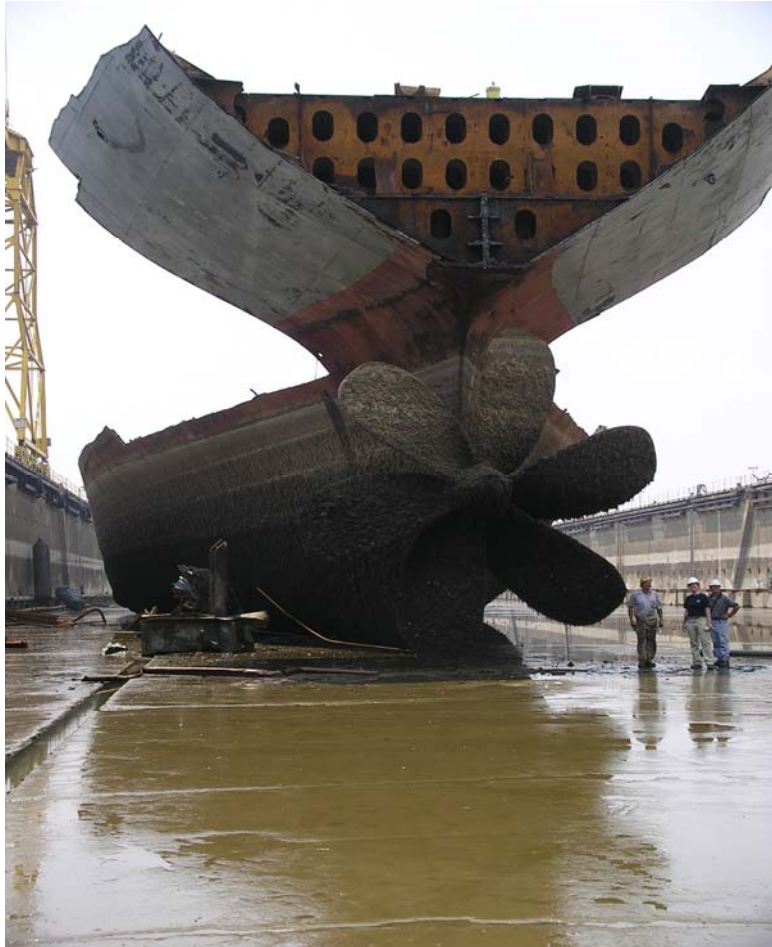


REPORT TO CONGRESS ON THE PROGRESS OF THE VESSEL DISPOSAL PROGRAM

January 2007



**U.S. DEPARTMENT OF TRANSPORTATION
MARITIME ADMINISTRATION**

TABLE OF CONTENTS

INTRODUCTION	1
I. MARITIME ADMINISTRATION ACCOMPLISHMENTS AND ACTIVITIES IN FISCAL YEAR 2006.....	1
New Program Challenge – Aquatic Nuisance Species	2
Able U.K. Contract for Foreign Recycling.....	3
Ship Disposal Funding	4
Ship Disposal Contracts	4
Transfer of Ships to the Navy for Disposal	5
Comprehensive Management Plan	5
Performance Measures	7
Program Progress in FY 2006	9
Ship Disposal Alternatives	12
Conclusions	15
II. PROGRESS OF THE U.S. NAVY’S VESSEL DISPOSAL PROGRAM ...	18
Introduction	18
Navy-Titled Obsolete vessels in the Maritime Administration National Defense Reserve Fleet	18
Accomplishments Since October 2005	18
Domestic Ship Dismantling	19
Navy Sink Exercises	19
Artificial Reefing	20
Remaining Inventory	21
Navy/MARAD Cooperation	21
Planned Activities	21
Conclusions	22
III. APPENDICES	
Appendix I: Table 1 – Navy Obsolete Vessels in the MARAD National Defense Reserve Fleet designated for disposal	24
Appendix II: Table 2 – Ship Disposal Project Task Order Status FY 99 Contract	25
Appendix III: Table 3 – Ship Disposal Project Task Order Status FY 05 Contract	27

Report to Congress on the Progress of the Vessel Disposal Program

INTRODUCTION

This report is submitted pursuant to the following statutory direction:

- The Senate Report [109-109, July 26, 2005] accompanying the Transportation, Treasury, Housing and Urban Development, the Judiciary, the District of Columbia, and Independent Agencies Appropriations Act, 2006, P.L.109-115; 119 Stat 2396 (2005), which requires periodic reporting on the progress made by the Maritime Administration (MARAD) to dispose of the entire inventory of obsolete ships within the National Defense Reserve Fleet (NDRF).
- The National Defense Authorization Act for Fiscal Year 2006, P.L. 109-163; Section 3505(a)(f), 119 Stat, 3552 (2006), which requires periodic reporting by the Secretary of Transportation, in coordination with the Secretary of the Navy, on progress made in implementing plans to dispose of obsolete ships in its program.

In Section I, this consolidated program report summarizes MARAD's ship disposal accomplishments in Fiscal Year (FY) 2006 and outlines the current ship disposal challenges and plans for FY 2007 and beyond. A review of the previous reports of the Ship Disposal Program, hereafter referred to as the Program, provide a historical perspective prior to FY 2006. In coordination with the Secretary of the Navy, this Report also includes in Section II the progress of the U.S. Navy's vessel disposal program.

I. MARITIME ADMINISTRATION ACCOMPLISHMENTS AND ACTIVITIES IN FISCAL YEAR 2006

Overview

The Floyd D. Spence National Defense Authorization Act for Fiscal Year 2001, Pub. L. 106-398, § 3502, 114 Stat. 1654 (2000) (the Act), required the disposal by September 30, 2006, of all vessels in MARAD's NDRF that were not assigned to the Ready Reserve Force or otherwise designated for a specific purpose. In 2001, MARAD established the Program to accomplish the requirements of the Act. Since the establishment of the Program, MARAD has aggressively pursued all feasible disposal alternatives including artificial reefing, deep-sinking, donation and sale of ships for recycling and reuse, and the potential for foreign recycling. Because of significant capacity limitations within the domestic recycling industry at the time, it became apparent at the start of the Program in 2001 and 2002 that conventional domestic dismantling, as the predominant means of disposal, was not adequate to dispose of all of MARAD's non-retention vessels by the September 2006 deadline as required by the Act. The domestic recycling industry continues to have a very limited capacity despite the fact that MARAD has qualified eight domestic facilities to compete for

recycling contracts, seven of which have been awarded contracts by MARAD. To date, the eighth facility has not been competitive from a best-value standpoint. The domestic ship recycling industry is heavily dependent on the supply of MARAD and Navy ships, thus capacity is a concern if budgets for ship disposal are not consistent and contractors experience large variations in workload that cause them to lay off trained and skilled workers.

At this time, due to statutory constraints contained in the Toxic Substances Control Act (TSCA) and other environmental statutes, foreign disposal of obsolete vessels is not a commercially practicable option. This is primarily due to the general TSCA prohibition on the export of polychlorinated biphenyls (PCBs) and the amount of time necessary to complete the formal Environmental Protection Agency (EPA) rulemaking process to gain an exemption to export MARAD's obsolete vessels containing PCBs.

In spite of the removal of 72 ships for disposal from MARAD's fleet sites from 2001 through FY 2006, there are currently 118 vessels in NDRF designated as obsolete that are not yet under contract for disposal. As the disposal agent for federally owned commercial type ships MARAD continually receive non-retention ships into the disposal inventory. An average of 13 ships per year is added to the disposal queue. Even with the significant progress made, MARAD was unable to achieve the requirements of the Act by the statutory deadline of September 30, 2006, which was first reported to the Congress in 2002. Insufficient domestic capacity, the lack of any active and qualified recycling facilities on the West Coast, and the lack of access to foreign recycling have limited the number of ships that can be disposed of annually. Even with the increases since 2003, domestic recycling capacity remains limited in spite of continued robust market demand for ferrous and non-ferrous scrap by both domestic and foreign smelters and record high prices for scrap steel that have been steadily climbing for the last 3 years. Reduced reliance on domestic conventional dismantling as the primary means of disposal will be necessary for MARAD to achieve the expedited disposition of the remaining vessels in the NDRF inventory, including additional vessels that are scheduled for disposal on a year-by-year basis.

New Program Challenge – Aquatic Nuisance Species

In addition to challenges associated with limited industrial capacity, MARAD faced a new challenge in FY 2006 that has significant budget and disposal rate implications for the foreseeable future. The MARAD was notified by the U.S. Coast Guard (USCG) late in the first quarter of FY 2006 that MARAD obsolete ships were required to comply with 33 CFR Part 151, Subpart D (pertaining to aquatic hull growth), which became effective in September 2004. While the regulation applies to "operating vessels" only, the USCG expanded the definition to include all vessels, including MARAD's non-retention ships that are not operational, and that will only be towed to a recycling facility for disposal. The USCG interpretation is meant to address the potential that the movement of ships for disposal via towing could serve as a vector for transmitting aquatic invasive species within the United States. Because the USCG denied the issuance of towing certificates needed to tow its vessels to recycling facilities until hull cleaning is accomplished, MARAD is incurring significant additional costs associated with regulatory compliance through the use of mechanical hull cleaning methods to mitigate the potential risk of invasive species transfer

for all ships prior to towing. This interim mitigation was agreed to by the USCG while MARAD developed a programmatic plan for defining and reducing the risk of transferring non-native aquatic nuisance species. The programmatic plan is currently in development. Because there is little known about the risks of transferring aquatic species by hull fouling, MARAD has undertaken research to identify potential invasive species on its vessels, risks related to various disposal alternatives, and possible mitigation measures appropriate to identified risks.

