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March 3, 1975

MEMORANDUM FOR:

MIKE DUVAL

THRU:

MAX FRIEDERSDORF
VERN LOEN

FROM:

CHARLES LEPPERT, JR.

SUBJECT:

Dick Sharood's Comments on Revival
of the Energy Transportation Security
Act.

Dick Sharood asked me to pass on to you his thoughts and comments to Congressman McCloskey on this matter.

You recall that Dick Sharood asked to discuss this matter with you in early February and you advised me to keep away from the issue because of negotiations going on. I suspect that is the reason for the comments on page two, first paragraph regarding the White House staff.

Attachment



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U.S. House of Representatives
 Committee on
 Merchant Marine and Fisheries
 Room 1334, Longworth House Office Building
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February 14, 1975.

MEMORANDUM

To: Congressman Paul N. McCloskey.

From: Dick Sharood, Minority Counsel.

Your office should have been contacted by now, or will soon be contacted, by the White House to ask you to participate in a meeting on Thursday, February 20th, by Secretary Dent of the Commerce Department, representatives of maritime labor and management, and the White House staff regarding a compromise proposal by the White House to dissuade the maritime people from pursuing the oil import quota legislation, the so-called Energy Transportation Security Act, in this session of Congress.

If this meeting does occur as scheduled, I hope you will attend, since the overall question of the state of our tanker fleet will continue to be a very politically sensitive issue and a very legitimate area of debate so far as our maritime policy is concerned.

The most immediate problem confronting the bureaucrats - principally Bob Blackwell, the Assistant Secretary of Commerce for Maritime Affairs - is what to do about the Seatrain shipyard in Brooklyn, New York. It has been closed, and 4000 blacks, Puerto Ricans and other disadvantaged people from the Brooklyn area put out of work. The federal government stands to lose upwards of \$100 million on loans which it has guaranteed. The New York City Congressional delegation is, needless to say, making political hay out of this. The culprit, according to them, is the President for having vetoed the Energy Transportation Security Act.

When the President vetoed that legislation, it is rumored on good authority, he telephoned Paul Hall, President of the SIU and said, in effect, "I can't sign this, but we'll work something else out." The White House staff has refused to give me any details of the deal they are concocting, and I haven't the slightest idea what it might involve. I suspect that this will involve something the Executive branch can accomplish administratively rather than a proposal that involves legislation, but in either event when the compromise surfaces, it and all the other aspects of our tanker program will come to the fore during the hearings on the FY'76 maritime authorization bill. These hearings will be scheduled as soon as the Executive Communication is received, probably before the end of the month.

I would like to lay out for you at this point all I know about the Seatrain fiasco and other adverse highlights of the effort to build tankers under the 1970 Merchant Marine Act. For many years, Seatrain Line operated a railroad car ferry service between New York, Florida and Cuba. It was a major link with Cuba, but of course after the Castro take-over the service was terminated. At that point, Seatrain was purchased by Howard Pack, a wealthy New York businessman who was by trade a furrier. Pack attempted, and to some degree succeeded, in imitating the intermodal concept then being pioneered by Sea-Land, which had started out providing a service similar to Seatrain to Puerto Rico. However, rather than transporting railroad cars by ship Sea-Land transported highway trailers. Seatrain operated a steadily expanding fleet of containerships up until the enactment of the 1970 Merchant Marine Act. While never achieving the status of Sea-Land, and being somewhat of a bad boy in the industry for its rate-making practices rumored to involve extensive illegal rebating, Seatrain did pioneer a number of innovative transportation techniques.

With the advent of the Merchant Marine Act of 1970, Pack became very much interested in tankers. At that time, competition in the liner trades had become intense largely due to the fact that the European shipowners had caught up with the United States, having put into service many new large containerships, virtually destroying the technological advantage that the United States had enjoyed for a period of about seven years.

The tanker business, of course, appeared to hold great promise in 1970, and Pack began to negotiate for construction subsidies with the then Maritime Administrator Andrew Gibson. At the same time, the maritime unions which had so actively supported the 1970 legislation were throwing their weight behind anyone who would come forward to build new ships, and were extremely bitter over the failure of the major oil companies to participate under this new tanker-building program.

Again during the same general timeframe, the Navy finally closed down the old Brooklyn Navy Yard. This move had been triggered by Robert McNamara when he was still Secretary of Defense, and after a number of years of political agonizing, the move was finally completed. I don't know who originated the scheme, but at some point in time the idea jelled that the Brooklyn Navy Yard could be utilized for the construction of tankers. It has a very large dry dock entirely suitable for this purpose. The aircraft carrier CONSTELLATION was, I believe, the last naval vessel constructed in Brooklyn. The dry dock was then at least 1,100 feet long to accommodate a carrier of this size.

In order to raise the capital required to convert the yard into a commercial operation, the Economic Development Administration of the Department of Commerce was approached, and on the basis of stimulating employment and job training for minorities in the Brooklyn area committed something in excess of \$50 million to this operation. I'm quite sure there was very extensive political lobbying to bring this about, since any careful analysis of the concept would have immediately brought out the fact that the skills required in modern shipbuilding cannot be imparted today the way Rosie the Riveter was trained to build Liberty ships in World War II. It is the difference between constructing a B-17 and the proposed B-1 bomber.

