

October 1989

NAVY CONTRACTING

Ship Chartering Practices of the Military Sealift Command



**National Security and
International Affairs Division**

B-232562

October 25, 1989

Congressional Requesters:

As requested, we reviewed the chartering practices of the Military Sealift Command (MSC). This review was undertaken at the request of 25 Members of Congress (see enclosed list). Although some of their concerns dealt specifically with a recent contract award for the charter of two tankers and a subsequent protest by Falcon Carriers, Inc., an unsuccessful offeror, we also addressed overall concerns regarding MSC's chartering practices. Our work focused primarily on whether MSC is applying its chartering practices consistently and fairly and according to applicable regulations (see app. I).

Results in Brief

In September 1988 MSC awarded two charters for tankers to replace two Falcon ships on which charters were about to expire. Falcon filed a protest with GAO on the bases that (1) MSC improperly altered the terms of the solicitation and (2) MSC's evaluation of the offers received was flawed. GAO sustained the protest.¹ However, as a result of Department of Defense (DOD) funding constraints, MSC's overall requirement for tankers was reduced by two ships for fiscal year 1990 and MSC informed us that it intended to cancel, on September 30, 1989, the charters on which Falcon filed its protest. The requirements have since been reinstated and MSC now intends to carry out the recommendations set forth in our January 30, 1989, decision. Although both Falcon ships have been at least partially utilized since the completion of their charters with MSC, the Falcon Leader is currently not in use. Moreover, Falcon missed a loan payment on the Falcon Leader, which was due on August 18, 1989, and the loan may go into default. Appendix II discusses the Falcon ships and related issues.

With the exception of the problems we found with MSC's two charters of tankers to replace the Falcon ships, our review of selected MSC charters disclosed no serious deficiencies or failures to comply with applicable laws or regulations. MSC was consistent in its application of procedures, and it fairly, logically, and reasonably resolved questions or disagreements with both commercial firms and MSC customers within DOD. We did find, however, a few cases where the contract files were not complete. Appendix III contains the details of our review of selected MSC charters.

¹Falcon Carriers, Inc., 68 Comp. Gen. 206 (1989), 89-1 CPD 496.

Background

MSC's primary mission is to provide strategic sealift. This is accomplished in part by chartering ships to transport DOD cargo such as petroleum products and dry cargo. In addition, MSC charters ships for special purposes required by DOD.

MSC charters ships under three types of contracts: bareboat, time, and spot charters. A bareboat charter is a contract for the exclusive use of a ship for a defined period of time, with MSC being responsible for crewing, operating, supplying, and servicing the ship. A time charter is a contract for the use of a ship and its crew for a specified period of time, with MSC paying the owner a fee to operate it and reimbursing the owner for fuel costs and port charges. A spot charter is a contract, at a fixed fee, for as little as a single voyage, with the owner operating the ship and paying all costs out of the fixed fee.

MSC awards bareboat charters infrequently. For instance, at the close of our review MSC had 10 ships under bareboat charters at a cost of about \$50 million per year, all of which had been chartered before 1981. MSC awards time charters for about 30 ships and spot charters for about 120 ships each year at annual costs of about \$200 million and \$50 million, respectively.

As requested, we did not obtain official written agency comments on this report. However, we did discuss the matters presented in the report with MSC officials and included their views where appropriate. These officials agreed that in a few cases not all documentation was included in the contract files. They agreed to locate and include the documentation in the appropriate files and assured us that this condition should not arise in the future.

We are sending copies of this report to the Chairmen, Senate and House Committees on Appropriations and Senate Committees on Governmental Affairs, on Armed Services, and on Commerce, Science and Transportation. Copies are also being sent to the Secretary of the Navy, the Commander of MSC, the Administrator of the Maritime Administration, and other interested parties.

GAO staff members who made major contributions to this report are listed in appendix IV.

A handwritten signature in black ink, appearing to read "Martin M. Ferber". The signature is fluid and cursive, with a prominent initial "M" and a long, sweeping underline.