Because of these enforcement decisions by the USCG, MARAD is faced with significant hull cleaning mitigation actions that have delayed the removal of ships from our fleet sites and added significantly to ship disposal costs in FY 2006. Mitigation and testing costs to date have averaged approximately \$80,000 per ship for an estimated annual cost of \$2 million and the potential exists for even greater costs if research shows that the interim hull cleaning measures currently in effect do not sufficiently reduce the risk of invasive species transfer.

An additional consequence of vessel hull cleaning actions by MARAD in California is a recent legal challenge by the San Francisco Bay Regional Water Quality Control Board (Board) alleging that MARAD's in-water hull cleaning violates the Clean Water Act and requires permitting by California State and/or regional water control boards. The MARAD is in discussions with the Board to determine whether MARAD hull cleaning activities are subject to additional regulatory requirements at the State or local level. Additional significant costs and vessel removal delays are possible with the addition of significant requirements.

AbleUK Contract for Foreign Recycling

In FY 2003, MARAD awarded a contract to export 15 ships (including two vessels to be transferred in a barter exchange agreement) to a qualified facility in the United Kingdom (UK). With four of the ships already in the UK the Sierra Club and the Basel Action Network sued, alleging that MARAD and EPA had violated the TSCA and other environmental statutes. A temporary restraining order was issued with respect to nine of the remaining vessels identified for dismantling in the AbleUK contract. The four ships towed to the UK in 2003 and two post-1980 built (PCB-free) ships were not subject to the temporary restraining order. Although this suit was dismissed, the Sierra Club has indicated to MARAD and EPA that there will be further litigation if MARAD attempts to export for disposal the remaining vessels. The legal challenge in the United Kingdom resulted in AbleUK being required to reapply for its local planning permissions/licenses and a Waste Management License for the facility upon gaining the local permissions. Approval would have allowed AbleUK to begin work in FY 2006 on the four MARAD ships at its facility, and make possible the export of the remaining ships under the contract in 2007.

AbleUK was expected to gain the required local permits in October 2006 with approval by the Hartlepoole Borough Council (HBC); however, the October 2006 vote by the HBC resulted in the refusal to approve AbleUK's applications, which was contrary to the strong recommendation for approval by HBC's own planning review committee.

Since the October vote, MARAD has been in discussions with AbleUK and the UK Environment Agency (EA) and is assessing what steps related to the contract are in the best interest of the U.S. Government. The MARAD continues to believe that AbleUK is qualified to accomplish ship recycling in an environmentally safe manner and that the export of obsolete ships to the UK for recycling is a cost-effective and feasible option. Since MARAD's discussions and consideration of actions related to the refused permit applications and the contract are both business proprietary and procurement sensitive, further details regarding MARAD's procurement considerations cannot be discussed in this Report. The MARAD is available upon request to brief Members of Congress regarding the AbleUK contract.

Ship Disposal Funding

The Consolidated Appropriations Act of 2006 included \$21 million for the disposal of obsolete ships, which \$3 million was earmarked for the continued decommissioning process for the nuclear reactor and hazardous materials on board the NS SAVANNAH.

Contract awards for the disposal of 22 ships were made in FY 2006 with the remaining \$18 million. The 22 ships awarded exceeded the FY 2006 goal of 15. With less emphasis by the Navy on conventional dismantling as a disposal method and an increase in the number of domestic contractors competing for MARAD's ships, the cost-per-ton disposal rate continued to trend lower throughout FY 2005 and FY 2006, resulting in the award and eventual disposal of more ships than anticipated and at a significantly lower cost-per-ton disposal rate.

In spite of awarding contracts for a number of vessels that exceeded the targeted goal there was a significant carryover of non-committed FY 2006 funds into FY 2007 in the amount of approximately \$15 million, which was reduced to \$9 million with several contract awards in the first quarter of FY 2007. The carryover amount is a result of robust domestic competition and continued strong international scrap steel prices, both of which resulted in a significantly lower cost-per-ton disposal rate for FY 2006 awards. Fiscal Year 2006 cost-per-ton calculations included the sale of five ships for recycling. The funding carry-over will allow MARAD to award contracts for additional obsolete ships in FY 2007. A major benefit of the carry-over is that the additional disposal awards into FY 2007 will level out the flow of dismantling work to the industry and thereby allow the industry the ability to keep its work force employed throughout the year.

Ship Disposal Contracts

Utilizing the Federal Acquisition Regulation (FAR) Test Program for Certain Commercial Items, MARAD implemented in January 2005 the use of Standing Quotations as the primary procurement method for soliciting ship disposal services. The use of Standing Quotations is a simplified acquisition procedure for the competitive procurement of commercial ship dismantling/recycling services. The Standing Quotation process allows interested vendors to submit quotations and proposals on a continuous basis. Since it is not possible to predict which vessels may have a positive recycling value to contractors (offerors), the Standing Quotation process includes a solicitation for both sales (purchase) offers and fee-for-service

offers. Those ships not receiving purchase bids are considered for fee-for-service contracts. Proposals are evaluated and those offers determined to be technically acceptable from the pool of standing quotations are considered for award. Based on the evaluation criteria posted in the Request for Quotation, contracts are then awarded to the offers that represent the best value to the Federal Government.

Transfer of Ships to the Navy for Disposal

The National Defense Authorization Act for Fiscal Year 2006, P.L. 109-163; Section 3505(b), 119 Stat, 3552 (2006) required MARAD to transfer at least four obsolete ships to the Navy for disposal through its vessel disposal program. A similar requirement to transfer an additional three ships to the Navy in FY 2007 appears in the John Warner National Defense Authorization Act for Fiscal Year 2007.

The MARAD and the Navy have utilized their 2003 Memorandum of Agreement to transfer vessels to the Navy for disposal via the Navy Deep Sea Sinking Exercise (SINKEX) Program. The MARAD has approved the transfer of seven vessels to the Navy under the program and believes that funding each of these transfers is in the best financial interest of the United States. Thus far, one of these vessels has been sunk.

Prior to passage of the 2006 Department of Defense Authorization Act, MARAD informed the House Armed Services Committee staff that a transfer of vessels to the Navy for use of Navy's existing recycling contracts provided little economic or convenience advantage to MARAD. Since MARAD has more qualified recycling facilities than the Navy and the two Navy facilities were also MARAD qualified facilities, the use of the Navy's recycling contracts offered MARAD no additional recycling capacity or competition. Nevertheless, MARAD also endeavored to use this method for vessel disposal.

A number of ships were identified by MARAD to the Navy in 2006 for disposal via the Navy's recycling program. Upon receipt of the quotations of the cost of these services, MARAD was able to approve one vessel for such disposal. Determinations and findings made pursuant to the Economy Act, which were required under the terms of the Department of Defense Authorization Acts of 2006 and 2007, showed that this one vessel was economically comparable to previous ships awarded by MARAD and could be disposed of more conveniently through the Navy's program, principally because of the Navy's oversight of the recycling project. With respect to the other vessels offered to the Navy for disposal, given the prices received from the Navy, MARAD was unable to make the required Economy Act findings that it was more economical to use the Navy's contractual recycling program than to use MARAD's current contractual program.

Comprehensive Management Plan

The FY 2006 Authorization of Appropriations, Title XXXV, Maritime Administration, Section 3505(c), contained a requirement for MARAD to develop a Comprehensive Management Plan (CMP) for the disposal of its obsolete ships. The CMP was developed, implemented and delivered to the Congress in July 2006. The plan addressed the Program's

strategy, performance measures, funding and decision-making framework for ship disposal in addition to identifying external factors that could affect execution of the plan.

The MARAD's disposal strategy, as discussed in the CMP, continues to be an integrated plan that includes critical elements that are considered for both the long-term disposal strategy and short-term disposal decisions. Elements that affect the cost and disposal rate of the MARAD's obsolete ships include:

- Capability, capacity and effectiveness of the various disposal options to cost-effectively expedite the disposal of ships
- Domestic and international scrap steel markets
- Disposal alternatives available to the Program
- Non-retention vessel condition and location
- Availability of non-retention ships to the Program for disposal
- Suitability of vessels for various disposal options
- Timing, level and availability of annual appropriated funding
- Environmental threat posed by specific vessels
- Ship specific proposals received by the industry
- Demand for ships to be artificially reefed, purchased and deep-sunk (through the Navy's SINKEX Program)

The Program's emphasis continues to be the expedited disposal of obsolete ships presenting the greatest environmental risk. Disposal alternatives such as artificial reefing, donation, deep-sinking and sales are less effective because the best candidates for those disposal options are generally vessels that are cleaner and in better condition. We believe MARAD's responsibility in this area is first and foremost the mitigation of environmental threats posed by older, deteriorated hulls that contain residual oil. While MARAD's disposal strategy continues to focus on dismantling/recycling as the most expeditious option currently available, all disposal options are continuously being evaluated.