Nevertheless, the deal was made, EDA committed the money for the yard itself, and the Maritime Administration signed the construction contracts with a subsidiary of Seatrain, which was the paper buyer of the vessel. Another subsidiary was set up to actually operate the Brooklyn Navy Yard. The equity

capital was borrowed by Pack from commercial banks using charters for the vessels as collateral. The first two ships constructed at the old Brooklyn Navy Yard were completed with cost overruns in excess of \$20 million. This, one could argue, represented the learning curve for the work force which, by and large, had no previous experience in any sort of shipbuilding.

Up to this point, at least, the whole project had some plausibility. Seatrain Line was, however, faced with the prospect of a multi-million dollar cost overrun, which it was not in a position to cover. It could not renegotiate the charters on the vessels at higher rates, and no other ship operator had approached Seatrain with a view toward building a vessel at the Brooklyn Navy Yard. The yard was Seatrain's private yard, for all practical purposes. Since we have no lack of good commercial shipyards, there simply was no reason for any other prospective tanker owner to select Seatrain, and of course Seatrain's technical difficulties leading to the cost overruns were well known in the industry.

The answer to Seatrain's financial problem was to build two more tankers with federal subsidy and, to partially cover its losses, apply for and receive a retroactive renegotiation of the construction subsidy on the first two vessels. By this time in 1973, Andrew Gibson was gone and Bob Blackwell had moved up from Deputy to Assistant Secretary of Maritime Affairs. It was he who approved the renegotiation of a construction subsidy on the first two vessels and the new subsidy for two more ships. I suspect, although I cannot document, that part of the subsidy money on the new ships also went into making up the loss on the first two.

The most unusual step, however, was to grant subsidy for the second two ships when Pack had no charter. At this point, the demand for tankers had begun to soften and the pressure to enact legislation such as an oil import bill to create an artificial demand had begun to gain momentum. Without a charter in hand for these ships, commercial banks would be extremely reluctant to put up the equity capital required for their construction - roughly, 65% of cost.

By whatever means, Seatrain was able to secure lines of credit, I suspect with substantial pressure from the White House, which was closely tied in with Paul Hall whose union had organized the shipyard workers in Brooklyn. With new subsidy contracts, Seatrain began to construct these tankers with no prospect whatsoever that they could be employed upon completion. Apparently everyone involved assumed that by the time the ships were in the water, the Energy Transportation Security Act would be law and a charter would materialize.

Today one of the ships is about 80% complete, and the second ship is approximately 30% complete. The banks have refused to advance any more credit, and the Maritime Administration is confronted with having to take one of two rather unpleasant actions. It can foreclose on the Title XI mortgage guarantees on these ships, or it can seek special legislation to permit it to advance additional monies to Seatrain. Foreclosure seems to be the only plausible course to follow. Unless Seatrain can obtain a charter, advancing additional money would simply put off foreclosure until some future date.

Upon foreclosure, the Maritime Administration will be faced with another set of choices - it can either scrap the vessels and take a total loss on the construction subsidies already advanced, or it can complete the construction of the vessels for the government's account, hoping eventually if the tanker market improves to sell the ships. Since the tanker market is not likely to improve for a number of years, it would make sense to complete only the ship that is already 80% along. The fourth ship of this series in the 30% stage of completion probably should be scrapped.

The EDA money invested in the yard itself probably will have to be written off as a total loss. I have no idea concerning the bath which the commercial banks will take, but it is bound to be substantial. There seems to be no chance of realistically keeping the Brooklyn Yard in the commercial shipbuilding business.

Enactment of the Energy Transportation Security Act would, of course, have changed all of this. Everyone would have been off the hook. I doubt that the White House was aware of all

of this prior to the President's veto. I long ago gave up personally trying to tell anyone at the White House anything. They simply don't listen. This does not seem to have changed since the Ford takeover. They are, however, acutely aware of all of this now.

There is no point in attempting to assess the blame for this rather sordid situation. Mistakes were made and a monumental cover-up has been undertaken. The principal operative has been Bob Blackwell, but he, I believe, has only done what both Paul Hall and the Nixon White House wanted done. Bob, of course, inherited a train of events that had been set in motion by his predecessor, Andrew Gibson. There was really no way Bob could have terminated this affair without closing down the Brooklyn Navy Yard in 1973. The White House simply would not have allowed that to be done. Bob might as well have quit, but that would not have changed anything.

The deal which is brewing now, and which is scheduled to be the subject of a meeting next Thursday, will not, I am sure, be billed explicitly as a bail-out for Seatrain, but that will have to be its principal goal. There are other yards which are in a similar situation, though not yet quite as desperate.

Insofar as what position, if any, you should take with regard to this whole affair, I would like to get together with you and discuss some options. I am attaching a number of papers relating to the tanker situation and the government's financial exposure; principally Secretary Dent's recent testimony before the Senate Commerce Committee. Interestingly enough, at that hearing no one questioned the wisdom of what has been done. They merely wanted to know what the government was going to do to make everything right again and put the people in Brooklyn back to work.

RNS:vln.

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