

STATEMENT FOR THE RECORD

OF

**H. E. SHEAR
MARITIME ADMINISTRATOR**

ON

BEHALF OF

THE

DEPARTMENT OF TRANSPORTATION

BEFORE THE

**SUBCOMMITTEE ON MERCHANT MARINE
MERCHANT MARINE AND FISHERIES COMMITTEE
U.S. HOUSE OF REPRESENTATIVES**

ON

**H.R. 5029, A BILL TO IMPROVE CERTAIN
MARITIME PROGRAMS OF THE DEPARTMENT OF
TRANSPORTATION, AND FOR OTHER PURPOSES.**

APRIL 3, 1984

**STATEMENT OF ADMIRAL HAROLD E. SHEAR, MARITIME ADMINISTRATOR
OF THE DEPARTMENT OF TRANSPORTATION, BEFORE THE SUBCOMMITTEE
ON MERCHANT MARINE OF THE HOUSE MERCHANT MARINE AND FISHERIES
COMMITTEE, WITH RESPECT TO H.R. 5029, A BILL "TO IMPROVE CERTAIN
MARITIME PROGRAMS OF THE DEPARTMENT OF TRANSPORTATION, AND FOR
OTHER PURPOSES."**

April 3, 1983

Mr. Chairman and Members of the Subcommittee on Merchant Marine. My name is Harold E. Shear. As the Maritime Administrator of the Department of Transportation, I am pleased to appear this morning to present the views of the Administration with respect to your bill, H.R. 5029, "To improve certain maritime programs of the Department of Transportation, and for other purposes." This is an important piece of legislation, and my testimony will address your proposed amendments to the Bankruptcy Act first, followed by the Title XI Guarantee Program, Section 214 of the Merchant Marine Act, 1936, and the Title XII War Risk Insurance Program. I will then address the issues raised by the Ranking Minority Member in his letter of March 14, 1984, to Secretary Dole.

The first two sections of H.R. 5029 would assist the Title XI Guarantee Program that is administered by the Maritime Administration.

Under Title XI of the Merchant Marine Act, 1936, the Secretary of Transportation guarantees obligations to finance or refinance the construction, reconstruction or reconditioning of U.S.-flag vessels in domestic shipyards. The Secretary of Commerce has similar authority with respect to fishing vessels and facilities.

Over the years, the Title XI Guarantee Program has been a very popular program, and most U.S.-flag operators have taken advantage of it. Recently, however, the program has been confronted by two separate problems: (1) proceedings to foreclosure when a defaulted shipowner is in bankruptcy and (2) flexibility in transferring vessels from defaulted shipowners to solvent purchasers. Your bill, H.R. 5029, addresses each of these problems.

Bankruptcy Code Amendment

Mr. Chairman. Our primary concern with the future of the Title XI Guarantee Program is the current inability of the Secretary to act to protect the national interests of the United States when operators of vessels financed with obligations guaranteed under the Program go into bankruptcy.

Prior to the Bankruptcy Reform Act of 1978 (Public Law 98-598), where there was a Title XI default by a shipowner in bankruptcy, the Bankruptcy Court did not have the statutory authority to enjoin the Secretary from foreclosing on the vessel mortgage of the debtor shipowner if the Secretary determined that such a foreclosure was in the best interest of the Government. The Bankruptcy Reform Act of 1978 removed the Secretary's absolute immunity from the bankruptcy stay or injunctive powers of the court. Instead, under the new Code, it appears that the intent of Congress was to have the Secretary take her place with other secured creditors with interests in various types of transportation equipment who are entitled to a partial immunity from a stay under Chapter 11 reorganization. Sections 1110 and 1168 of the 1978 Code

provide such partial immunity generally to secured creditors with certain interests in railroad stock, aircraft equipment, and vessels. Congress limited the class of vessels to which such immunity would apply to ICC-regulated inland and domestic vessels. There is no reason to believe from the legislative history of Section 1110, however, that Congress deliberately intended such a narrow classification. The consequence is that both the Secretary of Transportation and the Secretary of Commerce are now blocked by the automatic stay provisions of the law from foreclosing on their Title XI security, and must resort to the time consuming and arduous procedure required to seek relief from the stay.

