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Report to the Chairman, Committee on Government Operations, House of Representatives

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NAVY CONTRACTING

Military Sealift Command Contracts for Operation Desert Shield

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National Security and
International Affairs Division

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May 14, 1991

The Honorable John Conyers, Jr.
Chairman, Committee on
Government Operations
House of Representatives

Dear Mr. Chairman:

In response to your January 8, 1991, letter, we reviewed the Military Sealift Command's (MSC) contracting practices during Operation Desert Shield. We also examined the prices paid by MSC for ocean freight transportation services compared to those obtained before Iraq's invasion of Kuwait.

Results in Brief

Under severe time constraints, MSC followed established contracting practices to obtain required shipping to support Operation Desert Shield. Due to the urgency of the sealift requirements, several waivers and deviations from standard procurement processes were necessary. However, the contracts we reviewed showed that MSC generally obtained competition and complied with the Competition in Contracting Act.

The prices MSC paid were mixed and generally higher than previous prices paid for similar transportation. However, price comparisons were difficult when including the specific services obtained because of the differences in each case. After considering many factors, we concluded that the prices MSC negotiated were fair and reasonable under the circumstances.

Background

The U.S. Transportation Command, established in October 1987, provides global air, land, and sea transportation to meet national security objectives. It is responsible for the worldwide mobility planning of the military forces' transportation overseas during national emergencies. Its three component commands—the Military Airlift Command, the Military Traffic Management Command, and MSC—are generally responsible for making the necessary transportation arrangements for air, land, and sea, respectively. When sealift requirements exceed the capacity of MSC's peacetime-chartered ships and shipping agreements, MSC can activate the Maritime Prepositioning Force ships. Further, it can (1) instruct the Maritime Administration to activate ships from the Ready Reserve

Force and (2) enter into contracts with commercial carriers for additional military ocean freight transportation services.

MSC's contracting activities are governed by the Federal Acquisition Regulation and the Competition in Contracting Act. Additional laws, such as the Cargo Preference Act of 1904, which requires the use of U.S. flag ships when available to satisfy requirements, place other constraints on MSC.

MSC enters into two types of shipping arrangements to meet military transportation requirements during the surge and sustainment phases. Under the surge phase, MSC charters various types of U.S. flag ships from carriers to meet specific shipping needs. Ships are generally chartered for a long-term period or for one or two trips and are used primarily to move military units' equipment, supplies, and ammunition during the initial, surge phase of military deployments. MSC also enters into agreements for space aboard U.S. flag vessels with regularly scheduled liner services to carry containers of supplies or to carry breakbulk cargo in less than shipload lots between specific ports. Breakbulk cargo is that cargo which is not containerized. This type of shipping is called the sustainment phase, and the amounts and duration of cargo requirements are much less certain than during the surge phase. Before August 1990, MSC's existing Container and Shipping Agreements with U.S. carriers did not have rates in place for the Middle East because only a small volume of military cargo was regularly shipped to that area. The Agreements normally covered a 6-month period; however, the latest agreement started in April 1990.

In early August 1990, after the invasion of Kuwait by Iraq, MSC was notified of urgent shipping requirements from the U.S. Transportation Command. MSC began chartering additional ships for the surge movement of military supplies, ammunition, and unit equipment to the Middle East from U.S. and European ports. MSC normally charters only U.S. flag ships because of the Cargo Preference Act. However, because of the limited availability of U.S. ships, MSC chartered foreign flag ships soon after Operation Desert Shield started. Of the 206 ships MSC chartered between August 10, 1990, and January 18, 1991, 177 were foreign flag ships.

Also in early August, requirements for space aboard regularly scheduled U.S. ships to the Middle East for containerized and breakbulk sustainment cargo became an urgent requirement. The precise number and type of containers required and delivery dates were indeterminate for the sustainment cargo. However, the estimated volume was approximately

1,600 40-foot equivalent unit containers for the first month and about 1,200 units or more per week thereafter. The amount of the breakbulk cargo was not estimated.

