(S E R V E D)
(AUGUST 17, 1990)
(FEDERAL MARITIME COMMISSION)

FEDERAL MARITIME COMMISSION

46 CFR PART 540

[DOCKET NO. 90-01]

SECURITY FOR THE PROTECTION OF THE PUBLIC, MAXIMUM REQUIRED PERFORMANCE AMOUNT

AGENCY: Federal Maritime Commission.

ACTION: Final Rule.

SUMMARY: The Federal Maritime Commission ("Commission" or "FMC") amends its regulation at § 540.9(j) that specifies a $10 million maximum amount for insurance, escrow, guaranty, or surety bond required of passenger vessel operators as evidence of financial responsibility for indemnification of passengers for nonperformance of transportation. The Commission has determined that levels of unearned passenger revenue for some larger passenger vessel operators are well beyond $10 million. This amendment retains a ceiling, but increases it from $10 to $15 million. The Commission has determined $15 million to be adequate at this time for indemnification of the passenger public for nonperformance. Additionally, this Final Rule amends the existing 6-month reporting requirement at § 540.9(h) to require every operator to submit a statement of its highest unearned passenger revenue for each month in the 6-month reporting period. Further amendments, additions or deletions to 46 CFR Part 540 may be considered as part of Fact Finding Investigation No. 19, initiated this date, to determine if additional revisions to these regulations are in order.

EFFECTIVE DATE: One hundred and eighty days after publication in the Federal Register.

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SUPPLEMENTARY INFORMATION:

By notice published in the Federal Register of January 19, 1990 (55 FR 1850), the Commission issued a Notice of Proposed Rulemaking ("Proposed Rule") in the subject proceeding. The Proposed Rule would delete the current $10 million ceiling for coverage required of passenger vessel operators as evidence of financial responsibility for indemnification of passengers for nonperformance of transportation. This action was proposed in response to the effects of inflation, the increasing popularity of the passenger vessel industry, and the knowledge that some operators maintain unearned passenger revenue in excess of $10 million. Accordingly, as a means of ensuring adequate protection for the cruising public, the Proposed Rule would require all applicants/certificants without exception to qualify for a Certificate (Performance) for the full amount of unearned passenger revenue calculated in accordance with the 110 percent rule stated in 46 CFR § 540.5.

The Commission also proposed to amend its existing 6-month reporting requirement at 46 CFR § 540.9(h). The proposed reporting would require that every passenger vessel operator submit a statement of its highest unearned passenger revenue for each month in the 6-month reporting period since the last report. This data

would enable the Commission to monitor compliance with the Proposed Rule.

The Commission received 14 comments from interested parties. Ten commenters[1] generally opposed implementation of the Proposed Rule, and four commenters[2] favored its implementation. ICPL commented on behalf of a number of individual cruise lines,[3] certain of whom, while fully endorsing the comments of ICPL, submitted separate comments.

COMMENTS

ICPL submitted the most extensive comments. ICPL takes the position that the Commission's proposal needs modification in order to achieve the necessary objectives of protecting the public and avoiding over-regulation. It suggests that no factual record has

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[1]Commenters opposed to the Proposed Rule were: The International Committee of Passenger Lines ("ICPL"); The Peninsular and Oriental Steam Navigation Company of London, England, and its wholly-owned subsidiary, Princess Cruises, Inc. (collectively "P&O"); Royal Caribbean Cruises Ltd. ("Royal Caribbean"); Kloster Cruise Limited, d/b/a Norwegian Cruise and Royal Viking Line ("Kloster"); Carnival Cruise Line ("Carnival"); Admiral Cruises Inc. ("Admiral"); American Hawaii Cruises ("AHC"); the American Society of Travel Agents, Inc. ("ASTA"); American Canadian Caribbean Line, Inc. ("ACCL"); and the International Group of P & I Clubs ("P&I Group").

[2]Commenters favoring the Proposed Rule were Clipper Cruise Line ("Clipper"), Federated International Travel ("FIT") and Mr. Timothy J. Dacey and Mr. Harry Birger (cruise consumers).