Thus, at a time when the maritime industry is undergoing the most severe economic strains since the original enactment of the Title XI statute, the Secretary has been denied the authority to protect the public interest by foreclosing on the vessel security. The Secretary is precluded from realizing the collateral value of the vessels, even though she has to pay substantial funds on the Title XI Guarantee.

Section 2 of H.R. 5029 offers a solution to this problem in proposing to restore some of the protection accorded the Secretary prior to the enactment of the Bankruptcy Reform Act of 1978. As amended by that Act, section 362(a) of the Bankruptcy Code provides that the filing of a voluntary or involuntary petition for liquidation or reorganization operates as a stay of any judicial, administrative, or other proceedings against the debtor, including any action to create, perfect, or enforce any lien against property

of the bankrupt. Subsection (b) of Section 362 describes limited instances under which the stay does not operate. H.R. 5029 would add two new exceptions to subsection (b) generally providing that the automatic stay would not apply to the commencement of an action by the Secretary of Transportation or Secretary of Commerce to foreclose a mortgage on a vessel under the Ship Mortgage Act, 1920.

We support the objectives of the proposed amendments to the Bankruptcy Code set forth in Section 2 of H.R. 5029. However, we note that there appear to be two solutions to this problem: amending Section 362 of the Code or amending Section 1110 of the Code.

The approach taken in your bill would amend Section 362 of the Code. As I recall, this was the approach taken by the other body in its consideration of an amendment to S. 2336, the Maritime Authorization Act of 1983, in the 97th Congress. As you know, for reasons unrelated to the bankruptcy issue, that legislation was never enacted.

Since that time, we have had an opportunity to review various solutions to this grave problem currently confronting the Title XI Guarantee Program. After considerable thought and consultations, we have focused upon the second approach, amending Section 1110 of the Code. Section 1110 provides creditors with purchase money equipment security interests in aircraft certificated by the CAB or ICC-certificated domestic/inland vessels with an exemption from the automatic stay during reorganization proceedings if the debtor fails to cure the default within 60 days of filing. Consistent

with its purpose, section 1110 could be amended to remedy our concerns by redefining "vessel" to include all vessels potentially covered by Title XI guarantees whether or not their operations are ICC-certificated. In addition, because some Title XI projects may not involve a purchase as such and therefore would not result in purchase money equipment security interests, the amendment should also expand the class of creditors to include all those with preferred mortgages under the Ship Mortgage Act.

This is a very complex area, but I think you will agree that each approach has certain advantages and disadvantages. We favor the Section 1110 approach, as we believe it to be technically preferable and consistent with both transportation and bankruptcy policy. For example, Section 1110 specifically deals with secured creditors of transportation equipment. Section 362, on the other hand, has much broader application. Moreover, the legislative history of the Bankruptcy Act of 1978 indicates that the exemption from the automatic stay under Section 1110 was designed to give the debtor an opportunity (60 days) to "rehabilitate a business that may have a dramatic impact on the public interest." This 60-day period where no creditor could proceed against the debtor was thought to be preferable to a provision granting a secured creditor, such as the Secretary, immediate access to the debtor's property. Section 362 does not provide such a "grace period." The legislative history also shows that Congress thought that Section 1110 would apply to all types of vessels when, in fact, it only covered inland and domestic vessels. Therefore, we feel that

amending Section 1110 rather than Section 362 would make more sense from a transportation policy point of view, as it would bring consistency to the treatment of secured creditors of all types of transportation equipment. It also makes sense from a bankruptcy policy perspective because it provides an opportunity to the debtor to cure its default.

Moreover, the proposed amendment would provide the Secretary with the opportunity to proceed (after the 60-day period) to requisition a vessel held as security for a defaulted obligation in the event of a military contingency. Absent such an amendment, under current law, the Secretary could be delayed in carrying out her mandate to ensure that the United States has an adequate merchant marine in times of war or national emergency due to the necessity of obtaining court action under the Bankruptcy Code. Section 1110 provides an exemption from the power of the bankruptcy court to impose a stay, not just relief from the automatic stay upon filing of a petition under Chapter 11.