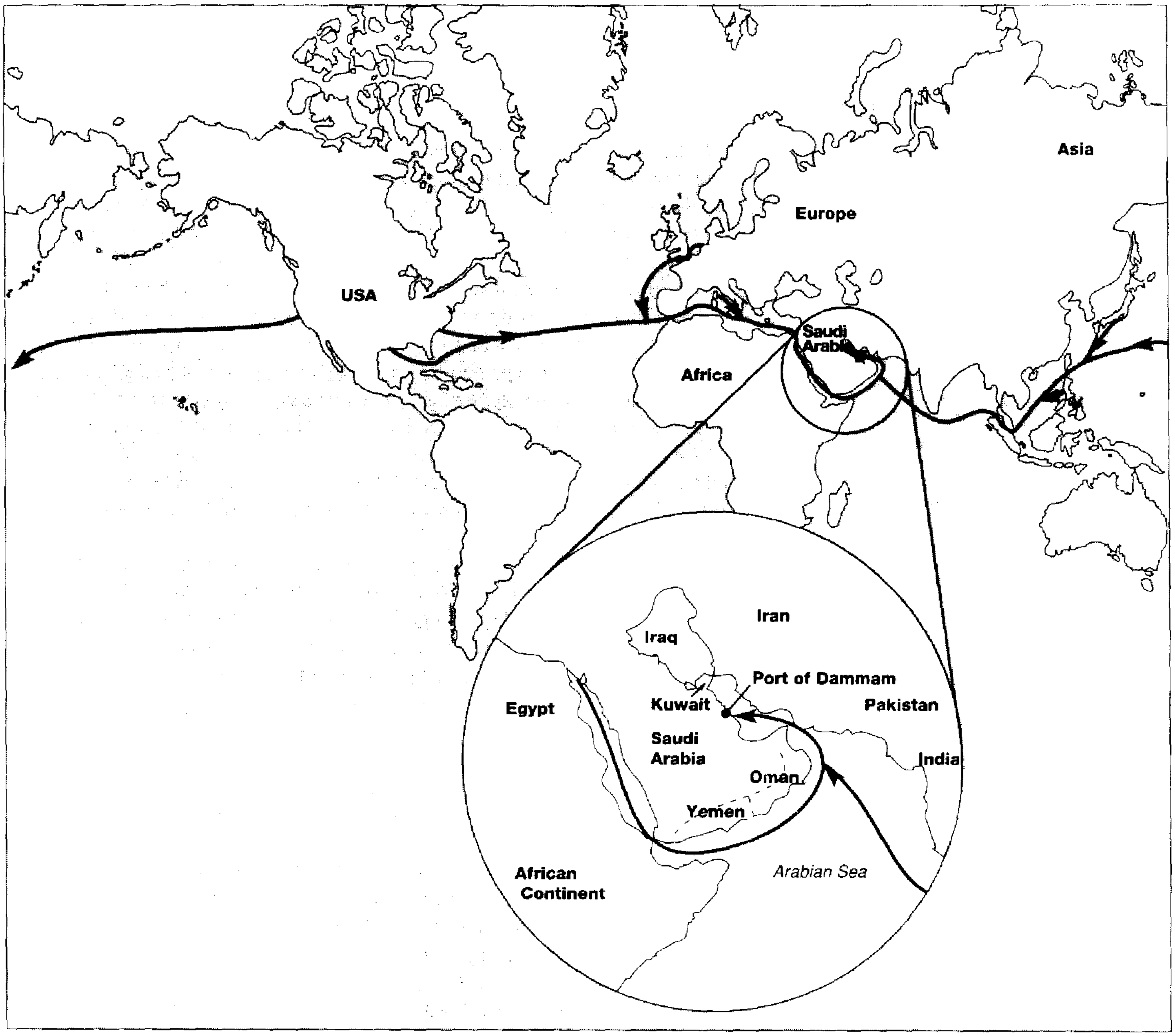
MSC Followed Contracting Procedures

MSC complied with the Competition in Contracting Act and other applicable laws and regulations. Because of the time constraints under which MSC was operating, certain procurement procedures, intended to enhance competition, were waived under an urgent national interest provision. For instance, the requirements to advertise upcoming ship charters in the Commerce Business Daily 15 days before issuance of a request for proposals and to wait another 30 days before receiving offers were both waived because of the need to have the ships under contract within a few days or even hours after the requirement became known. However, MSC was still able to achieve competition (the underlying principle of the Competition in Contracting Act) by electronically transmitting its requests for proposals directly to known shipowners and brokers worldwide. For the requests for proposals we reviewed, MSC asked for offers from an average of more than 100 potential suppliers and received an average of 8 offers for about 16 ships for each request for proposal.

In two instances a request for proposal was sent to one potential supplier. The first was sent in the first week of Operation Desert Shield, before MSC began chartering foreign-owned ships and after a market survey had shown that only one U.S. ship of the required type was available. The second was sent in December 1990, when there was a requirement to charter a U.S.