Martin M Ferber
Director, Navy Issues

List of Requesters

The Honorable Les Aspin, Chairman
Committee on Armed Services
House of Representatives

The Honorable John Conyers Jr., Chairman
Committee on Government Operations
House of Representatives

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

The Honorable Lloyd Bentsen
The Honorable William S. Cohen
The Honorable Alfonse D'Amato
The Honorable Phil Gramm
The Honorable Charles E. Grassley
The Honorable Daniel K. Inouye
The Honorable Daniel P. Moynihan
United States Senate

The Honorable Les AuCoin
The Honorable Helen Delich Bentley
The Honorable Jack Brooks
The Honorable Bob Carr
The Honorable Norman D. Dicks
The Honorable Bernard J. Dwyer
The Honorable Roy Dyson
The Honorable E. de la Garza
The Honorable Bill Green
The Honorable Frank McCloskey
The Honorable David R. Obey
The Honorable Martin O. Sabo
The Honorable Olympia J. Snowe
The Honorable Charles Wilson
The Honorable Don Young
House of Representatives

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Abbreviations

DOD	Department of Defense
MARAD	Maritime Administration
MSC	Military Sealift Command
RFP	Request for Proposals

Objectives, Scope, and Methodology

In order to respond to numerous congressional requests regarding MSC's chartering practices, we performed a detailed evaluation of MSC's awards of time charters for two tankers and selected and reviewed specific types of charters based on prior protests and various types of ships recently chartered. Our evaluation was designed to review selected MSC charters for evidence of (1) adherence to applicable laws and regulations, (2) fairness and reasonableness of MSC's decisions to resolve questions or disagreements with both commercial firms and MSC customers, and (3) overall consistency and application of MSC's chartering procedures. We did not review any bareboat charters because the most recent active charter was awarded before 1981.

For time charters, we determined that MSC had awarded 199 charters in the six fiscal years 1983 through 1988 and that GAO had received protests on eight requests for proposals (RFPs) initiated during those years. We selected these eight RFPs for review because we believed there was a higher probability of finding inadequate time chartering procedures on RFPs that had been protested than on those that had not been protested. These 8 RFPs resulted in 11 time charters of 20 ships from 8 owners. The Falcon Carriers, Inc., protest was reviewed separately.

MSC spot chartered about 120 ships each year and the award process was much more simplified than was the case with time charters. We also determined that both the necessity for spot chartering ships and the prices available on the commercial spot charter market varied substantially. As a result, we limited our sample size to nine spot charters awarded during fiscal year 1988 and two spot charters awarded during fiscal year 1989. The spot charters were judgmentally selected considering contract amount, ship type, U.S. or foreign flag, and frequency of award to particular contractors.

For the time and spot charters reviewed, we mainly used the records and correspondence maintained in MSC's chartering division. We concentrated on MSC's contracting procedures associated with the notification, competition, evaluation, and award phases of the contracting process. Some examples of the kinds of contracting procedures we tested follow:

- Notification. We verified the use of potential offerors' lists and public announcements.
- Competition. We evaluated MSC's analysis of the number and responsiveness of offers received.
- Evaluation. We evaluated MSC's treatment of all offerors for consistency and fairness and determined how technical qualifications were assured.

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- **Award.** We verified that the lowest cost (technically qualified) offeror was awarded a contract consistent with the terms and conditions of the original RFP.

We also determined if contract files were sufficiently documented to allow an independent review of the complete chartering process.

Our review was performed at the headquarters of MSC, Washington, D.C., from November 1988 through August 1989 and was conducted in accordance with generally accepted government auditing standards.

MSC's Time Charter Awards for Two Tankers

All of the congressional requests received related to MSC's decision to award time charters for two tankers—the Texaco New York and the OMI Champion—replacing existing contracts with Falcon Carriers, Inc. However, a number of requesters also asked if MSC considered other aspects, such as military usefulness and government loan guarantees, in its award process.

The Falcon Leader and the Falcon Champion

In 1980 Falcon Carriers, Inc., submitted an unsolicited proposal to MSC to replace four Falcon tankers that MSC had under bareboat charter with four new tankers. According to the proposal, MSC's overall costs would be substantially the same as those under the existing arrangement. Falcon proposed a firm time charter period of 5 years, with guaranteed payments sufficient to cover the loan payments on the new ships.

