U. S. Department of Transportation
Maritime Administration

MARITIME ADMINISTRATION

ANNUAL REPORT TO CONGRESS

FOR

VESSEL OPERATIONS REVOLVING FUND TRANSACTIONS

FOR

FISCAL YEAR 2017

January 2018

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List of Acronyms

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Defense Logistics Agency	(DLA)
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ESCO Marine, Inc.	(ESCO)
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J	
James River Reserve Fleet	(JRRF)
M	
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N	
National Defense Authorization Act	(NDAA)
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Ship Disposal Program	(SDP)
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V	
Vessel Operations Revolving Fund	(VORF)

REPORT TO CONGRESS

MARITIME ADMINISTRATION

REVENUES AND DISTRIBUTIONS FROM THE

VESSEL OPERATIONS REVOLVING FUND

DURING FISCAL YEAR 2017

EXECUTIVE SUMMARY

The Maritime Administration (MARAD) produced this Fiscal Year 2017 report to provide the following; 1) the total amount of funds, attributable to MARAD's Ship Disposal Program (SDP), credited in the most recently completed Fiscal Year (FY) to the Vessel Operations Revolving Fund (VORF) and any other account; 2) the balance of funds available at the end of that fiscal year in the VORF and any other account for which a credited amount was included; 3) a detailed description of the funds credited to and distributions from the VORF in that FY; 4) a summary of each project selected by the Maritime Administrator, for preservation and presentation to the public of MARAD's maritime heritage property, for which funds from VORF were expended in that fiscal year; and 5) a detailed description of the results of the Maritime Administrator's biennial assessment of MARD's SDP for FY 2017.

INTRODUCTION

This consolidated report is submitted in response to the direction of the National Defense Authorization Act (NDAA) for FY 2017 TITLE XXXV—MARITIME MATTERS, Sec. 3507 Use of National Defense Reserve Fleet scrapping proceeds. The specific language directing MARAD to provide the report states: "Not later than January 1 of each year, the Maritime Administrator shall submit to the Committee on Commerce, Science, and Transportation of the Senate and the Committee on Armed Services and the Committee on Transportation and Infrastructure of the House of Representatives a report on the management of the Ship Disposal Program of the Maritime Administration. The annual report shall include;

(A) the total amount of funds, attributable to the Ship Disposal Program of the Maritime Administration, credited in the most recently completed fiscal year to—
  (i) the Vessel Operations Revolving Fund established by section 50301(a) of title 46, United States Code; and
  (ii) any other account;

(B) the balance of funds available at the end of that fiscal year in—
  (i) the Vessel Operations Revolving Fund; and
  (ii) any other account for which a credited amount was included under subparagraph (A)(ii);

(C) a detailed description of the funds credited to and distributions from the VORF in that fiscal year; and
(D) a summary of each maritime heritage project selected by the Maritime Administrator, for preservation and presentation to the public of the Maritime Administration's maritime heritage property, for which funds from the Vessel Operations Revolving Fund were expended in that fiscal year.
(E) a detailed description of the results of the Maritime Administrator's biennial assessment of MARAD's Ship Disposal Program for FY 2017.

Section I – Funds Attributable to the Ship Disposal Program. This section provides an overview of funds credited to the VORF account in FY 2017 attributable to the sale of non-retention vessels for recycling by the MARAD SDP. The report also summarizes revenues credited to the VORF account related to ship disposal activities from FY's 2010-2017.

Section II - VORF Account Balances. This section provides an accounting of funds available in the VORF account and sub-accounts at the end of FY 2016.

Section III – VORF Revenues, Obligations and Funds Provided. This section provides a description of funds credited to the VORF account during FY 2017 including a summary of obligations and funds provided from the VORF account and the sub-accounts during the fiscal year.

Section IV – Maritime Heritage Projects. This section provides a summary of each project selected by the Maritime Administrator for preservation and presentation to the public of MARAD's maritime heritage property for which funds from the VORF were expended during FY 2017.

Section V - Biennial Assessment. This section provides a detailed description of the results of the Maritime Administrator's biennial assessment of MARD's SDP for FY 2017.

Section VI – Conclusion.

I. FUNDS ATTRIBUTABLE TO THE SHIP DISPOSAL PROGRAM

Ship Recycling Sales Revenue

The Vessel Operations Revolving Fund (VORF) is the repository for the receipt of funds attributable to the sale of non-retention vessels for recycling, for reuse and for the collection of liquidated damages assessed for late performance in the completion of ship recycling sales contracts. No other accounts have been established at MARAD for the receipt of funds attributable to the sale of non-retention vessels from the National Defense Reserve Fleet (NDRF) for the purpose of dismantlement or recycling.

While MARAD strongly encourages ship recyclers to provide performance bonds from third party financial institutions, there are isolated instances where a ship recycler will provide a direct wire transfer for the performance bond. On these occasions, the performance bond is credited into the VORF account, is not allocated to the sub-accounts, and is returned to the recycler upon successful completion of the ship recycling contract.

MARAD did not sell any non-retention NDRF vessels during FY 2017, resulting in $0 sales revenue. The only funds credited to the VORF in FY 2017 were the result of liquidated damages, in the amount of $1,863, assessed by the SDP for late performance in the completion of a ship recycling contract. Accrued revenue from the sale of non-retention NDRF vessels over the past eight fiscal years (FY’s 2010-2017) has been approximately $67 million for the dismantling/recycling of 57 ships as shown in Table 1.

Table 1: Vessel Sales Revenue

Vessel Sales Revenue by Fiscal Year									
Fiscal Year	**FY 2010**	**FY 2011**	**FY 2012**	**FY 2013**	**FY 2014**	**FY 2015**	**FY 2016**	**FY 2017**	**TOTAL**
Annual Sales Revenue ($):	$0	$7.6M	$18.9M	$24.6M	$9.8M	$6.1M	$52K	$0	$67M
Vessel Sales Contracts:	0	8	16	19	8	5	1	0	57

For this chart vessel sale revenues are calculated using the vessel contract award date as the date of receipt of sale revenues in each FY.