[3]ICPL is a trade association. Its comments represent the views of the following cruise lines: Bermuda Star Line; Carnival; Chandris Cruise Lines; Costa Crocierie S.P.A.; Crystal Cruises; Cunard Line Limited; Epirotiki Lines; Holland America Line; Kloster; Ocean Cruise Lines/Pearl Cruises; P&O; Premier Cruise Lines; Royal Caribbean; and Sun Line Cruises.

been developed to support changing the $10 million ceiling and that an evidentiary record is needed to support the proposed change. ICPL states that the Commission has not provided sufficient information to show that the current rule has failed its purpose, and it calls for an investigation and hearing to develop the record.

ICPL argues that any final rule should not be based on "the unsubstantiated worst case scenario," but the real need for passenger protection based on actual industry experience. It states that growth of the industry and higher levels of advance customer deposits confirm the stability of the industry and the esteem with which it is held by the traveling public. ICPL contends that performance coverage should protect the public against the operators that history shows create the greatest risk -- operators on a narrow financial footing and with little or no experience in cruise operations.

ICPL refers to the legislative history of P.L. 89-777, the law which the Commission's rules at issue here implement, stating that Congressional intent was to enact legislation directed at "fly by night" operators of questionable financial soundness and which would not result in over-regulation that financially burdens reputable cruise lines. ICPL further states that P.L. 89-777 was meant to provide for "financial responsibility," not an unconditional guarantee. ICPL alleges that section 2 of P.L. 89-777, which reduces the amount of protection per passenger as the number of vessel berths increases, evidences a Congressional

intention that passenger fares not be covered "dollar for dollar." ICPL asserts that "worst case scenario" situations were not intended to be covered.

ICPL contends that the record of the industry does not support the concerns of the Commission. It claims that only a few cruise operators have ceased operations and failed to perform, usually due to insolvency (i.e., small, undercapitalized lines), and that all passengers received refunds under the current rules.

Deletion of the "maximum" coverage is unnecessary and its cost unduly burdensome and onerous, according to ICPL. ICPL believes that a ceiling may be warranted because of the operator's history of performance, the operator's financial condition and the operator's type of operation (such as seasonal service), and recommends that the Commission might consider a sliding scale for performance coverage over $10 million.

ICPL states that the Protection and Indemnity Clubs ("P&I Clubs")[4] have been providing the required guaranties for the issuance of certificates, and have been requiring their cruise operator members to furnish bank guaranties to indemnify the Clubs for any liability that may be incurred under their guaranties filed with the Commission. ICPL believes that the continued viability of this system, which it claims has worked well in the past, will be at risk if the Commission removes all limits. It cites limited options for obtaining the large bonds or guaranties required if the

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[4]Protection and Indemnity Clubs are groups of vessel owners that band together to mutually protect and indemnify each other.

Proposed Rule is adopted. ICPL adds that the resulting substantial increase in costs of obtaining the increased coverage would necessitate capital restructuring over a long period of time to meet the new obligation.

Finally, ICPL suggests that the Commission address changes to the current self-insurance rule[5] to provide the industry with a viable option to the Proposed Rule and suggests that a thorough overall evaluation of the rules is needed in today's environment. ICPL states that the application of the rules to advertising of vessels under construction, seasonal operations, and vessel operator reporting standards requires examination in order to make the regulations, as a whole, responsive to current circumstances.

The separate comments of P&O, Royal Caribbean, Kloster, Admiral[6] and Carnival largely echo those of ICPL, but provide data on their own particular operations to demonstrate the financial soundness of established cruise operators.

P&O takes exception to the premise that, due to larger fleets creating higher levels of unearned passenger revenue industry-wide, the public is insufficiently protected. It concludes that the increase in the industry's popularity, fares and fleet size has led to an increase in financial stability and profits. P&O contends that, given developments in the industry, customers'

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[5]Qualification as a self-insurer under FMC rules at 46 CFR § 540.5(d) is not a part of the current rulemaking proceeding. Any additional changes to 46 CFR Part 540 not noticed in the Proposed Rule would require a separate rulemaking proceeding.

[6]Admiral is under common ownership with Royal Caribbean Cruises, Ltd.

deposits are now more secure than ever before, and the underlying rationale for the Proposed Rule is not supported by industry developments. P&O advises that, since the inception of the FMC's requirements for indemnification against non-performance, P&O's bond has never been needed to satisfy a performance failure. P&O submits that the extraordinary costs of the Proposed Rule are not commensurate with any perceived benefits.

