14846

116298

UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

COMMUNITY AND ECONOMIC DEVELOPMENT DIVISION

September 4, 1981

B-204453

The Honorable Walter B. Jones
Chairman, Committee on
Merchant Marine and Fisheries
House of Representatives

116298

The Honorable Gene Snyder
Ranking Minority Member
Committee on Merchant
Marine and Fisheries
House of Representatives

Subject: United States Lines, Inc.'s, Operating Differential Subsidy Agreement, Contract No. MA/MSB-483, Trade Route 5-7-8-9 (CED-81-154)

This letter is in response to the committee's request of July 13, 1981, for specific information on United States Lines, Inc.'s, acquisition of Farrell Lines, Inc.'s, rights to Federal operating differential subsidies on trade route 5-7-8-9. Trade route 5-7-8-9 runs between the U.S. North Atlantic ports and certain ports in the United Kingdom and continental Europe. The committee's specific questions and our answers follow. The details are provided in enclosure I.

1. How much did U.S. Lines pay Farrell for the subsidy rights to trade route 5-7-8-9?

   U.S. Lines will pay Farrell about $15 million for the subsidy rights to trade route 5-7-8-9 and the bareboat charter rights to two container vessels.

2. How do the vessel replacement provisions in U.S. Lines' subsidy contract for trade route 5-7-8-9 differ from the standard subsidy vessel replacement provisions?

   The vessel replacement provisions in U.S. Lines' subsidy contract are unique, varying significantly from the standard provisions in other subsidy contracts in terms of time allowed for vessel replacement. However, the Maritime Administration (MarAd) considered U.S. Lines' subsidy application to be a unique situation because of (1) U.S. Lines' older vessels, (2) reduced construction differential subsidy funding, and (3) contemplated legislative changes to the construction subsidy program.

(065552)

018389

3. Does U.S. Lines' pending application for subsidy on its other trade routes contain similar vessel replacement provisions?

   U.S. Lines and MarAd have not reached agreement on the replacement provisions to be included in U.S. Lines' pending subsidy application.

In answering the committee's questions, we interviewed agency officials and reviewed and analyzed records and contract files at MarAd headquarters in Washington, D.C. As the committee requested, we did not discuss these matters or obtain data from U.S. Lines or Farrell officials, nor did we obtain agency comments on the contents of this letter. However, we did discuss its contents with agency officials who agreed with the facts presented.

As arranged with the committee, we are sending copies of this letter to interested parties and will make copies available to others upon request. If you have any further questions regarding this matter, we would be pleased to discuss them with you.

Henry Eschwege

Henry Eschwege
Director

Enclosure

## HOW MUCH DID U.S. LINES PAY FARRELL FOR THE SUBSIDY RIGHTS TO TRADE ROUTE 5-7-8-9?

On November 7, 1980, Farrell and U.S. Lines entered into an agreement of assignment and assumption under which Farrell agreed to transfer and assign to U.S. Lines all of its interests and rights to trade route 5-7-8-9. These included Farrell's current subsidy contract and its rights to a pending subsidy contract on this trade route that was under consideration by MarAd. 1/ Farrell also agreed to transfer bareboat charters for two containerships--the Austral Ensign and Austral Endurance--to U.S. Lines. The charters expire in 1998.

U.S. Lines, in turn, agreed to accept the assignment of and assume Farrell's obligations concerning trade route 5-7-8-9 and the bareboat charters. Further, U.S. Lines agreed to

--deliver to Farrell a promissory note in the principal amount of $6 million payable over 7 years at 12 percent interest per year;

--transfer to Farrell three breakbulk vessels--Pioneer Commander, Pioneer Crusader, and Pioneer Contractor--to be traded in by Farrell to the Government; and

--pay Farrell an amount equal to the difference between $9 million and the amount received by Farrell (if less than $9 million) upon the trade-in of the three Pioneer vessels to the Government.

## HOW DO THE VESSEL REPLACEMENT PROVISIONS IN U.S. LINES' SUBSIDY CONTRACT FOR TRADE ROUTE 5-7-8-9 DIFFER FROM THE STANDARD SUBSIDY VESSEL REPLACEMENT PROVISIONS?

