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**AMERICAN
SHIPBUILDING**
ASSOCIATION

Statement of

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President

American Shipbuilding Association

Before the

House Armed Services Committee

Subcommittee on Seapower and Expeditionary Forces

March 20, 2007

Thank you, Mr. Chairman, Members of the Subcommittee, for holding this hearing on shipyard modernization initiatives and ship cost reductions.

The American Shipbuilding Association (ASA) is the national trade association of the six largest shipbuilders in the United States that build all of the capital ships for the U.S. Navy, and more than 70 companies that design and manufacture major ship systems and components. A membership list is attached.

Persistently low and unstable rates of naval ship production have taken a tremendous toll on the shipbuilding industrial base that is vital to our national defense. Since 2001, the Navy's fleet has plunged from 341 battle force ships to a 90 year low of just 276 ships today. Production rates of five capital ships a year, combined with ever changing program schedules and profiles, has presented U.S. shipyards with tremendous challenges in trying to manage workload to sustain our highly skilled engineering and production workforce, in having the ability to make investments in our facilities and processes, and in managing our day-to-day operations to ensure maximum efficiency in the design and construction of ships.

Put simply, there is no substitute for volume production in reducing the cost of every ship we build and in maximizing capital investments by our industry.

Even though we have struggled in an anemic production environment for many years, the shipyards have made and continue to make huge capital investments. Recent and on-going investments well exceed one billion dollars. These investments include the latest in automated design tools, covered facilities, an automated 4" steel cutting facility, facilities for constructing larger modules, cranes for increasing lift capability for larger modules, laser cutting equipment, state-of-the art panel lines, new and expanded power grids, and heavy moving equipment.

If asked, every shipbuilder would tell you that more capital investments in processes and facilities would increase efficiency and further reduce costs. Their ability to do so, however, depends on their cash flow, work projections, and profits to demonstrate a return on such

investments to their corporate parents. The current business environment for shipbuilding makes the corporate return on investment business case difficult to make given competing corporate interests and needs. Corporate investment dollars favor the facilities that have the largest profit margins and that show a growing order book.

Where shipyards may not be able to make the corporate return on investment business case, there are many investments that could be made in the shipyards that would show a very favorable return on investment to the Government. To make such investments possible, the American Shipbuilding Association asks you to consider legislation that would require the Navy to expand the use of “special incentive” fees in all Navy shipbuilding contracts for the purpose of investing in facilities and process improvements where the business case is made that the investment will result in a favorable return to the Navy.

The legislation we ask you to consider is a modified and expanded version of the current Capital Expenditure Program, or CAPEX, included in the *Virginia* Class Submarine contract. The CAPEX program provides for incentive fees to be awarded to the shipyards for the purpose of investing in facilities and process improvements if they make the case that such investments will result in savings in the program greater than the amount of the investment.

For example, an incentive fee award of \$7 million to Newport News Shipbuilding to invest in a second Modular Outfitting Facility will result in an estimated savings of approximately \$34 million in cost the *Virginia* Class Submarine Program. An investment of \$9 million by Electric Boat in a new coating facility at its Quonset Point shipyard will save an estimated \$140 million in the Program.

ASA recommends that the Navy include in all shipbuilding programs money for incentive fees for the purpose of capital investments if the contractor makes the business case that: 1) savings through changes in the design, material used, technology, or production process

would result in savings in the ship program, or; 2) a proposed investment itself would result in savings in a shipbuilding program or programs.

The proposed legislation recommends a fiscal year 2008 authorization and appropriation of \$100 million as seed money for contract incentive fees. It would direct the Navy to report back to Congress no later than May 1, 2008, on how the Navy has distributed or plans to distribute the \$100 million provided in FY08 for specific capital expenditures by shipbuilding program. It further provides that the Navy would budget annually money in all shipbuilding programs to provide incentive fees for the purpose of capital investment beginning in fiscal year 2009. Funding requested for incentive fees for this purpose would be required to be identified by the Navy by ship program concurrent with future budget submissions to the Congress.

This legislative proposal, which is attached to my statement, would reduce costs to the Navy by: 1) Emphasizing designs that translate into ships that are easier to produce; 2) Helping to control non-value requirement changes that add cost but are not operational necessities; 3) Reducing the costs of ship programs as a result of targeted investments, and; 4) Improving the competitiveness of shipyards in building both naval and commercial ships, which could in turn increase the number of ship orders in U.S. shipyards.