Royal Caribbean states that other insurance coverage already protects the cruise line and passengers. In addition to protection and indemnity coverage, Royal Caribbean identifies hull insurance which protects against loss in the event a vessel is damaged or lost, and loss of hire insurance in the event a vessel goes off hire as a result of damage to the vessel.[7] These, Royal Caribbean contends, greatly diminish the financial risk to the cruise lines and passengers in a "worst case scenario."[8] Royal Caribbean suggests that the Commission may want to explore other alternatives to the Proposed Rule which could include taking into consideration the length of time a line has been in business, whether or not a line has missed a sailing due to financial failure, and the general reputation that a line has earned. It also concurs (in connection with suggestions as to the self-insurance rule - see Footnote 5) that net worth provides a reliable and perhaps best measure of a

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[7]It should be noted that passengers may not have direct recourse for damages against the alternative forms of insurance coverage.

[8]Admiral also cites these alternative forms of insurance coverage in its comments.

company's financial stability.

Kloster maintains that financial stability can be measured by examining the financial statements of a cruise operator, and proposes that the net worth of such operators be used to measure financial stability. It states that this would rightfully give an advantage to larger, more financially stable companies over newly founded cruise companies that are more likely to default on passenger deposits. Kloster believes that the Proposed Rule could have an impact of more than $100 million on the economy, and that a major increase in costs or prices for consumers could take place. It suggests that the Commission take more time to study the impact of the Proposed Rule as a "major rule" as defined in Executive Order 12291, 46 FR 12193, February 27, 1981.

Carnival submits that an operator's responsibility to demonstrate financial responsibility should be controlled by its level of risk. It suggests that, if the Commission wants an operator to guarantee fares, this should be required only where the risk is high; but, as the risk of nonperformance diminishes, the operator's corresponding obligation should also diminish, from filing a guaranty to submitting that information necessary to establish financial responsibility. Carnival is of the opinion (in connection with suggestions as to the self-insurance rule - see Footnote 5) that net worth provides a reliable indication of a company's financial stability. It therefore suggests net worth as the appropriate measure for financial responsibility, with safeguards in the event the net worth, or acceptable multiples

thereof, fall below a certain net worth-unearned revenue ratio; thereafter, and until the required net worth levels are obtained, additional security would be required, such as the existing bond scheme.[9]

Admiral's comments echo many of those previously discussed and generally question why the Commission would consider changing a regulation that has achieved what it is intended to achieve, namely, the financial protection of passengers.

Comments by AHC also largely repeat those of the other commenters opposing the Proposed Rule. AHC submits that the FMC's proposal is not supported by any factual record, and, at a minimum, the Commission should hold a hearing to determine whether conditions in the cruise industry warrant any increase in the bonding and insurance requirements to carry out the purpose of Congress in enacting P.L. 89-777. It states that the proposed 110 percent bonding level is "unreasonable, wholly impracticable, and

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[9]Carnival requests that its comments be accepted by the Commission as a "formal Petition for Rulemaking with regard to the Self Insurance provisions of the rule. (Part 540 - Security for the Protection of the Public; Section 540.5(d).)." The request does not conform with the requirements of the FMC's rules at 46 CFR § 502.51, "Petition for issuance, amendment, or repeal of rule." The request is unclear and indefinite. It addresses itself to "all aspects" of the self insurance rule, but does not state the desired relief. It is unclear whether the "petitioner" is seeking amendment or repeal of the rule. Furthermore, facts to support the arguments made for review of the self insurance rule are not included in the document or in any way verified. The "petition" also fails to cite by appropriate reference the statutory provisions or other authority relied upon for relief (46 CFR § 502.69(a)), nor was it accompanied by remittance of a $50 filing fee (46 CFR § 502.69(b)). Therefore, Carnival's request is denied.

especially harmful to U.S.-flag carriers."[10] It proposes that, if the Commission determines to change the regulation, it should create a system which uses a "sliding scale" rather than a dollar-for-dollar bonding limit, takes into account the carrier's assets and financial ability to respond to claims, and provides a practical method for financially viable carriers to self-insure.[11]

ASTA states that the Proposed Rule contains no specific facts to justify imposing an unlimited funding requirement on passenger vessel operators. It argues that an unlimited funding requirement is unnecessary if the risks associated with purchases on the larger cruise lines are minimal. ASTA concludes that such a requirement would only increase prices to the consumer without providing a meaningful increase in protection. Finally, it suggests that it might be more cost effective if the Commission established, as an alternative to the Proposed Rule, financial standards for passenger vessel operators that trigger the need for increased protection when the standards are not met.

