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To: Lorraine D. Hunt OIRA ECON GUIDE/OMB/EOP@EOP

cc: Mitchell Daniels/OMB/EOP@EOP, John Graham/OMB/EOP@EOP, Veronica Vargas/OMB/EOP@EOP
Subject: World City America Inc. comments

Attention: Ms. Lorraine Hunt

Dear Ms. Hunt

Herewith comments on the Draft 2003 Report and Guidelines.

Attached pages also being sent by fax.

I am copying these documents to Dr. Graham et al. since they bear directly on, supplement, and reinforce our prior submissions and recent discussions with OMB/OIRA relative to DOT, MARAD, and the Title XI program.

Best Regards,

John S. Rogers,
Chairman & CEO
- A Legal Analysis.pdf

**World City America Inc.**

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April 3, 2003

Ms. Lorraine Hunt
Office of Information and Regulatory Affairs
Office of Management and Budget
NEOB, room 10202
725 17th Street, NW
Washington, D.C. 20503

Dear Ms. Hunt,

We are pleased to submit herewith the following comments on the Draft 2003 Report to Congress on the Costs and Benefits of Federal Regulations, Chapter II, Part 1, Guidelines for regulatory analysis.

We note that the Report deals primarily with regulatory actions in the context of proposed actions, the development of regulations, rule making, etc.

Since the impact of an agency's performance on its own mission and on the public may be affected as much by its internal practices based on its interpretation of applicable regulations as on the regulations themselves, we suggest that, in addition to focusing regulatory analysis on rule-making, proposed actions, alternative approaches, and other aspects of regulatory intervention, the agencies also be urged to apply the Guidelines for Regulatory Analysis to underlying interpretations and assumptions on which prevailing practices are based.

As stated in the OMB's Draft Report to Congress for 2002 (Federal Register, Vol. 67, No. 60, p. 15033, March 28, 2002):

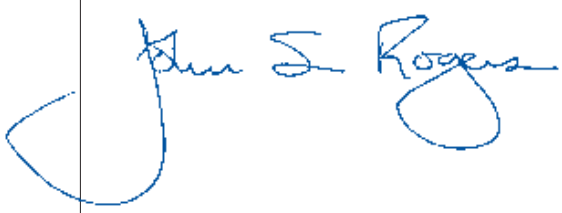
"Agencies also should look back and review existing rules to streamline and modernize those that are outdated, duplicative, ineffective, or unnecessary."

… to which should be added, "a review of how a rule is perceived and interpreted", as well as whether the perceived rule exists at all.

Such a periodic audit of prevailing assumptions also would avoid the stultifying effect of the "because we've always done it that way" syndrome.

The attached memorandum is a case in point, outlining a misconception of statutory law and resulting imposition of a non-existent requirement in the Title XI vessel financing assistance program which threatens to bring the entire program, and the agency infrastructure dedicated to that program and to one of its fundamental missions, to a standstill.

Respectfully submitted,



**Regulatory reform: The key to unlocking the potential of Title XI as an instrument for economic growth —**

***End the practice, not required by law, of conditioning the issuance of 'Letters Commitment' for ship construction loan guarantees on the availability of appropriated funds to cover costs.***

# A LEGAL ANALYSIS

**To:** **The Office of Management & Budget, Office of Information & Regulatory Affairs**

**From:** **World City America Inc.**

**Date:** **April 3, 2003**

*"What we ought to do is make those programs that exist work better."*

*President George W. Bush*

**Contents:**



*"Tear down regulatory barriers to job creation."*

*The President's Small Business Agenda*

| | |
|---|---|
| **I. Name of Regulation:** | **Shipping, Vessel Financing Assistance, Obligation guarantees** |
| **Regulating Agency:** | **Department of Transportation (DOT), Maritime Administration (MARAD)** |
| **Citation:** | **46 CFR Ch. II, Subchapter D, §298.1 et seq.** |
| **Authority:** | **Title XI, Merchant Marine Act, 1936, as amended, 46 App. U.S.C. 1271, et seq. & The Federal Credit Reform Act of 1990, Public Law 101-508, 2 U.S.C. 661a** |