Withholdings and Retentions:

I would also like to bring to the Subcommittee's attention a Navy practice of withholding and retaining earned payments to the shipyards that hurt our efficiency.

Cash flow is vital to the day-to-day operations of the shipyards and to their ability to pay their subcontractors in a timely fashion. Today, there is more than \$345 million being withheld or retained by the Navy in owed payments to the six shipyards as agreed to in their respective shipbuilding and overhaul contracts.

When shipyards do not receive payment on work performed in keeping with the schedule and terms of their contracts, their ability to operate efficiently can be significantly impaired. The

operations of major ship system and component manufacturers also suffer as payments to them are delayed. Should the shipyards be forced to borrow money to meet their financial day-to-day operating obligations, the interest costs associated with such loans are not billable to Navy contracts.

I urge the Subcommittee to consider legislation, which is attached, that would require the Navy to abide by the terms of its payment clauses and contracts as negotiated with each shipyard to ease a cash flow constraint that is unnecessarily being imposed on the industry. A question frequently asked is: "Why don't the shipyards go to court?" The policy and practice of most shipyards is to avoid if at all possible taking a dispute with the Navy to court since such action could halt work on ships and severely damage the working relationship with their predominant, if not only, customer. Action by the Congress, however, directing the Navy to abstain from this practice would solve the problem, or at a minimum, make the practice rare and significantly reduce the dollar value of payments withheld. Furthermore, it is in the Navy's own interest that the practice be stopped so that the shipyards have the cash flow to operate efficiently in building ships for the Navy.

Enforce U.S. Ship Acquisition Laws:

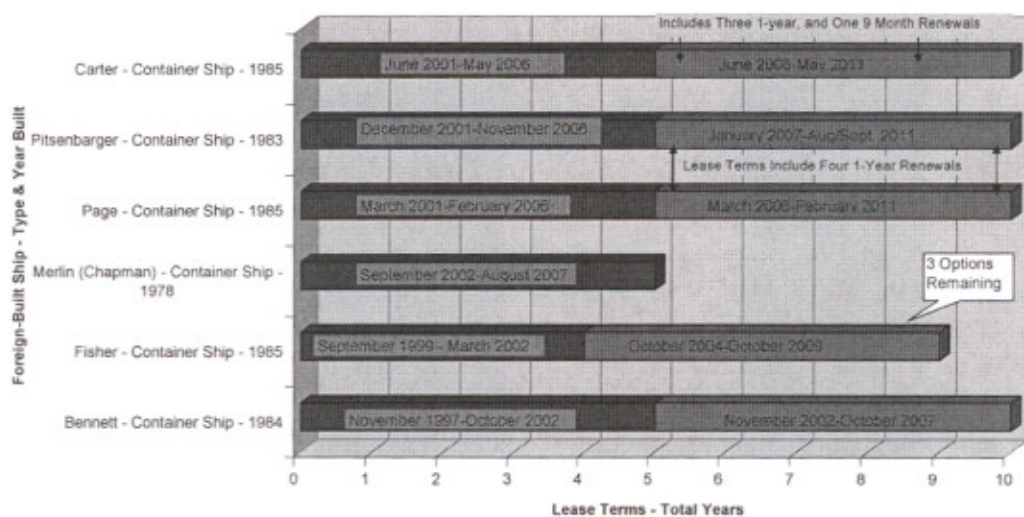
As stated earlier, there is no substitute for volume ship production in reducing the costs of ships.

Our industry does not propose that ships be budgeted or funded if there is no national defense requirement. However, when a long-term, dedicated military ship requirement exists, it should be filled by ships built in the United States in keeping with the letter and spirit of U.S. acquisition laws.

Ship production in the United States will not increase if DOD is allowed to meet its requirements by outsourcing shipbuilding to foreign shipyards by using long-term leases as a means to acquire foreign-built ships to meet dedicated military sealift and other missions.

As the chart below shows, there are six foreign-built ships that DOD is leasing for the purpose of prepositioning military equipment and ammunition. The terms of all of these leases is 59 months, including options. Five of the ships have had their 59 month leases renewed for an additional 59 months. This means that at the end of the contract period these ships will have been in continuous service to the military for two months shy of 10 years. Clearly, a long-term requirement exists for dedicated sealift ships. A long-term lease is a de facto purchase.