Through the use of full and open competition, MARAD continues to utilize all feasible disposal options available to achieve an environmentally acceptable "end state".

- To eliminate the backlog of high priority vessels accumulated in the 1990s. This has nearly been accomplished with only five high priority vessels, not under contract for disposal, remaining in MARAD's three fleet sites.
- To remove from the fleet sites all "high" and "moderate" priority ships at a rate of 20-24 ships per year. Elimination of the remaining five high and 23 moderate priority ships not currently under contract for disposal also mitigates the greatest risks to the environment at MARAD's fleets. The number of vessels removed by each disposal alternative will depend on and be determined by the industry proposals/pricing, funding availability, suitability of each ship for the disposal methods available/proposed, the outcome of the foreign recycling legal challenges, the availability of obsolete ships for disposal and other factors.

- To maintain only “low” priority/low-risk ships at the fleet sites. The target number of low priority obsolete vessels to be maintained on an annual basis is a total of 50-70 at all three fleet sites. With the designation of a projected average of 10-12 additional MARAD and DOD ships per year as obsolete an annual disposal rate of 20-24 ships will have to be maintained for 2-3 years beyond 2007 in order to achieve and maintain an obsolete vessel fleet size at a maximum range of 50-70 ships.
- To have a level of annual funding that permits the “end state” near-term annual disposal rate of 20-24 ships and then a level of funding in the out years that permits the disposal of at least the number of ships that are designated as obsolete on an annual basis. A failure to achieve an adequate level of funding and to maintain all disposal options will result in an accumulation of obsolete vessels, as in the 1990s.

Critical factors that impact the achievement of a realistic and environmentally responsible disposal “end state” include:

- Foreign recycling becoming a viable disposal option in 2007 and beyond.
- The Ship Disposal Program funding at levels in 2007 and beyond that allow consideration of proposals that include economies of scale.
- Designation of a majority of vessels as obsolete in the future that are in “fair” or “good” condition (i.e., low priority vessels with hull conditions of #4 & 5).

Performance Measures

The Program’s performance measures of vessels awarded, vessels removed and vessels disposed of are the best and most direct measure as to the Program’s progress in disposing of obsolete ships and meeting the Department’s environmental stewardship targets. The performance measures reflect ship disposal actions related to all disposal options including recycling, artificial reefing, sales and deep-sinking. Performance measure projections are based on variable factors including, but not limited to, the following:

- Timing of annual appropriations.
- Feasibility of disposal methods available to the Program.
- Legal challenges to Program initiatives.
- The competitiveness, capability, capacity, production throughput and performance of the disposal industry and individual contractors.
- The costs of aquatic nuisance species sampling, assessment and threat mitigation.
- The costs of environmental remediation of hazmat streams present on the obsolete ships.
- The Market price of recyclable steel.

Meeting future performance targets are subject to the same variables. Negative trends in any one or a combination of those variables can significantly affect the attainability of the performance targets. The targets for each year are established during the annual budget request process a year and a half prior to the specified budget year.

The three performance measures listed below are the major milestones of the ship disposal cycle. The annual cost-per-ton measure is indicative of the Program's efficiency even though variables that can significantly affect that particular measure, such as the market price of recyclable steel, are beyond the Program's control. The following tables include target and actual results through FY 2006 and the targets for FY 2007.

In addition, the difference (Δ) between the targets and actual results for vessel awards, removals and disposals over the last six years shows that the goals have been exceeded over the long-term in spite of annual goals not being met on a few occasions. The positive differential (Δ) between the targets and actuals is indicative of the Program's progress and effectiveness.

Number of contract awards for the removal of obsolete vessels from the National Defense Reserve Fleet (NDRF) sites for subsequent disposal.

	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>Totals (thru '06)</u>
Target:	3	3	11	14	15	13	13	59
Actual:	6	2	24	13	20	22		87 (Δ +28)

Number of obsolete vessels removed from the National Defense Reserve Fleet (NDRF) sites for subsequent disposal.

	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>Totals (thru '06)</u>
Target:	3	3	4	4	15	13	13	42
Actual:	6	6	2	15	18	25		72 (Δ +30)

Number of obsolete vessels disposed of (i.e. disposal action completed) from the National Defense Reserve Fleet (NDRF) sites.

	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>Totals (thru '06)</u>
Target:	3	3	4	4	15	15	15	44
Actual:	4	9	3	6	13	20		55 (Δ +11)

The following table shows the disposal achievements for FY 2006. Based on Program actions to date, it is anticipated that the FY 2007 award, removal and disposal goals will also be exceeded.

FY 2006 MARAD Ship Disposal Goals/Progress			
	<u>Goal</u>	<u>Actual</u>	<u>Variance</u>
Ships Awarded Disposal Contracts	13	22	+9
Ships Removed from MARAD Fleets	13	25	+12
Ships Disposed (Disposal Completed)	15	20	+5

The table below is a breakdown by Fiscal Year indicating the average cost-per-ton for disposal actions for Fiscal Years 2001 through 2007 based on the value of contract awards. The figure for the Fiscal Year 2007 is a projection. Disposal actions include vessel sales, legislated sales, legislated donations, artificial reefing, deep-sinking and dismantlement

services contracts. The actual cost-per-ton figures for FY 2005 and 2006 includes Suisun Bay Reserve Fleet (SBRF) vessels that were awarded to facilities in Texas because of a lack of qualified West Coast facilities. The cost-per-ton of those vessels elevated the overall cost-per-ton average for FY 2005 and FY 2006, with costs associated with West Coast vessel awards ranging \$.4 to \$.8 million higher than James River Reserve Fleet (JRRF) or Beaumont Reserve Fleet (BRF) vessels.

The award of West Coast ships to Texas facilities include a significant cost premium for the 5000+ mile tow, which includes a transit of the Panama Canal. As a point of comparison, the tow distance from the SBRF in California to Texas exceeds the 3000+ nautical mile distance from the JRRF to the AbleUK facility in the UK. Excluding the cost of the SBRF ships, the cost-per-ton has decreased from FY 2004 to 2006. This cost decrease is a result of increased domestic facilities, rising scrap steel prices, and strong domestic competition that did not exist prior to 2004. The cost per ton for the 22 vessels awarded in FY 2006 is \$83, which includes the sale of five vessels and represents a significant decrease over FY 2004 and 2005 costs.

Annual Program Cost/Ton Based on Disposal Actions Awarded in the Fiscal Year							
	FY '01	FY '02	FY '03	FY '04	FY '05	FY '06	FY '07
Number of Ships	6	2	24	13	20	22	13
Target Avg. Cost/Ton	(\$250)	(\$250)	(\$200)	(\$150)	(\$175)	(\$200)	(\$200)
Actual Cost/Ton	(\$253)	(\$127)	(\$133)	(\$107)	(\$109)	(\$83)	-

Program Progress in FY 2006

As outlined above, the program tracks three performance measures for the disposal of each vessel. These performance measures are vessels awarded, vessels removed from the fleets and vessels disposed. The three performance measurements are not confined to a specific time frame or Fiscal Year. Often ship disposal projects can span one, two, or even three years. Table one lists 44 vessels and indicates the date for which one, two or all three performance measures occurred. Performance measures that have a future occurrence are listed as pending. The table shows dates in bold font for each vessel awarded, removed and/or disposed during FY 2006. Program actions resulting in measurable performance on 44 ships in a single year represent significant progress in the disposal of obsolete ships and the mitigation of any environmental risks presented by those ships. All contract awards in FY 2006 have been to domestic recycling facilities or to the Navy for deep-sinking via its SINKEX program.

From the start of FY 2001 through FY 2006, MARAD has awarded contracts for the disposal of 87 obsolete ships, removed 72 ships from its fleet sites and completed disposal action on 55 vessels. While currently there are 118 non-retention ships in the fleets not under contract

and awaiting disposal, this figure includes 94 retention ships that have been downgraded since 2001 and added to the disposal queue.

The MARAD's accomplishments in FY 2006 were as a result of executing its CMP to continue the removal of the highest priority ships in all three reserve fleet sites. With award of the vessels shown in Table 1, only five high priority ships remain in MARAD's three fleet sites, two are not available for disposal because they are being held for donation to non-profit organizations or being assessed for historical significance. Two are scheduled to be used as artificial reefs in FY 2007, and one is included in a solicitation for recycling. Of the five remaining high priority vessels, three are located in the JRRF in Virginia, one in the SBRF in California and one in the BRF in Texas. As the high priority vessels become available for disposal they will be given priority for disposal, however, in the meantime MARAD's disposal plan focuses on the 23 moderate priority vessels that are not under contract for disposal, which includes 14 moored in the SBRF, five in the BRF, and the four moored in the JRRF. The MARAD's plan is to expedite the disposal of these ships to mitigate any potential for them becoming a risk to the environment.

