker fleet operating in the foreign commerce. Section III analyzes the effect of this proposed rulemaking on the naval auxiliary. Section IV addresses the effects of this rulemaking on shipyards. Section V considers other objectives of the Act that support this rulemaking. Section VI addresses the alternatives considered by MARAD.

I. The Alaska Oil Trade and the Need for Suitable Tankers

The main purpose for allowing the four VLCCs to remain in the domestic trade is to foster the development of suitable vessels for that trade. "Suitability" is determined not only by the physical ability of a vessel to carry a certain product, but by market conditions. As will be shown below, market conditions in the oil trade have fluctuated drastically since the advent of the CDS program, affecting the distribution of oil in both foreign and domestic markets.

A. ANS Crude Oil Production

When the Trans-Alaska Pipeline opened in 1977, Alaska North Slope (ANS) crude oil loadings averaged 629,000 barrels per day (b/d). Average loadings have steadily increased since then. In 1982, average loadings reached 1.62 million b/d. Production for 1987 is expected to be 1.8

million b/d. The most rapid growth occurred between 1978 and 1980 when average loadings grew at an annual rate of 18.4 percent. Average loadings from 1980 to 1986 grew at an annual rate of 2.2 percent. (See Table 11-2 in Regulatory Impact Analysis).

B. The Distribution of ANS Crude Oil

While ANS crude oil production has grown steadily since 1977, the distribution of that oil has changed dramatically. ANS crude oil is shipped to the West Coast, to Panama, to the Gulf and East Coasts from Panama, and to the Virgin Islands around Cape Horn.^{4/} In the five months of 1977 when ANS oil production began, approximately 75 percent of the oil from Valdez, Alaska was shipped to the West Coast, 24 percent to Panama (to be shipped to the Gulf/East Coasts), and two percent to the Virgin Islands. Shipments to Panama increased to 30 percent of total loading in 1980, and peaked at 43 percent in 1982. During this period, the volume of oil going to the West Coast dropped from 63 percent to 50 percent. During 1986, 32 percent of the Alaska oil was shipped to Panama, and 62 percent to the West Coast.

^{4/} All of the oil carried to the Virgin Islands currently is moved in foreign-flag vessels via Cape Horn.

The amount of future ANS shipments to Panama will likely decline, for several reasons. More ANS crude oil will likely be shipped to the West Coast during 1988 due to the imminent opening of the All-American pipeline from Southern California to the Texas Gulf, assuming the pipeline is completed in that time frame. This pipeline will have a capacity of 300,000 b/d and will ship surplus West Coast crude to the Gulf Coast for refining. While increases in West Coast crude production are anticipated, the surplus pipeline capacity would probably eliminate some need for vessels to carry the oil to Panama (to be shipped to the Gulf). Valdez loadings may decline in the 1990's due to production reduction as well as the potential construction of a 105,000 b/d (rated capacity) refinery at Valdez by Alaskan Refining, Inc. Products from the refinery may be transported abroad on foreign-flag tankers, thus reducing the shipments of oil from Valdez for U.S.-flag tankers.

C. Tanker Demand in the ANS Crude Oil Trade

Tanker demand in the ANS trade depends on ANS oil production and the distribution of the oil. As production increases, so does the amount of tonnage needed to carry the oil. However, the increase in demand for tankers may not be proportional to oil production if there is also a change in the distribution of the oil. For example, tanker demand

peaked in 1982 when approximately 182 billion-barrel miles of oil were shipped. This peak in demand was due not only to the increased production of oil, but also due to the peak in shipments to Panama (43 percent of total loadings). A drop in ANS crude oil shipments between 1982 and 1984 (from 7.2 million DWT to 5.9 million DWT) was attributable not to production, which remained fairly constant, but to a drop in oil shipments to Panama and corresponding rise in shipments to the West Coast.

The distribution of oil affects the demand for certain size tankers. Historically, VLCCs have carried the majority of oil from Alaska to Panama (See Table 111-2 in the Regulatory Impact Analysis). During 1986, about half the full-time equivalent tanker employment in the Alaska-Panama trade was for vessels from 200,000 DWT to 265,000 DWT; most of the other half was for VLCCs from 170,000 DWT to 190,000 DWT. A small percentage was carried by tankers from 110,000 DWT - 137,000 DWT, while only 0.6 percent in 1986 was carried by vessels under 100,000 DWT. (Historically, the share carried by tankers under 100,000 DWT has been no more than six percent.) Even prior to the 1985 CDS repayment by four of the VLCCs, the Valdez-Panama trade was dominated by

tankers over 100,000 DWT. Many of these were CDS built VLCCs operating under six month permissions in the domestic trade.

Several factors contribute to the suitability of the four VLCCs for this trade. VLCCs are more suitable for long-haul, high volume trades than smaller tankers, due to economies of scale. That is, tanker operating costs do not rise as fast as cargo volumes. Thus, VLCCs are more efficient and economical than smaller tankers for long-haul, high-volume trades. Studies of optimal ship size have shown that optimal ship size is determined by minimizing costs per ton at sea and in port. (In port, costs per ton increase with ship size; at sea, however, costs per ton decline with ship size). J.O. Jansson and D. Shneerson, "The Optimal Ship Size," Journal of Transport Economic and Policy, 217, 223 (Sept. 1982). VLCCs are more suitable for the Panama leg of the ANS trade because of the length of the voyage (approximately 4,950 miles). The at-sea time is significantly longer than any other legs of U.S.-flag oil shipments in the U.S. Another factor contributing to the suitability of the VLCCs for the Panama leg is the deep-draft of the Panama port, which can accommodate those larger

tankers. Because of these factors, VLCCs are able to carry oil in that trade more efficiently than smaller tankers under 100,000 DWT.

Conversely, smaller tankers are more suitable for the West Coast and upcoast (Gulf/East Coast) trade than the Panama trade. The Valdez-West Coast ANS trade has been served by vessels in all DWT ranges: 47 percent of the full-time equivalent tanker employment in that trade is carried by vessels under 100,000 DWT; 53 percent is carried by tankers over 100,000 DWT.

Once the oil reaches Panama, smaller tankers (i.e., under 150,000 DWT) are needed to carry the oil to the Gulf and East Coasts. (VLCCs are less suitable than smaller tankers for such short haul, low volume trades, because their capital and port charges, which are higher than those for smaller tankers, are spread over smaller cargo volumes.) Tankers under 55,000 DWT carry 22 percent of the Panama-Gulf/East Coast ANS oil. Tankers in the 55,000 DWT to 92,000 DWT range now carry about two-thirds of the ANS oil in this trade. Such tankers are more suitable for that trade than larger tankers because they often stop at many ports (which would not be economical for larger tankers to do), and most Gulf/East Coast ports are not deep-draft.

Further, the at-sea time is much less because of the shorter distances involved.

The Regulatory Impact Analysis indicates certain trends in the distribution of oil by trade and by vessel tonnage. Since the permanent entrance of the three CDS-built VLCCs in the domestic trade (i.e., from 1985-1986), the percentage of full-time equivalent tanker employment for VLCCs over 200,000 DWT in the Alaska-Panama trade has risen considerably, and employment by vessels under that tonnage range has decreased correspondingly. It appears that the trend of these VLCCs carrying the majority of Valdez-Panama ANS trade will continue.^{5/}

Allowing the four VLCCs to remain in the domestic trade makes the domestic fleet better balanced than it would be without these vessels in the trade. It should be noted that, even with the four VLCCs in the domestic trade, shortages of tankers have led to one smaller CDS-built tanker, the BEAVER STATE, entering the trade for a month

^{5/} It should be noted, however, that in some years, the full-time equivalent of three VLCCs operated in the ANS trade under six month waivers pursuant to 46 CFR Part 250.

under a section 506 waiver. (See Regulatory Impact Analysis). Further, only six percent of the domestic tankers (12 tankers) were in lay-up as of February 1987. This percentage is quite low, considering that February is a slow month for the upcoast oil trade and is a reasonable reserve to cover temporary losses from the active fleet due to casualties, safety inspections and repairs as well as seasonal increases in upcoast petroleum movements. As for the future, while ANS tanker loadings have increased from 629 thousand barrels per day in 1977 to 1,788 thousand barrels per day in 1986, loadings are expected to fall over the period 1988-95, due to a gradual decline in ANS production (Table II-2 of the Regulatory Impact Analysis) with uncertain consequences. Comments are invited specifically on the extent and the consequences of this decline in ANS production.

Finally, no data has been developed yet on the extent that the lower costs of transporting ANS crude on VLCCs, including those that repaid their CDS, has increased shipments to Panama since those four vessels were admitted to the trade. To the extent that occurs, overall tanker demand in the trade would be increased, and the displacement

caused by the entry of those vessels thereby reduced. Commenters are invited to submit such data.

D. Availability of Tankers in the Trade

When ANS crude oil loadings began in 1977, there were 215 privately-owned unsubsidized tankers (8.0 million DWT) in the U.S.-flag fleet (excluding special product tankers). Of those, only seven were over 100,000 DWT (totaling 848,000 DWT). An additional 15 tankers (2.3 million DWT) were on order for the domestic trade, of which 12 (2.0 million DWT) were over 100,000 DWT. Two tankers (totaling 259,900 DWT) were rebuilt under the Wrecked Vessel Act in 1981 and 1983 respectively. Five VLCCs repaid their CDS from 1977 to 1986 (totaling 1.2 million DWT). One new EXXON tanker was delivered in November 1986 and the second in April 1987 (those two vessels total 418,000 DWT). Both are currently operating in the domestic trade. No other U.S. tankers are currently under construction.

With the opening of the Alaskan pipeline in 1977, there has been a recurring shortage of suitable tankers in the ANS oil trade. MARAD has tried to alleviate this shortage in several ways. First, MARAD issued a rule in 1977 allowing CDS tankers over 100,000 DWT to carry ANS crude oil in the

domestic trade for six months in a twelve month period in exchange for a pro rata repayment of their CDS (46 CFR Part 250). Under that rule ("Part 250 rule") MARAD has approved temporary transfers of CDS-built VLCCs to the Alaska-Panama trade on 37 occasions. Such transfers peaked between 1980 and 1983 when there were approximately three CDS vessels (totaling 750,000 DWT) operating in the trade on a full-time basis.

Permissions for three CDS-built VLCCs -- ARCO INDEPENDENCE, MARYLAND and WILLIAMSBURGH -- to operate temporarily in the Alaskan oil trade were terminated on January 12, 1984. Their approval had been conditioned on the acquisition of suitable employment (by January 1984 when they would become available) of four over 100,000 DWT Jones Act vessels -- OVERSEAS BOSTON, OVERSEAS JUNEAU, OGDEN COLUMBIA, and PRINCE WILLIAM SOUND. When the latter two were not chartered, the conditional approvals were terminated in accordance with the order of October 7, 1983. No CDS-built VLCCs entered the ANS trade after that until the MARYLAND on November 15, 1984. Two additional VLCCs were granted waivers in January 1985 and January 1986. In addition, a CDS-built 90,000 DWT tanker (the BEAVER STATE)

made two voyages in the Valdez to West Coast trade under a section 506 waiver in March 1986.

From 1977 to the last approved transfer on November 1, 1985, eight CDS VLCCs operated under six month waivers at various times in the ANS trade. Of those eight, four are the subject of this rulemaking.