The volatility of the price of scrap steel and its impact on vessel sales is evident in the above table depicting the sale of vessels for recycling for FY’s 2010-2017. The table indicates a trough of zero vessel sales in FY 2010 increasing to a peak of 19 vessels sold in FY 2013 with a slow slide to another trough of zero vessels sold in FY 2017. In FY 2010, MARAD did not sell a single vessel for recycling but awarded service contracts for the recycling of 11 vessels. The price of scrap steel began rebounding in FY 2010 and from FY’s 2011-2013 MARAD sold 43 ships and generated approximately $51 million in revenue. The decline in vessel sales for recycling in FY’s 2014–2017 is directly attributable to the slowdown in domestic and international economic activity, reduced global demand for commodities, especially metals, and the subsequent collapse in the scrap metal markets.

In FY 2017, MARAD issued two separate ship recycling sale announcements for a total of four vessels. Due to the volatile scrap steel market MARAD was unable to sell a single vessel and instead had to award service contracts for the recycling of the four vessels. While scrap steel prices rebounded somewhat in FY 2017, the projected revenue from the sale of recyclable materials was insufficient to cover the recyclers costs of removing, towing, and disposing of the last two Consent Decree vessels from the Suisun Bay Reserve Fleet (SBRF). In addition, two vessels in the James River Reserve Fleet (JRRF), were offered for sale but did not sell due to the small size of one ship and the presence of mud ballast in four of the double bottom tanks on the large ship.[1]

Domestic Scrap Steel Prices

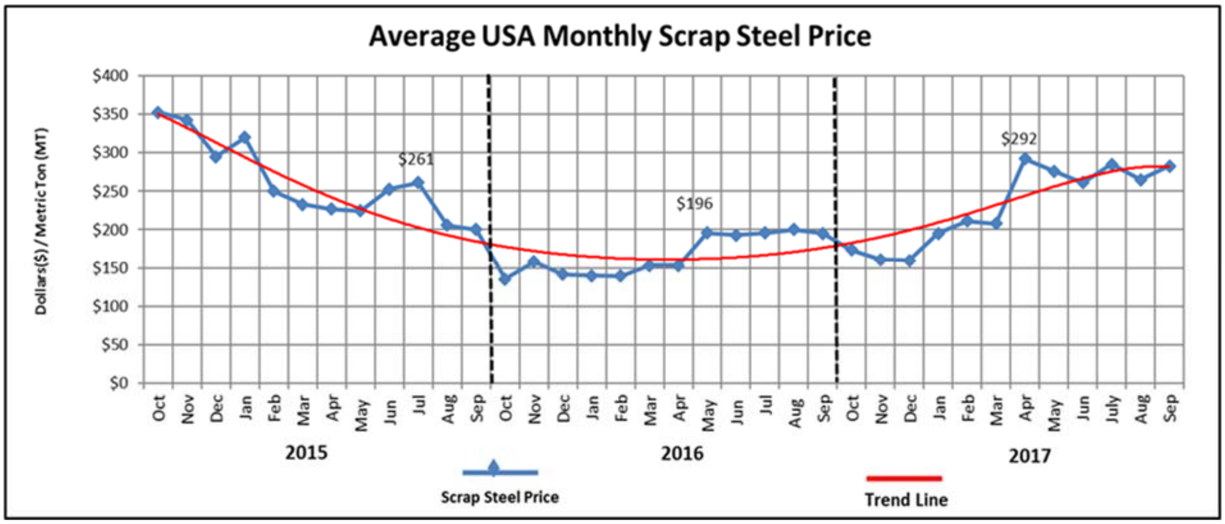
The MARAD ship disposal sales program is highly dependent on a robust domestic and international scrap steel market. When scrap steel sales are high MARAD sells non-retention vessels from its three NDRF fleet sites and Navy Inactive Ship Maintenance Office (NISMF) in Philadelphia, PA and Pearl Harbor, HI, for recycling at qualified facilities in Texas and Louisiana. As scrap metal prices fall, the total amount paid for each vessel also falls as the volatility in the scrap metal market makes it more difficult for each recycler to predict future scrap steel prices to sufficiently cover fixed and variable costs. Recyclers buy vessels with an eye towards future scrap steel prices because six months or more may elapse from the time they purchase a vessel to the time they sell the scrap steel product into the recycling market.

Figure A depicts the volatility of scrap steel prices in FY's 2015-2017. The domestic scrap steel market entered a downward spiral after reaching its $400 per metric ton peak in January 2014 with the most dramatic decline occurring in 2015. In January 2015, scrap steel prices were approximately $320 per metric ton and by October 2015 plummeted to a low of approximately $135 per metric ton; a 58% decrease. Scrap steel prices had collapsed to levels not seen in the previous 15 years. By December 31, 2015, scrap steel prices had drifted upward to around $142 per metric ton. From January through April 2016 scrap steel prices hovered between $140 and $153 per metric ton then limped along in the $190's per metric ton range through August before declining to $174 per metric ton by the end of October. In January 2017, scrap steel prices began to rebound and in February crossed the $200 per metric ton threshold and by April had reached $292 per metric ton. From May through September, they hovered in the $260-$285 per metric ton range.[2]

[1] The larger ship contained mud ballast, which is used as permanent ballast on board a vessel to assist with a vessel trim and stability. It is a form of drilling mud that may contain heavy metals and other contaminants. Removal of the mud ballast is accomplished during the ship recycling process, by hand, rendering removal and disposal costly and very labor intensive.

[2] MARAD Monthly Average USA Scrap Steel Price Trend Report.

Figure A: USA Scrap Steel Price Trends FY's 2015-2017



Source data for the Average USA Monthly Scrap Steel Price Trend chart is compiled from: The Scrap Register (http://www.scrapregister.com); Recycler's World, (http://www.recycle.net); Steel Insight (http://www.steel-insight.com); and United States Steel Corporation (https://www.ussteel.com) and www.worldsteel.org

The sharp decline in the price of scrap steel from late 2015 through mid-2017 greatly contributed to the uneconomical domestic market for ship sales. This caused ship recyclers to shun vessel sales in favor of service contracts to subsidize recycling costs on MARAD/Navy obsolete vessels. The collapse in scrap steel prices reversed the MARAD ship sales program to the point where ship sales were no longer feasible. MARAD procured ship recycling services with minimal available appropriated funds.