Table 1: MARAD FY 2006 Disposal Actions

Ship	Fleet	Contractor	Site	Vessel Award	Vessel Removal	Vessel Disposal	Final Amount (\$)
MORMACWAVE	JRRF	Esco Marine, Inc.	TX	8/09/04	11/26/04	10/31/05	(\$1,396,095)
NEOSHO	JRRF	Int'l Shipbreaking Ltd.	TX	12/18/04	2/9/05	11/8/05	(\$1)
SUNBIRD	JRRF	Bay Bridge Enterprises	VA	7/08/05	8/17/05	11/21/05	(\$85,920)
PROTECTOR	Portsmouth	All Star Metals, Inc.	TX	9/10/04	11/29/04	11/30/05	(\$533,042)
TIOGA COUNTY	SBRF	Esco Marine, Inc.	TX	6/22/05	8/17/05	1/4/06	(\$1,122,850)
WABASH	SBRF	Marine Metals, Inc.	TX	6/22/05	9/2/05	1/27/06	(\$1,366,580)
GENERAL WALKER	JRRF	All Star Metals, Inc.	TX	9/13/04	1/4/05	2/9/06	(\$1,136,350)
ALBERT MEYER	JRRF	Int'l Shipbreaking Ltd.	TX	7/18/05	8/30/05	2/10/06	(\$399,726)
MIZAR	JRRF	Bay Bridge Enterprises	VA	7/08/05	8/16/05	2/27/06	(\$243,900)
PRESERVER	JRRF	Bay Bridge Enterprises	VA	8/26/05	11/30/05	3/11/06	(\$107,640)
WAHIAKUM CNTY	SBRF	Esco Marine, Inc.	TX	6/22/05	8/24/05	3/13/06	(\$1,102,850)
NEPTUNE	JRRF	Int'l Shipbreaking Ltd.	TX	7/18/05	11/3/05	4/13/06	(\$398,601)
SANTA LUCIA	JRRF	Marine Metals, Inc.	TX	8/18/05	10/27/05	6/21/06	(\$565,827)
GENERAL DARBY	JRRF	Marine Metals, Inc.	TX	9/13/04	2/16/05	9/11/06	(\$1,137,878)
WACCAMAW	JRRF	Int'l Shipbreaking Ltd.	TX	8/26/05	10/11/05	7/20/06	(\$496,319)
PAWCATUCK	JRRF	Bay Bridge Enterprise	VA	8/26/05	10/19/05	In Progress	(\$569,373)
CONNECTICUT	SBRF	Int'l Shipbreaking Ltd.	TX	8/26/05	10/25/05	8/18/06	(\$1,299,327)
MARSHFIELD	JRRF	Bay Bridge Enterprises	VA	8/26/05	11/8/05	6/30/06	(\$335,000)
NEMASKET	SBRF	Esco Marine, Inc.	TX	8/26/05	1/9/06	6/6/06	(\$1,252,367)
MONTICELLO	SBRF	Navy SINKEX**	CA	9/9/05	Pending	TBD	(\$915,548)
MAUNA KEA	SBRF	Navy SINKEX**	CA	9/9/05	5/3/2006	7/12/06	(\$754,550)
PYRO	SBRF	Navy SINKEX**	CA	9/9/05	Pending	TBD	(\$754,549)
MAGALLANES	BRF	All Star Metals, Inc.	TX	11/14/05	1/6/06	In Progress	\$25,286
POINT LOMA	SBRF	Marine Metals, Inc.	TX	12/15/05	2/14/06	In Progress	(\$897,792)
FLORENCE	SBRF	All Star Metals, Inc.	TX	12/28/05	2/15/06	In Progress	(\$996,992)
GILMORE	JRRF	Bay Bridge Enterprises	VA	2/10/06	3/30/06	In Progress	(\$742,675)
IX-509	JRRF	N. Amer. Ship Recycling	MD	2/16/06	4/3/06	7/13/06	\$76,275
PRIVATE MURPHY	BRF	Esco Marine, Inc.	TX	2/23/06	4/11/06	In Progress	\$5,550
BEAUJOLAIS	BRF	Esco Marine, Inc.	TX	3/14/06	4/27/06	In Progress	(\$1,047,137)
ALLISON LYKES	BRF	S. Scrap Material Co.	LA	5/30/2006	7/8/06	In Progress	\$50,000
MALLORY LYKES	BRF	S. Scrap Material Co.	LA	5/30/2006	7/1/06	In Progress	\$50,000
PRIDE II	BRF	All Star Metals, Inc.	TX	6/2/2006	8/8/06	In Progress	(\$576,476)
SAUGATUCK	JRRF	Bay Bridge Enterprises	VA	6/2/2006	7/18/06	In Progress	(\$549,999)
BRINTON LYKES	BRF	Marine Metals, Inc.	TX	6/2/2006	7/13/06	In Progress	(\$555,212)
ORION	JRRF	N. Amer. Ship Recycling	MD	6/2/2006	7/27/06	In Progress	(\$734,230)
HANNIBAL VICTORY	SBRF	Marine Metals, Inc.	TX	6/6/2006	8/8/06	In Progress	(\$978,698)
BARNARD VICTORY	SBRF	All Star Metals, Inc.	TX	6/6/2006	7/10/06	In Progress	(\$1,376,699)
OCCIDENTAL V.	SBRF	All Star Metals, Inc.	TX	6/6/2006	10/5/06	In Progress	(\$1,191,987)
SIOUX FALLS V.	SBRF	Marine Metals, Inc.	TX	6/6/2006	8/2/06	In Progress	(\$978,698)
FLORIKAN	SBRF	Navy SINKEX**	CA	9/8/2006	TBD	TBD	(\$396,984)
CLAMP	SBRF	Navy SINKEX**	CA	9/8/2006	TBD	TBD	(\$363,484)
BOLSTER	SBRF	Navy SINKEX**	CA	9/8/2006	TBD	TBD	(\$363,484)
RECLAIMER	SBRF	Navy SINKEX**	CA	9/8/2006	TBD	TBD	(\$363,484)
MISSISSINEWA	JRRF	Navy IDIQ (ISL)	TX	9/19/2006	TBD	TBD	(\$.02)

**Vessels identified to the Navy Inactive Ships Program Office per FY 2006 Nat'l Defense Authorization Act requirement.

The MARAD is working to identify cost-effective, qualified facilities on the U.S. West Coast and in foreign markets that are interested in recycling the obsolete vessels located in the SBRF. A few foreign facilities have submitted cost-effective proposals for disposal of a large number of ships. The MARAD's challenge is to ensure that the facilities have the capability of dismantling ships in a manner that protects the environment, worker safety and health. The MARAD's ability to award future contracts to foreign facilities is contingent on its ability to obtain a relaxation of the restrictive nature of environmental regulations that have precluded vessel export, which currently require a multiyear EPA rulemaking process in order to acquire an exemption to allow the export of PCBs. There are currently no operational U.S. West Coast facilities dedicated to vessel dismantling/recycling available to the Navy or MARAD. In the absence of a foreign recycling outlet, this will continue to have a significant effect on the cost of disposing of the SBRF vessels.

Although MARAD has pre-qualified a West Coast contractor that would establish a dismantling facility in Vallejo, California, if awarded a contract, this company continues to submit higher bid prices than Brownsville, Texas, companies, even with the Brownsville companies towing the ships from the West Coast through the Panama Canal. Thus, the cost of dismantling ships located at the SBRF is inherently more expensive to scrap than ships located at either the Beaumont, Texas, or James River, Virginia, Reserve Fleets. The MARAD has mitigated this impact to some extent by arranging with the Navy to environmentally prepare ships from Suisun Bay, on a reimbursable basis, for SINKEX. The Navy then works with the active Navy fleet to use the ships as targets during Fleet exercises and removes the ships via tow.

Ship Disposal Alternatives

Domestic Recycling and Contractor Performance – The current high value of scrap metals among other factors is reducing the per ton cost to domestically dismantle vessels, allowing MARAD to contract for additional ships for dismantling and for the sale of some for dismantling. To date, domestic recycling is the most expedient method of disposal alternative compared to transfer of ships for use in Navy sink exercises, ship reefing or ship donation. With the increase of scrap metal commodity prices and increased contracting by MARAD for ship dismantling, MARAD has seen an increase in the number of domestic companies it has pre-qualified for dismantling services. In FY 2001, MARAD contracts involved only three domestic companies. Since then four additional domestic companies have been awarded ship dismantling contracts; two of those companies are located on the East Coast. To date, the eighth facility has not been competitive from a best-value standpoint. The MARAD is encouraging increased domestic competition to increase cost-effective and productive capacity. In spite of increases in the number of domestic facilities, domestic recycling remains the least cost effective disposal option for MARAD.

In light of the export limitation, and continuing challenges associated with alternative disposal methods, the rate of disposal is highly dependent on the availability of a consistent budget and cost effective domestic facilities. Industrial capacity, in terms of annual ship disposal rates, is difficult to quantify because of several factors including the variance in vessel condition and the scope of hazardous material remediation that is necessary.