The other four CDS-built vessels are the MARYLAND, MASSACHUSETTS, and NEW YORK (each 264,100 DWT), and the WILLIAMSBURGH (225,100). None of those vessels has applied to enter the ANS trade under Part 250 since November 1985. (The NEW YORK applied in November 1985 and operated until July 1986). At present, those four are in lay-up.

While the Part 250 rule alleviated the shortage of tankers to a large extent, it did not totally solve the problem. To alleviate the shortage, MARAD began accepting total repayment of CDS in exchange for domestic trading privileges. Since 1977, five vessels have totally repaid their CDS. The first was the VLCC STUYVESANT (224,700 DWT), which was allowed to enter the domestic trade in August 1977.

The second was the BAY RIDGE (225,000 DWT) which repaid its CDS in November 1980, after entering the trade for six months under a Part 250 temporary waiver in 1979. The other three VLCCs repaid their CDS pursuant to the most recent rule, and are still operating in the domestic trade. The four VLCCs in the trade that are the subject of this rulemaking total 976,000 DWT. They represent approximately 43 percent of the capacity operating in the Valdez-Panama trade.

Employment prospects for the four VLCCs in the ANS trade appear to be positive at least for the near future. It is with this near future in mind that these vessels repaid their CDS. Domestic trading restrictions for CDS-built vessels are lifted at the end of their statutory life (i.e., 20 years). The ARCO INDEPENDENCE and ARCO SPIRIT were built in 1977, the BROOKLYN in 1973, and the BAY RIDGE in 1979.^{6/} Since no new tankers are on order, and prospects for newbuildings seem unlikely, these four VLCCs would be among the most suitable vessels for the Alaska-Panama trade. If the four VLCCs remain in the domestic trade, there would

^{6/} Even without the present rulemaking, these vessels would be allowed to enter the domestic trade at the end of their 20 year useful life. Thus, the effects of this rulemaking would expire in the mid to late 1990s.

be an adequate supply of suitable tonnage to carry oil in that trade even if other older tankers are scrapped and if no new tankers are built.

If the four VLCCs were removed from the domestic trade, a shortage of the most suitable tonnage in the Alaska-Panama trade would occur, necessitating the entrance of smaller, less suitable tankers in that trade, and would also likely result in those VLCCs being laid up, since they are unable to compete in the foreign trade (see Section 11 of this proposed rule).

In conclusion, as far as can reliably be foreseen, the continued employment in the Alaskan oil trade of the four VLCCs that repaid CDS would benefit the U.S. domestic waterborne commerce by providing vessels that are most suitable for the Alaska-Panama oil trade and by providing an employed well-balanced merchant marine. The following other benefits would flow: The Treasury would retain the CDS repaid amount (\$142 million), the shipping public would receive transportation savings (estimated \$664-674 million) and the State of Alaska would earn revenues from reduced tanker rates (estimated \$186-189 million). It is not clear that there would be any negative impact on the domestic fleet by allowing such repayment. It is recognized that 12 tankers were in lay-up in February and with their lay-up,

the seamen to operate them were unemployed. This is only six percent of the total U.S.-flag domestic tanker fleet and provides a needed reserve for peak demand.

E. Safety of the VLCCs

Allowing the four VLCCs to remain in the domestic trade would also further the goal of section 101 of the Act to encourage the development of a fleet composed of the "safest" vessels. As is shown in the Environmental Assessment prepared for this proposed rule, these VLCCs are among the safest tankers, in terms of environmental risks. The change in oil spill risk for the ANS fleet is expected to continue to improve as more VLCCs and other large tankers replace, where permitted by navigation channel depths, smaller tankers. If the four VLCCs were not allowed to remain in the domestic trade, a tonnage shortfall could cause a greater oil spill risk if additional small vessels such as barges were to be employed to compensate for the shortfall.

II. The Foreign Trade

One of the goals of the Act is to encourage the development and maintenance of a merchant marine sufficient to carry "a substantial portion of the waterborne export and

import foreign commerce of the United States..." 46 U.S.C. 1101(a). The Court of Appeals criticized the previous CDS repayment rule for its "dubious proposition that the fleet will remain able to carry 'a substantial portion' of foreign commerce..." ITOC v. Dole, slip op. at 11.

The Court noted in a footnote to its decision overturning the prior CDS rule:

It may be, of course, that present conditions in the world shipping market make it impossible for the Secretary to find a way to meet all of the statutory objectives. If this is a problem, she should discuss it frankly and directly when she considers which measures to adopt in light of the objectives explicitly set out in the Act. Id. at 13-14, n.4.

While this proposed rulemaking would provide a domestic tanker fleet that is (1) sufficient to carry the domestic waterborne commerce of the United States and (2) composed of the "best equipped, safest, and most suitable types of vessels," MARAD acknowledges that it would have no effect on the U.S.-flag share of the water-borne export and import bulk foreign commerce of the United States.

The U.S.-flag foreign trade tanker fleet currently consists of 26 CDS-built tankers totaling three million deadweight tons, including six VLCCs and two ULCCs. (This excludes the four VLCCs that are the subject of this rulemaking and three CDS-built integrated tug-barges, but

Includes two CDS-built ore-bulk-oil carriers built with CDS.) This tonnage is insufficient to carry a substantial portion of the bulk foreign commerce. The six CDS-built VLCCs and two ULCCs (ultra large crude carriers) are currently laid up. Only one of the CDS-built tankers under 100,000 DWT is laid up. Seven of the tankers are employed in the foreign trade, while the remaining 12 tankers are under charter to the Military Sealift Command (6) or are employed in the preference trades (6) carrying Strategic Petroleum Reserve oil.

While the intent of MARAD's CDS and ODS programs was to provide a basis for a U.S.-flag fleet that is sufficient to carry a substantial portion of our bulk import and export trade, the assumptions of those programs were not met for VLCC tankers and most of these tankers built under the 1970 program are not competitive in the international market, as evidenced by the lay-ups. Moreover, even with the benefit of CDS, the capital costs of CDS-built VLCCs exceeds those of comparable foreign-built tankers. In addition, even the provision for full ODS could not offset the cost disadvantages of operating U.S.-flag tankers in the foreign trades, let alone address the capital cost disadvantages faced by these carriers.

The United States currently imports approximately 6.0 million barrels per day of crude oil and refined product, of which only three percent is carried on U.S.-flag tankers. Furthermore, a substantial portion of our crude oil imports--approximately 45 percent--are received from nearby sources including Canada, Mexico, Venezuela and the Caribbean region. The CDS-built VLCCs are unsuitable for these nearby import trades. (The CDS-built VLCCs are more suitable for long-haul voyages; see Section I above). Approximately 32 percent of U.S. crude oil imports are received from the distant Arabian Gulf and North Sea regions for which VLCCs would be suitable. In contrast, ten years ago U.S. crude oil and refined product imports averaged 8.8 million barrels per day. Only 14 percent of our crude oil imports were received from nearby sources while over 40 percent of our oil imports were received from the Arabian Gulf and North Sea regions.

During the last year, there has been an increase in oil exports from the Arabian Gulf region and a corresponding rise in demand for VLCCs in the international trade. Despite this increase it is unlikely that the U.S.-flag share of U.S. oil imports would increase, due to an oversupply of tonnage in the world tanker fleet.

As of January 1987, the world fleet contained over 235 million deadweight tons, of which approximately 200 million deadweight tons (85 percent) were actively employed. The remaining 35 million deadweight tons (15 percent) were idle; however, 30 million deadweight tons were in the over 200,000 DWT size class. The amount of idle capacity in the over 200,000 DWT size class represents more than 26 percent of the available tonnage in that class. Therefore, given the relative higher operating costs for U.S.-flag tankers and the amount of idle tonnage over 200,000 DWT in the world fleet, it is very likely that the four VLCCs that are the subject of this rulemaking would be laid up if they are required to leave the domestic trade, with loss of jobs to Jones Act seamen, or possibly scrapped.

In fact, of the nine VLCCs and two ULCCs built with CDS under the 1970 program, none has had any significant employment in the foreign commercial trades, other than occasional shipments of oil to the Strategic Petroleum Reserve, which are reserved to U.S.-flag carriage. The BAY RIDGE, which repaid its CDS in 1980, has been operating actively in the domestic trade since 1980. The other three VLCCs have been operating in the domestic trade regularly under six month waivers under Part 250 (a total of 17 times since 1978). Thus, the deployment of these four VLCCs to

the domestic trade would have no impact on U.S.-flag tanker presence in foreign trades. Finally, should world market conditions even reach the point where U.S.-flag VLCCs could be employed in the U.S. foreign or foreign-to-foreign trades, VLCCs that have continued to be active in the domestic trade would be much more readily available to the foreign fleet than vessels that are laid up and wasting or scrapped.

III. The Naval Auxiliary

One of the objectives of the Act is to foster the development of a merchant marine fleet "capable of serving as a naval and military auxiliary in time of war or national emergency, ..." 46 U.S.C. 1101(b).

In its comments on the prior CDS rule, the Defense Department expressed concern over the security implications of losing militarily-useful (i.e., product) tankers as a result of CDS repayment. MARAD has considered the effect on the naval auxiliary of allowing the four VLCCs to remain in the domestic trade (see Regulatory Impact Analysis). Market conditions and statutory requirements have contributed to a reduction in the number of U.S.-flag product tankers, including a declining upcoast (U.S. Gulf/East Coast) petroleum trade (the principal market for U.S.-flag product

tankers), the opening of the Trans-Panama Pipeline in 1982, and the anti-pollution standards of the Port and Tanker Safety Act (PTSA).

As a result of these factors, over a three year period for 1984 to 1986, 41 tankers, of the type considered highly military useful, were scrapped (see Regulatory Impact Analysis, Appendix 1). All had exceeded their statutory life of 20 years (see Regulatory Impact Analysis, Appendix 1). The average age of these tankers was 34 years. Further, the 1978 Port and Tanker Safety Act (PTSA) set certain anti-pollution requirements for tankers entering United States waters. By January 1, 1986, vessels between 20,000 and 40,000 DWT were required to have certain anti-pollution systems to prevent the discharge of oil-tainted water. To comply with the PTSA requirements, tanker owners had the option of retrofitting existing systems, reducing load lines (so as to carry less than 20,000 DWT), using port reception facilities to dispose of oily water, or scrapping ships. Due to the cost of retrofitting and resulting loss of cargo capacity, and the inherent limitations of reducing load lines or using port reception facilities to discharge oily water, many tanker owners scrapped their older, less efficient vessels. The PTSA served to speed up the natural

process of scrapping that occurs when tankers exceed their useful life.

Of those 41 that were scrapped, 25 were scrapped in 1984, nine in 1985, and seven in 1986. The vast majority of those lacked some or all of the anti-pollution features required by the PTSA.

These figures indicate that the scrapping that has occurred in the past three years is not attributable to CDS repayment but rather to the age of the vessels, their inability to economically retrofit to satisfy PTSA requirements and poor market conditions. Since the effective date of the PTSA (January 1, 1986), the number of product tankers scrapped has declined. MARAD believes that this decline will continue, since many older, more inefficient tankers have now been scrapped. In addition, since the enactment of the PTSA, a number of new product tankers have been built.

