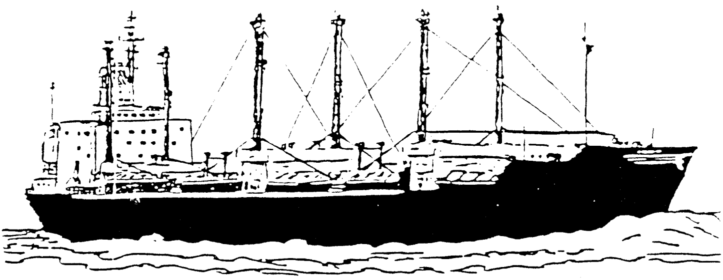
U.S. Department of Transportation
Maritime Administration

Calculating Fair and Reasonable Guideline Rates



GENERAL INFORMATION

The Maritime Administration of the Department of Transportation (MARAD) is the Federal Agency responsible for promoting and maintaining the U.S.-flag merchant marine necessary for the defense and economic security of the United States.

Cargo preference is the reservation, by law, for transporting on U.S.-flag vessels of a specified portion of oceanborne cargo which moves in international trade either as a result of the financial sponsorship of a Federal program or a guarantee provided by the Federal Government.

The Cargo Preference Act of 1954 requires that at least 50% of certain Government-generated cargoes be shipped on privately-owned U.S.-flag commercial vessels to the extent such vessels are available at *fair and reasonable rates for U.S.-flag vessels.* MARAD advises Government Agencies or their program participants concerning fair and reasonable rates. MARAD's regulations set forth in 46 CFR Part 382 - **Determination of Fair and Reasonable Rates for the Carriage of Bulk and Packaged Preference Cargoes on U.S.-Flag Commercial Vessels** - prescribe the primary administrative procedures and methodology for this process. This pamphlet is intended to provide general background and guidance on MARAD's procedures for determining fair and reasonable rates.

HISTORY

Section 901(b)(1) of the Merchant Marine Act of 1936, as amended (the Act), known as the Cargo Preference Act of 1954, requires that at least 50% of equipment, materials or commodities purchased by the United States or for the account of any foreign nation without provision for reimbursement, or acquired as the result of funds or credits from the United States, shall be transported on privately owned U.S.-flag commercial vessels, to the extent that such vessels are available at **fair and reasonable rates**. Section 901(b)(2) of the Act provides the authority for MARAD (by the delegation from the Secretary of Transportation) to issue regulations governing the administration of section 901(b)(1).

In 1989, MARAD issued regulations at 46 CFR Part 382 (the Rule), that initially became effective on January 1, 1990. Individual rates were based on eac ship's costs spread over at least 70% of cargo capacity. The costs for each vessel were reported separately and data reported to MARAD was routinely audited for accuracy.

In 1998, MARAD amended the rule to prescribe cos averaging as the methodology for rate calculation and to implement conforming procedural changes. Deriving rates from costs of all vessels in the size category eliminated the need for a new rate for mos vessel substitutions. In addition, the 70% rule was eliminated and operators were given the option of providing financial data certified by an outside auditor to reduce the need for additional audits.

REPORTING REQUIREMENTS

General

To participate in the carriage of preference cargoes, you must submit cost and operating data to MARAD for use in determining fair and reasonable rates. Data submission requirements are summarized below. Send information to the Director, Office of Costs and Rates.

Vessel Information

By April 30 of each year, cost information must be reported for the previous calendar year. After the initial reporting, capitalized vessel cost and speed and fuel consumption need only be updated when changes occur. For your convenience, MARAD can send you reporting formats to follow when submitting this information.

The initial filing for each vessel must include the vessel's name and official number; its summer DWT in metric tons; the date built, rebuilt and/or purchased; normal operating speed and the daily metric tons of fuel consumption associated with that speed for each type of fuel; metric tons of each type of fuel consumed each day in port while pumping and standing; and total capitalized vessel costs with applicable interest rates for indebtedness.