## II. Introduction

### ■ Eliminating a barrier to job creation

Abolishing the unnecessary and burdensome practice of requiring that funds for ship construction loan guarantees be appropriated or scored prior to the issuance of 'Letters Commitment'[1] – a practice based on a misinterpretation of the Credit Reform Act of 1990 as applied to the Merchant Marine Act of 1936 – will:

□ **free** MARAD from an unnecessary constraint that prevents the agency from fully utilizing its resources, personnel, and expertise to work effectively in partnership with the private sector in developing economically sound projects to address significant market opportunities, contribute to national economic growth, and advance the agency's overall mission;

□ **develop** competitive projects, free from political pressure, that will meet stringent cost-benefit criteria in terms of competitiveness and fiscal return to the nation, and, to the extent necessary, attract and justify required Congressional appropriations free from criticisms of 'corporate welfare'; and;

□ **help** strengthen America's economy in keeping with the President's Jobs and Growth Plan by stimulating business investment and spurring new job creation in the merchant marine and maritime industries, which are essential to national trade and security objectives.

This change in practice, which is within the existing authority of the Secretary of Transportation, is rendered all the more necessary by the imminent paralysis of Title XI vessel finance assistance program resulting from the failure, for the first time, of both the White House and Congress to fund for the ensuing fiscal year a program central to the ability of MARAD to perform, much less maximize, its most fundamental mission:

> *"to promote the development and maintenance of an adequate, well-balanced United States merchant marine, sufficient to carry the Nation's domestic waterborne commerce and a substantial portion of its waterborne foreign commerce, and capable of serving as a naval and military auxiliary in time of war or national emergency."*

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1 As recommended in Step #2 of "Six Steps to a New Paradigm for Title XI" submitted to the Office of Management and Budget, and included by OMB in its 2002 Report to Congress on "Stimulating Smarter Regulation". (The complete Six Steps, which also reinforce other national economic growth and competitiveness objectives, are attached as Annex A.)

### ■ Reviving a vital program for America's merchant marine

It is impossible to conceive of a well-balanced merchant marine, or a naval auxiliary, or a maritime manpower base – or, for that matter, a rational maritime policy to administer – without **ships**.

Simply put, the American private sector (for reasons peculiar to the shipping industry) is unable, without a cost-effective financing assistance program, to finance the ships necessary to maintain a meaningful merchant marine or a merchant mariner employment base for either commercial trade or national security requirements, or take advantage of significant market opportunities from the booming cruise market, to creation of a short-sea shipping system (to address escalating domestic highway congestion), to OPA90 double-hull tanker requirements, to renewal of the aging Jones Act fleet.

The Title XI loan guarantee program has been the only such device available to U.S. shipowners (except for outright subsidy programs no longer available), and, aside from some recent high-profile defaults that have generated much of the recent criticism, the program has paid its own way, turned a profit for the nation, and currently accounts for nearly 900 vessels operated by over 90 individual shipowners, creating many thousands of jobs for Americans, ashore and at sea, and a broad range of economic benefits and fiscal returns for the nation.

The change in approach from present practice outlined herein (which is consistent with prevailing law and within the existing authority of the Secretary of Transportation) will place the Title XI program on a new and constructive footing, and permit the continued processing and approval of loan guarantees for economically sound projects to be implemented as funds become available.

## III. Applicable Law

### ■ Summary Statement

There is no basis in law for imposition on the Title XI application review and approval process of a requirement that funds equal to the cost of the projected but as yet uncommitted loan guarantee be appropriated as of the time of issuance of a "Letter Commitment" – as opposed to at the time of the execution of the final commitment to guarantee.

The imposition of this unnecessary requirement, which chills the full potential of the Title XI program for identifying and developing economically sound projects that contribute to national maritime and economic objectives, is based on a misunderstanding of the application of the Credit Reform Act of 1990 to the Merchant Marine Act of 1936, and a confusion of the "Letter Commitment", issued under Title XI regulations, with the Secretary's "commitment to guarantee" provided for in the statute as well as in the regulations.