-owned ship for security reasons, and MSC had already chartered most of the U.S.-owned ships of the required type. Of the three suppliers known to have an acceptable ship available, two expressed no interest during telephone calls from various MSC officials, so MSC negotiated a charter with the other supplier.

To support the immediate container and breakbulk cargo requirement to Middle East destinations for Operation Desert Shield, MSC used a new procurement that incorporated much of the existing worldwide container and shipping agreements with U. S. flag carriers. This new procurement included seven new routes to the Middle East and became known as the Special Middle East Sealift Agreement (SMESA). (See fig. 1.)

Figure 1: SMESA Routes to Dammam, Saudi Arabia



Within a 2-week period in August 1991, MSC (1) electronically transmitted the request for proposal to all 13 carriers with contracts under

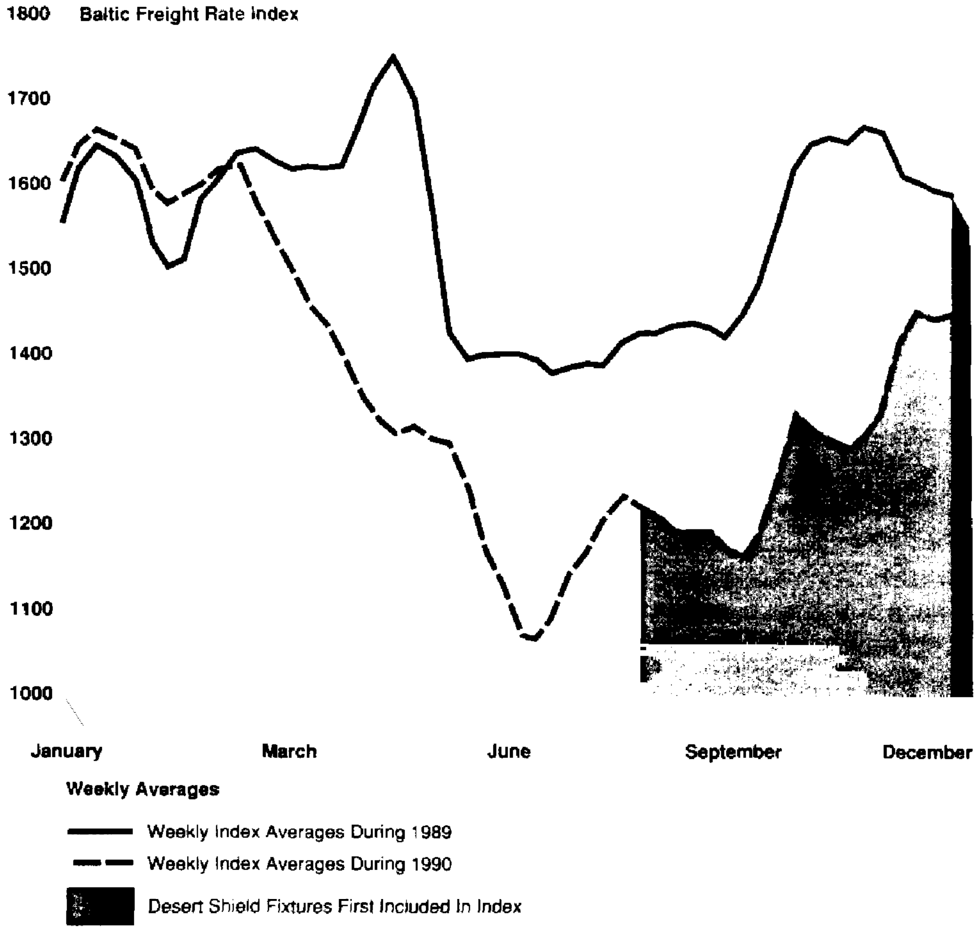
MSC's worldwide agreements, (2) received the initial offers, (3) performed technical and pricing analyses, (4) negotiated the offers, (5) requested and received the best and final offers, and (6) awarded contracts to seven carriers for container and general cargo service on the SMESA routes. During normal operations, this entire process would have taken about 6 months.