The Defense Logistics Agency (DLA) has had similar results when selling Navy combatant vessels for recycling.[3] DLA sold six vessels in February 2015 for $52,888 and cancelled the most recent sales solicitation in August 2016 when they received no technically qualified offers. DLA did not issue a sales solicitation in FY 2017 because they are constrained from selling additional Navy combatant vessels until the Navy completes a programmatic environmental assessment for the disposal of its inactive ships. The Navy continues its consultation with the National Marine Fisheries Service (NMFS) regarding the completion of an environmental biological programmatic assessment designed to evaluate the Inactive Ships Program and its effects on threatened or endangered species and their dependent ecosystem. A component of the biological programmatic assessment is the development of a management approach to address the uncertainties regarding the transfer for recycling of inactive vessels that contain biofouling organisms and what impact their transit may have on the environment. Since FY 2013, the Navy has focused appropriations on recycling its backlog of obsolete conventionally powered aircraft carriers. Five aircraft carriers have been awarded to three ship recyclers in Brownsville, TX. [4]

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[3] The Defense Logistics Agency is the Navy's designated sales agent for the disposal of conventional combatant type-vessels via recycling.
[4] The three ship recyclers awarded contracts for the dismantlement of the aircraft carriers are also the three MARAD qualified ship recyclers.

There are numerous factors that affect whether the recycling of non-retention vessels is accomplished through vessel sales with revenue to the Government or in the procurement of recycling services with appropriated funds. The primary factors include the market price of scrap metals, the vessel's size/condition, the type and quantity of hazardous materials, the quantity and type of recyclable materials, the amount of competition for each vessel, the duration/cost of the tow from the fleet to the recycling facility, and the cost to remove marine growth prior to towing to different bio-geographical areas. The highest-costs are typically associated with SBRF vessels due to the current environmental requirement to dry-dock each vessel to remove marine growth prior to removal and start of the 5,000-mile tow to a Gulf Coast recycling facility. These cost factors render the sale of SBRF vessels the first impacted by and the last to recover from volatile scrap steel prices.

During periods of low scrap steel prices, revenues from the sale of the vessel scrap ferrous and non-ferrous metals are insufficient to cover the fixed costs of purchase, towing, insurance, and labor much less the unknown costs for hazardous material remediation. Predicting the market price of scrap steel five to six months after contract award, when the vessels are undergoing dismantlement, in a declining scrap steel market, along with disposal of unknown quantities of ship board hazardous materials, is too great a risk for the smaller recyclers to accept. These factors limit competition for the purchase of vessels, with the recycling industry looking to MARAD and the Navy to subsidize the disposal of non-retention vessels through the procurement of ship recycling services.

MARAD requests annual ship disposal program funding to mitigate the volatility of the scrap steel markets, continue disposal of the worst conditioned vessels and to help maintain an industrial base of qualified ship recycling facilities. Flexibility to quickly pivot from ship sales, due to the volatile downturns of scrap steel prices, to procurement of recycling services provides MARAD continuity of ship disposal awards that minimizes increasing the backlog of obsolete vessels in the fleets, continues the removal of the worst conditioned vessels, helps to maintain the domestic qualified ship recycling industrial base and minimizes the threat of potential environmental incidents.

Scrap Steel Market Outlook

International scrap steel prices are expected to decline in the latter half of 2017 primarily due to the decelerating Chinese economy. China closed most of its outdated induction furnaces in FY-2017 shifting production to meet demand for this sector to mainstream steel makers. In 2018, global growth is expected to moderate, mainly due to slower growth in China, while in the rest of the world, steel demand will continue to maintain its current momentum. The lack of a strong growth economy to replace China will continue to dampen steel demand in the future. However, bright spots in the international scrap steel arena include the broadening of the European Union economic recovery; Indian government reforms, which are expected to bring about a better investment climate enhancing growth potential; and that Turkish steel demand is expected to resume growth momentum in 2018. Additionally, Japanese steel demand is showing better than expected performance benefitting from the government stimulus package, improving exports and preparations for the 2020 Olympic games. The overall outlook for international scrap steel markets is an expectation of moderate but continued growth.[5]

[5] Worldsteel Association October 2017 Short Range Outlook.

The U.S. economy continues to exhibit sturdy economic fundamentals supported by strong consumer spending and rising business confidence. Steel mill inventory levels remain high and mills were able to procure all the scrap material need through September. Steel mills tend to reduce operations in November and December which may soften the demand for scrap steel beginning in 2018.[6] The price of scrap steel usually rebounds in the second quarter of each year as growth escalates due to rising demand. The advent of tax reform in the U.S. coupled with a proposed infrastructure stimulus package will bode well for the construction and steel industries in 2018.

In the absence of inflationary and recessionary pressures in the commodity markets political turmoil provides the primary risk to future domestic and international scrap steel prices and overall commodity demand. The U.S. policy shifts towards protectionism, trade re-negotiations, lack of tax reform and economic stimulus, Brexit talks, international anxieties on the Korean peninsula and continuing tensions with Iran can all conspire to dampen demand, reduce growth and pose a structural risk to the global economy.

California Court Consent Decree

In March 2010, the U.S. District Court for the Eastern District of California issued a Consent Decree for the removal of obsolete ships from the SBRF.[7] At the beginning of FY 2017, 55 of 57 SBRF vessels, 96% had been removed from the SBRF for disposal, leaving two ships listed in the Consent Decree remaining to be removed by the September 30, 2017 deadline. MARAD completed the removal of the remaining two SBRF vessels in July of 2017 ahead of the consent decree deadline.

[6] Scrap Price Bulletin, (http:// www.scrappricebulletin.com)

[7] The March 2010 Consent Decree can be found at http://www.waterboards.ca.gov/water_issues/programs/enforcement/docs/suisunbay_decree.pdf

II. VORF ACCOUNT BALANCES

National Maritime Heritage Act

The National Maritime Heritage Act (NMHA) (54 USC § 308704 Funding) requires the allocation and distribution of obsolete vessel sales proceeds into the VORF. MARAD ship disposal sales receipts are allocated to the VORF and distributed to the various sub-accounts. Prior to the passage of the FY 2017 NDAA on December 23, 2016, the distribution of the vessel sales proceeds from the VORF to the sub-accounts was as follows;

(A) **(VORF A)** 50% shall be available to the Administrator of the Maritime Administration for such acquisition, maintenance, repair, reconditioning, or improvement of vessels in the NDRF.