U.S. Dependence on Foreign-Built Ships



Source: American Shipbuilding Association; U.S. Navy Military Sealift Command

Section 7309 of Title 10 U.S. Code states that a vessel purchased for all branches of the Armed Forces shall be built in the United States. The Budget Enforcement Act of 1990 resulted in regulations defining a vessel lease of five years or more as a purchase.

Because these leases are one month shy of five years, they are not ruled as purchases in violation of the Budget Enforcement Act or U.S. acquisition laws. However, the practice of having a foreign-built ship under continuous service to the Department of Defense for almost ten years should by the definition of government regulations be classified as a purchase.

If DOD is permitted to outsource a portion of its dedicated military fleet to foreign shipyards, the cost of the ships DOD does buy from U.S. shipyards will increase as volume in the shipyards and throughout the defense manufacturing base is reduced.

My industry commends Chairman Gene Taylor and Congresswoman Jo Ann Davis for sponsoring legislation to limit the lease terms of foreign-built ships to a period of no longer than two years. This legislation would grandfather the foreign ships that have already been converted from commercial ships to military auxiliary ships that are presently being used by DOD. It would, however, going forward remove the economic incentive of a foreign ship owner to invest in the conversion of a used, commercial ship to a military ship in the absence of an assured 59-month lease to recover that investment.

Congress established the National Defense Sealift Fund in 1990 for the express purpose of providing a fund where all services could budget for the construction of ships in the United States to meet their dedicated strategic sealift needs.

ASA urges Congress to include the Taylor/Davis legislation in the fiscal year 2008 National Defense Authorization Act, and asks that this Subcommittee encourage DOD to budget in the National Defense Sealift Fund in its fiscal year 2009 budget submission to Congress funds for the construction of the ships it needs for strategic sealift.

Thank you for your consideration of these recommendations to strengthen the shipbuilding industry.

Membership of the American Shipbuilding Association

Shipyards

Avondale

New Orleans, LA

Bath Iron Works Corporation

Bath, ME

Electric Boat Corporation

Groton, CT

Quonset Point, RI

Ingalls Shipbuilding

Pascagoula, MS

National Steel & Shipbuilding Co.

San Diego, CA

Newport News Shipbuilding

Newport News, VA

Partners

Advanced Structures Corp.

Deer Park, NY

American Bureau of Shipping

Houston, TX

American Iron & Steel Institute

Washington, DC

American Metal Bearing Co.

Garden Grove, CA

AMSEC

Virginia Beach, VA

San Diego, CA

APEX Steel Corp.

Englewood, NJ

ATSCO

Mentor, OH

AVEVA Inc.

Wilmington, DE

Baker Sheet Metal Company

Norfolk, VA

BWXT

Lynchburg, VA

Idaho Falls, ID

Mt. Vernon, IN

Barberton, OH

Communications Company, DRS

Wyndmoor, PA

Converteam Inc.