### U.S. Lines' vessel replacement provisions

On January 9, 1981, U.S. Lines and MarAd entered into a 20-year subsidy contract for trade route 5-7-8-9. Article I-9 of the contract provides that U.S. Lines, within 2 years of the date of the contract, will enter into construction contracts or will agree to charter for the long term, four new container vessels. If U.S. Lines fails to enter into these construction contracts or charters, the subsidy shall terminate, unless a replacement program for all vessels named in the contract whose economic life will terminate within the contract period has been agreed to by U.S. Lines and MarAd during the 2-year period. Further, this article provides

---

1/U.S. Lines never initiated service under Farrell's existing subsidy contract. The contract expired Dec. 31, 1980.

that if the construction contracts or charters are entered into, U.S. Lines agrees within 4 years after the date of the subsidy contract to submit a specific replacement program for certain named vessels. The replacement program may include the four vessels to be constructed or chartered. If, however, U.S. Lines and MarAd fail to reach a replacement program agreement within 5 years, the subsidy shall terminate.

The article further provides that any construction contract required pursuant to the replacement program be executed by U.S. Lines at least 3 years before the termination of the economic life of the vessel(s) or within 1 year after the replacement program has been agreed to, whichever is later.

U.S. Lines' contract replacement requirements also contain the standard provisions concerning agreed vessel construction. That is, the vessels to be constructed shall be eligible for construction differential subsidy and if subsidy funds are not available at time of construction, the required construction will be deferred.

<u>The standard subsidy contract vessel replacement provision</u>

Article I-9 in the standard subsidy contract provides for a vessel replacement program. It further provides that if the operator and MarAd agree to the economic viability of vessel replacement and if construction subsidy funds are available, the operator will execute construction contracts for replacement vessels at least 3 years before termination of the vessels' economic lives. Also, the operator must agree that not later than 5 years before the termination of the economic life of the vessel or vessels, the operator will submit an updated replacement program to MarAd. If the operator and MarAd fail to reach a new replacement agreement at least 3 years before the termination of the economic life of the vessels, then MarAd may require the operator to replace the vessels as they had previously agreed when the subsidy contract was entered into.

The standard article I-9 further states that if the operator should fail to comply with the requirements of article I-9 or to proceed diligently to the satisfaction of the Government with its obligations in the acquisition or construction of new vessels, the failure shall constitute default and MarAd may modify or terminate the subsidy contract.

According to MarAd's Deputy Associate Administrator for Maritime Aids (Trade), U.S. Lines' vessel replacement clause is unique, representing a deviation from MarAd's standard provisions in terms of the time periods allowed for vessel replacements. However, he believes that U.S. Lines' replacement obligations are no less stringent than other subsidy contracts. He stated that the standard subsidy replacement provisions were not practical because (1) U.S. Lines was entering the subsidy program with a fleet approaching the end of its economic life, (2) there was concern about the availability of construction subsidy funds, and (3) legislative changes were being contemplated for the construction subsidy program and other MarAd programs. He further stated that MarAd agreed to the contract knowing that U.S. Lines would apply for subsidy on its other trade routes and that the replacement program under the subsidy contract for trade route 5-7-8-9 would be considered in negotiating a replacement program for the entire U.S. Lines fleet. The Deputy Associate Administrator stated that, under U.S. Lines' subsidy contract, if MarAd and U.S. Lines do not agree on a replacement program, the subsidy would be terminated. He added that under all other subsidy contracts, if the operators failed to replace their vessels, MarAd could terminate the subsidy and probably sue the operator for performance of the contract's vessel replacement provisions if the operator continued in business.

## DOES U.S. LINES' PENDING APPLICATION FOR SUBSIDY ON ITS OTHER TRADE ROUTES CONTAIN SIMILAR VESSEL REPLACEMENT PROVISIONS?

On February 17, 1981, U.S. Lines applied for subsidy for its other trade routes. A specific replacement program was not identified in the application and there was no requirement for U.S. Lines to provide one at that time. However, the subsidy application stated that U.S. Lines was formulating plans to build replacement vessels. As of August 14, 1981, MarAd and U.S. Lines were negotiating the terms of a new subsidy contract, including a vessel replacement program. Negotiations include providing for a vessel replacement program that will cover the entire U.S. Lines fleet, including vessels on trade route 5-7-8-9.