The operating cost information required annually is listed on Schedule 310, which is available from the Office of Costs and Rates. Similar vessels within a category should be reported together on the same schedule. Both operating cost information and the number of operating days reported should be for the calendar year ending December 31. When reporting operating days, note that active days are defined as when a vessel or tug/barge unit is in a seaworthy condition, fully manned, and either in operation or standing ready to begin operation.

Port and Cargo Handling Information

Twice a year, port and cargo costs shall be reported for all cargo preference voyages terminated during the period. The report shall identify the vessel, cargo and tonnage, and round trip voyage itinerary including dates of arrival and departure at ports of load and discharge. MARAD will routinely provide reminders listing voyages executed during the period.

THE RATE CALCULATION

The Preference Voyage

The basis for the fair and reasonable rate will be an estimate of the actual preference voyage. In constructing the time required to execute the voyage, MARAD will make several assumptions. The voyage will be assumed to be round-trip from and to the ports designated in the cargo tender and with the return in ballast to a port or port range selected by MARAD as the most appropriate. One-way rates will also be calculated for vessels that are scrapped or reflagged before returning to the U.S. These rates will not include a ballast return. Days in port loading and discharging will be estimated based on specified cargo tender terms with a factor to account for delays and days not worked. The transit time will be calculated utilizing the average speed of vessels in the appropriate vessel category (see below) reduced by a weather delay factor. Additional time will be added for vessel bunkers and canal transits.

Determining Average Costs

Average daily costs will be calculated at least twice a year for vessels in four size categories. All operators reporting costs to MARAD under this program will be informed of the cost averages. Vessel categories are based on the vessel's summer deadweight tons (DWT) and average costs will be determined by category. The categories are:

Category I - Less than 10,000 DWT
Category II - 10,000 - 19,999 DWT
Category III - 20,000 - 34,999 DWT
Category IV - Greater than 35,000 DWT

The Fair and Reasonable Rate

MARAD will routinely calculate rates on both a round-trip and one-way basis. In both cases, the fair and reasonable rate will be the total of four components:

1. Operating Costs
2. Capital Costs
3. Port and Cargo Handling Costs
4. Brokerage and Overhead

Operating Cost Component

To facilitate using current spot market fuel prices when calculating fair and reasonable guideline rates, the operating cost component is divided into two segments: the daily averages of operating costs (except fuel) and average daily fuel costs. The total of the two segments will be multiplied by estimated total voyage days to yield the total operating component for the voyage.

Capital Cost Component

This component includes an allowance for depreciation and interest and a return on equity. The average annual amounts for vessels in the category will be divided by 300 operating days to determine a daily amount. The new vessel allowance and the return on working capital will then be added to the total and the sum multiplied by estimated voyage days to determine the capital cost component used in the fair and reasonable rate calculation.

Port and Cargo Handling Cost

Costs used to determine this cost component will be based on data received on completed cargo preference or commercial voyages and augmented with the most current data from all available sources. Actual cargo tender terms for the commodity, load and discharge ports, and lot size will serve as a basis for calculations.

Brokerage and Overhead

MARAD will add the cost components for operating, capital, and port and cargo handling and multiply that sum by an 8.5 percent allowance for broker's commissions and overhead.

Elements of Operating Cost

ELIGIBLE OPERATING COSTS - SCHEDULE 310 will be added together and divided by the number of operating days for vessels within a category to yield a daily operating cost. The costs will be indexed to the current year.

FUEL COSTS will be determined on the basis of actual fuel consumed at sea and in port. The average daily fuel consumption at sea and in port will be determined for each category. MARAD will use current spot market fuel prices from published sources to produce the fuel segment of the operating cost component.

Elements of Capital Cost

DEPRECIATION will be straight-line based on a 20-year economic life. Vessel acquisitions and capitalized improvements will be depreciated straight-line over the remainder of the 20-year period, but not fewer than 10 years, commencing with the capitalization date for the acquisition or improvements.

