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November 11, 2002

The Honorable William G. Schubert
Maritime Administrator
Maritime Administration
U.S. Department of Transportation
400 Seventh Street, S.W.
Washington, D.C. 20590

Re: Reductions and Enhancements in Federal Income Tax Collections associated with Proposed Changes in the Maritime Administration Capital Construction Fund Program.

Dear Administrator Schubert:

Fulbright & Jaworski L.L.P. is pleased to present the results of the study commissioned by the Associate Administrator for Shipbuilding on the federal income tax revenue effects associated with modifications which the Maritime Administration has proposed in the operation of its Capital Construction Fund Program. Fulbright, and its consultant's LECG LLC, will be prepared to present our study results and conclusions in person and to answer any questions which you or other Maritime Administration personnel may have on whatever schedule you or they believe appropriate.

SUMMARY

The LECG Report concludes that the adoption of the Proposed Changes: (A) will increase investment in coastwise trade vessels and MODUs needed to meet established national transportation needs and energy self sufficiency objectives; and (B) will create significant additional economic activity and employment in the United States. The LECG Report further concludes that this increased economic activity will result in an increase in the net present value of federal tax revenues collected, in excess of the tax revenues currently deferred because of CCF Program deposits, which will amount to more than

$3 of additional tax collected for each $1 of tax deferred.

DISCUSSION

1. *The Project.* Pursuant to a Maritime Administration ("MARAD") contract dated September 30, 2002 Fulbright & Jaworski L.L.P. ("Fulbright") was retained to conduct a study concerning the MARAD Capital Construction Fund program ("CCF Program") and the reductions and enhancements of federal income tax receipts that would be associated with the adoption of certain MARAD proposed changes in 46 App. U.S.C. 1177. In brief, the proposed changes would modify existing law to include mobile offshore drilling units ("MODUs") as "vessels," and to include vessels engaged in the domestic contiguous trades as "qualified vessels," as those terms are defined in subsection 1177(k) (the "Proposed Changes").[1]

2. *Qualifications.* Fulbright and its personnel are experts in the financing of U.S. flag vessels, with a long history of experience with the CCF Program and the governing law at 46 App. U.S.C. 1177 and 26 U.S.C. 7518 and the regulations set out at 46 C.F.R. Part 390 and Part 391. Its personnel have advised clients concerning the application of the CCF Program in a variety of differing factual situations.[2] For purposes of this study Fulbright retained LECG LLC("LECG"), a respected firm of economists and financial consultants, with an established expertise in economic modeling and in the preparation of cost benefit analyses.[3] Fulbright associated LECG on the basis of these qualifications, and because LECG had recently conducted a detailed study of the economic contribution that the U.S. commercial shipbuilding industry makes to the national economy.

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[1] The text of the Proposed Changes is attached as Exhibit A. The work called for under the MARAD contract is referred to as the "Project."

[2] A Fulbright & Jaworski L.L.P. qualifications memorandum is attached as Exhibit B.

[3] A LECG LLC qualifications memorandum is attached as Exhibit C.

3. *Project Methodology.* Fulbright personnel have worked with LECG personnel at every stage of the Project to assure the correct application of the CCF Program law and regulations. Fulbright personnel have reviewed the LECG LLC report to The Honorable William G. Schubert, "Quantitative Estimate of the Costs and Benefits of Extending the CCF Program to Include Coastwise Vessels and MODUs," dated November 8, 2002 (the "LECG Report," which is being submitted to MARAD as the Project work product. We are confident that the Conclusions reached in the LECG Report are consistent with the correct application of the CCF Program law and regulations.

4. *LECG Report Conclusions.* The LECG Report concludes that:

(A) Extending the CCF Program to include U.S. coastwise vessels and MODUs will have a positive net present value economic benefit and a positive net present value effect on Federal government tax receipts. For every $1 of net present value tax revenues foregone on the income out into the CCF Program, the Federal government would obtain more than $3 of incremental net present value revenues.

(B) Extending the CCF Program to include U.S. coastwise vessels and MODUs will result in greater investment spending on them. If CCF can be used to finance investment in U.S. coastwise vessels and MODUs, this will reduce the financial cost of this investment (i.e., it essentially will reduce their prices). If the price of something is lower, more will be spent on it than would have been the case otherwise.

ADDITIONAL COMMENTS

There is probably general agreement with the proposition that virtually all segments the U.S. domestic contiguous trades are "capital starved."

> *There are current domestic trade's shipbuilding opportunities for fleet replacement and expanded needs for our OPA '90 and other coastwise and Gulf of Mexico energy related services; fleet replacements for the non-contiguous services; and vessels for expanding ferry needs in passenger and passenger/vehicle services in coastwise, Great Lakes and inland services. . . . In reviewing the domestic transportation scene we can probably agree upon the areas of need, and upon the vessel design and shipyard construction solutions. The problem that remains is that of attracting the equity capital and long term debt financing necessary to fund these projects on a*

basis which is sufficiently economical to allow project success. In the end, U. S. shipbuilding opportunities during the current decade will be constrained, not by transportation needs, or vessel design or shipyard capacity, but by the lack of reasonably priced capital which is likely to be dedicated to meeting national waterborne transportation needs.