Further, any effect that the four VLCCs would have on the militarily-useful tankers would be indirect, unlike the above factors. VLCCs and these smaller tankers generally do not compete in the same trades. As discussed above, VLCCs have historically served the Alaskan-Panama trade, and

smaller tankers serve the Panama Gulf/East Coast trades. While a mix of vessels serve the West Coast, the four VLCCs have not entered that trade. Thus, any effect the VLCCs may have on the smaller tankers would be through an indirect displacement. That is, the VLCCs, being more cost-effective, may "bump" other large tankers that could serve the Alaska-Panama trade. In turn, these large tankers could operate in the West Coast and Panama/Gulf trade, picking up oil that could have been carried by smaller tankers. A trend in this direction is indicated by Table III-2 in the Regulatory Impact Analysis. However, such "bumping" effects are much more remote than the effects of the PTSA, the Trans-Panama Pipeline, and declining market conditions, over which MARAD has no control.

Moreover, the current goal of the Navy is to increase the number of tankers in the Ready Reserve Force from eight to twenty by the year FY 1992. Even if there were a direct corollary to CDS repayment and the 12 tankers laid up in February 1987, the Navy has the opportunity to purchase those vessels for their military usefulness at such time as they became commercially unattractive.

Based solely upon these objectives of section 101 of the Act, the Secretary concludes that the CDS repayment rule

proposed herein furthers those objectives. The four VLCCs would increase the most suitable U.S. domestic fleet with minimal impact on the existing fleet, and they are not expected to have a significant impact on carriage of U.S. foreign commerce, U.S. shipyard construction, or the U.S. Naval auxiliary capacity. Their retention in the Jones Act fleet will also result in \$142 to the U.S. Treasury for CDS repayment, transportation savings to the shipping public and increased revenues for the State of Alaska.

IV. Shipyards

One of the objectives of the Act is to encourage the development of a merchant marine fleet "supplemented by efficient facilities for shipbuilding and ship repair." While this proposed rulemaking would not actively promote this goal, it also would not have a significant adverse effect on U.S. shipbuilding. MARAD acknowledges that future shipbuilding prospects with or without this proposed rule do not look positive. Even without CDS repayment, the growth prospects for the domestic petroleum trades are not sufficient to require the construction of additional tanker capacity.

No orders for the construction of unsubsidized tankers over 100,000 DWT were placed between April 1976 and August

1984. On August 27, 1984, EXXON placed an order for construction of two 209,000 DWT tankers in the United States for employment in the ANS trade. Since then, no orders have been placed to build unsubsidized tankers over 100,000 DWT.

Two foreign-flag tankers over 100,000 DWT were rebuilt in the United States for the ANS crude oil trade in 1981 and 1983 under the Wrecked Vessel Act (46 U.S.C. 14). Under this Act, foreign-built vessels that are wrecked off the U.S. coast are eligible to enter the U.S. domestic trade provided the vessel is purchased by a U.S. citizen and rebuilt in the United States at a cost that is at least three times the appraised salvage value.

The first vessel, the OVERSEAS BOSTON (123,700 DWT), was rebuilt in 1981 and the second vessel, the OGDEN COLUMBIA (136,000 DWT), was rebuilt in 1983. Due to the existing capacity in the domestic trade and the predicted growth patterns in the petroleum trade, allowing the four CDS-built VLCCs to remain in the domestic Jones Act fleet permanently will have little effect on the amount of domestic tanker construction.

V. Other Objectives of the Act

While section 101 of the Act establishes the general objectives of the Act, other parts of the Act give more

specific guidance on interpretation and implementation of these goals. The Act explicitly and implicitly establishes other policy goals in furtherance of the maintenance and development of the U.S. merchant marine fleet. Among these goals, mentioned in the prior CDS final rule (50 FR 19170), are efficiency and competition. Each of these goals has been recognized by the courts as valid policies for promoting the U.S. merchant marine fleet.

A. Efficiency

The goal of efficiency of the fleet is mentioned throughout the Act. Among the express goals of section 101 is that the merchant marine shall be composed of "suitable" vessels manned by "efficient" crews. Certainly, the idea of "suitable" vessels should encompass efficiency as a principal component.

The goal of efficiency is particularly important in the CDS program, which is designed to produce vessels of "high transport capability and productivity." Merchant Marine Act, 1936, as amended, sec. 501 (46 U.S.C. App. 1151). Other provisions in the Act are intended to promote fleet modernization. Under section 213, the Secretary is required to report to Congress annually on the scrapping of old vessels, and the relative cost of ship construction and

reconditioning in U.S. shipyards. The capital construction reserve fund was established in section 511 to promote construction or acquisition of new vessels. The Secretary's authority to acquire obsolete vessels for an allowance of credit under section 510(b) is intended "to promote construction of new, safe, and efficient vessels to carry the domestic and foreign waterborne commerce of the United States...."

While the Act appears to clearly promote the policy of efficiency, the Department of Transportation authorization statute further declares it to be an overriding purpose that national transportation policies and programs be "conductive to the provision of fast, safe, efficient, and convenient transportation at the lowest cost consistent there with. . . ." 49 U.S.C. 1101. Any ambiguity in the Merchant Marine Act regarding the goal of promotion of efficiency is resolved in favor of that goal through the purposes and policies established in the Department's statute.

In addition to these explicit statutory provisions promoting efficiency of the U.S. merchant marine fleet, several recent court decisions have affirmed that one objective of the Act is to encourage modernization and

efficiency. For example, the Supreme Court's decision confirming the Secretary's statutory authority to grant permanent release to vessels under CDS restrictions found that a basic goal of the Act was to encourage the maintenance of an "effective merchant marine" with a "fleet [that] was to be modern and efficient." Seatrains Shipbuilding Corp. v. Shell Oil Co., 444 U.S. 572, 584 (1980). Further, the D.C. Circuit recently described the first goal of the Act as promoting "a well-equipped and efficient merchant fleet." American Trading Transportation Co., v. United States, 791 F.2d 942, 944 (D.C. Cir. 1986); see also Sea-Land v. Dole, 723 F.2d 975, 976 (D.C. Cir. 1983).

The above statutory provisions and judicial interpretations strongly support the goal of promoting efficiency and modernization of the U.S. merchant marine fleet. These goals would be furthered by this proposed rulemaking, which will allow the four VLCCs, which are among the most efficient U.S. tankers in the fleet, to remain active in the domestic trade.

B. Competition

While the Act does not explicitly list competition as one of its goals, the promotion of competition in the

foreign and domestic trades is implicit in the Act. The Act's ODS and CDS programs are intended to give the U.S. merchant marine fleet certain financial resources to compete with lower-cost foreign fleets while not guaranteeing any profit. In particular, Congress made this objective clear in enacting the Merchant Marine Act of 1970, which extended those programs to the unregulated bulk trades. See Merchant Marine Act, 1936, 603(b) 46 U.S.C. 1173(b); H. Rep. No. 1073, 91st Cong., 1st Sess., 38 (1969). The Jones Act trade does not receive such financial assistance, but is insulated from foreign competition by the Act's bifurcation of the foreign and domestic trades. That is, the Act restricts competition in the Jones Act trade only to the extent necessary to protect unsubsidized U.S. operators from the benefits of the Act's financial assistance programs (such as ODS and CDS) which assist the U.S. foreign trade vessels in competing against low-cost foreign-flag competition. In the domestic trade, the Secretary has a duty "to minimize interference with the free market forces normally at work. . . ." ITOC v. Lewis, supra, 690 F.2d at 917.

In its seminal case on the relation between the foreign and domestic trades, the D.C. Circuit stated that "competition is not 'unfair' within the meaning of the Act when it does not involve diversion of money to unsubsidized

domestic operations from subsidized foreign operations, to the disadvantage of an unsubsidized operator. Congress plainly did not intend to prevent that sort of competition."

Pacific Far East Line, Inc., v. Federal Maritime Board, 275 F.2d 184, 186 (D.C. Cir. 1960). Other courts have likewise recognized the overriding public policy in favor of competition in the domestic trade and in national transportation policy. See e.g., Matson Navigation Co., v. Connor, 258 F. Supp. 144, 158 (N.D. Cal. 1966), aff'd per curiam, 394 F.2d 514 (9th Cir. 1968); Bowman Transportation, Inc., v. Arkansas-Best Freight System, Inc., 419 U.S. 281, 198-99 (1974).

Finally, the Supreme Court made clear its preference for fair competition (as opposed to regulated entry under six month permissions) in its decision confirming the Secretary's authority to accept permanent repayment in Seatrain Shipbuilding Corp. v. Shell Oil Co. 444 U.S. 572, 589-90 (1980):

Section 506 . . . permit[s] a vessel that enjoys the benefits of CDS to operate outside the foreign market only in narrow circumstances, generally upon a highly discretionary administrative decision, and no more than six months a year. And we have no doubt that it would be flatly inconsistent with one congressional intent were the Secretary or this court to conclude that a temporary release not meeting these conditions was proper. But a permanent release upon full repayment is quite different. It irrevocably locates the vessel in

the unsubsidized fleet and, thus, poses no danger of a supercompetitor skimming the cream from each market. It creates no long-term instability. And it confers no windfall. On the contrary, at least where repayment of the CDS includes some amount reflecting capital costs which would have been incurred had no subsidy been available, such a transaction merely permits a once subsidized vessel to enter the domestic trade on a footing equal to that of vessels already in that trade. It was not the purpose of the Act to prohibit such entry

Thus, to the extent that the capacity allowed to enter the domestic trade under CDS repayment would have been allowed to participate in the trade under six month permissions, allowing total CDS repayment therefore would necessarily be consistent with the "purpose of the Act" Id.

In fact, where the Secretary issued the NPRM on total CDS repayment in January 1983, the full time equivalent of three CDS built VLCCs had been operating in the trade under six month permissions. Thus, allowing total repayment for three VLCCs under that rulemaking is squarely within the Supreme Court's holding.

VI. Alternatives

MARAD has considered three alternatives in preparing this rulemaking. The first is to maintain the status quo, i.e., to allow the four VLCCs to remain in the domestic trade. The costs and benefits of this alternative have been

discussed at length in this statement, and in the Regulatory Impact Analysis. Further costs, evaluated in the Regulatory Impact Analysis, include the recent Title XI defaults of three VLCCs that were previously in the domestic trade under six-month waivers, and partial defaults of two other CDS-built VLCCs (STUYVESANT and BAY RIDGE). These costs were not necessarily attributable to CDS repayment and in any event are irreversibly expended at this time (i.e., returning the four VLCCs to the foreign trade would not recover this money). The total default cost to the government has been \$137.5 million.

Another relevant consideration is the effect on the existing Jones Act (i.e., domestic) fleet. As of February 19, 1987, twelve Jones Act tankers were laid up (totaling approximately 650,000 DWT). On the other side of the ledger, if CDS repayment is not allowed for the four VLCCs, they are likely to be laid up (approximately 705,000 DWT).

MARAD believes that the suitability of the four VLCCs for the Alaska-Panama trade outweighs any possible disadvantages. Of the twelve tankers that are laid up, three tankers (totaling 146,000 DWT) are over 20 years old. The remaining nine tankers include the one tanker (the

PRINCE WILLIAM SOUND, 123,400 DWT) and eight smaller tankers that could serve in the ANS trade, although at a much higher cost per ton than VLCCs currently operating in that trade (see Regulatory Impact Analysis). For example, the cost of operating a 50,000 DWT tanker in the Valdez-Panama trade is approximately, \$25.00 per ton, compared to \$9.19 per ton for a 265,000 DWT VLCC operating in the same trade. Further, as noted above, larger tankers are more suitable than smaller tankers from an environmental standpoint because they make fewer voyages and port calls than smaller tankers to carry the same amount of oil, thus reducing the risk of collisions and oil spills (see Environmental Assessment)

A second alternative considered would be for MARAD to do nothing, i.e., to allow the rule to be vacated as of July 16, 1987, and for the three VLCCs to leave the domestic trade, and to consider the BAY RIDGE separately. The costs of doing nothing would be a shortage of the most suitable tonnage for the Valdez-Panama trade and the likely lay-up of the three VLCCs that repaid CDS under the 1985 rule. Other costs of this alternative would be the loss to the government of CDS repayments of \$105.8 million from those three VLCCs, the reduction of Alaska state revenues due to higher transportation costs in later years, and the loss of transportation savings to the shipping public.