Pittsburgh, PA

Curtiss-Wright Flow Control Corp.
Cheswick, PA

D.G. O'Brien, Inc.
Seabrook, NH

Dresser-Rand
Olean, NY
Painted Post, NY
Wellsville, NY
Houston, TX

DRS Technologies
Parsippany, NJ

Earl Industries, LLC
Portsmouth, VA

EBC Industries
Erie, PA

**Electric Power Technologies, Inc.,
DRS**
Hudson, MA

Electronic Systems Inc., DRS
Gaithersburg, MD

EMS Development Corporation
Yaphank, NY

ESAB Welding & Cutting
Florence, SC

Fairbanks Morse
Beloit, WI

Flo-Tork, Inc.
Orrville, OH

G. E. Marine
Cincinnati, OH
Lynn, MA

General Atomics
San Diego, CA
Tupelo, MS

General Cable Corp.
Highland Heights, KY

Guill Tool & Engineering Co., Inc.
West Warwick, RI

Henschel
Newburyport, MA

Hose-McCann Telephone Co.
Deerfield Beach, FL

IMECO, Inc.
Iron Mountain, MI

IMO Pump
Monroe, NC
Columbia, KY

International Paint
Houston, TX
Union, NJ

Jamestown Metal Marine Sales
Boca Raton, FL

Jered LLC
Brunswick, GA
Iron Mountain, MI

L3 Communications Marine Systems
Leesburg, VA

L3 Communications
New York, NY

Lasercut, Inc.
Branford, CT

Laurel Technologies, DRS
Johnstown, PA

Lister Chain & Forge, Inc.
Blaine, WA

Marlo Coil
High Ridge, MO

Marotta Controls, Inc.
Montville, NJ

Motion Industries, Inc.
Birmingham, AL

Nelson Stud Welding, Inc.
Elyria, Ohio

ODI Advanced Technology Systems
Daytona Beach, FL

Oil States Industries
Arlington, TX

Pacific Consolidated Industries
Riverside, CA

PacOrd
San Diego, CA

PCE
San Diego, CA

Portland Valve, Inc.
South Portland, ME

Power & Control Technologies, DRS
Danbury, CT
Milwaukee, WI

Power Paragon
Anaheim, CA

Power Technology Inc.
Fitchburg, MA

Raytheon Integrated Defense Systems
Tewksbury, MA

Rolls-Royce Naval Marine
Walpole, MA
Pascagoula, MS
Annapolis, MD

Sargent Controls & Aerospace
Tucson, AZ

The Sherwin-Williams Company
Cleveland, OH

SPD Electrical Systems
Philadelphia, PA

Sperry Marine
Charlottesville, VA

**Surveillance Support Systems,
DRS**
Largo, FL

Tano/EDI
Metairie, LA

Technical Services, DRS
Chesapeake, VA
San Diego, CA

TECO-Westinghouse Motor Co.
Round Rock, TX

**Training & Control Systems, Inc.,
DRS**
Ft. Walton Beach, FL

Tyco Electronics
Harrisburg, PA

UCT Coatings, Inc.
Stuart, FL

US Joiner
Waynesboro, VA

U.S. Pioneer, Inc.
Tulsa, OK

VACCO Industries
South El Monte, CA

Village Marine
Gardena, CA

Waggaman Crane Services
Waggaman, LA

Warren Pumps
Warren, MA

Wartsila Lips, Inc.
Chesapeake, VA

Westwood Corp.
Tulsa, OK

Winchester Roll Products, Inc.
Winchester, NH

W & O Supply Inc.
Jacksonville, FL

York International
York, PA

NATIONAL DEFENSE AUTHORIZATION ACT FOR FISCAL YEAR 2008
DIVISION A—DEPARTMENT OF DEFENSE AUTHORIZATIONS
TITLE I—PROCUREMENT
SUBTITLE C—NAVY PROGRAMS
SEC. 12X. CAPITAL EXPENDITURE INCENTIVES IN NAVY VESSEL
CONSTRUCTION CONTRACTS FOR ALL CLASSES OF SHIPS AND
SUBMARINES.

(a) **DIRECTIVE TO INCLUDE CONTRACTUAL INCENTIVES.**—*The Secretary of the Navy shall provide and budget for capital expenditure incentives to support investment in shipyard facilities and process improvements in current and future Navy vessel construction contracts under a vessel program, for all classes of ships and submarines, where the Secretary approves a fully supported business case analysis submitted to the Navy by a contracting shipyard for—*

(1) *a proposal intended to create savings in vessel program construction costs through alterations in the design, material, technology, or manufacturing process of the vessel program being contracted for construction; or*

(2) *a proposal intended to create savings in vessel program construction costs as a result of investment in shipyard facilities and process improvements.*

(b) **CONSIDERATION AND APPROVAL OF SUBMITTED PROPOSALS.**—*Pursuant to paragraph (a), the Secretary shall take into consideration any such business case analysis and proposal demonstrating a projection of favorable return on investment to the Navy. The Secretary shall then provide the contracting shipyard a full, fair, and good faith written evaluation of any such business case analysis and proposal not later than 60 days after the date of submission, and shall base approval of any such proposal upon determination by the Secretary that the proposal is sound and therefore in the best interests of the vessel program under the contract.*

(c) **PROHIBITION AGAINST CIRCUMVENTING INCENTIVES.**—*The Secretary shall not allow circumvention of contractual capital expenditure incentives through change orders or any other contractual instrument, device, or exercise of any option seeking benefit for the Navy from any element of a proposal submitted by a contracting shipyard under this section that is not approved by the Secretary, nor shall the Secretary disapprove of a proposal solely on the basis that a related project was initiated prior to the proposal's submission.*

(d) **AUTHORIZATION OF APPROPRIATIONS.**—*Funds are hereby authorized to be appropriated for fiscal year 2008 for capital expenditure incentives to support investment in shipyard facilities and process improvements in Navy vessel construction contracts for all classes of ships and submarines in the amount of \$100,000,000.*

(e) **REPORTING REQUIREMENT.**—*Not later than May 1, 2008, the Secretary shall submit to the Committees on Armed Services of the Senate and the House of Representatives a report on the amounts that have been and that are planned to be contractually allocated by the Navy to fund capital expenditure incentives, as authorized to be appropriated by paragraph (d) and pursuant to paragraph (a).*

(f) **ANNUAL BUDGETING REQUIREMENT.**—*The Secretary shall submit as part of the Navy's overall budget request to the Committees on Armed Services of the Senate and the House of Representatives the amounts specifically requested by the Navy*

for each Navy vessel program pursuant to paragraph (a) for fiscal year 2009 and annually thereafter.