However, due to capacity and resource limitations, the seven domestic facilities that have been awarded contracts over the past few years have demonstrated a potential cost effective capability to dismantle and recycle up to a total of 20 to 25 vessels per year, which includes MARAD, the Navy and commercial work. Further, even at award rates that are lower than the industry's potential capacity, the limitations of many domestic facilities often result in significant delays of months after contract award before the facility finally takes possession of the vessels and commences dismantling work. This is particularly true when multiple ships are awarded at the same time to the same facility. It is also not uncommon for domestic facilities to request significant schedule extensions for completing the work beyond the original contract performance period, only a portion of which can be classified as excusable delays. Over the past 2 years the majority of MARAD's qualified domestic facilities have had significant production throughput problems, significantly delaying completion of recycling projects awarded by MARAD. Without increases in trained workforce resources to improve production throughput, an improvement in the situation is not likely.

While timely performance of many of the contractors in the limited domestic ship disposal industry is at times a challenge to the Program, it had been considered manageable because of the direct, hands-on project/contract management and on-site facility oversight applied by MARAD. However, an area of concern for FY 2007, and perhaps beyond, is the additional pressure that may be on domestic industrial capacity as a result of the number of ship disposal awards made in FY 2006 and FY 2007 by MARAD and Navy disposal programs. However, this may be of a lesser concern as the Navy expects to decrease the number of recycled ships due to dwindling inventory. The Navy's program currently awards recycling contracts to only two domestic facilities, which is sufficient for its projected reduction of annual dismantling to two or three ships per year. These two contractors are also qualified contractors under MARAD's program and are considered the two domestic facilities with the greatest current capacity. The two contractors have several on-going MARAD disposal contracts in addition to Navy work. The combined effect of the Navy and MARAD awards to these two contractors has the potential to exceed the capacity for the balance of FY 2007 barring some unforeseen increase by those facilities in resources and production throughput. In fact, because of the backlog of work, one of the two contractors has not been active in pursuing MARAD ships for most of FY 2006 and has indicated to MARAD that they may not be able to respond to the MARAD's solicitations for the majority of FY 2007.

While MARAD has aggressively pursued the participation of domestic facilities in the recycling of MARAD ships, and is encouraged with the increase from three to eight in the number of qualified facilities since 2003, there is a note of caution moving forward because of the sharing of limited industrial facilities between MARAD and the Navy. The capacity, resources and management of domestic contractors will be tested in light of the significant number of disposal awards made in FY 2006, which will need to be completed in FY 2007, and in light of the number of vessel awards anticipated for FY 2007 by both Programs. Exaggerated capacity claims by the domestic industry in the past, that heretofore have not materialized, will also be tested. Significant delays in the removal of awarded ships from the fleet sites continued as well as increasing schedule overruns by dismantling contractors are anticipated in FY 2007 as the limits of domestic capacity and capability are exceeded.

Foreign Recycling - Based upon proposals received and an investigation of facilities abroad, MARAD continues to believe that environmentally sound facilities exist abroad that offer the United States very competitive prices for the disposal of MARAD's obsolete vessels. Foreign options could provide the additional capacity and competition necessary to accelerate the disposal of MARAD's 118 obsolete ships and mitigation of the environmental threat they present. However, due to the 40 C.F.R. Part 761 prohibitions on the export of regulated PCBs in common shipboard materials that most often cannot cost-effectively be removed without physically dismantling the ship, MARAD has been unable to successfully recycle any vessels abroad due to legal challenges and regulatory constraints. In spite of the difficulties involved, the best value contract award in 2003 for the disposal of 13 ships, plus two ships under a barter agreement, to a qualified UK facility may still be feasible if the company is successful in obtaining the necessary operating and environmental permits. The four vessels exported as part of that contract remain on hold for disposal and are thus unable to be dismantled until the UK legal issues are resolved and all required permits are in place. The MARAD is currently in the iterative process of evaluating additional recycling proposals involving two countries other than the UK for the recycling of MARAD's obsolete ships.

Artificial Reefing - Reefing has potential that is currently constrained by limited demand for ships by the coastal States. The limited demand is a result of a general reluctance of States to be responsible for the preparation, tow and sinking of the ships, and to share in the significant costs associated with reefing activities. In FY 2006 MARAD was granted a legislative change that provides the flexibility to determine the time and place of vessel transfer to a coastal State. This change will allow MARAD to take an active role and share more responsibilities for preparing a ship for reefing, if it is determined to be in the best interest of the government. Cost sharing with the States also has the potential to increase demand to some degree. The MARAD has the authority to provide financial assistance to the States and will consider such requests if they are comparable to the costs of other feasible disposal methods. However, MARAD will consider providing significant financial assistance to States only for vessels MARAD considers to be a higher priority. Unfortunately, the fact remains that higher priority ships, generally, are not good reefing candidates.

Best Management Practices (BMP) for the preparation of ships to be used as artificial reefs have been developed through the interagency efforts of MARAD, EPA, Navy, National Oceanic and Atmospheric Administration (NOAA), USCG, Army Corps of Engineers (ACE) and National Marine Fisheries Service (NMFS). The BMPs were implemented in FY 2006 and will provide consistent vessel preparation guidance nationwide. However, the requirements in the BMPs to remove all solid PCBs above the regulated limits could negate any potential cost advantage of artificial reefing compared to conventional dismantling.

The vessel TEXAS CLIPPER I has been transferred to the State of Texas for reefing preparations. In addition, MARAD currently has two additional ships in the approval process for use as artificial reefs in Florida and the Cayman Islands.

Vessel Sales - This is a low revenue to no-cost option to the Government for selected vessels. Prior to 2006 the sale of vessels was not a significant disposal option in terms of

numbers of ships. In FY 2006 the increase in domestic vessel purchases was a result of the increased market price of steel and “sales of opportunity” for the companies purchasing the vessels. In spite of the sale of five vessels in FY 2006, it is not likely to be a trend that can be relied upon for significant domestic sales of vessels on an annual basis. The MARAD anticipates the sale of at least four ships in FY 2007 for recycling and reuse. This includes the sale for re-use of three obsolete vessels deployed in Japan that were recently downgraded and that would have otherwise been returned to the U.S. for disposal at significant expense.

It is not surprising that, given the large demand for scrap metal on the international markets, MARAD continues to receive numerous inquiries for the sale of its obsolete vessels to foreign ship recyclers. However, because of the restrictions that TSCA imposes on the export of MARAD ships that contain regulated PCB's, foreign sales for recycling currently are not commercially practicable in the present legal environment, even to environmentally sound facilities.

Vessel Donation - Donation of vessels is based on the demand of non-profit historical preservationist and humanitarian groups. Historically, donation has not been a significant disposal option in terms of numbers of vessels; however, MARAD has established a formal donation program to support the efforts of legitimate not-for-profit groups to acquire and preserve vessels. The formal program is intended to replace the previous practice where organizations obtained special legislation for the donation of ships. The authorization for the formal program is contained in Section 3512 of Pub. L. 108-136, The National Defense Authorization Act for Fiscal Year 2004.

Deep Sinking - Joint Navy/MARAD ship disposal projects through the Navy's sink at-sea live-fire training exercises (SINKEX Program). Deep-sinking is a low-volume option with costs comparable to artificial reefing. Vessels are prepared for sinking by the Navy in accordance with procedures that protect the environment as agreed to between the Navy and the EPA. The MARAD and the Navy executed a Memorandum of Agreement on September 5, 2003, for the deep sinking of MARAD ships through the Navy's program. Pursuant to this agreement, the vessel GAGE has been prepared by the Navy; however, the sinking of this vessel has been postponed due to the historical assessment process and donation interest in the vessel. Three ships were prepared for SINKEX in FY 2005 and one was sunk. Four additional ships were also approved by MARAD for SINKEX in FY 2006 and are awaiting SINKEX preparations by the Navy. The feasibility of SINKEX as a future disposal option will depend on cost-effectiveness estimates from the Navy that are comparable in cost to MARAD's other disposal alternatives. A disposal rate of two to three ships per year through deep-sinking at this point is considered possible.

Conclusions

This Report outlines the significant legal challenges and domestic industry opposition to the export of obsolete ships by MARAD. Nonetheless, an aggressive program of maximizing the use of disposal funding and pursuing all feasible disposal options resulted in the award of 55 contracts to dispose of a significant number of high-priority vessels in the last 3 years.

Those awards and the subsequent removal of vessels from the fleet sites reversed a trend in the growth of the number of obsolete ships in MARAD's custody.

The progress and momentum gained since FY 2003 needs to be sustained to achieve the goals identified by the Administration and Congress. The award and removal of the majority of MARAD's high priority ships since the start of the Program in 2001 have significantly mitigated the threat of residual oil discharge into the environment. Section 3502 of the National Maritime Heritage Act (P.L. 106-398 signed October 30, 2000), which extended the Congressional disposal mandate to September 30, 2006, also listed 39 obsolete ships that posed the most immediate threat to the environment. Of the 39 ships identified in 2000 as high priority, only one ship has not yet been removed from MARAD's fleets. That ship should be removed from the fleet in early 2007.

These successes notwithstanding, the statutory disposal deadline of September 30, 2006, for disposal of all MARAD's obsolete ships, were not met. However, as MARAD first reported to the Congress in 2002, it was unlikely that MARAD would be able to dispose of the more than 120 obsolete ships by the deadline, due to external impediments that did not allow access to all cost-effective disposal methods and the lack of additional competitive ship disposal capacity. Those constraints still exist today, despite the increase from three to eight qualified domestic disposal firms. Moreover, the legal challenges to vessel export that MARAD encountered in 2003 on the AbleUK disposal contract have effectively suspended the export of vessels containing solid PCBs as a ship disposal option. In addition, the TSCA formal rulemaking process has significantly delayed near-term prospects for contract awards resulting from cost-effective export proposals.