The benefits of this alternative could be reduced government loan exposure risk on existing Jones Act tankers and the possibility of some of the laid up domestic tankers operating in the ANS trade. However, due to the age and small size of most of those tankers, they would be unsuitable for the Valdez-Panama trade. Further, only six percent of the domestic tanker fleet is laid up. A six percent lay-up is a reasonable reserve for covering temporary losses from the active fleet due to casualties (three in 1986), surveys and repairs, as well as seasonal increases on the upcoast petroleum movements.

Under this second alternative, shipbuilding demand for new crude tankers would still be minimal, if any, due to the high cost of U.S. shipbuilding, the unlikely availability of future CDS funds due to budget constraints, and the predicted future decline in the volume of crude carried in the Alaska-Panama trade.

The third alternative considered would provide for other U.S.-flag tanker owners to repay CDS in return for unrestricted domestic trading privileges. Under this approach, those vessel owners with the best prospects for employment would likely choose to repay within the specified time period. Unrestricted repayment would reduce the need

for federal issuance of temporary permission to enter the ANS trade. Fiscal benefits could also be the greatest under this alternative. However, it is unlikely that any more vessels would repay under this alternative, since only three repaid when the window was open for one year and two EXXON 209,000 DWT Jones Act tankers have recently been delivered. This alternative would cause the most disruption to the Jones Act as there would be uncertainty in the market. Shipyard demand for new crude tankers would remain at a minimal or non-existent level.

E.O. 12291, Statutory Requirements and DOT Procedure

The Maritime Administrator has determined that this rule is major under the criteria of Executive Order 12291. Pursuant to the Department of Transportation's Regulatory Policies and Procedures (February 26, 1979), this rule is also considered to be "significant" because it concerns a matter on which there is substantial public interest.

The Maritime Administrator certifies that it would have no significant economic impact on a substantial number of small entities pursuant to the Regulatory Flexibility Act of 1980 (5 U.S.C. 601 et seq.) The companies owning and chartering the four VLCCs at issue, and companies owning or chartering tankers

possibly affected by the rulemaking in the foreign and domestic trades, are either large oil companies or large independent shipping companies. ?

A draft Regulatory Impact Analysis has been prepared and is available for public review and copying in the Docket (R-110) in the Office of the Secretary, Maritime Administration (room 7300). It discusses the important economic aspects of this proposed rule.

An Environmental Assessment of the proposed rule has also been prepared, and may be inspected at the Office of the Secretary, Maritime Administration, room 7300. The Environmental Assessment concludes that the effect of the proposed rule would be that greater quantities of ANS oil would be transported in VLCCs than in smaller vessels, fewer total trips would be made by a smaller number of vessels, the risk of accidental oil spill would be reduced as the number of trips decreases. In addition, the tankers which have repaid CDS include a number of safety and environmental features required by statute. Overall, the risk to the environment would be reduced with the proposed rule as compared to without it. On the basis of this environmental assessment, the Maritime Administration has tentatively concluded that the proposed rule would not result in a significant environmental impact to the human environment.

PART 276 - [AMENDED]

46 CFR Part 276.3 is revised to read as follows:

1. The authority citation for Part 276 continues to read as follows:

Authority: Secs. 204(b), 207, 506, and 714, Merchant Marine Act, 1936, as amended (46 U.S.C. 1114(b), 1117, 1156 and 1204) Pub. L. 86-518 (74 Stat. 216); Reorganization Plans No. 21 of 1980 (64 Stat. 1273) and No. 7 of 1981 (75 Stat. 840), as amended by Pub. L. 91-469 (84 Stat. 1036); and Dept. of Commerce Organization Order 10-8 (36 FR 19707), July 23, 1973), unless otherwise noted.

2. 276.3 Total Repayment.

(a) The Maritime Administration reaffirms the allowance of the irreversible total repayment of unamortized construction-differential subsidy (CDS), with interest, and rescission permanently of the domestic trading restrictions related to the grant of CDS for tankers of any deadweight tonnage for applications and approval between June 6, 1985 and June 5, 1986,

in accordance with the terms and conditions of subsection (b). The approved applications were for the ARCO INDEPENDENCE, ARCO SPIRIT and BROOKLYN.

(b) Repayment Terms. The full repayment amount consists of the unamortized CDS, as determined by the Maritime Administration, with compounded interest on that amount. The interest rate is the same as the long-term interest rate the owner obtained, or would have obtained if long-term debt financing had been used, in financing the owner's portion of the tanker. Unless the Maritime Administrator determined that using interest rates other than long-term bond rates was justified, such rates are used. If more than one long-term bond was issued to finance the owner's portion of a specific tanker, or if one or more of such bonds has more than one rate (such as a serial bond) an average interest rate is computed weighted by the proportion of each bond par value to the total par value of all long-term bonds issued to finance the owner's tanker. The interest payable on the unamortized CDS is computed by continuous compounding of the interest until the day of repayment. For purposes of this paragraph, "long-term bond rates" are either actual Title XI bond rates on a specific owner's tanker or the Title XI long-term bond rate at the time the tanker's statutory life began.

78.

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DRAFT REGULATORY IMPACT ANALYSIS
CONSTRUCTION DIFFERENTIAL SUBSIDY REPAYMENT

GOVERNMENT AFFAIRS

APR 27 '87

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March 1987

I. EXECUTIVE SUMMARY

This Regulatory Impact Analysis provides background information and examines the various impacts and effects of the proposed rule to allow the owners of tankers built with Construction Differential Subsidies (CDS) to repay those subsidies and use those vessels in the domestic trades.

A. BACKGROUND

i. Jones Act Oil Trade. Section 27 of the Merchant Marine Act, 1920 (The Jones Act), generally requires that all cargo transported in the domestic trades be carried on vessels built in the United States, documented under United States law, crewed by U.S. seamen, and owned by U.S. citizens. Jones Act tankers are built without construction subsidy and operate in the domestic trades without direct federal operating assistance. Tankers built with construction-differential subsidy (CDS) are also U.S.-built, U.S.-manned, and U.S.-owned, but, under the Merchant Marine Act, 1936, these vessels are not permitted permanent trading privileges in the domestic trades.

Section 506 of the Merchant Marine Act, 1936, as amended, grants the Secretary of Transportation the authority to permit the temporary transfer of CDS-built ships into the domestic trades, provided the transfer of any ship does not exceed a six-month period in any year, and provided CDS is repaid on a pro rata basis. The Secretary also has the authority in appropriate cases to eliminate all domestic trade restrictions on a vessel constructed with CDS in exchange for full repayment, with interest, of the carrier's outstanding CDS obligation.

ii. The 1970 Tanker Program. The Merchant Marine Act of 1970, amended the Merchant Marine Act of 1936 to authorize for the first time tankers to be built with CDS for use in the foreign trades. Thirty-four petroleum tankers have been built under this program, including nine VLCCs and two ULCCs.

iii. Alaskan Oil Trade. In 1977, following the opening of the Trans Alaska Pipeline System (TAPS), the demand for large U.S.-flag crude tankers to carry Alaskan crude oil from Valdez, Alaska, to Panama (for transshipment to Gulf and East Coast ports) was greater than the Jones Act fleet could accommodate. In order to alleviate the shortage of suitable tanker capacity, a regulation was promulgated to allow very large crude carriers (VLCCs are vessels in excess of 160,000 deadweight tons (DWT))* built with CDS to enter the Alaskan trades on a temporary basis.

* London Tanker Brokers' Panel Ltd. Publishers of AFRA (Average Freight Rate Assessments) defines VLCC as 160,000 to 319,999 DWT tanker.

B. RULEMAKING ON CDS REPAYMENT

1. History of Rulemaking. In 1977, the Maritime Administration (MARAD) adopted regulations to allow CDS-built tankers over 100,000 deadweight tons to enter the Alaskan crude oil trade on six-month waivers, provided they repay a pro rata portion of their outstanding CDS obligation. In addition, MARAD in 1977 allowed total CDS repayment on the VLCC STUYVESANT. In Seatrains Shipbuilding Corp. v. Shell Oil Co., 444 U.S. 572 (1980), the Supreme Court upheld the Secretary's authority to accept total CDS repayment, but did not address the issue of when such authority should be exercised. In 1978 MARAD published a Notice of Proposed Rulemaking that would allow CDS repayment. After the adoption of its interim rule, on November 13, 1980, MARAD allowed total repayment for the VLCC BAY RIDGE, an action that was contested by the Independent U.S. Tanker Owners' Committee.

In Independent U.S. Tanker Owners Committee v. Drew Lewis 690 F. 2d 908, the Court of Appeals concluded that MARAD was not legally obliged to issue rules limiting its discretion with regard to CDS payback, but vacated the interim rules on procedural grounds.

The Department of Transportation published a new NPRM on January 31, 1983 (48 FR 4408). That NPRM, which was issued by the Secretary, proposed to permit total CDS repayment for U.S. tanker vessels and formed the basis for the final DOT rule.

Shortly after the close of the comment period on the NPRM, the Congress took action to prevent the Secretary from promulgating a final rule. The DOT FY 84 Appropriations Act (Pub. L. 96-78, August 15, 1983) prohibited the enforcement of any rule with respect to the repayment of CDS until 60 days following the promulgation of any such rule. Thereafter, the Commerce Department's FY 84 Appropriations Act (Pub. L. 98-166, November 28, 1983) imposed an additional restriction that prohibited DOT from enforcing any CDS repayment rule until after June 15, 1984. However, in August of 1984, the FY 85 Appropriations Act for Commerce, Justice and State, which provided appropriations for the Maritime Administration, imposed yet another restriction. That Act prohibited the Department from enforcing any CDS repayment rule until May 15, 1985 (Pub. L. 96-411, August 30, 1984).

On May 7, 1985, the Department published in the Federal Register a final rule which allowed any owner or operator of a tanker built with CDS to repay its subsidy (with interest) and consequently obtain a permanent removal of the ban on domestic trading privileges. The amount of repayment included the unamortized CDS on the vessels plus compounded interest on that amount. The interest rate to be used for computational purposes was the rate of the original Title XI obligation on the tanker or the Title XI long term bond rate at the time of delivery. The final rule included a one-year time limit after the rule's effective date during which total CDS repayment had to be made. That time limit was from June 6, 1985 through June 6, 1986. During that time, three VLCCs repaid their CDS: the ARCO INDEPENDENCE, ARCO SPIRIT, and the BROOKLYN. The total amount of CDS repaid by these ships was \$105.8 million. Those ships are now operating in the domestic trade.

On January 16, 1987, the Court of Appeals for the District of Columbia held that the Secretary of Transportation violated section 553(c) of the Administrative Procedure Act by adopting this final rule on CDS repayment. The Court vacated the rule, but withheld issuance of its mandate until July 16, 1987 "to avoid further disruptions in the domestic market and to allow the Secretary to undertake further proceedings to address the problems of the merchant marine trade." Independent U.S. Tanker Owners Committee v. Dole, Civil Action Nos. 85-01555, 85-01740, 85-01752 and 85-1771 (D.C. Cir. January 16, 1987). The Court ruled that, as of July 16, 1987, the present rule will be vacated and conditions will be returned to the status quo ante, before the CDS repayment rule took effect, subject to any "further action" that the agency may have taken in the interim.