### ■ The Merchant Marine Act of 1936 (the Act)

Section 1103(a) of the Act (46 App. U.S.C. 1273) authorizes the Secretary of Transportation "to guarantee, and to enter into commitments to guarantee" obligations eligible to be guaranteed under the title (e.g. for financing defined ship construction and shipyard modernization on specified terms), and Sec. 1103(e) provides that

> "Any guarantee, or commitment to guarantee, made by the Secretary under this title shall be conclusive evidence of the eligibility of the obligations for such guarantee…"

The phrases "commitment to guarantee an obligation" and "guarantee of an obligation" are terms of art used repeatedly and consistently in the Act as well as in the regulations applicable to Title XI of the Act (46 CFR II Sec. 298 et seq.) The phrase "Letter Commitment", which appears in the regulations (as discussed below), is not found in the Act.

■ **The Credit Reform Act of 1990**

The Credit Reform Act was enacted in the wake of loan defaults in the Savings and Loan industry, which, since they were backed by government guarantees without corresponding appropriations to cover potential defaults, contributed to the federal deficit beyond the budgetary control of Congressional appropriators.

In order to place limits on the authority of federal agencies to make loans and loan guarantees, Sec. 504 of the Credit Reform Act provides in pertinent part as follows:

> "(b) APPROPRIATIONS REQUIRED – Notwithstanding any other provision of law, new direct loan obligations may be incurred and **new loan guarantee commitments may be made** for fiscal year 1992 and thereafter only to the extent that –
>
> (1) new budget authority to cover their costs is provided in advance in an appropriations Act;
> *(emphasis supplied)*

■ **The question:**

Since one of the federal programs affected by the appropriation requirement of the Credit Reform Act is Title XI of the Merchant Marine Act of 1936 under which the Secretary of Transportation (acting through MARAD) is authorized to commit the federal government to loan guarantees to assist in the financing of ship construction and shipyard modernization, the question arises: **When is a "new loan guarantee commitment…made" under the Merchant Marine Act within the meaning of the Credit Reform Act?**

■ **Title XI regulations:**

The regulations governing the Title XI process (46 CFR II Sec. 298 et seq.) provide for issuance by the Secretary of a "Letter Commitment" as one of a series of steps in the review and approval process. The Merchant Marine Act, 1936 makes no reference to a "Letter Commitment", which is solely a creation of the regulations.

It is clear for the following reasons that the "Letter Commitment" provided for in the regulations does *not* constitute the "commitment to guarantee" referred to in the Merchant Marine Act, and that the latter is the operative commitment contemplated by the Credit Reform Act:

(a) the Letter Commitment provided for in the regulations is not "conclusive evidence of the eligibility" of the project for a guarantee (the *statutory* definition of the operative commitment under the Act), but is conditioned on the applicant's subsequent compliance with specified requirements, and is so defined in the regulations:

> "*Letter Commitment* means a letter from us to you, setting forth specific determinations made by us with respect to your proposed project, as required by the Act and regulations of this part, and stating our commitment to execute Guarantees, subject to compliance by you with any conditions specified therein." (Sec. 298.2 Definitions)

(b) The regulations, and practice under the regulations, distinguish between the term "Letter Commitment" and the statutory term "commitment to guarantee obligations":

> e.g., Sec. 298.43(a):
> "The regulations in this part are effective August 21, 2000, and apply to all applications made, Letter Commitments, Commitments to Guarantee Obligations, or Guarantees issued or entered into on or after August 21, 2000, under section 1104(a) of the Merchant Marine Act, 1936, as amended."