Regardless of the outcome of the AbleUK contract, it has become clear to MARAD that, under existing environmental laws and regulations, the export of ships for recycling is currently not a practicable method of disposal for MARAD or for recycling companies interested in foreign recycling. The future export of vessels under the regulatory scheme established by TSCA can be accomplished only through an exemption to TSCA provided in a rulemaking by the EPA. However, the legal and practical requirements for a TSCA exemption rulemaking can easily take one to two years. The TSCA exemption rulemaking process is not workable within the framework of a Federal procurement action with a commercial facility. Thus, it is evident that the legislative requirement to select disposal facilities on a "best value" basis without predisposition towards foreign or domestic facilities is a practical impossibility.

Given the legal requirements imposed by TSCA that must be met before any foreign vessel disposal can take place, MARAD is restricted to essentially using domestic recycling facilities as the only option for expedited disposal. A favorable March 2, 2005 ruling by the U.S. District Court for the District of Columbia did not provide MARAD with relief from the requirements of TSCA. While the Court concluded the EA prepared by MARAD fully met its obligations under the National Environmental Protection Act ("NEPA") and dismissed the plaintiff's complaint, the court's ruling does not remedy the underlying environmental issues under TSCA that triggered the legal action initially and does not preclude plaintiffs or other

citizens from immediately filing another civil action against MARAD to deny the export of obsolete ships.

The effective loss of vessel export as a disposal option has prevented MARAD from taking advantage of very cost-effective proposals, including some that are at no cost to the government. These options would be especially valuable for MARAD's vessels on the West Coast where there is only one qualified facility for vessel disposal, which thus far has not successfully won a competitive procurement. The Department of Transportation is available to provide technical assistance to the Congress related to possible statutory changes to allow MARAD to have access to this important disposal option and to carry out such disposals.

Access to the vessel export option will significantly reduce disposal costs and expand capacity. In FY 2001, six ships were disposed of domestically through contract awards to three different facilities. The final unit costs were approximately \$253 per ton. In FY 2003, the AbleUK contract involved the export of 13 ships at a unit cost of \$144 per ton, and with the barter provision for title to two additional obsolete ships the total disposal unit cost for the 15 ships was \$104 per ton. Since FY 2003 the per ton disposal cost has continued to decrease, down to \$83 in FY 2006, which included the sale of five ships for recycling. The decrease in per ton costs since FY 2001 is attributable to a combination of factors including the increased competition represented by foreign proposals and domestic contractors, and an increase in the international market price of recyclable steel. While the decrease in per ton costs is encouraging, the significant capacity limitations of the domestic disposal industry show little potential for increases in the annual disposal rate of ships. Without the benefit of a competitive dismantling/recycling facility on the West Coast, there is little potential for increases in domestic recycling capacity.

While disposal methodologies such as foreign recycling and artificial reefing present many difficult challenges, the cost-effective, long-term solution to responsible and safe ship disposal must include these disposal alternatives. Without access to additional disposal facilities the rate of disposal is unlikely to increase beyond the current rate and the costs associated with ship disposal will be unlikely to decrease.

Notwithstanding the export challenges, MARAD will continue to investigate all alternatives identified in this report, and others that we may identify, to expedite the disposal of its obsolete vessels at qualified facilities and at the least cost to the Government, while giving consideration to worker safety and the environment, as required by the Floyd D. Spence National Defense Authorization Act for Fiscal Year 2001.

II. PROGRESS OF THE U.S. NAVY'S VESSEL DISPOSAL PROGRAM

Introduction

Pursuant to Division M - Section 102 of House Joint Resolution 2 for the 108th Congress (Public Law 108-7) (also referred to as the "Consolidated Appropriation Resolution, 2003"), the Secretary of the Navy and the Secretary of Transportation shall report to the Congressional defense committees no later than March 1, 2003, regarding the total number of obsolete vessels in the Administration's (MARAD) National Defense Reserve Fleet (NDRF) designated for disposal, the comparative condition of the vessels, the method of disposal, and the projected costs for disposal of each vessel.

Pursuant to Section 3505 of the Fiscal Year 2006 Department of Defense Authorization Act (Public Law 109-163), the Secretary of Transportation, in coordination with the Secretary of the Navy, is required to report on the progress made in implementing the vessel disposal plan developed under subsection (c) for disposal of obsolete NDRF vessels in a timely manner, maximizing the use of all available disposal methods, including dismantling, use for artificial reefs, donation, and Navy training exercises.

While not required by Section 3505 of P.L. 109-163, this portion of the report responds to the Consolidated Appropriation Resolution, 2003 regarding Navy-titled obsolete vessels in MARAD's NDRF and updates the progress of the U.S. Navy's vessel disposal program, which was addressed in MARAD's October 2005 report to Congress released by the Secretary of Transportation.

Navy-Titled Obsolete Vessels in the Maritime Administration National Defense Reserve Fleet

The total number of Navy-titled vessels that are designated for disposal and remain in MARAD NDRF facilities is 13. See attached Table 1 - Navy-Titled Obsolete Vessels in the Maritime Administration National Defense Reserve Fleet designated for disposal, provides information regarding the method of disposal and projected cost of these vessels.

Accomplishments Since October 2005

As of September 30, 2006, the total number of Navy-owned inactive ships in storage is 63, most of which are located at the Navy's inactive ship maintenance facilities, but includes the 13 ships noted in Table 1 that are located at MARAD's facilities. These 63 ships represent an environmental liability valued at \$89.6M, which is the portion of the ship dismantling and recycling cost for all 63 ships that is attributable to hazardous material removal and disposal in accordance with all Federal, State and local environmental laws and regulations. As discussed below, the Navy continues to make significant progress in the reduction of its inactive ship inventory by maximizing the use of all disposal methods, thus reducing the Navy's environmental liability associated with the disposal of these ships.

Domestic Ship Dismantling

The Navy continues to execute its strategy of utilizing multiple ship disposal methodologies to reduce the size of the inactive ship inventory, including foreign military sales, ship donations, experimental/target use, and domestic ship dismantling. In addition, Public Law 108-136 provides authority for the Navy to transfer vessels stricken from the Naval Vessel Register directly to a State, Commonwealth, or possession of the United States, municipal corporation, or political subdivision for use as an artificial reef.

Since October 2005, five additional ships have been completely dismantled and recycled under the Navy's Ship Disposal Project contracts. Six additional task orders were awarded in FY 2006 under the new competitive FY 2005 Indefinite Delivery/Indefinite Quantity (IDIQ) contract. See attached Table 2 - Ship Disposal Project Task Order Status – FY 1999 Contract, highlights the status of task orders under the Navy's Ship Disposal Project contracts that were competitively awarded on a best-value basis since September 1999. The Ship Dismantling program enables the Navy to continue reducing its inventory of stricken ships, as expected in Senate Armed Services Committee Report 107-62 of Sep 12, 2001, while ensuring that ship dismantling will be completed in a timely and cost-effective manner in compliance with all environmental and occupational safety laws and regulations.

During FY 2006, a total of seven new Ship Disposal Project contracts were awarded to either Metro Machine Corporation (MMC) for ship dismantling in Philadelphia, PA; or International Shipbreaking Limited (ISL) or ESCO Marine Incorporated (ESCO), for ship dismantling in Brownsville, TX. All firm-fixed priced task orders were competed amid all three contractors, and are administered by Navy Supervisor of Shipbuilding, Conversion and Repair USN (SUPSHIP) Bath, ME. See attached Table 3 - Ship Disposal Project Task Order Status – FY 2005 Contract, highlights the status of task orders under the new Ship Disposal Project contracts awarded in FY 2005.

On July 15, 2006, however, MMC closed it's facility. Due to reallocation of MMC overhead to each facility, the Philadelphia facility was no longer viable. Additionally, the unionized labor force has much higher wages than their competitors in Brownsville, TX. The Navy completed an analysis to determine whether another ship scrapping contractor was needed to replace MMC. However based on current inactive ship inventory and a number of methods available to reduce this inventory it was determined that another contractor is not necessary at this time. The requirement for another contractor will be revisited periodically.

Navy Sink Exercises

Since October 2005, ten additional ships and craft¹ have been environmentally prepared and sunk during Fleet at-sea live-fire training exercises in water depths of at least 6,000 feet and at least 50 miles from land, in accordance with 40 CFR Section 229.2. The exercises provide valuable live fire capability to maintain Fleet readiness.

¹ Inactive ships sunk during Fleet at-sea live-fire training exercises since October 2005 include ex-O'Brien (DD 975), ex-comte De Grasse (DD 974), ex-Stump (DD 978), ex-Yocona (WMEC 168), ex-Butte (AE 27), ex-YSR 11, ex-Mauna Kea (AE 22), ex-Belleau Wood (LHA 3), ex-Mars (AFS 1) and ex-Thorn (DD 988).