Prices Appear Reasonable

The prices that MSC obtained to charter ships appear reasonable, considering the market conditions under which the contracts were made. Some of the required types of ships—especially roll-on, roll-off ships for carrying vehicles—are in short supply worldwide. Additionally, shipowners may have been reluctant to remove ships from established trade because they might not be able to re-enter that trade after filling a short-term MSC requirement.

Another reason we believe the prices MSC obtained for emergency shipments to the Gulf were reasonable is that freight rates, in general, had begun to rise before August. Figure 2 displays data from Knight-Ridder, Inc.'s Transportation News Ticker, published in the Journal of Commerce. It represents the weekly averages of the Baltic Freight Index during 1989 and 1990. The index is comprised of 15 freight routes representing global rates for dry cargo shipments. The index can be used by bulk shipping owners and charterers as a basis for futures trading on the Baltic International Freight Futures Market in London, and as such should be reflective of movements in worldwide bulk freight rates. As shown, freight rates for dry cargo type shipping normally fluctuate with the seasons, rising during late summer and fall, peaking in winter, and falling again in the spring and early summer.

Figure 2: Baltic Freight Index: Weekly Averages During 1989 and 1990



Source: Data extracted from weekday Baltic Freight Index published in the Journal of Commerce, Transportation News Digest, and provided GAO by Knight-Ridder, Inc.

The timing of Operation Desert Shield required MSC to enter the chartering market heavily during late summer and fall when freight rates were already normally rising.

To meet urgent sealift requirements, MSC had to act under severe time constraints to obtain ships that met restrictive type, speed, size, and availability requirements in order to deliver specific cargoes on or before the required delivery dates. Also, to meet requirements, MSC issued requests for proposals detailing the technical qualifications of the needed ships. Based on the files we reviewed, we determined that after receiving the shipowners' responses, MSC eliminated from consideration the offered ships that could not meet their requirements and conducted negotiations with the technically qualified offerors in the competitive range. In several instances, we found that the same ship was offered for charter in succeeding requests for proposals at different prices, further demonstrating the supply-demand factors evident in the marketplace.

MSC officials told us that they established negotiating goals at what they believed to be fair prices per square foot (or per cubic foot, depending on ship type) and attempted to negotiate to these goals. MSC's negotiations resulted in the award of charter contracts at an average reduction of 10.9 percent from the lower offered prices and several reductions exceeded 50 percent. Additionally, MSC chartered eight ships twice during our review. Of these eight ships, the price of the second charter was higher for one ship, the same for one, and lower for the other six. The average second-charter price reduction was 9 percent.

The container and breakbulk prices or rates MSC obtained for SMESA also appeared to be reasonable under the circumstances. The prices for the many routes, zones, and commodity categories were mixed, with some higher and some lower in the very few instances where direct comparisons with previous rates could be made. MSC negotiated the offers with the contractors and obtained lower rates in some final offers.

The price analysis techniques MSC used to determine fair and reasonable prices for SMESA proposals were (1) comparison between the carriers for identical routes and (2) comparison with competitive published price lists, published market prices of commodities, and similar indexes.