Flexibility in Administering the Title XI Guarantee Program

Our second concern pertains to the general economic health of the U.S. maritime industry. Recent economic dislocations have placed great stress on certain segments of the industry.

As the Members of this Subcommittee know, the usual security of the bondholders is the Title XI guarantee that if the shipowner does not pay them, the U.S. Government will. The security of the Secretary of Transportation for the Title XI Guarantee is a preferred mortgage on the vessel. Under existing law, in the event

of an uncured default, the Secretary must pay off the existing Title XI bondholders in order to foreclose on the ship mortgage. Thereafter, unless there is a prompt sale by the debtor, it is necessary for the Secretary to bid for the vessel at the Admiralty foreclosure sale, take title to the vessel, and attempt to sell it to other U.S. operators.

Section 1 of H.R. 5029 would give the Secretary of Transportation an additional option in the event of an uncured default. The new option, added by your bill, is intended to authorize the Secretary to assume the periodic payments of the shipowner to the bondholder, and foreclose on the ship mortgage with the bonds in place. At the Admiralty foreclosure sale, another U.S. operator could bid for and take title to the vessel with Title XI financing already in place. That vessel purchaser would assume the bond payments from the Secretary of Transportation. H.R. 5029 is intended to provide identical authority for the Secretary of Commerce. Such additional flexibility would appear to offer the following advantages:

- a. The outstanding bonds could be part of the sale of the vessel.
- b. The Title XI Fund need not be called upon to pay off the bondholders in the event of a shipowner's default.
- c. The Secretary need not go through the formality of purchasing the vessel prior to its sale to another U.S. operator.
- d. The vessel purchaser need not be required to arrange for new Title XI financing, but could assume the responsibility for bond payments from the Secretary at the foreclosure sale.

With respect to the proposed amendments to Title XI of the Merchant Marine Act, 1936, we would appreciate the opportunity to discuss with your staff certain minor language changes that we believe are required to carry out the intent of Section 1 of your bill.

Mr. Chairman, the Administration deeply appreciates your concern for the current problems being encountered by the Title XI Guarantee Program, and we strongly support the objectives of the first two sections of the bill.

Section 214 of the Merchant Marine Act, 1936

The Administration supports Section 3 of H.R. 5029, which would amend Section 214 of the Merchant Marine Act, 1936.

Section 214 generally pertains to the power of the agency to subpoena witnesses and documents in connection with proceedings. The proposed amendment makes certain minor technical changes to generally conform that provision to the enactment of the landmark legislation known as the Shipping Act of 1984.

Title XII War Risk Insurance Program

Section 4 of your bill would extend the Title XII War Risk Insurance Program for an additional five years, and is supported by the Administration.

Mr. Chairman, as you and the Members of the Subcommittee know, Title XII of the Merchant Marine Act, 1936, is stand-by legislation which authorizes the Secretary of Transportation, with the approval of the President, to provide war risk and certain marine and liability insurance for the protection of vessels, cargoes, and

crew life and personal effects, when commercial insurance cannot be obtained on reasonable terms and conditions.

Commercial war risk insurance policies now in effect contain automatic termination clauses which cause such insurance to terminate upon hostile detonation of a nuclear device of war or upon the outbreak of war (whether there is a declaration of war or not) between any of the following countries: United States of America, United Kingdom (or any other member of the British Commonwealth), France, the Union of Soviet Socialist Republics, and the Peoples Republic of China. Without Government war risk insurance, American vessels would be without protection against loss by risks of war after termination of the commercial policies. Ships and cargoes could not be moved without adequate insurance coverage.

War risk insurance was provided by the Government in both World Wars I and II, and proved both necessary and effective in protecting the United States and its waterborne commerce, with total premium receipts in excess of loss paid. At the present time, this Title XII authority is scheduled to expire on September 30, 1984. Section 4 of H.R. 5029 would extend this authority for an additional five years and is supported by the Administration in order to ensure the continued support of United States oceangoing commerce.