(c) The closings at which commitments to issue guarantees are executed occur at least six weeks after the issuance of a Letter Commitment;

> Sec. 298.2 Definitions:
> "*Closing* means a meeting of various participants or their representatives in a Title XI financing, at which a **commitment to issue Guarantees is executed**, or at which all or part of the Obligations are authenticated and issued and the proceeds are made available for a purpose set forth in section 1104(a) of the Act, or at which a Vessel is delivered and a Mortgage is executed as security to us…
>
> "*Commitment Closing* means a meeting of various participants or their representatives in a Title XI financing at which a **commitment to issue Guarantees is executed** and the forms of the Obligations and the related Title XI documents are also either agreed upon or executed."
>
> Sec. 298.3(f)(5):
> "If we issue you a Letter Commitment, you must submit two (2) sets of the Closing documentation to us for review at least six (6) weeks prior to the anticipated Closing. The six weeks time period will give us time to complete an adequate review of the documentation. You must use our standard form of documentation."

(d) U.S. citizenship requirements must be established on three separate occasions: once prior to issuance of a Letter Commitment (Sec. 298.10[b]), once prior to the Commitment Closing (Sec. 298.10[c][1]), and again on the date of the Closing (Sec. 298.10[c][2]).

(e) Among the formal Closing documentation required to be submitted at least six weeks prior to Closing is "Document 1 - Commitment to Guarantee Obligations by The United States of America", the detailed form of which is set forth on MARAD's Web site under "Title XI Closing Documentation".

The misconception over application of the Credit Reform Act to the Title XI program, stemming from the differing uses of the word "commitment", also is embodied in the description of the program on MARAD's web site, which states:

> "Under the Federal Credit Reform Act of 1990, appropriations to cover the estimated costs of a project must be obtained prior to the issuance of any approvals for Title XI financing." ***
>
> "If the application is approved, a letter commitment to guarantee the obligations will be issued, stating the requirements necessary for closing."

■ **Conclusion:**

Under the Credit Reform Act of 1990, no appropriation against the cost of a prospective loan guarantee is required prior to the making of a loan guarantee commitment, and such commitment under the Merchant Marine Act of 1936 does not occur on the issuance of a Letter Commitment or at any time

prior to execution of a "Commitment to Guarantee Obligations by The United States of America" at a Commitment Closing.

## IV. Summary Cost-Benefit Advantages

Ending the current practice of conditioning issuance of a Letter Commitment on availability of appropriated funds, in light of current administration and Congressional unwillingness to provide advance appropriations for as yet unknown and unapproved projects:

■ will **encourage private sector investment** in the development of new projects that would create new job opportunities, contribute to economic growth, and warrant government financing assistance and appropriation of funds once fully reviewed and approved;

■ will mobilize, harness, and **optimize existing MARAD resources** to work in partnership with the private sector in developing and perfecting economically sound projects for the national benefit;

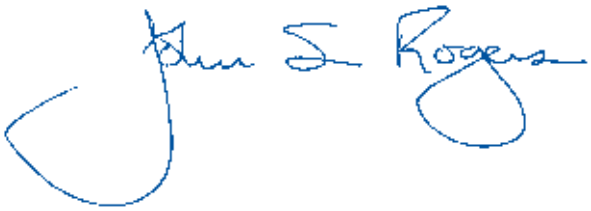
■ will **reduce private sector costs** by eliminating a system under which the great majority of applications, however worthy, and representing significant investment, time, and effort, are frustrated by denial of approval based solely on the absence of advance "blind" appropriations for the Title XI program generally;

■ will **reduce public sector costs** (a) by optimizing the use of MARAD personnel and organizational resources in fully developing projects that fulfill the agency's mission, rather than restricting their potential to projects sustainable by pre-existing appropriations, and (b) by not prematurely allocating ("scoring") appropriated funds, at time of issuance of the Letter Commitment, to projects which may never receive a formal Commitment to Guarantee Obligations (a result which, in the recent past, has tied up major portions of funds appropriated for the Title XI program [e.g. WAK Engineering, and COSCO]);

■ will **minimize government risk** by imposing conditions in the Letter Commitment that will enhance economic soundness, including in conformity with recent DOT Inspector General recommendations, while at the same time assuring the applicant, on the basis of a detailed and continuing MARAD review and oversight, of issuance of a loan guarantee once such conditions are satisfied and appropriated funds become available;