By letter dated March 10, 1987, counsel for the BAY RIDGE requested that a proceeding on the BAY RIDGE be conducted independently of proceedings with respect to the three vessels which repaid CDS pursuant to the repayment rule that has been vacated by the Court of Appeals. However, this rulemaking will take the BAY RIDGE into consideration.

The Proposed Rule:

The proposed rule would reaffirm the allowance of the repayment of CDS, with interest, and rescission of domestic trading restrictions for tankers that applied and were approved from June 6, 1985 through June 6, 1986. The approved applications were for the ARCO INDEPENDENCE, ARCO SPIRIT, and BROOKLYN. Further, this proposed rule would reaffirm the allowance of the repayment of CDS, with interest, and rescission of the domestic trading restriction for the BAY RIDGE, which was approved to repay its CDS in November 1980.

The Purposes and Policies of the Merchant Marine Act

MARAD believes that promulgation of the proposed rule will further the ability of the U.S.-flag tanker fleet to meet the objectives of the Merchant Marine Act, 1936, as amended (Act).

The goals of the Act are to foster the development and encourage the maintenance of an American merchant marine that is "(a) sufficient to carry its domestic waterborne commerce and a substantial portion of the waterborne export and import foreign commerce of the United States and to provide shipping service essential for maintaining the flow of such domestic and foreign waterborne commerce at all times, (b) capable of serving as a naval auxiliary in time of war or national emergency, (c) owned and operated under the United States flag by citizens of the United States, insofar as may be practicable, (d) composed of the best-equipped, safest, and most suitable types of vessels, constructed in the United States and manned with a trained and efficient citizen personnel, and (e) supplemented by efficient facilities for shipbuilding and ship repair."

C. TRANSPORTATION IMPACT ANALYSIS

Based on the operating and demand characteristics of each market, CDS repayment results in the possible displacement of less suitable vessels by more suitable vessels. VLCCs are more suitable for long-haul, high volume trades, e.g., Valdez-Panama, than smaller tankers, simply because vessel operating costs do not rise as fast as cargo volumes. ^{1/} VLCCs are less suitable than smaller tankers for short haul, low volume trades because their capital costs and port charges, which are higher than those for smaller tankers, are spread over smaller cargo volumes. The combination of economies of tanker size, length of voyage, tanker operating costs, size restrictions, and the demand for Alaskan crude oil at specific ports are the main factors that determine tanker deployment. As a result of these forces, the most suitable tankers would serve each distinct market.

The competitive displacement process just described has and will, for two reasons, result in substantial transportation savings. First, as outlined above, readjustment in the size composition of vessels operating in each market occurs. Larger vessels with lower operating costs replace smaller, higher cost tankers; therefore, the average size of the vessels operating in each trade increases. Second, allowing CDS VLCCs permanent entry into the domestic trades increases competition and ensures that tanker rates correspond more closely to the cost of operating the most suitable vessels for each trade.

D. OTHER IMPORTANT IMPACTS

1. Fiscal Impacts. In addition to the tanker owners and shippers, the federal and State of Alaska governments benefit by repayment of CDS for the four vessels.

a. Construction Differential Subsidy Repayment. The CDS repayment, itself, is the most immediate fiscal impact. MARAD received \$142 million in CDS repayments from the four VLCCs: ARCO INDEPENDENCE (\$44 million), ARCO SPIRIT (\$42 million), BAY RIDGE (\$36 million), and BROOKLYN (\$19 million).

b. Alaska State Revenues. The State of Alaska receives revenues from the sale of Alaskan crude oil from a royalty on production and a severance tax. On average, Alaska receives about 28 cents of each dollar of increase in the wellhead price, resulting from reductions in transportation costs, i.e., wellhead price as equal to refinery price less transportation costs. CDS repayment by the four VLCCs nets the State of Alaska 28 cents for each dollar of transportation savings.

^{1/} See, for example, J.O. Jansson and D. Shneerson. "The Optimal Ship Size," Journal of Transport Economics and Policy, September 1982, pp. 228-238.

ii. National Security Issues. The Defense Department has expressed concern over losing additional numbers of the tankers under 100,000 deadweight tons from the active fleet. Three factors have worked over time to decrease the number of militarily useful tankers: a declining product tanker trade, the start-up of the Trans-Panama Pipeline, and the recently enacted Port and Tanker Safety Act. As a result of these factors, 41 U.S.-flag tankers of 1.3 million DWT of the type considered highly militarily useful have been scrapped over the period 1984-86. As of February 1, 1987, there were 49 militarily useful tankers at least 20 years old in the U.S.-flag fleet compared to a total of 32 under 20 years of age.

iii. Foreign Trades. The decline in world petroleum demand, changes in the geographic pattern of U.S. petroleum trades, i.e., reduced U.S. dependence on distant sources of crude oil, and the high cost of operating U.S.-flag vessels have made U.S.-flag VLCCs unsuitable for U.S. foreign trades. For example, the cost of operating a U.S.-flag, 225,000 DWT tanker is three times that for a similar size foreign-flag tanker. MARAD cannot provide new subsidies to offset the cost disadvantages of operating U.S.-flag VLCCs in the foreign trades. CDS repayment has not reduced the U.S.-flag participation in foreign commerce. If not allowed to operate in the domestic trades, the four VLCCs would be unemployed and possibly scrapped.

iv. Shipyards. Even without CDS repayment, the growth prospects for the domestic petroleum trades are not sufficient to require the construction of significant additional tanker capacity. Therefore, allowing these four CDS-built vessels to enter the domestic Jones Act fleet permanently will have little effect on the amount of domestic tanker construction.

E. CONCLUSION

Allowing the four VLCCs to repay the outstanding CDS (plus interest) in return for unrestricted access to the Jones Act crude oil trades furthers the policy and purposes of the Act by making the domestic segment of the American merchant marine better balanced than it would be without these vessels in the trade. In addition, these vessels because of their characteristics, including size, permit the Secretary to make progress toward the goal of developing a merchant marine with well equipped, safe and suitable vessels. That is, the four VLCCs are more suitable vessels for the long-haul, high volume ANS trades than smaller ships. Furthermore, the elimination of the current uncertainty on the use of the VLCCs in the ANS trade would make it easier for oil companies and tanker owners to plan for the future. Given the high operating costs for U.S.-flag tankers (relative to foreign-flag tankers) and the amount of idle tonnage over 200,000 DWT in the world fleet, it is very likely that the four VLCCs would be laid up if they were required to leave the domestic trade.

In summary, allowing the four VLCCs which repaid CDS under the final rule to remain in the domestic trades would ensure that the most suitable U.S.-flag vessels are deployed in these trades in accordance with the purposes and policies of the Merchant Marine Act of 1936.

II. INTRODUCTION

A. HISTORY

Section 27 of the Merchant Marine Act, 1920 (the Jones Act), generally requires that all cargo transported in the domestic trades be carried on vessels built in the United States, documented under United States law, crewed by U.S. seamen, and owned by U.S. citizens. Under the Merchant Marine Act, 1936, Jones Act tankers must be built without construction subsidy and must operate without direct federal operating assistance. Tankers built with construction-differential subsidy (CDS) are also U.S.-built, U.S.-manned, and U.S.-owned, but these vessels are not permitted permanent trading privileges in the domestic trades because of the subsidy they received.

Since the end of World War II, water transportation of petroleum products has declined in importance, as pipelines have become the dominant mode for domestic, long-haul, petroleum product shipments. For example, domestic coastwise movements of petroleum products have trended down from 195 billion ton-miles in 1980 to 131 billion ton-miles in 1984. Moreover, within the water transportation mode, the importance of ocean barge movements has increased at the expense of tanker movements. More and more, tanker traffic in petroleum products has relied upon the movement of residual fuel oil (the so-called "dirty trades") and other nonpipeline compatible products, rather than refined products, such as gasoline and jet fuel ("clean trades"). By the late 1960s, the Jones Act tanker fleet consisted primarily of small, less than 55,000 deadweight ton (DWT) product tankers that operated between the Gulf and East Coasts, supplemented by a limited number of small crude carriers operating in that same area.

When Alaska North Slope (ANS) oil was first discovered in the late 1960s, it was expected that West Coast markets would require virtually all the ANS oil. Large tankers in the 120,000 to 130,000 DWT size category were ordered in anticipation of the ANS crude trade. By the time the TAPS opened in 1977, it was obvious that West Coast markets could not absorb all ANS crude for three reasons: ANS production was much higher than originally anticipated; West Coast demand had not grown as rapidly as expected; and California oil production was higher than expected. It thus became necessary to transport ANS crude to other markets through the Panama Canal to the Gulf Coast, East Coast, and Puerto Rico. The distance from Valdez to Panama is approximately twice that from Valdez to Long Beach; thus increases in crude oil movements from Valdez to Panama expanded the demand for tankers over 200,000 DWT in the domestic trades.

ANS crude was carried to Panama by tankers over 200,000 DWT, by some of the 120,000 to 130,000 DWT tankers built to serve the West Coast trades, as well as by smaller vessels. At Panama the oil was offloaded to smaller tankers for shipment through the Panama Canal. Some of this oil was transported by 55,000 to 90,000 DWT crude tankers; a large number of small product tankers less than 55,000 DWT also transported ANS crude through the Canal. Many of these product tankers were built more than 20 years ago for the then extensive domestic product trade.

By 1977, demand for large U.S.-flag crude tankers to carry ANS oil from Valdez, Alaska, to Panama was greater than the Jones Act fleet could satisfy. In order to alleviate the shortage of large, Jones Act crude tanker capacity, VLCCs built with CDS were given permission to enter the ANS trade on a temporary basis. These vessels were originally built for the foreign crude trade, but the decline in world petroleum demand, changes in the geographic pattern of U.S. petroleum trades, i.e., reduced dependence on distant sources of crude oil, and the high cost of operating U.S.-flag vessels have made U.S.-flag VLCCs unsuitable for U.S. import trades. For example, the operating cost for a U.S.-flag, 225,000 DWT tanker is three times that for a similar size foreign-flag tanker. Given current budget restrictions, MARAD cannot offset the cost disadvantages of U.S.-flag tankers, e.g., through new operating-differential subsidy (ODS) or CDS contracts, in the foreign trades. Vessels over 100,000 DWT have never received ODS.

Section 506 of the Merchant Marine Act, 1936, grants the Secretary of Transportation authority to permit the temporary transfer of CDS-built ships into the domestic trades, provided the transfer of any ship does not exceed a six-month period in any year, and provided CDS is repaid on a pro rata basis (i.e., in proportion to the vessel's statutory life).

The Secretary also has the authority to eliminate all domestic trade restrictions on a vessel constructed with CDS in exchange for full repayment (with interest) of the CDS obligation. A 1980 Supreme Court decision on full repayment of CDS and release of Jones Act trading restrictions addressed the differences between pro rata repayment under six-month permissions and full repayment.