Artificial Reefing

In June 2005, the ex-ORISKANY was towed to inactive reserve fleet in Beaumont, TX for the 2005 Hurricane season and awaits the issuance of a PCB risk-based disposal permit by the EPA. Additional preparation work (hurricane preparedness, towing preparations, final cleanup work, etc.) was performed in Beaumont, Texas.

Also in June 2005, the Navy submitted all documentation to EPA Region IV related to the Prospective Risk Assessment Model (PRAM), a computer simulation model that predicts the ecological and human health risk of solid PCB containing materials built into the construction of a vessel. Review of PRAM by EPA internal reviewers as well as the external Science Advisory Board (SAB) was necessary for EPA to issue the risk based disposal approval for ex-ORISKANY. In November and December 2005 the Navy submitted response to comments received by EPA and the SAB with final revised documents submitted to EPA in January 2006.

On February 15, 2006, the Navy received a risk-PCB disposal approval from the EPA Region IV for the ex-ORISKANY artificial reefing project. The risk-based PCB disposal approval was issued pursuant to EPA regulations and was based on EPA's findings that the disposal action will not pose an unreasonable risk of injury to health or the environment. This permit along with the May 2006 release of the final BMP for preparing vessels intended to create Artificial Reefs by EPA and MARAD allowed the Navy to sink the ex-ORISKANY in May 2006. Upon receipt of the risk-based PCB disposal approval from the EPA, the ship was towed from Beaumont on March 16, 2006 and arrived in Pensacola on March 22, 2006 where final sink preparations were undertaken.

On May 15, 2006, the ex-ORISKANY was towed from Pensacola to the reef site located within the Escambia East Large Area Artificial Reef permitted site about 22.5 nautical miles southeast of Pensacola Pass. On Tuesday May 16, 2006, under close support and supervision by interagency support personnel from U.S. Army, U.S. Coast Guard and State of Florida, the vessel was accurately and securely anchored utilizing a four-point anchoring system.

At 10:25 a.m. Central Time (CT) on Wednesday May 17, 2006, detonation of approximately 750 pounds of explosives distributed at 22 through hull sea-chest valve locations allowed for a controlled sinking of the vessel. Thirty-seven minutes later (at 11:02 a.m. CT) the ex-ORISKANY sank beneath the waves landing upright on the ocean floor. There were more than 350 private vessels on the one-mile safety zone to observe the sinking that day.

The ship currently sits upright in the exact location and configuration requested by the State of Florida being at 30° 02' 38" North latitude, 87° 00' 25" West longitude with bow facing south. The depth to top of dive tower is 71 ft, depth to bottom is 211 ft, depth to flight deck at base of island 135 ft, depth to flight deck, port side aft 137, 140 ft., and horizontal visibility up current of island (starboard side) 80 ft.

Remaining Inventory

As of October 31, 2006, the Navy's inventory of inactive conventionally powered ships totaled 65, including 15 retention assets for possible future reactivation, 6 logistic support assets held for extended Fleet stripping, and 44 ships designated for disposal by Foreign Military Sales transfer, ship donation for public display, Navy sink exercise, domestic dismantling, or artificial reefing.

Navy/MARAD Cooperation

The Navy and MARAD are also engaging in cooperative strategies addressing their respective inactive ship inventories and are meeting at regular intervals to share lessons learned on ship disposal programs. Ongoing initiatives include:

The Navy and MARAD executed a Memorandum of Agreement (MOA) that supports MARAD with on-site contract surveillance where the Navy and MARAD both have ship dismantling contracts in place with the same contractor.

The Navy and MARAD have executed a MOA under which the Navy provides turn-key environmental preparation on a reimbursable basis for former Navy ships that can be used in Navy sink exercises. In 2006, the Navy accomplished environmental preparations for sink exercises on ex-MAUNA KEA (AE-22), ex-MONTICELLO (LSD-35), and ex-PYRO (AE-24) for MARAD. Additionally, the ex-MAUNA KEA (AE-22) was sunk during a Navy training exercise in June 2006. An agreement was signed in FY 2006 to prepare the ex-FLORIKAN (ARS-9), ex-CLAMP (ARS-33), ex-BOLSTER (ARS-38), and ex-RECLAIMER (ARS-42) located at MARAD Suisun Bay, CA.

The Navy and MARAD signed a Memorandum of Agreement (MOA) under which ex-Navy vessels are transferred from MARAD to the Navy for disposal under current Navy Ship Dismantling IDIQ contracts which would comply with requirements of Section 3505 of the FY 2006 National Defense Authorization Act, Public Law 109-163. The ex-MISSISSINEWA has been awarded under the Navy contract to International Shipbreaking Ltd., in Brownsville, TX.

Planned Activities

Domestic Ship Dismantling

In first quarter of FY 2007, the Navy will solicit proposals for four additional ships under its IDIQ contracts for dismantling with award in FY 2007, which will further reduce the inventory of inactive ships.

Navy Sink Exercises

The Navy will continue to environmentally prepare ships stricken from the Naval Vessel Register for Fleet at-sea, live-fire training exercises and in support of new ship acquisition programs. Approximately eight ships per year are utilized for these purposes.

Artificial Reefing

The Navy has begun preparations on the ex-FORRESTAL for artificial reefing. The distribution of regulated PCBs onboard the ex-FORRESTAL is much different from that of the ex-ORISKANY in location and matrix concentration. Therefore, the primary method of clean up of regulated PCBs onboard the ex-FORRESTAL is through remediation rather than acquiring a risk-based PCB disposal approval. However, if after sampling and analyses it is determined that regulated PCBs cannot be safely and efficiently removed from the vessel and removal of PCBs does not affect the integrity of the vessel, then a risk-based PCB disposal approval will be sought with the EPA.

Navy/MARAD Cooperation

The Navy and MARAD will continue to engage in cooperative strategies addressing their respective inactive ship inventories and are meeting at regular intervals to share lessons learned on ship disposal programs. Future initiatives include:

Under the Navy and MARAD MOA where the Navy provides turn-key environmental preparation on a reimbursable basis for former Navy ships that can be used in Navy sink exercises, the ex-FLORIKAN (ARS-9), ex-CLAMP (ARS-33), ex-BOLSTER (ARS-38), and ex-RECLAIMER (ARS-42) located at MARAD Suisun Bay, CA, will be prepared and utilized in training exercises. An estimate was provided for ex-ESCAPE (ARS-6) located in James River Reserve Fleet in Virginia for environmental preparations. The MARAD will decide in early FY 2007 whether the Navy should execute the environmental preparation on the ex-ESCAPE.

Section 3507 of the National Defense Authorization Act for 2007, Public Law 109-364, provides MARAD with the authority to transfer during FY 2007 no fewer than three obsolete combatant vessels to the Navy for disposal that are acceptable to the Navy, subject to the availability of Department of Transportation appropriations and consistent with section 1535 of title 31, United States Code, popularly known as the Economy Act. The MARAD will identify the three ships for transfer to the Navy for disposal subject to the provisions of the Economy Act, which may be competed for dismantling under the Navy's IDIQ contracts for ship dismantling or prepared for and disposed of under the Navy's sink exercises.

Conclusions

As addressed in the Navy's August 10, 2001 Report to Congress on the Disposal and Scrapping of Stricken U.S. Navy Ships, the Navy remains committed to reducing and eliminating any environmental risks posed by its inactive ships, and to reducing the size of the inactive ship inventory utilizing multiple ship disposal methodologies (i.e., foreign military sale transfers, ship donations, experimental/target use, title transfers to MARAD, domestic ship dismantling, and artificial reefing) that are most advantageous to the Navy, while also evaluating additional options for ship disposal.

Delaying ship disposal creates unnecessary risks and increases life cycle costs as inactive ships designated for disposal continue to deteriorate with age and the cost to maintain them increases. However, the Navy cannot sustain full utilization of all available ship disposal methodologies due to anticipated future budget limitations for ship disposal, and the Navy is therefore decreasing its emphasis on ship dismantling, which is the highest cost of all ship disposal options available.

Table 1 – Navy-Titled Obsolete Vessels in the Maritime Administration (MARAD) National Defense Reserve Fleet designated for Disposal

Ship	Location	Method of Disposal	Projected Cost of Disposal
AFDM 2 drydock	MARAD Beaumont, TX	FY 2006 National Defense Authorization Act proposes to grant AFDM 2 to the Port of Port Arthur, TX	\$0
Gallup (PG 85)	MARAD Beaumont, TX	Scrap	\$250,000
Oriole (MHC 55)	MARAD Beaumont, TX	Foreign Military Sale	\$0
Falcon (MHC 59)	MARAD Beaumont, TX	Foreign Military Sale	\$0
Osprey (MHC 51)	MARAD Beaumont, TX	Logistics Support Asset	\$500,000
Robin (MHC 54)	MARAD Beaumont, TX	Logistics Support Asset	\$500,000
Iowa (BB 61)	MARAD Suisun Bay, CA	Donation hold	\$0
Sea Shadow (IX 529)	MARAD Suisun Bay, CA	Donation hold	\$0
Triumph (AGOS 1)	MARAD Suisun Bay, CA	Transfer to another Navy activity for use as a training vessel	\$0
Jouett (CG 29)	MARAD Suisun Bay, CA	Navy Sink Exercise	\$750,000
Horne (CG 30)	MARAD Suisun Bay, CA	Navy Sink Exercise	\$750,000
Proteus (IX 518)	MARAD Suisun Bay, CA	Navy Sink Exercise or artificial reefing	\$800,000
Fort Fisher (LSD 40)	MARAD Suisun Bay, CA	Navy Sink Exercise	\$400,000

Notes:

- (1) Ships designated for Navy sink exercise or artificial reefing may also be placed under contract for domestic ship dismantling based on availability of funding and determination of the disposition that is most advantageous for the Navy for the purpose of inactive ship inventory reduction.