"U.S. Shipbuilding 2002: Opportunities Abound: Financing Needed," MARITIME REPORTER & Engineering News (June 2002).

But, there may be no more dramatic example of the problems which the U.S. faces as a result of this "starvation" than those presented in achieving the U.S. flag tank vessel replacements mandated by OPA 90.

Today, only 21 out of a total of 48 product tankers in the U.S.-flag fleet are double-hulled. Ten of these double-hull tankers were built or rebuilt in the last seven years and are now OPA compliant. Of the remaining double-hull product tankers, five are 16 years old and the remaining six are 25 years old or older, meaning that they will reach the end of their economic useful life well before the 2015 deadline for replacement of all single-hull tank vessels. No new orders have been placed for [product] tankers since 1997.

With the 2005 phase out deadline only 30 months away, much uncertainty remains about whether sufficient U.S.-flag tonnage will exist to meet coastwise product movement and national security demands. Absence of sufficient U.S.-flag capacity for coastwise petroleum movement will result in a ceding of our domestic market to foreign import substitution (i.e. foreign oil imported into U.S. in foreign-flag vessels) -- a proposition not in the best interest of current U.S.-flag operators, maritime labor, U.S. shipyards and our national security requirements and counter to the Administration's call for the nation to become more energy self-sufficient.

A major factor restraining tank vessel construction today is the lack of adequate financing.

"OPA 90 Phase Out of Environmentally Risky Vessels – Much to be Done," Shipbuilders Council of America (April 2002).

The OPA 90 problem which is the subject of this concern is the short-fall in U.S. flag product tankers. These vessels are engaged the historic U.S. Gulf Coast to north of Hatteras, and in Gulf to Florida and West Coast trades, and in movements on the West Coast itself. U.S. shipbuilders and U.S. flag independent operators have viewed this as a market of major opportunity for the coming decade. But this market may well slip away.

The U.S. market for petroleum products will exist. The issue is how these petroleum needs will be supplied.[4] The substitution of foreign built, foreign flag OPA 90 qualified vessels will occur when there is a lack of OPA 90 qualified U.S. vessel capacity, or when the U.S. vessel charter rates become so high that the delivered cost of petroleum products from foreign refineries delivered by these foreign flag vessels becomes less than the delivered cost of domestic refined products delivered by U.S. vessels.[5]

Insofar as domestic shipbuilding and ship operation and the U.S. economy are concerned, the result of the substitution of such foreign built vessels will be fewer vessels built in U.S. shipyards, and fewer vessels operated under U.S. flag, with the transfer of this economic activity to shipyards and ship operators outside of the U.S., and a corresponding reduction in taxable activity and tax collections.

We believe that MARAD's Proposed Changes making the CCF Program available to the contiguous domestic trades would attack both of these OPA 90 problems. It would accelerate the construction of these OPA 90 vessels, and it would enable domestic owner-operators to offer lower charter hire rates.

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[4] See, "U.S. Tank Vessel Markets, Impact of OPA-90 Double Hull Requirements," MARAD Office of Statistical and Economic Analysis (June 2002).

[5] There are a number of U.S. markets where foreign petroleum products delivered on foreign flag tankers will be substituted for domestic products once U.S. flag transportation costs reach a certain level. An operator's daily rate is a build-up of vessel operating costs and capital costs and profit. There is little that can be done to reduce U.S. tanker operating costs, except through the substitution of tug barge units where this is feasible. So, one must focus on the capital cost component. This can be broken into two parts, the cost of the vessel and the cost of financing the vessel. MARAD's Proposed Changes in CCF Program availability address both of these issues.

Fulbright & Jaworski L.L.P. and LECG LLC have appreciated the opportunity to be of service which this commission has provided. We hope that you will hesitate to be in contact with us should as questions may develop in the course of your review.

Very truly yours,

H. Clayton Cook, Jr.

Enclosure: LECG LLC, Report to the Honorable William J. Schubert, November 8, 2002.

Exhibit A. Text of Proposed Changes
Exhibit B. Statement of Work
Exhibit C. Fulbright & Jaworski L.L.P. qualifications memorandum;
Exhibit D. LECG LLC qualifications memorandum
Exhibit E. LECG LLC, "The Economic Contribution of the U.S. Commercial Shipbuilding Industry" (April 2002)
Exhibit F."U.S. Shipbuilding 2002: Opportunities Abound: Financing Needed," MARITIME REPORTER & Engineering News (June 2002)
Exhibit G."OPA 90 Phase Out of Environmentally Risky Vessels - Much to be Done," Shipbuilders Council of America (April 2002).