In 1981, after negotiating the ship specifications, financing details, and charter rates, MSC and Falcon amended the bareboat charters on the four existing ships to record their agreement on the construction and substitution of two new ships. Falcon planned to use government subsidies and loan guarantees provided by the Maritime Administration (MARAD) to finance most of the construction cost. However, because of constraints on MARAD's budget for construction differential subsidies, the agreement was for two new ships, not four ships.

The first ship, the Falcon Leader, was delivered and accepted in August 1983. The charter was for 5 years (ending in August 1988), with provision for one option period of either 18 months or 5 years to be agreed upon later. The second ship, the Falcon Champion, was delivered and accepted in January 1984 under the same terms and conditions as the Falcon Leader.

At the end of the 5-year basic period, MSC decided not to exercise the option on the Falcon Leader because a market survey showed that other ships were available at more economical rates. MSC therefore issued an RFP to time charter a U.S. flag tanker for the transportation and storage of DOD petroleum products. The new charter period was for 17 months, with provision for two 17-month option periods. Five firms responded with offers, including OMI Bulk Transport, Inc.; Texaco Refining and Marketing, Inc.; and Falcon.

MSC then requested best and final offers, and four offers were received. MSC evaluated these offers on a cost-per-ton basis, considering such factors as cargo capacity, charter hire cost, fuel costs, and port charges. It

also considered the effects of certain ship features, such as bow thrusters and an inert gas system. These latter features were not present on all offered ships but could decrease costs by reducing (1) the number of tugs required for docking and (2) the time required to load cargo. MSC determined the costs of a hypothetical round trip for part of the contract period and calculated storage costs for half of the contract period. MSC's evaluation showed Texaco to be the low offeror, with OMI second and Falcon third.

After receiving the final offers, MSC determined that it needed to charter a second ship. Therefore, on September 7, 1988, MSC awarded a time charter to Texaco for the Texaco New York, starting in October 1988, and one to OMI for the OMI Champion, starting between January and February 1989.

On September 9, 1988, Falcon protested to GAO the award of these charters. Falcon's primary bases for protesting were that (1) MSC had improperly relaxed the mandatory delivery schedule after receipt of best and final offers and (2) MSC's cost evaluation of the offers was flawed because the cost-per-ton for storage was given 8-1/2 times the weight of the cost-per-ton for the transportation part of the contract.

After reviewing the contract files and recomputing the cost-per-ton for each offered ship, on January 30, 1989, GAO issued a decision on Falcon's protest. GAO recommended that a new round of best and final offers be entered between Texaco and Falcon and that the charter with Texaco be canceled if Texaco does not have the low offer after an evaluation giving equal weight to costs in both the storage and transportation modes. GAO stated that OMI's charter should not be disturbed because GAO's recomputation found OMI to be the low offeror by a substantial margin. GAO also awarded Falcon the cost of pursuing the protest, including attorney's fees.

Texaco and MSC requested that GAO reconsider its decision. MSC provided evidence that as a result of funding constraints identified by the Joint Chiefs of Staff, its overall requirement for tankers had been reduced by two ships for fiscal year 1990. It stated that, on the basis of the reduction in tanker requirements and the higher costs associated with terminating the charters on its other tankers, it intends to cancel the Texaco and OMI charters on which Falcon had filed its protest on September 30, 1989. Therefore, MSC believed it would be impracticable to enter another round of best and final offers because there would be only a few months of performance available after recompetition. Further, MSC suggested

that GAO amend its recommendation to (1) delay any recompetition until such time, before September 30, 1989, as a new requirement may be identified, (2) open recompetition to all companies (not just Texaco and Falcon) wishing to compete, and (3) reverse the award of protest costs and attorney's fees to Falcon.

On the basis of MSC's representations, GAO withdrew its recommendation for another round of best and final offers but reaffirmed its recommendation that future evaluations give appropriate weight to MSC's anticipated requirement for transportation and storage. It also reaffirmed its award of protest and attorney's fees. Since MSC's arguments persuaded GAO to revise its recommendation, GAO dismissed Texaco's request for reconsideration as academic.