...a permanent release upon full repayment is quite different (from temporary permission). It irrevocably locates the vessel in the unsubsidized fleet, and thus poses no danger of a super-competitor skimming the cream from each market. It creates no long-term instability. And it confers no windfall. On the contrary, at least where repayment of the CDS includes some amount reflecting capital costs which would have been incurred had no subsidy been available, such a transaction merely permits a once subsidized vessel to enter the domestic trade on a footing equal to that of vessels already in the trade. It was not the purpose of the Act to prohibit such entry 2/

Five CDS-built VLCCs have been allowed to repay their CDS obligation: the STUYVESANT (224,700 DWT) on an ad hoc basis in August 1977, the BAY RIDGE (225,000 DWT) through an adjudicative decision in November 1980; and the BROOKLYN (226,200 DWT), the ARCO SPIRIT (262,400 DWT), and ARCO INDEPENDENCE (262,400 DWT) under a DOT final rule in 1985-86.

2/ Seatrain Shipbuilding Corp. vs. Shell Oil Co., 44 U.S. 572 (1980).

The 1978 Port and Tanker Safety Act (PTSA) set certain antipollution requirements for all tankers over 20,000 DWT entering United States waters. By January 1, 1986, vessels between 20,000-40,000 DWT were required to have certain antipollution systems to prevent the discharge of oil-tainted water. Tanker owners had several compliance options: retrofit existing systems, reduce load lines (so as to carry less than 20,000 DWT), use port reception facilities to dispose of oily water, or scrap ships and construct replacement vessels. The cost of retrofit, as well as the loss of cargo capacity that it entails, has accelerated the scrapping of older vessels. While the PTSA requirements should have no effect on the demand for tanker capacity, it has contributed to the scrapping of the older, less-efficient product tankers — the U.S.-flag tanker fleet has fallen from 226 vessels of 11.0 million DWT in January 1983 to 165 vessels of 10.4 million DWT in January 1987. 3/

B. ALASKA CRUDE OIL TRANSPORTATION: 1978-1986

1. Historical Production and Distribution of ANS Crude Oil. ANS crude oil loadings have grown steadily since 1977, as shown in Table II-1. The most rapid growth occurred between 1978 and 1980 when average loadings grew at an annual rate of 18.4 percent. In contrast, average loadings grew at an annual rate of 2.2 percent from 1980 to 1986.

At the same time that ANS crude oil production was growing, the distribution of the oil changed dramatically. In 1980, long-haul shipments from Alaska to Panama were 459,000 b/d (30 percent) of total loadings. By 1982, the volume of oil going to the Gulf/East Coasts via Panama climbed to 701,000 b/d (43 percent). During this same period, the volume of oil going to the West Coast (including Alaska and Hawaii) dropped from 956,000 b/d (63 percent) to 817,000 b/d (50 percent).

After 1982, the distribution of ANS crude shifted again, with an increase in the share of oil going to the West Coast and a decrease in the share of oil going to the Gulf/East Coasts. Between 1982 and the 1986, shipments to the West Coast rose from 817,000 b/d (50 percent) to 1.11 million b/d (62 percent), while shipments to Panama fell from 701,000 b/d (43 percent) to 569,000 b/d (32 percent).

3/ Petroleum tankers not including integrated tug barge units.

ii. Forecast of Alaska Crude Oil Production and Distribution. While ANS tanker loadings have increased from 629 thousand barrels per day in 1977 to 1,788 thousand barrels per day in 1986, loadings are expected to fall over the period 1988-95, due to a decline in ANS production (Table II-2).

The opening of the All American Pipeline in 1988 will likely further dampen the demand for VLCCs in the Valdez-Panama trades. The pipeline will have a capacity to move 300,000 barrels per day of either California or ANS crude oil Southern California to the Texas Gulf. To the extent that ANS crude oil is shipped through the pipeline or more ANS crude oil is shipped to California to replace California crude, less oil will be shipped from Valdez to Panama.

Another factor which may reduce the demand for U.S.-flag tankers in the ANS trades in the early 1990's is the potential construction of a 105,000 barrel per day (rated capacity) refinery at Valdez by Alaskan Refining, Inc. Products from the refinery may be transported abroad on foreign-flag tankers, thus reducing Valdez loadings for U.S.-flag tankers.

Given the uncertainty regarding tanker demand in the Valdez-Panama trade in the 1990's, it is highly unlikely that new ships will be built for the trade. Thus, the four VLCCs which repaid their CDS should remain among the most suitable vessels for the trade in the near future.

Furthermore, even without CDS repayment, the growth prospects for the domestic petroleum trades are not sufficient to require the construction of significant additional tanker capacity. Therefore, allowing the four CDS-built vessels to enter the domestic Jones Act fleet permanently will have little effect on the amount of domestic tanker construction.

Table II-1

Average ANS Crude Oil Loadings at Valdez
(Thousands of Barrels Per Day)

Destination	1977- 5 mos.	1978	1979	1980	1981	1982	1983	1984	1985	1986
West Coast	458	681	841	901	813	760	775	887	936	1,005
Alaska	11	14	7	11	21	19	27	33	59	70
Hawaii	-	15	30	44	34	38	35	46	44	38
Panama	150	344	306	459	528	701	698	574	629	569
Virgin Islands	10	38	81	106	126	100	107	118	119	99
Gulf/East Coasts (via Panama)	-	-	4	13	14	3	7	2	7	6
TOTAL	629	1,092	1,269	1,534	1,536	1,621	1,649	1,660	1,794	1,788

Source: Maritime Administration.

Table II-2

Forecast of Alaska Crude Oil Production
(thousands of barrels per day)

	<u>North Slope</u>	<u>Cook Inlet</u>	<u>Total</u>
1987	1,806	40	1,846
1988	1,726	32	1,758
1989	1,662	27	1,689
1990	1,538	22	1,560
1991	1,481	20	1,501
1992	1,369	17	1,386
1993	1,274	15	1,289
1994	1,346	13	1,359
1995	1,228	10	1,238
2000	767	8	775

Source: Alaska Department of Revenue, Petroleum Production
Revenue Forecast--Quarterly Report, December 1986.

C. CURRENT CDS REGULATIONS AND THEIR APPLICATION

i. Six-Month Permissions. As shown in Table II-3, 43 temporary permissions have been granted to CDS-built tankers since 1977. CDS-built VLCCs secured 37 of these permissions; CDS-built 90,000 DWT tankers secured six. Prior to total CDS repayment the domestic service permissions to VLCCs, normally for six-month periods, had been the only recent employment for five of the seven CDS-built VLCCs. CDS-built 90,000 DWT tankers have secured six grants of permission ranging from 14 days to two months. Since 1980, the only employment outside of the ANS trades for CDS-built VLCCs has been for movements of oil for the Strategic Petroleum Reserve. There have been no applications for six-month VLCC waivers since November 1, 1985.

Permissions for three CDS-built VLCCs — ARCO INDEPENDENCE, MARYLAND and WILLIAMSBURGH — to operate temporarily in the Alaskan oil trade were terminated on January 12, 1984. Their approval had been conditioned on the acquisition of suitable employment (by January 1984 when they would become available) of four Jones Act vessels over 100,000 DWT — OVERSEAS BOSTON, OVERSEAS JUNEAU, OGDEN COLOMBIA, and PRINCE WILLIAM SOUND. When the latter two were not chartered, the conditional approvals were terminated in accordance with the order of October 7, 1983. No CDS-built VLCCs entered the ANS trade after that until the MARYLAND on November 15, 1984. Two additional VLCCs were granted waivers in January 1985 and January 1986. In addition, a CDS-built 90,000 DWT tanker made two voyages in the Valdez to West Coast trade under a section 506 waiver in March 1986.

ii. 100,000 DWT Full Employment Rule. Before a CDS-built VLCC tanker receives permission to temporarily enter the ANS trade under section 506 of the Merchant Marine Act of 1936, Jones Act tankers over 100,000 DWT not employed may object and block approval (see 46 CFR Part 250). In May 1986, the U.S. Court of Appeals for the District of Columbia Circuit, remanded a case involving six-month waivers for two VLCCs back to MARAD for consideration of the impact of such waivers on vessels under 100,000 DWT.

D. OPTIONS FOR CHANGE OF CDS REGULATION

This proposed rulemaking considers three main options. The first option (rulemaking) is to allow the four tankers that have repaid CDS under the interim and existing rule (June 1985) to remain in the domestic trades. These vessels, BAY RIDGE (225,000 DWT), BROOKLYN (226,200 DWT), ARCO SPIRIT (262,400 DWT), and ARCO INDEPENDENCE (262,400 DWT) are presently active in the long-haul ANS trades. They are among the most suitable U.S.-flag tankers for the ANS-Panama trade (Table II-3). The second is to vacate the rule and prevent the BAY RIDGE, BROOKLYN and two Arco vessels from operating in the domestic trades. A variation of this option would permit temporary waivers to be continued. The third option would provide a six-month period for other U.S.-flag tanker owners to repay CDS in return for unrestricted domestic trading privileges.

Table II-3

Section 506 Waivers in Alaskan Oil Trade

<u>Vessel</u>	<u>Docket No.</u>	<u>Dates of Operation</u>	
		<u>From</u>	<u>To</u>
AMERICAN INDEPENDENCE	S-594	3/18/78	9/18/78
" "	S-658	3/2/80	9/5/80
" "	S-697	9/23/81	3/18/82
ARCO INDEPENDENCE (ex AMERICAN INDEPENDENCE)	S-719	10/1/82	4/3/83
" "	S-741	11/14/83	1/9/84
AMERICAN SPIRIT	None	1/2/78	3/1/78
" "	S-633	2/18/79	3/9/79
" "	S-638	3/23/79	4/13/79
" "	S-656	12/19/79	6/13/80
" "	S-682	1/24/81	7/22/81
ARCO SPIRIT (ex AMERICAN SPIRIT)	S-710	3/21/82	9/19/82
" "	S-731	3/22/83	9/13/83
BAY RIDGE	S-662	4/17/80	11/20/80
BEAVER STATE	None	1/25/79	2/18/79
" "	None	2/19/79	3/4/79
" "	S-709	2/25/82	4/27/82
" "	S-786	3/27/86	4/26/86
BROOKLYN	S-654	12/25/79	6/12/80
" "	S-683	2/14/81	9/6/81 1/
" "	S-712	5/24/82	11/28/82
" "	S-734	5/27/83	11/14/83
" "	S-762	1/2/85	6/22/85
CHESTNUT HILL	S-595	2/18/78	3/5/78
KITTANNING	S-714	3/30/82	4/18/82
MARYLAND	S-592	4/3/78	10/9/78
" "	S-644	8/25/79	3/31/80
" "	S-675	11/4/80	5/10/81
" "	S-703	11/19/81	4/24/82
" "	S-721	10/28/82	4/18/83
" "	S-742	10/18/83	1/12/84
" "	S-761	11/15/84	5/12/85

<u>Vessel</u>	<u>Docket No.</u>	<u>Dates of Operation</u>	
		<u>From</u>	<u>To</u>
MASSACHUSETTS	S-600	6/27/78	1/10/79
"	A-139	12/19/79	6/21/80
"	S-681	1/1/81	3/7/81
NEW YORK	S-566	8/10/77	11/12/77
"	S-669	7/16/80	2/15/81 <u>2/</u>
"	S-713	5/22/82	11/9/82
"	S-733	5/9/83	11/10/83
"	S-780	1/19/86	7/18/86
WILLIAMSBURGH	S-666	5/29/80	12/1/80 <u>1/</u>
"	S-704	1/15/82	5/8/82
"	S-720	11/23/82	5/15/83
"	S-743	12/10/83	12/25/83

1/ Includes one intermediate foreign trade voyage

2/ Includes oil storage in Delaware Bay

III. SUITABILITY ANALYSIS

The preamble of the Merchant Marine Act, 1936, as amended (Act), states that the purpose for enactment is "To further the development and maintenance of an adequate and well-balanced (emphasis added) American merchant marine, to promote the commerce of the United States, to aid in the national defense, to repeal certain former legislation, and for other purposes." In Title I -- Declaration of Policy (Section 101) it is stated further that "It is necessary for the national defense and development of its foreign and domestic commerce that the United States shall have a merchant marine (a) etc.