Our attempt to compare Middle East liner prices before and after Operation Desert Shield proved inconclusive. Because of low military cargo volumes, the existing MSC container and shipping agreements did not have any established rates for the movement of military containerized cargo to the Middle East when Operation Desert Shield began. When shipments were required, containers of military cargo were booked on U.S. flag carriers at commercial tariff rates to that port. Existing MSC breakbulk rates for routes to the Red Sea region were extended and rates modified as needed to cover the cost of diverting a ship for a special cargo delivery to a Middle East port. MSC officials told us that when they determined SMESA price reasonableness, they compared proposed prices to available rates published in the commercial tariff for that region and to modified MSC worldwide container and shipping agreement rates. Because none of the routes and commodities matched directly, MSC officials had to make adjustments to the rates for comparison purposes.

One close match of a SMESA and commercial route was a U.S. East Coast to Dammam, Saudi Arabia route. For containerized cargo, the general cargo 40-foot container rates under SMESA were lower than the prior rate charged the government under the commercial tariff, but were higher in two cases and lower in another for 20-foot containers. For breakbulk cargo on this route, Operation Desert Shield rates were higher. MSC officials justified this, stating that the prior rates were only to Red Sea ports and were adjusted to extend the route to the Persian Gulf and to factor in the cost of servicing additional ports.

Comparison of military to commercial cargo rates requires knowledge of what services are included. The commercial tariff rates between two ports for different types of cargo commodities vary greatly and are not identical to military categories. Therefore, they can not be directly matched. Rate comparisons must also consider different sizes and types of shipping containers. In addition, elements such as ports used, foreign flag carriers included, scheduled departures, and transit times require adjustments to rates before comparisons can be made.

To meet urgent operational requirements, MSC officials said that their SMESA awards were also based on more than price alone. These awards were also based on scheduled sailing frequencies, cargo capacities, and transit speeds. For example, two of the carriers with lower prices for the route leaving U.S. East Coast ports to the Middle East had small capacity ships compared to the weekly volume required, with one scheduled to sail only every 2 weeks and the other every 10 days, each with slow transit times of 35 to 40 days. A third carrier's rate was slightly higher, but its ships had the required capacity needed, sailed every 10 days directly to Dammam, and had a transit time of 23 days.

Scope and Methodology

We interviewed and obtained information from the Departments of Defense and the Navy, MSC, and other government officials. We reviewed pertinent records as well as directives and guidelines. We also interviewed and obtained data from knowledgeable sources in the shipping industry, including a carrier, a freight forwarder, and several brokers, transportation analysts, and publishers.

To determine MSC's compliance with applicable procurement laws and regulations, we randomly selected and examined 30 of the 73 requests for proposals issued for ships that were chartered between August 10, 1990, and January 18, 1991. We also examined another 22 requests for proposals that were issued during the two busiest chartering periods in which we believed pressure to shortcut required procedures would have been the greatest. Our conclusions are based on the results of our examination of the proposals contained in the random sample, even though the other proposal files we examined also support our findings.

Based on our sample, we believe the results of our review are representative of the conditions present in the entire universe of 73 requests for proposals. The proposals in our sample resulted in the charter of 99, or 48 percent, of the 206 ships contracted for during the period. Adding the other 22 proposals not randomly selected, we examined contracting actions for a total of 174 of the 206 ships MSC chartered during the period.

We conducted our review from January through April 1991 in accordance with generally accepted government auditing standards. As requested, we did not obtain written agency comments on this report. However, we discussed its contents with officials from the Military Sealift Command. We have incorporated their comments as appropriate.

Unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from its issue date. At that time we will send copies of this report to the Chairmen, Senate and House Committees on Appropriations and on Armed Services, and Senate Committee on Governmental Affairs; the Secretaries of Defense and the Navy; the Commanders of the Transportation Command and the Military Sealift Command; and the Director of the Office of Management and Budget. Copies will also be made available to others on request.

Please contact me at (202) 275-6504 if you or your staff have any questions concerning this report. Major contributors to this report are listed in appendix I.

Sincerely yours,

Martin M Ferber
Director, Navy Issues

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