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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D C 20548

B-169094 Com. May 18, 1970

RELEASED

Dear Mr. Whitehurst:

Your letter of February 13, 1970, requested this Office to look into the total cost involved in a decision by the Maritime Administration, Department of Commerce, to offer foreign ship dismantlers an opportunity to bid on the sale of surplus vessels. We understand that your concern is with the total cost to the U.S. economy resulting from this decision. Accompanying your request was a letter dated January 30, 1970, to you from the Peck Iron and Metal Company, Inc., Portsmouth, Virginia, suggesting that this Office determine (1) the value of surplus Liberty ships in the James River where the scrapping of these ships is restricted to U S. citizens within the continental United States and (2) the foreign sales price that would have to be established to equal the overall economic benefit to the U.S. economy if the vessels were sold domestically.

A fair price for a surplus vessel can sometimes be determined by competitive bidding. This price, however, may be influenced by such factors as the dismantler's demand for vessels and the number of vessels which Maritime decides to offer in any given period. Although the supply of surplus vessels is currently very large, the number of domestic vessel dismantlers is limited and their demand for surplus vessels is relatively small. Therefore, although competitive bidding is usually considered an appropriate method of establishing fair market prices, it does not appear that competitive bidding is necessarily a valid method under these circumstances.

Another method of determining a fair price of a vessel to be sold for scrapping is the "end product method" whereby an estimate of the quantity and quality of scrap metal which can be derived from scrapping the vessel is made and a value based on the market price of such scrap metal is established. To this would be added the value of any equipment and machinery which could be sold separately rather than scrapped. This value is then reduced by the dismantler's average cost of operations attributable to ship-dismantling operations and a reasonable profit This method is probably not precise and would entail obtaining engineering estimates and having access to the books and records of a representative group of dismantlers.

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Similarly, the foreign sales price that would equal the overall economic benefit to the U.S. economy if the vessel were sold domestically would be difficult to determine and would involve many assumptions. We believe that, aside from the problems in establishing a domestic fair price which would be a factor in establishing a foreign sales price, any impact on the overall U.S. economy from domestic sales is difficult to quantify. For example, it would be difficult to determine the effect that domestic sales would have upon employment since domestic dismantlers might obtain other items having scrap value if conditions make it difficult or impractical to obtain surplus vessels for dismantling.

In view of the difficulties involved in determining the fair domestic and foreign prices, we limited our review to an examination of Maritime records and to discussions with cognizant Maritime officials to obtain information on Maritime's sale of surplus vessels.

Sales of surplus vessels by Maritime for scrapping are made under conditions which require that the vessels be dismantled within a specified time period and that the vessels not be used by the buyer for any purpose other than for scrapping. The sales contracts provide that liquidated damages be paid by the buyer and that the contract be terminated if the vessels are used for any unauthorized purpose or if not dismantled within the specified time. Maritime periodically examines the dismantlers' operations to ascertain whether the vessels sold are being dismantled as specified by the contracts.

On December 8, 1969, the Maritime Administrator announced that surplus vessels at east coast reserve fleet sites, which had been offered for sale for scrapping to domestic ship dismantlers and for which no acceptable bids had been received, would be offered for sale to citizens of friendly foreign countries for scrapping. Currently, Maritime's east coast reserve fleet sites are at Hudson River, New York, and James River, Virginia. With few exceptions, Maritime has restricted the sale of surplus vessels to domestic ship dismantlers. This restriction still applies to Gulf and west coast surplus vessels because, according to Maritime's Deputy Administrator, the rate of domestic sales from these areas has been sufficient to dispose of the vessels within a reasonable time.

According to the Administrator, the decision to offer surplus vessels for sale to citizens of friendly foreign countries, after first offering the vessels exclusively to domestic ship dismantlers, was made because of the need to accelerate sales due to the progressive deterioration of the hulls of vessels at the east coast reserve fleet sites. He stated that deterioration had reached a point where he believed that many of the vessels might sink within 3 to 5 years.

According to Maritime records, 22 surplus vessels at the James River site have experienced "holing-through" incidents--water leaks below the flotation line caused by hull deterioration--some more than once, during the period July 1, 1965, through December 29, 1969. From January 1, 1968, through December 1969, the number of holing-through incidents almost doubled from those experienced from July 1, 1965, to December 31, 1967. According to Maritime officials, these incidents will increase as the vessels get older because they do not receive hull preservation. Although there have not been any holing-throughs reported on vessels at the Hudson River site, Maritime officials have informed us that holing-throughs can be expected to occur. According to these officials holing-throughs have occurred to date only at the James River site because anaerobic bacteria in the James River increases the rate of hull deterioration.