(B) **(VORF B)** 25% percent shall be available to the Administrator of the Maritime Administration for the payment or reimbursement of expenses incurred by or on behalf of State Maritime Academies (SMA) or the United States Merchant Marine Academy (USMMA) for facility and training ship maintenance, repair, and modernization, and for the purchase of simulators and fuel.

(C) (VORF C) The remainder (25%) shall be available;

- (i) (**VORF C1)** To the Secretary to carry out the National Park Service's National Maritime Heritage Grant Program[8] and
- (ii) **(VORF C2)** If otherwise determined by the Administrator of the Maritime Administration, for use in the preservation and presentation to the public of maritime heritage property of the Maritime Administration. [9]

National Maritime Heritage Act – Amended by the FY 2017 NDAA

The FY 2017 NDAA amended Section 308704 of the NMHA effective December 23, 2016 as follows;

(A) (VORF A) 50% shall be available to the Administrator of the Maritime Administration for such acquisition, maintenance, repair, reconditioning, or improvement of vessels in the NDRF.

(B) (VORF B) 25% percent shall be available to the Administrator of the Maritime Administration for the payment or reimbursement of expenses incurred by or on behalf of State Maritime Academies or the USMMA for facility and training ship maintenance, repair, and modernization, and for the purchase of simulators and fuel.

(C) (VORF C) 25%, the remainder, shall be available to the Secretary to carry out the Program.

- *(i) (VORF C1) All 25% provided to the Secretary to carry out the NPS, NMHGP.*
- *(ii) (VORF C2) Set Aside - Not less than 25% of the amounts available in (C)(i) each fiscal year for the NMHGP shall be used for preservation and presentation to the public of maritime heritage property of the Maritime Administration.[10]*

The set aside ensures MARAD will receive at a minimum 25 percent of the 25 percent (approximately 6.25%) of the funds allocated to the VORF C2 sub-account for the preservation and presentation to the public of MARAD's maritime heritage property.

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[8] The Secretary referenced in this statute is the Secretary of the Interior, the home agency of the NPS, the recipient agency for VORF funds and administrator of the NMHGP.

[9] In 2013 MARAD and the NPS entered into a MOA which established the 12.5% allocation of the VORF C funds. The amounts are adjustable based on consultation and each agency's requirement.

[10] The intent of the amendment to the VORF C fund distribution is to designate the remaining 25% of available funds to the Secretary of the Interior to carry out the NP's NMHGP. Not less than 25% of the funds designated to the NPS are to be set aside for preservation and presentation to the public of maritime heritage property of the Maritime Administration.

MARAD has determined the FY 2017 NDAA VORF C sub-account allocation change does not require a retroactive reallocation of previously credited sales proceeds prior to the passage of the statute. Funds in the VORF sub-accounts prior to passage of the FY 2017 NDAA will therefore be allocated in accordance with the previous allocation process. Sales proceeds credited to the VORF after passage of the FY 2017 NDAA will be allocated under the new allocation process.

FY 2016 End of Year VORF Account Balances

MARAD has created VORF sub-accounts patterned on the NMHA funding allocation requirements of Section 308704 to actively manage the ship recycling sale revenues credited into the VORF account. The FY 2016 end of fiscal year balance of funds for the specified VORF sub-accounts is listed in Table 2.

Table 2: FY 2016 Fiscal Year End VORF Sub-Account Balances

Vessel Operating Revolving Fund Sub-Account Balances	
VORF A (NDRF)	$5,970,417
VORF B (SMA's & USMMA)	$2,126,925
VORF C1 (NPS)	$4,959,152
VORF C2 (MARAD)	$2,286,817
Suspense Account	$4,263,952
Total	$19,607,263

Amounts reflect fund totals as of September 30, 2016.

Ship Disposal Sales Revenue Retained – Suspense Account

Sales proceeds credited to the VORF account from ship recycling sales are only available for distribution under the funding provisions of the NMHA, when the contracts under which those sales proceeds were received have been closed. Only at that time is it clear that the sales proceeds are no longer subject to claims by the recycling contractor. Recycling contractors can submit claims against the contract's sales proceeds until the recycling contract is completed and the contract is closed. To ensure that sufficient funds are available if refund of all or a portion of the purchase price to the recycler is necessary, sales proceeds are placed into a VORF suspense sub-account until all contingent liabilities are extinguished. Once all contract contingent liabilities are satisfied, the sales proceeds are distributed from the suspense account into the other appropriate VORF sub-accounts as per the funding requirements of the NMHA.

Contingent Liabilities

Where a sales contract is still in performance and has not been closed, a contractor can make a claim against the sales proceeds. As an example, MARAD awarded a sales contract for the recycling of the vessel VANGUARD on September 25, 2013 to Marine Metal, Inc. (MMI). MMI completed the dismantlement of the vessel on September 24, 2014. MMI filed a claim against MARAD on September 15, 2014 to recover $556,281 of the purchase price it claimed it overpaid for the right to recycle the non-retention vessel. MMI's claim was based on its argument that MARAD's vessel documentation did not accurately convey the correct tonnage of the vessel, the result being MMI recycled less steel than estimated when they submitted their sales offer. MARAD denied MMI's claim based on the fact the solicitation and sales contract explicitly offered the vessel in the "AS IS WHERE IS" condition and made no warranties expressly or implied as to the accuracy of any vessel documentation. MMI filed an appeal with the Civilian Board of Contract Appeals (CBCA) seeking the return of a portion of the sales price. On June 6, 2016, the CBCA issued their decision denying MMI's appeal because under the terms of the contract MMI assumed the risks of the vessel's condition. However, MMI had until October 4, 2016, to appeal the CBCA's decision; therefore, these sale proceeds were not available for distribution during the two-year period because they were at risk for a continuing liability. MMI did not file an appeal with the Federal Circuit court therefore the claim was closed and the sales proceeds were no longer encumbered by a contingent liability.

Another example of the need to retain rather than distribute sales proceeds exists when a recycling contractor files for bankruptcy or otherwise fails to perform the recycling contract. In October 2014 ESCO Marine, Inc. (ESCO) purchased two MARAD vessels for recycling for a total of $3,655,852, delivered them to their facility and was actively recycling both vessels. On March 6, 2015, ESCO filed for bankruptcy re-organization leaving the two Ex-MARAD vessels in unfinished states of dismantlement. In the event ESCO fails to complete the recycling and is unable to sell the vessels to another MARAD qualified ship recycler, MARAD may need to take back the vessels and re-procure recycling services to prevent the vessels from becoming an environmental and/or navigational safety hazard. MARAD has set aside the ESCO sales proceeds as a contingency in the event MARAD is required to re-procure the two unfinished vessels. Even if ESCO were able to complete the recycling, it could still file claims against MARAD requesting a partial refund of its purchase price.