Title XI Program Concerns

Mr. Chairman. As you know, Mr. Snyder forwarded to Secretary Dole a copy of his letter to you conveying certain concerns

regarding the Title XI Program. These concerns were brought to Mr. Snyder's attention by representatives of the inland waterways industry, and he requested that my testimony today be broadened to address these issues.

The first concern is whether the Title XI Guarantee Program has contributed to the current oversupply of inland towboats and barges and offshore tug/supply vessels.

During the late 1970's the amount of Title XI financing of inland vessels and offshore vessels increased as construction activity increased and as the benefits of Title XI financing became more widely recognized among those particular operators.

Due to the recent economic downturn, all segments of the maritime industry are depressed, and the demand for inland and offshore vessels in particular has fallen abruptly. This oversupply of equipment is primarily the result of a drop in market demand, although a contributing factor was an influx of the new vessel construction.

The use of various forms of ownership (corporate, partnership, trust, etc.) has been one means for the maritime industry to attract new equity capital. Tax considerations have undoubtedly influenced some transactions, but the majority of Title XI financed projects involved well established companies with strong market demand and operators with considerable industry experience and expertise. The Administration is sensitive to the concerns of the Congressman that the Title XI Guarantee Program not be a contributing force to overtonnaging or aiding financial arrangements that

are not sound and justified. At the present time we are in the final stages of a rulemaking that is intended, among other things, to set forth more stringent economic and financial criteria that will be applied in evaluating Title XI Guarantee applications and administering other aspects of the Title XI program. An emphasis on economic soundness of Title XI projects will decrease the possibility of trades being overtonnaged by vessels financed by government guarantees.

The second concern has to do with the same rulemaking. MARAD published a Notice of Proposed Rulemaking in the August 13, 1983, FEDERAL REGISTER, which, among other things, proposes that priority in the processing of ship financing guarantee applications shall go to vessels of particular military usefulness and those to be constructed in shipyards within the mobilization base. This is a Notice of Proposed Rulemaking on which we have received comments. These comments, which include the concerns you have raised here, are currently under review within the Department. We hope to promulgate a Final Rule within the next 60 days.

The third and final concern pertains to the current MARAD practice of selling vessels under foreclosure.

Mr. Chairman. I wish to assure Mr. Snyder and the Members of the Subcommittee that all foreclosure sales of vessels with defaulted Title XI Obligations are conducted by the Court with public notice and are open to all interested bidders. Prior to foreclosure, a shipowner which owns vessels with defaulted Title XI debt may offer the vessels for sale, with or without competitive

bids. In bankruptcy situations, the Maritime Administration cannot force the sale of vessels with defaulted Title XI debt until the termination of the automatic stay by the Bankruptcy Court. If a bankruptcy petition has been filed, any sale of the equipment is subject to approval of the Bankruptcy Court and therefore the Maritime Administration. If H.R. 5029 is passed, MARAD would have the power to sell the vessel without the approval of the Bankruptcy Court.

In many cases the sale of a vessel by the shipowner prior to foreclosure assures the Government of its best possible recovery of the collateral value of the equipment, without the costly delays imposed by the automatic stay of the Bankruptcy Code. A private sale prior to foreclosure often minimizes costs that would eventually be borne by the Maritime Administration, such as insurance, custodian fees and similar expenses. In cases of default, the Maritime Administration has attempted to facilitate their sale prior to foreclosure by soliciting a wide range of potential purchasers and by providing interested parties with information concerning vessels that may be available. This affords the opportunity to attain the highest possible price for a defaulted vessel. In this regard, the Maritime Administration routinely mails lists of defaulted equipment to potential purchasers.

Nevertheless, the delays inherent in the bankruptcy process tend to increase the urgency of disposing of the vessel prior to actual foreclosure and possible bankruptcy. This may have an

unintended adverse impact on the price that can be obtained for the asset. This legislation would improve this situation by increasing the flexibility of the Secretary to act upon default or upon a subsequent bankruptcy.

Mr. Chairman, that concludes my prepared statement. I will be pleased to answer any questions you or the Members of the Subcommittee may have.

Thank you.