■ **will convert the Letter Commitment from a premature obstacle to industrial development, to a detailed "road map", arrived at in the spirit of public-private partnership, for productivity, competitiveness, access to sound market opportunities, and economic growth.**

Respectfully submitted,



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## SIX STEPS TO A NEW PARADIGM FOR TITLE XI...
## all within the existing authority of the Secretary of Transportation

**Focus on market-driven growth**

**1.** Prioritize projects according to contribution to market-driven economic growth in investment, jobs, and tax revenues, and to other policy goals (*step 4 below*). Require an Economic Growth Impact Statement.

**Revise sequencing**

**2.** Reverse sequence of steps for large projects meeting economic growth criteria: **First – Commitment:** based on a detailed preliminary showing, the applicant receives a conditional Letter Commitment for issuance of a loan guarantee upon strict compliance with specified technical, contractual, and economic criteria — rather than requiring applicant to bear the cost of fully establishing more burdensome criteria up front without any assurance of ultimate approval; **Second – Compliance:** the Government's unconditional commitment would thereafter become effective upon issuance by the Secretary of a "Letter of Compliance" (formalization of a step already contemplated by the regulations[1]); and **Third – Funding:** Congressional funding under the Credit Reform Act would be made on the basis of fully approved projects — not unlike defense appropriations for weapons systems — rather than as blind funding for unspecified future projects (alternatively, defer "scoring" against prior appropriations to issuance of the "Letter of Compliance") [2].

**Require cost competitiveness**

**3.** Prevent use of Title XI as a "subsidy" for shipyards by requiring that ship construction cost (a) be proved by executed contracts as a condition to issuance of the "Letter of Compliance" (as opposed to permissible use of estimates under existing regulations); and (b) qualify for a guarantee (i.e. up to 87.5%) only to the extent that the construction cost is competitive (e.g. based on a formula for comparison with European yard costs, but exclusive of direct and indirect foreign subsidies).

**Incorporate parallel national policy goals**

**4.** Require applicant impact statements detailing the extent of project contributions in areas such as strengthening the industrial base, energy conservation and alternative sources, and environmental protection; Require agency showing of compliance with the criteria of the **President's Management Agenda** (performance and results-oriented, citizen-centered, market-based, and cooperative spirit of public-private partnership), and **Federal Regulatory Reform** ("smart regulation, quality regulation," elimination of barriers to job creation). **E-Government:** Disseminate program criteria, pro-forma schedules, and terms of Letters Commitment issued for approved projects on the Internet as guidance for applicants, agency staff, and other government branches and departments.

**Support complementary policies and legislation**

**5.** The Department of Transportation and MARAD should promote maritime policy and legislative initiatives, within the administration and with Congress, that enhance U.S. markets for American products (e.g. for an American-flag cruise industry: enforcement of antitrust laws against concentration in foreign-flag fleets, strict enforcement of coastwise laws [the Passenger Vessel Services Act] to curtail foreign-flag encroachment in protected domestic markets, and changes in laws on depreciation, on tax deductibility for shipboard meetings, and to extend of the Capital Construction Fund [CCF] to vessels performing contiguous coastwise domestic itineraries).

**Advocate non-federal contribution to cost of Title XI**

**6.** Endorse an amendment to appropriation legislation (ruled budget neutral by the Congressional Budget Office) to reduce the cost of the Title XI program by allowing contributions from other sources to supplement federal appropriations.

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1 46 CFR Sec. 298.2(n): "Letter Commitment means a letter from the Secretary to an applicant...stating the Secretary's commitment to execute Guarantees, subject to compliance with any conditions specified therein." Such conditions subsequent are commonplace in Title XI practice.

2 This sequencing of appropriation (or scoring) on or after issuance of the "Letter of Compliance", rather than as of issuance of the Letter Commitment (as is the present unnecessary practice), is completely consistent with the statute, the existing regulations, and the Credit Reform Act, as outlined in the foregoing Legal Analysis.