It is noted that a key section of the policy statement covers a description of what kinds of vessels should compose the American merchant marine -- one that is composed of the best-equipped, safest, and most suitable (emphasis added) types of vessels."

Allowing the four VLCCs to remain in the Jones Act trades furthers the policy and purposes of the Act by making the domestic segment of the American merchant marine better balanced than it would be without these vessels in the trade. In addition, these vessels because of their characteristics, including size, permit the Secretary to make progress toward the goal of developing a merchant marine with well-equipped, safe and suitable vessels.

It is the view of the Secretary that the four VLCCs are more suitable vessels for the long-haul, high volume ANS trades than ships of a smaller size, because of their efficiencies and economy of scale.

Based on the operating and demand characteristics of the long-haul, high-volume ANS trades, CDS repayment has resulted in the displacement of smaller vessels with more suitable, large ships. The negative impact of this displacement on the employment of smaller tankers is offset by the benefit of having more suitable vessels in the domestic trade.

The cost of transporting a barrel of oil varies significantly, depending upon the size of the vessel. Large tankers carry crude at a lower cost per barrel than small tankers simply because operating costs do not increase as fast as cargo volumes. The relative efficiency of larger tankers becomes even more pronounced over longer hauls because the vessel's fixed costs can be spread over more barrel-miles. ^{4/} The demand for oil in each market, of course, affects the tanker size used in that trade. Finally, port draft restrictions and terminal restrictions prevent vessels over a certain size from entering specific ports and terminals. (The port draft restrictions can sometimes be overcome by light loading or lightering, which increases barrel-mile costs). Thus, the combination of economies of tanker size, length of voyage, tanker operating costs, size restrictions, and the quantity of ANS crude demand at specific ports are the main factors that determine ANS tanker deployment.

^{4/} See, for example, J.O. Jansson and D. Shneerson. "Optimal Ship Size," Journal of Transport Economics and Policy, September 1982, pp. 228-238.

The data presented in Table III-1 illustrate the operating economies of larger tankers in the long-haul Valdez to Panama oil trade. For example, a 90,000 DWT tanker has total costs per delivered long ton of crude oil (Valdez to Panama) which are 57 percent greater than those of 265,000 DWT tanker in the same trade.

Table III-1
U.S.-Flag Tanker Operating and Capital Costs,
Valdez-Panama*

<u>Tanker Size</u>	<u>\$ Per Long Ton</u>
265,000 DWT	9.19
225,000 DWT	11.09
170,000 DWT	12.42
120,000 DWT	13.44
90,000 DWT	14.17
50,000 DWT	25.00

* - Fuel and operating expenses from Maritime Administration's Estimated Vessel Operating Costs, 1984. Capital costs based on actual vessel cost at 10 percent interest rate.

Furthermore, large tankers are more suitable than smaller tankers from an environmental standpoint because they make fewer voyages and port calls than smaller tankers to carry the same amount of oil, thus reducing the risk of collisions and oil spills. 5/

As Table III-2 shows, the distribution of full time equivalent employment in the Alaska to Panama trade, and other ANS trades, has changed in favor of larger tankers since the CDS-built vessels (ARCO SPIRIT, ARCO INDEPENDENCE (July 1985) and BROOKLYN (June 1986)) repaid their subsidy. The apparent displacement, or bumping of smaller tankers from the trade has led to increased overall efficiency and safety in the distribution of ANS crude.

5/ See U.S. Dept. of Transportation, Environmental Assessment, CDS Repayment, March 1987.

Table III-2

Estimated Full-Time Equivalent Tanker Employment*
in the ANS Trade
(Deadweight in Thousands)

	1982	1983	1984	1985	1986
Employment by Trade and Size:					
Valdez-West Coast					
170-190	322.9	198.4	353.0	353.4	439.0
110-137	705.4	615.0	459.9	511.0	599.3
55-92	694.0	731.3	729.9	827.6	816.3
Under 55	66.9	91.2	262.9	165.1	105.9
Subtotal	1,789.2	1,635.8	1,805.6	1,857.0	1,960.4
Valdez-Panama					
Over 200	1,249.4	1,174.7	506.5	708.0	1,071.8
170-190	1,405.0	1,440.3	1,276.8	1,310.9	1,050.5
110-137	529.8	531.7	632.8	644.5	288.7
55-92	204.5	87.7	138.9	47.4	11.5
Under 55	0.0	0.0	7.4	0.0	3.9
Subtotal	3,388.7	3,234.3	2,562.3	2,710.7	2,426.4
Panama-Gulf/East					
110-137	0.0	0.0	0.0	4.4	115.6
55-92	837.5	856.6	814.2	868.7	721.4
Under 55	1,236.1	634.4	315.4	329.3	241.7
Subtotal	2,073.6	1,491.0	1,129.6	1,202.3	1,078.7
TOTAL	7,251.5	6,361.0	5,497.4	5,769.9	5,465.5

* Numbers may not add due to rounding.

Source: Maritime Administration.

IV. TRADE AND FLEET ANALYSIS

A. Trade

The demand for U.S.-flag tankers with domestic trading privileges, particularly VLCCs, increased sharply with the opening of the TransAlaskan Pipeline in 1977. The primary market for Alaska oil has been the West Coast, followed by the Gulf and East Coasts (Table II-1).

B. Ship Deployment

There were 5.5 million DWT of tanker capacity (full-time equivalents) in the Alaskan crude oil trades in 1986 which included 2.0 million DWT operating from Valdez to the West Coast, 2.4 million DWT deployed from Valdez to Panama and 1.1 million DWT transshipping ANS oil from Panama to the U.S. Gulf and East Coasts; 200,000 + DWT tankers, e.g., the four that repaid CDS, have been deployed only in the Valdez-Panama trades, due to draft restrictions of West Coast ports (see Table III-2).

C. Availability of Large Crude Oil Tankers for the ANS Trades

i. Unsubsidized U.S.-Flag Tankers

At the time that ANS crude oil loadings began, there were 215 privately owned unsubsidized tankers (8.0 million DWT) in the U.S.-flag fleet (excluding special product tankers), of which only 7 were over 100,000 DWT (848,000 DWT). An additional 15 tankers (2.3 million DWT) were on order for the domestic trade, of which 12 were over 100,000 DWT (2.0 million DWT). Table IV-1 lists the unsubsidized U.S.-flag tankers over 100,000 DWT.

Table IV-1

Unsubsidized U.S.-Flag Tankers Over 100,000 Deadweight Tons

	<u>Year Built/ Rebuilt</u>	<u>Deadweight Tons</u>
<u>In Fleet as of August 1, 1977</u>		
ARCO ANCHORAGE	1973	120,600
ARCO FAIRBANKS	1974	120,600
ARCO JUNEAU	1974	120,600
MANHATTAN	1962/69	113,900
MOBIL ARCTIC	1972	129,000
OVERSEAS JUNEAU	1973	120,000
PRINCE WILLIAM SOUND	1975	123,400
		<u>848,100</u>

Table IV-1 (cont'd)

	<u>Year Built/ Rebuilt</u>	<u>Deadweight Tons</u>
<u>On Order as of August 1, 1977</u>		
ATIGUN PASS	1977	173,400
KEYSTONE CANYON	1978	173,400
B.T. ALASKA	1978	188,100
TONSINA	1978	122,900
BROOKS RANGE	1978	173,400
THOMPSON PASS	1978	173,400
B.T. SAN DIEGO	1978	188,100
KENAI	1979	123,100
EXXON NORTH SLOPE	1979	173,400
EXXON BENECIA	1979	172,800
ARCO ALASKA	1979	188,400
ARCO CALIFORNIA	1980	188,400
		<u>2,038,800</u>
<u>Rebuilt Under the Wrecked Vessel Act</u>		
OVERSEAS BOSTON	1974/81	123,700
OMI COLUMBIA	1974/83	136,200
		<u>259,900</u>
<u>CDS Repayment</u>		
STUYVESANT	1977	224,700
BAY RIDGE	1979	225,000
ARCO INDEPENDENCE	1977	262,400
ARCO SPIRIT	1977	262,400
BROOKLYN	1973	226,200
		<u>1,200,700</u>
<u>New Construction</u>		
EXXON VALDEZ	1986	209,000
EXXON LONG BEACH	1987	209,000
		<u>418,000</u>
TOTAL AVAILABILITY		4,765,500

No orders for the construction of unsubsidized tankers over 100,000 DWT were placed between April 1976 and August 1984. However, on August 27, 1984, Exxon placed an order for the construction of two 209,000 DWT tankers in the United States for employment in the ANS crude oil trade. The first vessel was delivered in November 1986 and the second in April 1987.

Two foreign-flag tankers over 100,000 DWT were rebuilt in the United States for the ANS crude oil trade in 1981 and 1983 under the Wrecked Vessel Act (46 USC 14). Under this Act, foreign-built vessels that are wrecked off the U.S. coast are eligible to enter the U.S. domestic trade provided the vessel is purchased by a U.S. citizen and rebuilt in the United States at a cost that is at least three times the appraised salvage value. The first vessel, the OVERSEAS BOSTON (123,700 DWT), was rebuilt in 1981 and the second vessel, the OGDEN COLUMBIA (136,000 DWT), was rebuilt in 1983.

ii. Temporary Transfer of CDS-Built VLCCs

In June 1977, MARAD approved the temporary transfer of the CDS-built tanker, AMERICAN SPIRIT (262,400 DWT), to the Alaska-Panama trade for six months prior to 46 CFR Part 250 becoming final. Although tankers over 100,000 DWT were under construction at that time, there was insufficient suitable capacity available to meet the immediate shipping requirements in that segment of the Alaskan crude oil trade.

MARAD has approved the temporary transfer of CDS-built tankers to the Alaska-Panama trade on 43 occasions. The temporary transfers were at their highest level between 1980 and 1983 when there were approximately three CDS-built VLCCs (750,000 DWT) in the trade on a full time basis. Table II-3 lists the MARAD approvals for the temporary transfer of CDS-built vessel to the Alaska trade.

iii. Total CDS Repayment

In August 1977, MARAD approved the total repayment of CDS on the VLCC STUYVESANT (224,700 DWT). Competitors in the ANS crude oil trade filed suit, challenging MARAD's authority to grant full CDS repayment in exchange for permanent release of domestic trading restrictions. In February 1980, the U.S. Supreme Court ruled that the Secretary does have authority to grant permanent release from domestic trading restrictions in exchange for total CDS repayment, plus interest.

MARAD issued its second approval for CDS repayment in November 1980 on the BAY RIDGE (225,000 DWT). However, the U.S. Court of Appeals vacated the interim rule and ordered MARAD to conduct new rulemaking proceedings.

By letter dated March 10, 1987, counsel for the BAY RIDGE requested that a proceeding on the BAY RIDGE should be conducted independently of proceedings with respect to the three vessels which repaid CDS pursuant to the repayment rule that has been vacated by the Court of Appeals. However, this rulemaking will take the BAY RIDGE into consideration.