The Maritime Administrator has stated that, based on Maritime's judgment of the capacity of east coast ship dismantlers to dismantle vessels, it would take about 10 years to remove the surplus vessels from the James River and Hudson River reserve fleet sites. On the basis of domestic sales of surplus vessels from east coast sites for the 5-year period ended December 31, 1969, we estimate that it would take about 7 years to dispose of the 261 surplus vessels in the James River and Hudson River sites at December 31, 1969. This estimate does not include 168 vessels in a preserved status--those vessels being maintained for possible reactivation--which may be declared surplus in the future.

According to Maritime records, 304 vessels from the east coast were offered for sale to domestic dismantlers for scrapping or nontransportation use during the 5 calendar years ended December 31, 1969. Of this total, 198 vessels were sold for about $8.8 million, no bids were received on 53 vessels, and bids were rejected on 53 vessels.

In addition to the 304 vessels offered for sale to domestic dismantlers, 21 vessels were offered for sale under conditions permitting either foreign or domestic dismantling--14 were sold to foreign companies for about $1 million and seven were sold to domestic companies for about $580,000 and subsequently were resold to foreign dismantlers. Of the 21 vessels, nine were sold subsequent to the Maritime Administrator's announcement that foreign sales would be permitted. The other 12 vessels had been obtained by Maritime under its Ship Exchange Program. Under this program, vessels are traded in to Maritime by American-flag operators in exchange for Maritime reserve fleet vessels and the operator pays Maritime the difference between the values of the vessel traded in and the vessel received from Maritime. Foreign sales of these 12 vessels were allowed to give the operator the highest possible trade-in allowance.

During this same time period, Peck Iron and Metal Company submitted bids on 79 of the 325 vessels offered for sale and, as high bidder, purchased three for about $132,000.

From December 8, 1969--the date the decision was announced to offer vessels to foreign citizens for scrapping--through March 3, 1970, Maritime sold 16 vessels to foreign citizens for about $1.6 million, including 13 Liberty ships for about $1.2 million. When the 16 vessels were last offered for sale exclusively to domestic dismantlers, bids were received on only two, neither of which were for Liberty ships. The high bids were $40,106 and $45,678.

Government surplus disposal laws and regulations require that a fair price be obtained for vessels sold for scrap. Consequently, a "floor price" has been established for Liberty ships offered for sale and all bids for Liberty ships are measured for reasonableness against this price. The floor price for a Liberty ship is currently $40,000. About 75 percent of the surplus vessels at the two east coast reserve fleet sites at February 28, 1970, were Liberty ships.

The Peck Iron and Metal Company believes that the floor price established by Maritime for a Liberty ship is too high. The Company also contends that east coast dismantlers are not consistently purchasing Liberty ships at, or in excess of, this price which is a further indication that the floor price is too high.

Maritime officials advised us that the floor price was adminstratively determined after considering the amount of scrap metal obtainable from a Liberty ship; the prices on the scrap-metal market; equipment and machinery, if any, on the ship which need not be scrapped; and past sales of ships. It is Maritime's view that the floor price is not excessive As evidence of this, Maritime notes that the floor price for a Liberty ship, $40,000, has not changed during the past year, notwithstanding the fact that the market price for scrap metal obtainable from a Liberty ship has risen as much as 30 to 40 percent in some east coast locations during this period. This increase in scrap metal prices, however, has been offset to some extent by increases in costs of operation.

With regard to the Company's view that east coast dismantlers are not consistently purchasing Liberty ships at, or in excess of, the floor price, Maritime records show that for the 5 calendar years ended December 31, 1969, 118 Liberty ships were sold for about $5.3 million to east coast dismantlers for scrapping. These 118 vessels were sold at prices ranging from $40,103 to $50,600 each, or an average price of about $45,000. Peck Iron and Metal Company's average bid for Liberty ships during this period was about $24,000, ranging from a low bid of $14,106 to a high bid of $42,667. The floor price established by Maritime for Liberty ships was $45,000 from January 1965 through December 1968 and $40,000 from January 1969, when, according to Maritime officials, the floor price was reduced because of the then-declining market prices for scrap metal.

We believe that the practice of establishing floor prices is necessary to ensure that the Government receives a fair price since the number of vessels available for sale exceeds the demand. We believe also that the establishment of the floor price should continue to be an administrative determination by the Maritime Administration.

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This information is being provided to several other members of the Congress who have made similar requests. The contents of this report have been discussed with Maritime officials; however, Maritime has not had an opportunity to formally comment on the report.

We trust that the foregoing information will be of assistance to you.

Sincerely yours,

Elmer B. Staats

Comptroller General
of the United States

The Honorable G. William Whitehurst
House of Representatives