Until the contract is closed, the precise amount of funds received by MARAD is subject to the risk of future liabilities. There are a number of instances in which purchasers of property have filed claims against the U.S. for a refund of the purchase price.

Marine Metals Inc.'s claim for a refund of the purchase price highlights the fact that the sales proceeds should not be made available for distribution as required by the NMHA until the contract is closed. If the full amount of the sales proceeds received from MMI had been distributed under the NMHA and the CBCA ordered a partial refund of the purchase price, MARAD would have no funds to pay such a judgment. There is no MARAD appropriation available to pay such judgments.

In such a situation, the Judgment Fund would have to pay the amount of the judgment with MARAD having a responsibility to petition Congress for funds to repay the Judgment Fund. Stranger still would be the legal anomaly that the sales proceeds distributed under this scenario would be in excess of the amount of sale proceeds adjudicated by a court or board as due the U.S. Clearly, such a result counsels that sales proceeds are to be retained in a VORF suspense sub-account until it is clear that such funds are no longer subject to contractor claims.

In ESCO's case they emerged from bankruptcy re-organization on May 1, 2017, as HRP Brownsville, LLC (HRP). The sales contracts for the two Ex-MARAD vessels were novated to HRP and HRP is actively dismantling and recycling the two vessels. The novation of the ESCO sales contracts to HRP extinguishes the contingent liability allowing the ESCO sales proceeds in the suspense account to be distributed as required by the NMHA.

The MMI and ESCO situations both involve contingent liabilities which could result in reducing the purchase price. Until all contingent liabilities have been extinguished, sales proceeds received by MARAD will be allocated to the VORF suspense account and not distributed to the appropriate VORF sub-accounts and thus will not be available for the purposes set forth in the statute until that time.

III. VORF REVENUES OBLIGATIONS AND FUNDS PROVIDED

Table 3 provides a listing of NDRF vessels sold for recycling and the associated sales proceeds and receipts credited to the VORF account in FY 2017.

Table 3: FY 2017 Vessels Sales Receipts

Vessel Sales Reciepts	
Revenues	
Vessel Sales	$0
Collections	$1,863
Total	**$1,863**

- **Vessel Sales:** MARAD ship recycling sales revenues in FY 2017 were $0 as no vessels were sold in the fiscal year.
- **Collections:** MARAD collected $1,863 of liquidated damages assessed by SDP for late performance in the completion of a ship recycling contract. These funds were allocated to the VORF sub accounts as required by the NMHA.

Table 4 provides a summary of the transactions within each VORF sub-account in FY 2017. The balance column is the funds available in each sub-account at the beginning of FY 2017. The Funds Available column provides the total funds available in each sub-account during the fiscal year. The accompanying narrative provides a description of the fiscal year activity within each sub-account.

Table 4: FY 2017 VORF Sub-Account Summary of Internal Transactions

VORF Sub-Account Summary of Internal Transactions					
Beginning Balance, Allocations, Credits, Recoveries					
Sub-Accounts	Balance	Allocations	Credits	Recovery	Funds Availble
VORF A (NDRF)	$5,970,417	$2,131,976	$932	$243,153	$8,346,477
VORF B (SMA's & USMMA)	$2,126,925	$1,065,988	$466	$0	$3,193,379
VORF C1 (NPS)	$4,959,152	$532,994	$233	$0	$5,492,379
VORF C2 (MARAD)	$2,286,817	$532,994	$233	$471,600	$3,291,644
Suspense Account	$4,263,952	($4,263,952)	$0	$0	$0
Total	$19,607,263	$0	$1,863	$714,753	$20,323,879

- **<u>Suspense Account</u>:** Funds totaling $4,263,952 became eligible for distribution to the other sub-accounts due to the following events, which extinguished claims against the sales proceeds.
  - MMI did not file an appeal with the Federal Court which eliminated their claim against $556,281 in sales proceeds.
  - The ship recycling sales contract for the vessel FLINT was completed releasing $51,819 in sales proceeds.
  - ESCO emerged from bankruptcy re-organization as HRP Brownsville, LLC releasing $3,655,852 in sales proceeds.

- **<u>VORF A</u>:** In accordance with the 50% funding allocation required by the NMHA the following transactions occurred in this sub account.
  - Funds in the amount of $2,131,976 were credited from the suspense account.
  - Funds in the amount of $932 were allocated from the collected $1,863 liquidated damages.
  - Funds in the amount of $243,153 were recovered from prior year contract closeout actions.

- **<u>VORF B</u>:** In accordance with the 25% funding allocation required by the NMHA the following transactions occurred in this sub account.
  - Funds in the amount of $1,065,988 were credited from the suspense account.
  - Funds in the amount of $466 were allocated from the collected $1,863 liquidated damages.

- **<u>VORF C1</u>:** In accordance with the MOA between the NPS and MARAD whereby the NPS and MARAD have agreed to split the funds equally, 12.5% each, the following transactions occurred in this NPS NMHGP sub account.[11]
  - Funds in the amount of $532,994 were credited from the suspense account.
  - Funds in the amount of $233 were allocated from the collected $1,863 liquidated damages.

- **<u>VORF C2</u>:** In accordance with the MOA between the NPS and MARAD whereby the NPS and MARAD have agreed to split the funds equally, 12.5% each, the following transactions occurred in this MARAD heritage sub account.
  - Funds in the amount of $532,994 were credited from the suspense account.
  - Funds in the amount of $233 were allocated from the collected $1,863 liquidated damages.
  - Funds in the amount of $471,600 were recovered from prior year contract closeout actions

[11] Per the 2013 MOA with the NPS MARAD provides funding for the NMHGP on a consulted basis with the NPS to support the announced NMHGP cycle. Per agreement the initial funding provided to the NPS for each grant cycle is $2M from the VORF C-1 sub-account. When requested by the NPS MARAD will provide additional funds, above the $2M, from the VORF C-2 sub-account to support award of additional grant projects within the specific grant cycle.