On January 31, 1983, the Department of Transportation issued a Notice of Proposed Rulemaking concerning the policy for total CDS repayment in an effort to increase efficiency and minimize Federal Government intervention in the allocation of large tankers to the ANS crude oil trade.

Shortly after the close of the comment period on the NPRM, the Congress took action to prevent the Secretary from promulgating a final rule. The DOT FY 84 Appropriations Act (Pub. L. 96-78, August 15, 1983) prohibited the enforcement of any rule with respect to the repayment of CDS until 60 days following the promulgation of any such rule. Thereafter, the Commerce Department's FY 84 Appropriations Act (Pub. L. 98-166, November 28, 1983) imposed an additional restriction that prohibited DOT from enforcing any CDS repayment rule until after June 15, 1984. However, in August of 1984, the FY 85 Appropriations Act for Commerce, Justice and State, which provided appropriations for the Maritime Administration, imposed yet another restriction. That Act prohibited the Department from enforcing any CDS repayment rule until May 15, 1985 (Pub. L. 96-411, August 30, 1984).

On May 7, 1985, the Department published in the Federal Register a final rule which allowed any owner or operator of a tanker built with CDS to repay its subsidy (with interest) and consequently obtain a permanent removal of domestic trading privileges. The amount of repayment included the unamortized CDS on the vessels plus compounded interest on that amount. The interest rate to be used for computational purposes was the rate of the original Title XI obligation on the tanker or the Title XI long term bond rate at the time of delivery. The final rule included a one-year time limit after the rule's effective date during which total CDS repayment had to be made. That time limit was from June 6, 1985 through June 6, 1986. During that time, four tankers repaid their CDS: the ARCO INDEPENDENCE, ARCO SPIRIT, BAY RIDGE, and the BROOKLYN. The total amount of CDS repaid by these ships was \$142 million. Those ships are now operating in the domestic trade.

On January 16, 1987, the Court of Appeals for the District of Columbia held that the Secretary of Transportation violated section 553(c) of the Administrative Procedure Act by adopting this final rule on CDS repayment. The Court vacated the rule, but withheld issuance of its mandate until July 16, 1987 "to avoid further disruptions in the domestic market and to allow the Secretary to undertake further proceedings to address the problems of the merchant marine trade." Independent U.S. Tanker Owners Committee v. Dole, Civil Action Nos. 85-01555, 85-01740, 85-01752 and 85-1771 (D.C. Cir. January 16, 1987). The Court ruled that, as of July 16, 1987, the present rule will be vacated and conditions will be returned to the status quo ante, before the CDS repayment rule took effect, subject to any "further action" that the agency may have taken in the interim.

Since the one-year window for total CDS repayment expired no CDS-built tankers have been temporarily transferred to the Alaska-Panama trade under 46 CFR Part 250. The last transfer was approved for the NEW YORK (264,100 DWT) and the vessel left the trade on July 18, 1986.

D. Laid-up Tonnage Available for the ANS Trades

Domestic tankers in long-term lay-up or temporarily idled as of February 1987 totaled 12 vessels of 649,609 DWT. Of these, 3 tankers totaling 146,600 DWT are over 20 years old. The remaining nine tankers include the PRINCE WILLIAM SOUND (123,400 DWT) and smaller tankers that could serve in the ANS trades, though at much higher cost per ton delivered than the VLCCs currently operating in the trade.

Table IV-2

Privately-Owned Petroleum Domestic Tankers Laid-up*
(as of February 1987)

<u>Vessel Name</u>	<u>Year Built/Rebuilt</u>	<u>DWT</u>
FALCON COUNTESS	1972	37,276
FALCON LADY	1971	37,276
COVE TRADER	1959	46,400
DELAWARE TRADER	1982	50,057
ASPEN	1971	80,600
PRINCE WILLIAM SOUND	1975	123,400
MOUNT WASHINGTON	1963	49,400
BENNINGTON	1963	50,800
CHARLESTON	1956/80	39,400
FREDERICKSBURG	1958/80	39,000
JACKSONVILLE	1982	48,000
NEW YORK	1983	48,000
TOTAL	Avg. 14 years	649,609

* This list does not include vessels waiting to go into the National Defense Reserve Fleet and tankers of less than 6,000 DWT.

E. The Foreign Trade

One of the goals of the Act is to encourage the development and maintenance of a merchant marine sufficient to carry "a substantial portion of the waterborne export and import foreign commerce of the United States..." 46 USC 1101(a). The Court of Appeals criticized the previous CDS repayment rule for its conclusion that the fleet will remain "more than adequate to carry an appropriate share of U.S. foreign oil commerce if such opportunities should arise." The Court then concludes that the rule "will make it impossible to retain a fleet that can carry all domestic traffic and" a substantial portion 'of foreign traffic' at all times which is explicitly set out as an objective in section 101(a) of the statute. ITOC, supra at 12.

The Court noted in a footnote to its decision overturning the prior CDS rule

It may be, of course, that present conditions in the world shipping market make it impossible for the Secretary to find a way to meet all of the statutory objectives. If this is a problem, she should discuss it frankly and directly when she considers which measures to adopt in light of the objectives explicitly set out in the Act.

While this proposed rulemaking would provide a domestic tanker fleet that is (1) sufficient to carry the domestic waterborne commerce of the United States and (2) composed of the "best-equipped, safest, and most suitable types of vessels...", there would be no effect on the U.S.-flag share of the waterborne export and import foreign commerce of the United States.

The U.S.-flag foreign trade tanker fleet currently consists of 26 CDS-built tankers totaling 3 million DWT. (This excludes the four VLCCs that are the subject of this rulemaking and three CDS-built integrated tug-barges, but includes two CDS-built ore-bulk-oil carriers built with CDS.) The six CDS-built VLCCs and ULCCs (ultra large crude carriers) are currently laid-up as is one CDS-built 90,000 DWT tanker. Seven of the tankers are employed in the competitive foreign trade, while the remaining 12 tankers are under charter to MSC (6) or are employed in the preference trades (6).

While the intent of MARAD's CDS and ODS programs was to provide a U.S.-flag fleet that is sufficient to carry a substantial portion of our import and export trade, most of the large tankers built under the 1970 program are not competitive in the international market. MARAD cannot provide new subsidies to offset the cost disadvantages of operating U.S.-flag tankers in the foreign trades.

The United States currently imports approximately 6.0 million barrels per day of crude oil and refined product, of which only 3 percent is carried on U.S.-flag tankers. Furthermore, a substantial portion of our crude oil imports—approximately 45 percent—are received from nearby sources including Canada, Mexico, Venezuela and the Caribbean region. The CDS-built VLCCs are unsuitable for these short haul import trades. Approximately 32 percent of U.S. crude oil imports are received from the distant Arabian Gulf and North Sea regions for which VLCCs would be suitable.

In contrast, ten years ago U.S. crude oil and refined product imports averaged 8.8 million barrels per day. Only 14 percent of our crude oil imports were received from nearby sources while over 40 percent of our oil imports were received from the Arabian Gulf and North Sea regions.

During the last year, there has been an increase in oil exports from the Arabian Gulf region and a corresponding rise in demand for VLCCs in the international trade. Despite this increase, the supply of tonnage in the world tanker fleet is more than adequate to carry the United States' current volume of oil imports and will remain adequate to carry our future oil imports.

As of January 1987, the world fleet contained over 235 million DWT, of which approximately 200 million DWT (85 percent) were actively employed. The remaining 35 million DWT (15 percent) were idle; however, 30 million DWT were in the over 200,000 DWT size class. The amount of idle capacity in the over 200,000 DWT size class represents more than 26 percent of the available tonnage in that class. Therefore, given the relative higher operating costs for U.S.-flag tankers and the amount of idle tonnage over 200,000 DWT in the world fleet, it is very unlikely that the four VLCCs that are the subject of this rulemaking would be laid up if they are required to leave the domestic trade.

In fact, of the nine VLCCs and two ULCCs built with CDS under the 1970 program, none has had any significant employment in the foreign commercial trades, other than occasional shipments of oil to the Strategic Petroleum Reserve, of which a share is reserved for U.S.-flag carriage. The deployment of four CDS-built VLCCs to the domestic trade thus would have no impact on the U.S.-flag tanker presence in foreign trades.

V. NATIONAL SECURITY ISSUES

The Defense Department has expressed concern over the national security implications of losing product tankers from the U.S.-flag fleet. Three principle factors have contributed to a reduction in the number of U.S.-flag product tankers: a declining upcoast (U.S. Gulf-East Coast) petroleum trade, the principal market for U.S.-flag product tankers, start-up of the Trans-Panama Pipeline (October 1982), and the anti-pollution standards of the Port and Tanker Safety Act (PTSA) which required product tankers in the 20,000-40,000 DWT range to be retrofitted by January 1, 1986 for operation in U.S. ports. As a result of these factors, 41 U.S.-flag tankers of 1.3 million DWT of the type considered highly militarily useful have been scrapped over the period 1984-86 (see Appendix I).

As of February 1987, there were 12 U.S.-flag privately-owned domestic tankers of 649,609 DWT in lay-up. Of these, nine of 503,003 DWT were less than 20-years old -- the statutory economic life of a tanker. These tankers represent a reasonable reserve, 6 percent of the total U.S.-flag domestic tanker fleet, to cover temporary losses from the active fleet due to casualties, (three in 1986), safety inspections and repairs; as well as seasonal increases in upcoast petroleum movements -- February is traditionally a slack month in the U.S. Gulf-East Coast trade.

In fact, as recently as March 24, 1986, the BEAVER STATE (90,000 DWT CDS-built vessel) was admitted to ANS-West Coast trade for one month on a section 506 (Merchant Marine Act of 1936) waiver because no suitable unsubsidized vessel was available for the trade. (Action upheld by District Court in Civil Action No. 86-0896, American Trading and Transportation Co., Inc. et al., vs. United States of America et al.) The action reflects the need to have slack non-VLCC capacity available, i.e., tankers in temporary lay-up to meet peak demand situations in the domestic tanker trades.

As shown in Table V-1, as of February 1, 1987, 32 percent of the U.S.-flag domestic tanker tonnage under 100,000 DWT was at least 20 years old. Given the age distribution and potential scrapping rates for militarily useful tankers (less than 100,000 DWT), it does not appear that allowing the four VLCCs which repaid CDS to remain in the domestic trade will result in unemployment for domestic tankers beyond that which is necessary to meet peak demand situations.

Thus, allowing the four VLCCs to remain in the domestic trades will further the Agency's statutory objectives of promoting a suitable, well-balanced merchant marine, i.e., capable of efficiently serving normal as well as peak demands in the domestic petroleum trades.

Table V-1

Age Distribution of U.S.-flag Privately-Owned
Tankers with Domestic Trading Privileges
February 1, 1987*

	Less than 10 Yrs.		10-14 Yrs.		15-19 Yrs.		20 Yrs. or More		Total	
	No.	000 DWT	No.	000 DWT	No.	000 DWT	No.	000 DWT	No.	000 DWT
Less than 100,000 DWT	28	1,345	19	828	35	1,810	49	1,859	131	5,842
100,000 DWT or greater	15	2,559	11	1,883	-	-	1	114	27	4,556
TOTAL	43	3,904	30	2,711	35	1,810	50	1,973	158	10,398

* Excludes chemical tankers, integrated tug/tank barge units and tankers of less than 6,000 DWT.

Source: Maritime Administration.