(g) IMPLEMENTING REGULATIONS.—The Secretary shall promulgate any regulations necessary to implement this section not later than 180 days after the date of the enactment of this Act.

NATIONAL DEFENSE AUTHORIZATION ACT FOR FISCAL YEAR 2008
DIVISION A—DEPARTMENT OF DEFENSE AUTHORIZATIONS
TITLE I—PROCUREMENT
SUBTITLE C—NAVY PROGRAMS
SEC. 12X. WITHHOLDINGS AND RETENTIONS.

(a) *DEFINITIONS.*—For purposes of this section, a “withholding”, as it relates to a payment based upon percentage of completion of construction or overhaul of a Navy vessel, is defined as any difference between the actual amount approved for payment and the amount determined by multiplying one hundred percent of the allocated total contract price for such vessel by the percentage of physical progress or completion of the vessel. Also for purposes of this section, a “retention” is defined as any amount less than one hundred percent of the allocated total contract price of a Navy vessel that is not paid by the Navy to a shipyard for the construction or overhaul of such vessel after delivery of the vessel to the Navy.

(b) *PROHIBITION AGAINST WITHHOLDINGS.*—The Secretary of the Navy shall not allow any withholding, nor the placement of any conditional requirement by the Navy on the release of any earned payment based upon percentage of completion of construction or overhaul of a Navy vessel.

(c) *LIMITATION ON RETENTIONS.*—The Secretary shall not allow any retention beyond the lesser of the expiration of a contractual guaranty period or one year after the vessel is delivered to the Navy, nor the placement of any conditional requirement by the Navy on the release of any retention.

(d) *PROHIBITION AGAINST COMPENSATORY ADJUSTMENTS.*—Neither the rates of payments based upon percentage of completion of construction or overhaul, nor guaranty retentions shall be affected by the timely release of withholdings and retentions resulting from the enactment of this Act.

(e) *REPORTING REQUIREMENT.*—Upon the enactment of this Act and then again upon the passage of every six-month period thereafter, the Secretary shall submit to the Committees on Armed Services of the Senate and the House of Representatives a report describing the precise amounts of current Navy withholdings and retentions in the construction and overhaul of Navy vessels.

(f) *IMPLEMENTING REGULATIONS.*—The Secretary of Defense shall promulgate any regulations needed to implement this section not later than 180 days after the date of the enactment of this Act.

NATIONAL DEFENSE AUTHORIZATION ACT FOR FISCAL YEAR 2008

TITLE ___ GENERAL PROVISIONS

SUBTITLE ___ POLICY RELATING TO SHIPYARDS AND VESSELS

Sec. ____ . LIMITATION ON LEASING OF FOREIGN-BUILT VESSELS

(a) IN GENERAL –

(1) Chapter 141 of title 10, United States Code, is amended by inserting after section 2401a the following new section:

‘Sec. 2401b. Limitation on lease of foreign-built vessels

(a) LIMITATION – The Secretary of a military department may not make a contract for a lease or charter of a vessel for a term of more than 24 months (including all options to renew or extend the contract) if the hull or a component of the hull, or superstructure of the vessel is constructed in a foreign shipyard.

(b) PRESIDENTIAL WAIVER FOR NATIONAL SECURITY INTEREST –

(1) The President may authorize exceptions to the limitation in subsection (a) when the President determines that it is in the national security interest of the United States to do so.

(2) The President shall transmit notice to Congress of any such determination, and no contract may be made pursuant to the exception authorized until the end of the 30-day period beginning on the date on which the notice of the determination is received by Congress.’

(2) The table of sections at the beginning of such chapter is amended by inserting after the item relating to section 2401a the following new item:

‘2401b. Limitation on lease of foreign-built vessels.’

(b) EFFECTIVE DATE – *Section 2401b of title 10, United States Code, as added by subsection (a), shall apply with respect to contracts entered into after the date of the enactment of this Act.*