Table 5 provides a summary of funds obligated, distributed or made available to each of the NMHA Program recipients from funds available in the VORF sub-accounts for FY 2017. The FY 17 ending balance represents the funds available at the beginning of FY 2018.

Table 5: FY 2017 VORF Program Obligations, End of Fiscal Year Balance

VORF Sub-Account Summary of Obligations			
Funds Available, Obligations, Final Fiscal Year Balance			
Sub-Accounts	Funds Availble	Obligations	FY 17 Ending Balance
VORF A (NDRF)	$8,346,477	$5,869,773	$2,476,704
VORF B (SMA's & USMMA)	$3,193,379	$789,241	$2,404,138
VORF C1 (NPS)	$5,492,379	$5,035,398	$456,981
VORF C2 (MARAD)	$3,291,644	$368,043	$2,923,601
Suspense Account	$0	$0	$0
Total	$20,323,879	$12,062,455	$8,261,424

Below is a breakdown of the FY 2017 transactions from each VORF sub-account.

- **VORF A**: Funds obligated in FY 2017 totaled $5,869,773 for the following NDRF projects.

Project	Description	Funding
Lifeboat Installation	Installation of Safety-Lifeboats on six Fast Sealift Ships	$3,850,000
HVAC Installation	Procure Heating, Ventilation and Air Conditioning equipment for future installation on the Cape Washington	$1,125,000
Annual Maintenance	Perform annual maintenance and repairs on the M/V Freedom Star	$292,773
Habitability Repairs	Accomplish U.S. Marine Corp habitability repairs on the SS Wright	$365,000
Hull Repairs	Accomplish additional hull coating and repairs on the M/V Harkness during dry-docking	$137,000
Containment Booms	Procure and distribute containment booms to the Cape Ray, Cape Race and Cape Rise	$100,000
	Total Funds	$5,869,773

- **VORF B**: Funds obligated to the USMMA and the six State Maritime Schools totaled $789,241 in FY 2017. Amounts to the individual schools are listed in the table below.

Academy	Funds
U.S. Merchant Marine	$69,241
Maine Maritime	$120,000
Massachusetts Maritime	$120,000

Great Lakes Maritime	$120,000
Texas A&M Maritime	$120,000
California Maritime	$120,000
SUNY Maritime	$120,000
Total Funds	$789,241

- **VORF C1:** MARAD provided $5,035,398 to the NPS in FY 2017 to support maritime heritage projects selected by the NPS in the NMHGP.

- **VORF C2**: MARAD expended $1,738,917 in FY 2017 for the preservation and presentation to the public of MARAD's maritime heritage property. These funds include amounts on open contracts from prior year obligations. Project durations and funding obligations span multiple fiscal years.

- **SUSPENSE ACCOUNT:** In early FY 2017 all funds in the suspense account totaling $4,263,952 were released from encumbrance and were distributed to the other sub-accounts in accordance with the pre-FY 2017 NDAA amended NMHA allocation requirements.

IV. MARITIME HERITAGE PROJECTS

Table 6 presents a list of each project selected by the Maritime Administrator, for preservation and presentation to the public of MARAD's maritime heritage property, for which funds from the VORF C2 sub-account were expended in FY 2017.

Table 6: FY 2017 MARAD Maritime Heritage Projects

FY 2017 VORF C2 (HQ) MARAD Maritime Heritage Projects		
	Heritage Project Description	**Expended Funds**
1	Travel, administrative, and miscellaneous expenses for management of MARAD's Maritime History and Heritage Program.	$13,198
2	Vessel History Database: Phase III. Appending historical information pertaining to MARAD-owned shipwrecks. Upgrading database functionality through the development of additional queriable data fields.	$68,441
3	Vessel History Database: Data Normalization. Appending historical research and documentation pertaining to MARAD-owned shipwrecks for compliance with the National Historic Preservation Act Section 110 historic preservation responsibilites.	$109,772
4	Historical documentation of MARAD's participation in wars, major conflicts and humanitarian assistance actions and activites.	$78,870
5	Secure, protect and preserve MARAD heritage artifacts and assets stored at Cheatham Annex that were previously removed from WWII-era to present day vessels.	$22,669
6	Continue conservation and preservation of MARAD heritage assests Cheatham Annex.	$165,595
7	National Park Service: Historic American Engineering Record (HAER), Continue collecting and compiling vessel drawings, photographs, historical records, operational and engineering data for six Ready Reserve Force vessels. The ongoing documentation recordation project will produce, for each vessel, a historical report which describes each vessels complexity and historical significance.	$21,534
8	Conserve and repair damaged ship models including display cases and bases.	$9,292
9	Complete the 360-degree virtual tour/photo documentation of Ready Reserve Force vessels Admiral William M. Callaghan and SS Petersburg.	$10,600

FY 2017 VORF C2 (HQ) MARAD Maritime Heritage Projects		
	Heritage Project Description	**Expended Funds**
10	Conduct a condition assessment and pre-conservation survey of heritage assets at MARAD HQ and regional offices.	$32,411
11	Continue scanning of historically significant documents, drawings and plans.	$2,091
12	USACE -PA/Landscape Management Plan/Maintenance and Repair Manual	$52,834
13	NDRF Oral History Projesct: Continue recordation project for National Defense Reserve Fleet individual oral history Interviews.	$17,548
14	NS Savannah Heritage Projects: Include Electrical Power Survey Phase 2, Replacement of 120 Volt Transformers, Fire Hazard Analysis, Marine Engineering and Drafting services.	$595,000
15	NS Savannah Nuclear Historian Consultation: Continue development of NS Savannah Hational Historic Preservation Act for Section 110 historic preservation responsibilites.	$15,082
16	NS Savannah National Park Service HAER: Supplemental Recordation Project. The supplemental documentation recordation project will further describe the vessels complexity and historical significance.	$78,397
17	NS Savannah National Historic Preservation Act Heritage Projects:	$400,202
18	NS Savannah Operations History: Oral History Project, Continue oral history interviews recordation project.	$41,081
19	Clean, preserve and conserve seven paintings at the U.S. Merchant Marine Academy	$4,300
	Total Funds Expended in FY 2017	**$1,738,917**

V. BIENNIAL SHIP DISPOSAL PROGRAM ASSESSMENT SUMMARY – FY 2017

Overview

In accordance with 40 U.S.C. § 548, MARAD shall dispose of surplus vessels of 1,500 gross tons or more which the Administration determines to be merchant vessels or capable of conversion to merchant use.[12] By this statute, MARAD is the exclusive disposal agent for all federally owned merchant-type obsolete vessels greater than 1,500 gross tons. These include obsolete merchant ships moored at NDRF sites that, while part of the NDRF, are not assigned to the RRF, or otherwise designated for a specific purpose. It includes merchant-type vessels owned by other Federal Agencies that meet the statutory gross tonnage threshold. When ships are determined to be no longer useful for defense or humanitarian relief missions, the SDP arranges for their responsible disposal, on a worst-first basis at domestically qualified ship recycling facilities.