Table 2 – Ship Disposal Project Task Order Status – FY 1999 Contract

Ship/Towed From	Contractor	Awarded	Completed	Final Net Cost to Navy	Cost per ton
Blakely (FF 1072) INACTSHIPMAINTO Philadelphia	Metro Machine Corp., Philadelphia, PA	Sep 1999	Sep 2000	\$5,172,449	\$1,592
Paterson (FF 1061) INACTSHIPMAINTO Philadelphia	Baltimore Marine Industries, Baltimore, MD	Sep 1999	Jun 2000	\$4,385,074	\$1,349
Bagley (FF 1069) MARAD Suisun Bay	International Shipbreaking Ltd., Brownsville, TX	Sep 1999	Sep 2000	\$2,997,529	\$922
Lockwood (FF 1064) MARAD Suisun Bay	Ship Dismantlement and Recycling Joint Venture (VSE Corp./Earth Tech), San Francisco, CA	Sep 1999	Aug 2000	\$3,385,985	\$1,042
Voge (FF 1047) INACTSHIPMAINTO Philadelphia	Metro Machine Corp.	May 2000	Jan 2001	\$2,614,337	\$968
Gray (FF 1054) MARAD Suisun Bay	Ship Dismantlement and Recycling Joint Venture (VSE Corp./Earth Tech)	May 2000	Aug 2001	\$2,922,153	\$899
Cochrane (DDG 21) INACTSHIPMAINTO Pearl Harbor	International Shipbreaking Ltd.	Nov 2000	Oct 2000	\$2,268,025	\$687
Biddle (CG 34) INACTSHIPMAINTO Philadelphia	Metro Machine Corp.	Dec 2000	Jan 2002	\$3,700,814	\$661
Lot of seven minesweepers INACTSHIPMAINTO Philadelphia	Baltimore Marine Ind.	Dec 2000	Feb 2002	\$3,825,039	\$869
Meyerkord (FF 1058) MARAD Suisun Bay	Ship Dismantlement and Recycling Joint Venture (VSE Corp./Earth Tech)	Dec 2000	Sep 2001	\$2,925,127	\$900
Lang (FF 1060) MARAD Suisun Bay	Ship Dismantlement and Recycling Joint Venture (VSE Corp./Earth Tech)	Jan 2001	Sep 2001	\$2,924,651	\$900
Harry E. Yarnell (CG 17) INACTSHIPMAINTO Philadelphia	Metro Machine Corp.	Feb 2001	Apr 2002	\$3,302,625	\$590
Hewitt (DD 966) Towed from homeport of San Diego upon decommissioning	International Shipbreaking Ltd.	Tow Aug 2001 Scrap Nov 2001	Nov 2002	\$3,144,520	\$524

Edward McDonnell (FF 1043) INACTSHIPMAINTO Philadelphia	Metro Machine Corp.	Dec 2001	Jul 2002	\$2,272,377	\$842
Claude V. Ricketts (DDG 5) INACTSHIPMAINTO Philadelphia	Metro Machine Corp.	Dec 2001	Oct 2002	\$2,702,506	\$819
Coontz (DDG 40) INACTSHIPMAINTO Philadelphia	Metro Machine Corp.	Feb 2002	Apr 2003	\$3,376,077	\$650
Francis Hammond (FF 1067) INACTSHIPMAINTO Bremerton, WA	International Shipbreaking Ltd.	Feb 2002	Jan 2003	\$1,436,224	\$442#
Preble (DDG 46) INACTSHIPMAINTO Philadelphia	Metro Machine Corp.	Mar 2002	Jan 2003	\$3,377,173	\$532
Halsey (CG 23) MARAD Suisun Bay	International Shipbreaking Ltd.	Nov 2002	Nov 2003	\$2,933,079	\$500#
Mahan (DDG 42) INACTSHIPMAINTO Philadelphia	Baltimore Marine Ind.	Jan 2003	Jul 2004 +	\$3,141,501	\$603
Sampson (DDG 10) INACTSHIPMAINTO Philadelphia	Metro Machine Corp.	Feb 2003	Oct 2003	\$2,818,980	\$854
England (CG 22) MARAD Suisun Bay	International Shipbreaking Ltd.	Sep 2003	Oct 2004	\$1,097,851	\$187
Sellers (DDG 11) INACTSHIPMAINTO Philadelphia	Metro Machine Corp.	Sep 2003	Sep 2004	\$2,455,863	\$744
MacDonough (DDG 39) INACTSHIPMAINTO Philadelphia	Metro Machine Corp.	Sep 2003	Sep 2004	\$3,020,864	\$580
Roarke (FF 1053) INACTSHIPMAINTO Bremerton, WA	International Shipbreaking Ltd.	Oct 2003	Oct 2004	\$1,466,295	\$451
Gridley (CG 21) MARAD Suisun Bay	International Shipbreaking Ltd.	Nov 2003	Feb 2005	\$1,857,478	\$399#
Lawrence (DDG 4) INACTSHIPMAINTO	Metro Machine Corp.	Nov 2003	Oct 2004	\$2,572,898	\$780

Philadelphia					
Luce (DDG 38) INACTSHIPMAINTO Philadelphia	Metro Machine Corp.	Mar 2004	Jun 2005	\$2,784,842	\$535
Aubrey Fitch (FFG 34) INACTSHIPMAINTO Philadelphia	Metro Machine Corp.	May 2004	May 2005	\$1,757,021	\$603
Leahy (CG 16) MARAD Suisun Bay	International Shipbreaking Ltd.	Jul 2004	Jul 2005	\$1,948,000	\$348#

+ Due to the bankruptcy of Baltimore Marine Industries, the contract was terminated for default and the ex-Mahan task order was re-awarded to Metro Machine Corp. for dismantling in Philadelphia.

Towing accomplished by Navy assets, not part of contract cost.

Table 3 – Ship Disposal Project Task Order Status – FY 2005 Contract

Ship	Contractor	Awarded	Completed	Net Cost to Navy	Cost per ton
Sterrett (CG 31) MARAD Suisun Bay	International Shipbreaking Ltd.	Jul 2005	In Progress	\$2,784,982*	\$416*
Barney (DDG 6) INACTSHIPMAINTO Philadelphia	Metro Machine Corp.	Jul 2005	Feb 2006	\$1,419,924*	\$478*
Dahlgren (DDG 43) INACTSHIPMAINTO Philadelphia	ESCO Marine, Inc.	Jul 2005	Apr 2006	\$1,197,395*	\$239*
John Rodgers (DD 983) INACTSHIPMAINTO Philadelphia	International Shipbreaking Ltd.	Sep 2005	In Progress	\$1,867,580	\$283
Farragut (DDG 37) INACTSHIPMAINTO Philadelphia	International Shipbreaking Ltd.	Sep 2005	In Progress	\$2,074,275	\$415
Oliver Hazard Perry (FFG 7) INACTSHIPMAINTO Philadelphia	Metro Machine Corp.	Sep 2005	Apr 2006	\$2,515,714	\$839
Seattle (AOE 3) INACTSHIPMAINTO Philadelphia	ESCO Marine, Inc	Sep 2005	In Progress	\$1,385,726	\$127
Detroit (AOE 4)	ESCO Marine, Inc	Sep 2005	Oct 2006	\$1,785,726	\$164

INACTSHIPMAINTO Philadelphia					
Stark (FFG 31) INACTSHIPMAINTO Philadelphia	Metro Machine Corp.	Oct 2005	Jun 2006	\$1,718,836	\$572
San Diego (AFS 6) INACTSHIPMAINTO Philadelphia	ESCO Marine, Inc	Apr 2006	In Progress	\$1,635,000	\$172
Moosbrugger (DD980) INACTSHIPMAINTO Philadelphia	ISL	May 2006	In Progress	\$1,469,850	\$222
John Hancock (DD981) INACTSHIPMAINTO Philadelphia	ISL	May 2006	In Progress	\$1,469,850	\$222
Fox (DD981) MARAD Beaumont	ISL	Jul 2006	In Progress	\$397,788	\$63
Des Moines (CA134) INACTSHIPMAINTO Philadelphia	ESCO	Aug 2006	In Progress	\$755,000	\$47#
Mississinewa (AO-144) MARAD James River Fleet, Newport News	ISL	Sep 2006	Pending Tow	\$0.02	\$0
Santa Barbara (AE-28) INACTSHIPMAINTO Philadelphia	ESCO	Oct 2006	Pending Tow	\$781,089	\$77#

* Firm-fixed price award cost. Additionally, contractors are eligible for \$150,000 award fee for superior environmental and safety performance.

Towing accomplished by Navy assets, not part of contract cost.