The requirement, however, for the two tankers has been reinstated and MSC informed us by letter dated September 19, 1989, that it will carry out the recommendations set forth in our January 30, 1989 decision. Accordingly, MSC will request a new round of best and final offers from Texaco and Falcon for the contract under which the ship Texaco New York is now operating. By letter dated September 20, 1989, attorneys for Texaco notified MSC that they do not agree with MSC's intention to recompetite the contract on which Texaco has been performing, and they believe MSC has no legal basis for canceling Texaco's ongoing contract.

Military Usefulness

Some requesters asked if MSC considered special features on the Falcon ships that would likely improve the ships' military usefulness. Falcon believed, for instance, the exclusion of gray cast iron in engines and machinery would make its ships better able to withstand the shock of attack or bombing than other ships. It also believed the installation of dual diesel engines for redundancy, the increased cruising speeds and ranges of its ships, and the nuclear/chemical/biological washdown system on the Falcon Leader would make the ships more militarily useful and should have been considered in evaluating its proposal.

MSC is generally required by the Competition in Contracting Act of 1984 (P.L. 98-369) to seek full and open competition in the procurement of ship charters. The act requires that solicitations of offers specify the agency's needs in a way that promotes competition and that offers be evaluated solely on the factors specified in the solicitation. The act also states that the type of specification included in the solicitation depends on the needs of the agency and the market available to satisfy those needs.

Although MSC could have specified in the RFP that the features discussed by Falcon be included on any ships offered, if the features were necessary for the ships' intended use, such restrictive specifications could limit competition and/or increase costs. The question then becomes one of a trade-off between military use and cost, and we believe such a decision should be left to the procuring agency, which is best able to assess its true needs.

Government Loan Guarantees

A major share of the construction financing for the two Falcon ships was guaranteed by MARAD under provisions of title XI of the Merchant Marine Act of 1936 (46 U.S.C. 1274). Because several requesters questioned whether MARAD's potential liability for repayment of these loans should be considered in the competitive process for ship charters, we determined if MSC considered the possibility of Falcon defaulting on the these loans when it awarded the two charters to the other companies.

MSC documents show MSC did not consider the possibility of default on these loans when it decided to replace the Falcon charters through a new solicitation and determined the winners of the resulting competition. It believes that title XI loan guarantees should not be considered in the competition for chartering ships because all U.S. flag companies should have an equal right to compete for government business. MSC said that there are many ships in the U.S. flag fleet with outstanding title XI guarantees and that many of these ships are available for charter because of current market conditions. MSC believes that imposing a special interest policy to guarantee employment to uncompetitive title XI ships would set a dangerous precedent.

In general, MARAD agrees with MSC's position that in selecting a vessel for employment, special consideration should not be given to a vessel on the basis of it having title XI financing. However, MARAD points out that the Falcon Leader and the Falcon Champion present a unique situation in that MSC was significantly involved in the design of the vessels. As a result, the vessels have special features that, while militarily desirable, are not commercially useful. MARAD believes MSC should be obligated to give the Falcon vessels title XI capital costs special consideration in their selection process.

According to MARAD, Falcon met all debt obligations on the two ships through July 24, 1989. However, an August 18, 1989, loan payment on the Falcon Leader was not made. Falcon then had a 30-day grace period in which it could, but did not, make this payment. Currently, the trustee

Appendix II
MSC's Time Charter Awards for Two Tankers

bank, as the agent for Falcon's bondholders, may allow as much as 60 additional days for Falcon to make the payment or may place the loan in default, at any time, and demand payment of the full balance from MARAD.

MSC and MARAD advised us that since redelivery in January 1989, the Falcon Champion has made two voyages for the government of Israel and two voyages for commercial charterers. The ship was then dry-docked for about 30 days, and it is currently chartered for additional voyages for the government of Israel. The Falcon Leader was used by MSC for spot charters from October 1988 to early July 1989 but is currently not in use. According to MSC, there are currently no known spot charter requirements for the Falcon Leader; however, these requirements cannot normally be predicted more than a few weeks in advance.

MSC's Chartering Practices

A number of requesters were concerned about MSC's overall practices for chartering ships. Thus, we examined selected time charter and spot charter contract files. With respect to these contracts, the results of our assessment disclosed that MSC was fairly and consistently applying its contracting rules and regulations.