Until FY 2001, MARAD relied exclusively on vessel sales as the primary method for the disposal of its obsolete vessels. In the late 90's, as a result of investigative reporting which uncovered environmental violations and worker health and safety abuses during Navy ship recycling operations, Congress authorized MARAD, via the FY 2001 NDAA, to establish a ship disposal program to scrap its backlog of obsolete vessels through acquisition and recycling services from a selection of qualified scrapping facilities.[13] Congress directed MARAD to select scrapping facilities on a best value basis consistent with the FAR with consideration towards a facilities ability to scrap vessels: a) at the least cost to the Government; b) in a timely manner; c) while protecting worker health and safety; and d) minimizing impact to the environment.

Performance Strategies

The MARAD SDP is a mature Government program that consistently and effectively utilizes its available resources to reduce the backlog of obsolete ships in the fleets and minimize the risk of environmental contamination due to the long-term storage of the obsolete vessels in the NDRF. The SDP's strategic plan is to dispose of non-retention vessels in a timely manner, maximizing the use of all available disposal methods. SDP's approach is a dual-track, market-based methodology that strives to mitigate disposal impediments and to maximize the full potential of all disposal methods while disposing of the most vessels possible given the resources and disposal methods available. The management approach in place assesses, on a continuous basis, all variables that affect the disposal of obsolete ships. Those variables include:

- domestic and international scrap steel market conditions;
- the number, condition, and location of obsolete ships;
- disposal alternatives realistically available to MARAD;
- capacity, capability, and production throughput of disposal facilities;
- availability of non-retention ships for disposal; and
- availability of budgetary resources.

[12] 40 USC 548: Surplus Vessels

[13] Public Law 106-398 Floyd D. Spence National Defense Authorization Act for Fiscal Year 2001, Sec. 3502 Scrapping of National Defense Reserve Fleet Vessels.

The effectiveness of this strategy has been proven through the successful disposal of 220 obsolete MARAD vessels since FY 2001. The initial backlog of ships on hand when the program was established has been eliminated, the risk to the environment reduced and a core group of qualified domestic ship recycling facilities established. Performance milestones on an annual basis consist of removing for disposal an equal or greater number of obsolete vessels than are designated for disposal and enter the disposal queue.

Procurement Method

The primary disposal methods available to the program are the sale of vessels for recycling or the procurement of recycling services through the use of appropriated funds. Ninety-five percent of all vessel disposal actions since FY 2001 have been via ship recycling. The program has evolved a streamlined vessel sales and acquisition methodology. Utilizing the FAR Part 13 Commercial Acquisition Procedure Standing Quotations MARAD qualifies ship recycling facilities through the submittal of general technical proposals. Once qualified the ship recycling facility is eligible to submit sales or service offers for the disposal of MARAD selected non-retention vessels. MARAD periodically identifies specific vessel(s) for disposal via an electronic Announcement issued only to qualified ship recycling facilities. The announcement contains both a Request for Sales Offers and a Request for Price Quotations (RFPQ) as identified under the solicitation. The requests are independent of each other and only when no RFSO's are received will MARAD officially request RFPQs. For either type of contract awards are made based on the best value criteria described in the SDP solicitation. The streamlined vessel recycling acquisition process has been refined to the point where the SDP can issue a vessel announcement, receive either sales or service offers, conduct the best value evaluations and issue contract awards in under sixty calendar days.

Information and Communication

The SDP conducts an annual outreach campaign canvassing other Federal agencies that own and operate merchant type vessels that meet the 1,500 gross ton statutory requirement. Their five-year vessel retirement plans are compiled into the OSDP Annual Report and also included in the Programmatic Biennial Assessment required by Congress. The program monitors the price of international and domestic scrap steel via publications, web sites and discussions with the ship recyclers.

The program compiles and posts on its home page on the MARAD web site the OSDP Annual Report which provides a recap of the past fiscal year activities as well as future projections of vessel disposals. The OSDP Annual Report is shared with the ship recycling industry to assist in their forecasting analysis for current and future vessel disposal opportunities. MARAD senior leadership is kept appraised of the actions of the SDP through regular meetings. All ship disposal award recommendations are routed through the Maritime Administrator via an acknowledgement memorandum which informs senior leadership of the recommended action.

The SDP organizes an annual ship recycling Town-Hall meeting and ship recycling facility tour. The meeting is held in Brownsville, TX and affords the recycling industry the opportunity to discuss industry issues in an open forum. During the facility tours the recyclers can discuss proprietary facility issues. The Maritime Administrator, Senior MARAD leadership, United States Coast Guard, Department of Labor, Texas Environmental Office and Port of Brownsville officials attend. Invitations are also issued to the two Texas Senators, and the local Brownsville Congressional representative. The meeting has been very successful in fostering open communication between Government and industry to the extent that phone calls between both parties are sufficient to answer concerns or provide information. The transparency provided by the town hall meeting and open communications has assuaged previous suspicions between both MARAD and the recyclers.

Program Effectiveness

The SDP has proven to be very adept at taking advantage of the volatile scrap steel market. Increasing scrap steel prices allows the program to react to surges in the price of scrap steel by selling more vessels. The SDP has been able to sell large numbers of non-retention vessels when the price of scrap steel is rising or at market highs. Conversely, when the price of scrap steel falls the SDP has difficulty selling vessels for recycling and is sluggish to pivot to procuring ship recycling service using appropriations. This is primarily a function of limited available funding at the time of the market fluctuation. A minimal annual base funding level for the procurement of ship recycling services would eliminate this issue and allow the SDP the flexibility to readily respond to down cycles in scrap steel prices, continue the removal of non-retention vessels mitigating environmental threats and vessel backlogs and assist in maintaining a skilled industrial base of qualified ship recycling facilities.