INTEREST EXPENSE will be based on debt equal to 75 percent of the owner's original capitalized vessel cost and principal payments made in equal annual installments over the economic life of the vessel. The owner's interest rates will be applied to this constructed debt. For variable interest rates, the owner's rate when the capital cost component is calculated will be used. Where there is no interest rate available or no vessel debt, MARAD will use the ten-year T-bill rate plus one percent.

RETURN ON EQUITY will be based upon a five-year average of recent rates of return for a cross section of transportation industry companies, including maritime companies. Equity used will be the vessels' constructed net book values less constructed principal.

RETURN ON WORKING CAPITAL will be a return on the dollar amount necessary to cover operating and voyage expenses

NEW VESSEL ALLOWANCE will be included for newly built vessels and vessels acquired when five years of age or less. It will equal ten percent of the vessel's capitalized costs during the first year following construction or acquisition and will decline by one percentage point each year, ending when the vessel is ten years old The daily allowance will be the annual amount divided by 300 days.

Typical Port and Cargo Handling Costs

PORT AND CARGO HANDLING COSTS include fees for vessel wharfage and dockage, canal tolls, cargo loading and discharging costs, cargo supervisors employed and other voyage costs associated with transporting the preference cargo. When operators fix preference cargo subject to meeting the fair and reasonable rate standard, they should be prepared to provide MARAD with their estimate of port and cargo handling costs during the rate calculation process. During this process, documentation may be required for unusual costs or unusually high costs.

QUESTIONS AND ANSWERS

Will my guideline rates be lower under the averaging system?

Some guideline rates will be lower under averaging. To measure the impact of averaging, a sample of rates were recalculated under the averaging system and compared to the rates calculated over a several year period under the previous system. For the sample data, 42% of guideline rates went up when the rates were calculated using the category averaging system and 58% went down. However, since guideline rates are a ceiling not a floor, only 12% of fixture rates would have been affected. The affect on your guideline rates will be determined by whether your costs are higher or lower than the average for your category.

Do my filing requirements change under averaging?

MARAD has made some changes to reduce your filing burden. While the information in the annual reporting requirements remain the same under the averaging system, you can now aggregate similar vessels within a size caegory and report the costs on one schedule. Also, operators must submit cost data in the format that conforms with the accounting practices reflected on their trial balance and audited financial statements. Post voyage reporting requirements have changed to a semi-annual filing for voyages completed during the period. Previously reports were due within 60 days after completing each individual voyage.

What happens if I don't file my data with MARAD?

As under the old system, if your data is not on file with MARAD when you bid for a preference cargo, your bid may be considered nonresponsive. When the shipper agencies receive a bid that contains an unfamiliar vessel they typically telephone MARAD to inquire whether the vessel's costs are on file. If you have not submitted data to MARAD and decide to bid on a preference cargo, it is wise to call the Office of Costs and Rates before you submit your bid. You can then file via fax.

When I submit information in the middle of a rate year will the average be recalculated to include my data?

Category averages will be recalculated at least once during the rate year, so your cost information will be included in the averages at some point.

Will my data still be subject to audit?

MARAD reserves the right to audit data it receives. All data received will be carefully reviewed and data that appears out of line could trigger an audit request. However, the revised rule contains a specific reference to having a CPA review information being sent to MARAD and perform an engagement consistent with professional standards. The intent of the new provision is to reduce the need for audits by the Department of Transportation's Inspector General. Data submitted without a CPA review will be subject to periodic audit.

POINTS OF CONTACT

The MARAD staff look forward to working with you. For advice or information, copies of MARAD regulations, or reporting formats concerning fair and reasonable rates, contact the Office of Costs and Rates at:

Mail: U.S. Department of Transportation
Maritime Administration
Office of Costs and Rates
Room 8117
400 7th St., S.W.
Washington, DC 20590
Tel.: (202) 366-2324
Fax: (202) 366-7901

For general questions on Cargo Preference Laws contact:
U.S. Department of Transportation
Maritime Administration
Office of Cargo Preference
Room 8118
400 7th St., S.W.
Washington, DC 20590
Tel: (202) 366-4610
Fax: (202) 366-7901

Or visit MARAD's web site:
http://marad.dot.gov/