ACCL asks the Commission to allow some method of self-insurance (see Footnote 5) or use of liquid assets, together with other qualifications, to avoid the cost of a bond. Those savings

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[10]AHC advises that, due to higher operating costs and certain restrictions on gambling and duty free shop operations in the domestic trades, its operating margins are not as readily available as foreign lines' to fund vastly increased bonding requirements. It states that any increase in bonding will penalize AHC and other U.S.-flag lines for having their services based in U.S. ports. AHC contends that U.S.-flag carriers benefit the U.S. economy by creating jobs and purchasing domestic products and services.

[11]See Footnote 5.

could arguably be passed on to passengers.

The P&I Group requests that the Commission establish a more realistic limit than proposed in the rule, and questions the ability of the P&I Clubs to continue to provide evidence of financial responsibility for cruise operators at the proposed increased level.[12] It expresses fears that the present system, which it contends works well, may be replaced by one which is cumbersome and expensive without any corresponding benefit to the consumer. The P&I Group acknowledges, however, that inflation may well have eroded the ceiling originally fixed and that the cruise industry has grown. However, it regards these factors as militating for a change in the ceiling, not its abolition.

Advocates of the Proposed Rule generally support the change based on observations by the Commission that passenger vessel fleets have been consolidated; fares have increased; vessel capacity has increased; and unearned passenger revenues are maintained well in excess of $10 million by some operators. Mr. Dacey believes that the Proposed Rule will provide consumers with greater confidence that their deposits are protected. FIT concurs that the existing ceiling of $10 million is too low and that the protection of the public will be better achieved by the Proposed Rule, as does Clipper. Clipper also cites (as did AHC) the various disadvantages of the smaller American cruise lines vis-a-vis the larger foreign flag operators. Mr. Birger suggests that the

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[12]At the present time the P&I Club guaranty is the method most widely used to satisfy the FMC's nonperformance financial responsibility requirements.

interest earned by passenger vessel operators on prepaid fares would offset any increased bond cost that would result from the Proposed Rule.

DISCUSSION

Upon review of the comments, the Commission has determined to issue a modified Final Rule. The modifications to the Proposed Rule reflect both the Commission's concerns for the widening gap between the unearned passenger revenues of some operators and the existing $10 million ceiling, and the concerns of the majority of the commenters regarding the public benefits to be derived from the Proposed Rule vis-a-vis the resulting cost to the industry.

The six major arguments expressed by the commenters are summarized below and discussed in turn:

1. The Commission should conduct a formal investigation before the $10 million ceiling is eliminated.

The Final Rule retains a ceiling but increases it from $10 million to $15 million. An increase in the ceiling amount is deemed necessary because of consolidation of passenger vessel fleets, increases in fares and vessel capacity, and some unearned passenger revenue amounts well in excess of $10 million. In addition, inflationary trends continue to exert pressure on the price of passenger fares. The P&I Group noted in its comments that inflation may have eroded the ceiling originally fixed, that the cruise industry has grown significantly, and that these factors militate for a change in the ceiling. The amount of the increase in the current ceiling ($10 million to $15 million) is predicated, for the most part, upon the increase in the consumer price index

("CPI") since the last increase in the ceiling which occurred in 1981. The index for 1981, as represented in the April 1990 publication of Economic Indicators, is 90.9; the same index for March 1990 is 128.7 -- a 42 percent increase. A 50 percent increase in the ceiling is fair and should not be unduly burdensome on the industry.[13]

2. There should be a complete revision of the Commission's passenger vessel operator financial responsibility regulations.

Many commenters observe that the Commission's regulations have served the cruising public well in the past, and Commission records bear out these observations. Nevertheless, they suggest that a complete revision of the Commission's financial responsibility regulations may be in order. The Commission agrees that alternative approaches should be explored. Accordingly, a Fact Finding Investigation is being instituted by separate order this date to develop current financial and operational information regarding the passenger vessel industry to determine whether any additional or alternative means of regulation would be appropriate in the area of financial responsibility.