MARAD internal controls, acquisition procedures, information and communication processes, budgetary and reporting structures provide a framework whereby the SDP has a low risk of not meeting its goals and objectives based on the execution of its processes and procedures. The program will always remain subject to external factors beyond its control that can impact its ability to meet its goals and objective. These primary factors bear repeating and include: a) the market price of scrap metals; b) the vessel's size/condition; c) the type and quantity of hazardous materials; d) the quantity and type of recyclable materials; e) the amount of competition for each vessel; f) the duration/cost of the tow from the fleet to the recycling facility; and g) the cost to remove marine growth prior to towing to different bio-geographical areas.

Consent Decree Completion

In FY 2017, MARAD completed the removal of all 57 non-retention SBRF vessels that were included in the U.S. District Court for the Eastern District of California Consent Decree issued in March 2010. The last two vessels departed the SBRF in July 2017 ahead of the September 30, 2017 Consent Decree deadline. The Consent Decree imposed aggressive annual cumulative vessel removal targets which the SDP exceeded in each year. Table six provides the cumulative Consent Decree annual targets and MARAD's actual cumulative vessel removals for FY's 2010-2017.

Table 6: Consent Decree Annual Cumulative SBRF Vessel Targets and Actuals.

Consent Decree Annual Cumulative SBRF Vessel Removal Targets and Actuals								
Fiscal Year	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**
Target:	10	20	28	32	38	44	50	57
Actual:	11	26	36	44	52	54	55	57

VI. CONCLUSIONS

An aggressive program of maximizing the use of ship disposal appropriations and pursuing all feasible disposal options has resulted in the removal of 221 obsolete vessels since FY 2001. Those removals from the fleet sites have reversed a trend in the growth of the number of obsolete ships in MARAD's custody. As of October 1, 2017, there were only 13 NDRF non-retention ships available for disposal remaining in MARAD's three fleet sites, which is a historic low.

Moreover, the best-value award and removal of all of the Program's high priority ships has significantly mitigated the threat of residual oil spills and exfoliating paint discharges into the environment.

MARAD has credited approximately $67 million in ship sales revenue to the VORF since FY 2010. The VORF A sub-account has distributed approximately $36.4 million to various projects associated with repairs, maintenance and upgrades to vessels in the NDRF. The VORF B sub-account has distributed approximately $17.6 million to the USMMA and six State Maritime Academies for facility and training ship maintenance, repair, and modernization, and for the purchase of simulators and fuel. The VORF C sub-account has distributed approximately $16 million of which $10.8 million has been provided to the NPS for utilization in the NMHGP.

The Coast Guard Authorization Act of 2015 required the Government Accountability Office (GAO) to conduct an audit of funds credited and distributed from the VORF since fiscal year 2005. In this report, GAO assessed the extent to which, 1) MARAD's accounting for and allocation of the proceeds in the VORF were consistent with applicable law and 2) MARAD's disbursement of those proceeds was consistent with applicable law. GAO recalculated the allocation of proceeds against requirements, examined support for VORF payments related to NPS and the maritime academies, and tested a statistical sample of VORF-funded MARAD and NDRF expenses. GAO issued its report in February 2017 and found that MARAD's disbursements from the VORF to the NDRF, USMMA and six State Maritime Academies and the NPS were consistent with applicable law. GAO offered no recommendations for changes to MARAD's VORF collection and disbursement procedures. The GAO Report can be found at http://www.gao.gov/products/GAO-17-280.

The market price of recyclable steel is the primary factor that affects the Government's ability to sell vessels for recycling and procure recycling services. The price of scrap steel is volatile in nature, unpredictable, and derived from worldwide economic conditions. It directly affects other ship recycling variables such as; the availability of competitive recycling facilities with available capacity and adequate production throughput; dry-dock availability (for SBRF ships); the costs of environmental remediation of hazardous material streams such as asbestos, PCBs and loose exterior paint present on the non-retention vessels; and the nature and number of vessels recycled in the U.S. both government and non-government.

The collapse of scrap steel prices beginning in 2014 lasting through mid-2017 fueled by slowing worldwide demand for processed and finished steel products, depressed the domestic ship recycling industry whereby recycling facilities were unable to purchase MARAD/Navy vessels for recycling. The low price of scrap steel makes it uneconomical for ship recyclers to recycle MARAD/Navy non-retention vessels without award of a service contract to subsidize costs. The slow rebound in scrap steel prices beginning in early 2017 has reduced the cost of procuring recycling services but steel prices have not sufficiently rebounded significantly to reduce the recycler's risk in overcoming factors such as towing distance, vessel size and condition and type of hazardous materials on board the ships.

The decline in vessel sales reduces proceeds credited into the VORF account, and when combined with reduced ship disposal appropriations lessens the SDP's flexibility to award vessel recycling service contracts in the face of declining scrap steel prices. This imbalance between the award of vessel sales and service contracts leaves both MARAD and the Navy unable to respond to volatile scrap steel prices, sustain a steady flow of vessels in the disposal queue, and preserve the ship disposal industrial base. Extended declines in the scrap steel markets churn the ship recycling industry. Smaller qualified ship recycling facilities are the first to feel the effects of lower prices and reduced scrap steel demand. Severe market downturns, as we have recently experienced, reduces their access to financing, decreases their competitive advantage and leads to consolidation, buyouts and closures. Uncorrected the imbalance will lead to an increase in the backlog of obsolete vessels in the MARAD fleet anchorages, greater environmental risk, less competition and available ship recycling capacity and lower sales offers and higher costs for procurement of recycling services.

Significant market fluctuations in scrap steel prices and trends in any one or a combination of those variables are beyond MARAD control and can significantly affect meeting performance targets. Positive trends in the majority of the variables boost vessel sales, increasing sales revenue which increases funds available for the NMHGP. Negative trends in the variables reduce or eliminate vessel sales, decrease sales revenue and require appropriated funds to dispose of non-retention vessels.

Reliance on MARAD ship sales as the primary revenue stream into the VORF to fund projects in the NDRF, to provide additional funds to the USMMA and the six State Maritime Academies and to fund maritime heritage projects in the NPS's NMHGP is not sustainable in the long term given the volatility of the scrap steel market, the minimal number of non-retention vessels in the disposal queue and the projected low number of future vessel retirements.