Time Charters

MSC currently has about 74 ships under time charters; these charters involve various types of ships for specific purposes as well as for the transportation of cargo. The ships are selected from commercial sources and are usually U.S. flagged. Thus, when MSC needs a specific type for a specific purpose, it usually solicits the U.S. maritime industry for suitable candidates.

Time periods for existing MSC time charters range from 6 months to 5 years depending on when the original time charters were signed. However, since fiscal year 1985 MSC has restricted time charters to 17 months with provisions for up to two 17-month options, in compliance with a legislatively mandated 18-month limitation.

As discussed in appendix I, to examine MSC's practices for awarding time charters, we reviewed 8 RFPs that were protested to GAO and that resulted in 11 time charters of 20 ships from 8 owners. (This selection excluded the Falcon Carriers issue previously discussed.) The chartered ships included harbor tugs, a support ship for deep submergence research ships, a sonar calibration support ship, a tug with an accompanying barge, and large cargo ships. We also reviewed MSC's files to identify complaints made to other government agencies by the bidders but not officially protested to GAO.

MSC's goal in awarding time charters is to meet DOD's transportation requirements at the lowest cost. Our review of the eight RFPs demonstrated that MSC does strive to achieve this goal by requesting proposals from as many ship owners/operators as it can identify—as many as 450 in the cases we reviewed—and selecting the lowest cost, technically qualified offer. Also, MSC attempts to accommodate offerors' concerns when they can without compromising customers' needs or other requirements. For instance, MSC extended the delivery date and allowed for additional "reasonable cause" delay on one RFP in response to an offeror's complaint that the time originally allowed may not be sufficient for ship modifications or construction that would be needed to meet requirements. However, MSC must meet regulatory requirements,

and it refused to relax requirements that certain offered ships be certificated for the carriage of passengers as required by Coast Guard regulations.

Our review of the eight RFPS disclosed no serious deficiencies or failures by MSC to comply with applicable statutes or regulations regarding notification, competition, evaluation, or award. Of the 10 bid protests associated with these RFPS, 6 were dismissed as untimely or for failing to have required documentation, 3 were denied on their merits, and 1 was withdrawn by the protester. However, our review of MSC's contract files did find a few instances where documents referred to in support of various decisions were not contained in the files. We believe each procurement decision should be fully supported and each file should include all relevant documents.

Overall, on the basis of the time charters reviewed, we believe MSC is securing ships at competitive costs while fairly and consistently applying appropriate contracting rules and regulations.

Spot Charters

MSC awards spot charters when regularly scheduled commercial carriers or MSC controlled ships cannot meet DOD's short term transportation requirements. Reasons include the quantity or type of cargo to be transported, the location to which the cargo is to be carried, the customer's time frames, or a combination of these factors. When MSC needs a ship for a spot charter, it competes in the commercial spot market for the ship; thus, it is subject to the competitive forces of the market at that time. The costs involved in this type of charter are influenced by the number and types of ships available to sail to a particular location as well as the ships' suitability to carry the desired cargo when needed.

MSC awarded 119 spot charters for the shipment of various cargos ranging from ammunition to petroleum during fiscal year 1988, and none of the spot charters were formally protested by offerors to GAO. Of the 11 MSC spot charters we reviewed, 10 were for U.S. flag ships and 1 was for a foreign flag ship. Nine of these charters were awarded during fiscal year 1988 and represented about 14 percent of the \$51.4 million value of spot charters that year. In addition, we selected two charters awarded during fiscal year 1989 because they were among the most recent awards at the time of our review and represented the most current MSC chartering practices.

We found MSC's spot chartering policies were sufficiently flexible to allow for and control the variances peculiar to individual charters. For example, MSC provided such variances as allowing (1) a contractor to receive payments at the completion of stated voyage segments rather than upon completion of the entire voyage in order to alleviate a cash flow problem and (2) a contractor to use excess cargo-carrying capacity for commercial purposes. Further, its procedures for notifying potential offerors of a chartering opportunity and informing them of changes made to solicitations appeared reasonable and fairly applied. Moreover, we did not find any serious deficiencies or failures by MSC to comply with applicable statutes or regulations regarding notification, competition, evaluation, or award. Thus, we believe that MSC's overall policies for spot chartering are adequate to comply with applicable statutes and regulations.

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