The Commission is aware of the ambiguities contained in P.L. 89-777 sections 3(a) and 3(b). Section 3(a) states that financial responsibility may be established by providing financial information to the Commission or, alternatively, by posting a bond -- with no indication as to the amount of assets required in the

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[13]The $10 million ceiling, which was set in 1981, represented an increase from the original $5 million ceiling, based on these same considerations.

financial statement, but with the admonition in section 3(b) that if a bond is filed its amount shall be equal "to the estimated total revenue for the particular transportation." Moreover, it is unclear as to whether section 3(b) refers to a single trip or to all the trips for which deposits have been made.

The literal language of the statute favors the former interpretation, although this may be inconsistent with the statute's intent. There is no indication that raising the ceiling to $15 million, parallel to the rise in CPI over the period, would be insufficient to cover the unearned passenger revenue actually collected for any single voyage being offered at this time. However, the Commission expects the investigation instituted on this matter will produce enough information on which to base any recommendations to Congress to resolve these ambiguities.

3. There is no evidence that the present system of establishing financial responsibility for nonperformance is inadequate.

As previously indicated, some passenger vessel operators maintain unearned passenger revenues in excess of the current $10 million ceiling. Unearned passenger revenues of such magnitude indicate the potential for harm to the passenger public should the large operator suffer severe financial reverses. The Commission believes that it need not await a financial failure before addressing adequate levels of financial responsibility for the passenger public's protection.

4. The P&I Clubs would be unable to continue providing guaranties if the $10 million ceiling is removed.

The P&I Group addressed this issue in its comments as follows:

> If no provision is made for a ceiling at all then it is plain the exposure of a major operator would number in the hundreds of millions and not tens of millions. It is equally plain that the other shipowner members of any P&I Associations would be unwilling to tie up general funds of the Association to that extent . . . .

Fifteen larger passenger vessel operators who have been operating for a number of years currently maintain evidence of financial responsibility in the maximum amount of $10 million. Most of these operators have submitted a guaranty issued by a P&I Club. The P&I Clubs have questioned their ability to issue guaranties in the increased amounts prescribed in the Proposed Rule. Furthermore, since the P&I Clubs require the operators to collateralize the guaranties, the operators have stated that this would subject them to a severe financial hardship.

The Commission has determined not to do away with a ceiling amount on insurance, escrow, guaranty, or surety bond required. Information developed in the Fact Finding Investigation established concurrently with this rule may, however, support actions to the contrary.

5. The Commission should consider the record of larger cruise operators in establishing the amount of financial responsibility required for nonperformance.

Commission records support the contentions of the larger operators concerning their record of performance. The most recent passenger vessel failures have involved new or small operators.[14] Longevity of service and ability to refund deposits or fares for

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[14]Aloha Pacific Cruises, American Cruise Lines, Exploration Cruise Lines, and Great Pacific Cruise Lines.

nonperformance of transportation may be relevant to evidence of financial responsibility. These factors may be considered in the Fact Finding Investigation instituted this date, and further support the imposition of a ceiling on the required bonds.

6. The self-insurance requirements should be changed to eliminate the requirement that assets be located in the U.S. and the requirement for maintenance of working capital.

Any amendment of the self-insurance requirements would go beyond the scope of this proceeding and would require a further rulemaking. Self-insurance requirements may, however, be addressed in the Commission's Fact Finding Investigation No. 19.

The Final Rule also includes amending the existing 6-month reporting requirement at 46 CFR § 540.9(h), consistent with the Proposed Rule. It requires that every passenger vessel operator submit a statement of its highest unearned passenger vessel revenue for each month in the 6-month reporting period since the last report. This data will enable the Commission to monitor reported levels of unearned passenger revenue.

Other comments and arguments on the Proposed Rule not specifically addressed herein have been fully considered by the Commission and found either to be without merit or to be rendered moot by the Commission's modification of the Proposed Rule.

<u>**SUPPLEMENTAL COMMENTS**</u>

Subsequent to the close of the comment period, and the Commission's decision at an open meeting to increase the ceiling to $15 million, AHC was granted leave to file supplemental comments in this rulemaking. In its supplemental comments, AHC expresses

its concern that a fair and reasonable transition period be allowed for the implementation of the increase of the ceiling amount to $15 million. Specifically, it states that the increase should be scheduled so as to give affected carriers adequate time to arrange the financing and collateral necessary in connection with the increase.

AHC suggests a three-part implementation plan. First, it suggests a six-month delay in the effective date for the increase, citing the need to generate additional cash-flow to collateralize the 50% increase in the maximum amount or, alternatively, to refinance existing debt or undertake some form of supplemental financing. Second, it suggests that extensions of time beyond the proposed six-month compliance date be granted for "good cause shown." Essentially, AHC outlines the following criteria to qualify for such an extension:

1. The carrier has been in business for five years or more without claims against its bond;
2. There are no pending or threatened claims against the carrier's existing $10 million bond; and
3. The carrier demonstrates to the Commission that it has made diligent efforts to secure the additional financing necessary to support the additional performance bond, and there is reasonable expectation that such financing will be forthcoming.

Finally, AHC suggests "that the Commission should include a provision authorizing it to waive any of the self-insurance

provisions of 46 C.F.R. Section 540 within its sole discretion, in order to permit carriers to meet the additional $5,000,000 requirement through this mechanism."

The Commission believes that a six-month delay in the implementation of the increased ceiling amount is not unreasonable. As AHC indicates in its supplemental comments, the evidence of financial responsibility which carriers have posted in most cases must be fully collateralized by cash or equivalents as a requirement of underwriters providing such evidence. The underwriters generally will not issue a bond or other evidence unless it is supported by cash deposits or equivalents. Given the nature of the industry, some carriers (particularly smaller companies) may be unable to accumulate an additional $5 million in cash from their operations over a short period of time. Cash flows are needed to meet operating expenses and other operational commitments to service debt and are, therefore, not readily accumulated in the short term. The Commission, therefore, will grant a six-month delay in effectiveness of the Final Rule.

The Commission, however, rejects AHC's proposal to waive the self-insurance provisions to permit carriers to meet the additional $5 million required in the Final Rule. Part of AHC's suggested waiver mechanism (Items 2 and 3) are beyond the scope of the instant rulemaking proceeding and would require further notice and comment. The Fact Finding Investigation can serve to develop facts relevant to whether there should be any change in the self-insurance rules. It is the more appropriate vehicle for

consideration of this issue.

The Federal Maritime Commission has determined that this Final Rule is not a "major rule" as defined in Executive Order 12291, 46 FR 12193, February 27, 1981, because it will not result in: (1) an annual effect on the economy of $100 million or more; (2) a major increase in costs or prices for consumers, individual industries, Federal, State, or local government agencies, or geographic regions; or (3) significant adverse effect on competition, employment, investment, productivity, innovations, or on the ability of United States-based enterprises to compete with foreign-based enterprises in domestic or export markets.

The Acting Chairman of the Commission certifies, pursuant to section 605(b) of the Regulatory Flexibility Act, 5 U.S.C. 601, et seq., that this Final Rule will not have a significant economic impact on a substantial number of small entities, including small businesses, small organizational units, and small governmental jurisdictions.

The collection of information requirements contained in this regulation have been approved by the Office of Management and Budget under the provisions of the Paperwork Reduction Act of 1980 (P.L. 96-511) and have been assigned OMB control number 3072-0012.

List of Subjects in 46 CFR Part 540:

Insurance, Maritime carriers, Penalties, Reporting and recordkeeping requirements, Surety bonds, Transportation.

Therefore, pursuant to 5 U.S.C. 553; sec. 3. Pub. L. 89-777, 80 Stat. 1356-1358 (46 U.S.C. app. 817e); sec. 43 of the Shipping

Act, 1916 (46 U.S.C. app. 841a); and sec. 17 of the Shipping Act of 1984 (46 U.S.C. app. 1716), the Federal Maritime Commission amends Part 540 of Title 46 of the Code of Federal Regulations as follows:

1. Section 540.9(h), third sentence, is amended by removing the period and adding, ", and include a statement of the highest unearned passenger vessel revenue accrued for each month in the 6-month reporting period."

2. In §540.9, paragraph (j) is amended by replacing "10" with "15" at the end of the paragraph.

3. Form FMC-131, Part II - Performance, introductory paragraph is amended by replacing "ten (10)" with "fifteen (15)" in the second sentence; and paragraph 8 is amended by replacing "ten (10)" with "fifteen (15)".

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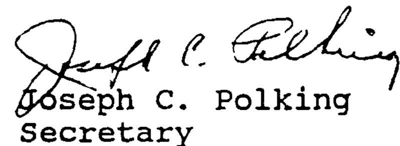
By the Commission.



Joseph C. Polking
Secretary