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FEDERAL MARITIME COMMISSION

46 CFR Part 540

[DOCKET NO. 92-50]

FINANCIAL RESPONSIBILITY REQUIREMENTS FOR NONPERFORMANCE OF TRANSPORTATION -- REVISION OF SELF-INSURANCE QUALIFICATION STANDARDS

AGENCY: Federal Maritime Commission.

ACTION: Notice of Proposed Rulemaking.

SUMMARY: The Federal Maritime Commission proposes to amend its procedures for establishing passenger vessel financial responsibility for nonperformance of transportation. The proposed rule provides that: (1) operators demonstrating a minimum of five years of operation in the United States trades with a satisfactory explanation of any claims for nonperformance of transportation need meet only net worth standards to qualify as self-insurers; and (2) operators qualifying for self-insurance may not use the sliding scale provisions to qualify for a Certificate (Performance).

DATE: Comments on or before [insert date fifteen (15) days after publication in the Federal Register].

ADDRESS: Send comments (original and fifteen copies) to:

Joseph C. Polking
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Federal Maritime Commission
800 North Capitol Street, N.W.
Washington, D.C. 20573
(202) 523-5725

FOR FURTHER INFORMATION CONTACT:

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SUPPLEMENTARY INFORMATION:

BACKGROUND

Section 3 of Public Law 89-777, 46 U.S.C. app. 817e, ("Section 3") is administered by the Federal Maritime Commission ("Commission" or "FMC"). Section 3 requires certain passenger vessel operators to establish their financial responsibility to indemnify passengers for nonperformance of transportation.[1] The Commission issues a Certificate of Financial Responsibility for Indemnification of Passengers for Nonperformance of Transportation to operators that demonstrate adequate financial responsibility.

The Commission's regulations implementing Section 3 are at 46 CFR 540, Subpart A. These regulations generally provide that passenger vessel operators may evidence their financial responsibility by filing with the Commission a guaranty, escrow

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[1]Section 3 provides, in pertinent part:

> No person in the United States shall arrange, offer, advertise, or provide passage on a vessel having berth or stateroom accommodations for fifty or more passengers and which is to embark passengers at United States ports without there first having been filed with the Federal Maritime Commission such information as the Commission may deem necessary to establish the financial responsibility of the person arranging, offering, advertising, or providing such transportation, or, in lieu thereof, a copy of a bond or other security, in such form as the Commission, by rule or regulation, may require and accept, for indemnification of passengers for nonperformance of the transportation.

arrangement, surety bond, insurance or self-insurance in an amount established by the Commission. This amount is based upon the operator's unearned passenger revenue ("UPR")[2] and must equal 110 percent of the operator's highest UPR over a 2-year period. The maximum coverage amount currently required is $15 million.

This proceeding is an outgrowth of the Notice of Proposed Rulemaking in Docket No. 92-19, Revision of Financial Responsibility Requirements for NonPerformance of Transportation ("NPR"). There the Commission proposed several revisions to its regulations governing the establishment of passenger vessel responsibility for the nonperformance of transportation,[3] including eliminating the requirement that operators maintain both working capital and net worth in the United States equal to 110% of their UPR to qualify as self-insurers. Only net worth equal to 110% of UPR would be required. Additionally, annual reporting

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[2]UPR is defined under 46 CFR 540.2(i) as:

> . . . that passenger revenue received for water transportation and all other accommodations, services, and facilities relating thereto not yet performed.

[3]Specifically, the Commission proposed revising its Section 3 rules to: (1) consider a factor-based sliding scale in determining individual operators' coverage levels; (2) modify its Section 3 self-insurance rules to allow operators to maintain only net worth in the United States equal to 110% of their UPR to qualify as self-insurers; (3) increase the frequency of filing for certain financial statements by self-insurers; (4) consider special provisions in its rules for "whole-ship contracts"; and (5) adopt a draft form escrow arrangement for the guidance of industry interests who require greater flexibility to accommodate fluctuating levels of UPR. For more information on the Commission's proposals and additional background, see the NPR (57 FR 19097 (May 4, 1992)) and the final rule in Docket No. 92-19 (57 FR 41887 (September 14, 1992)).

requirements applicable to self-insurers would be increased to semiannual reports.

The Commission's final rule in Docket No. 92-19 essentially adopts the proposed revisions noted above, with the exception of the self-insurance change. The Commission believes that the self-insurance proposal set forth in Docket No. 92-19 requires certain conditions to ensure adequate protection for those funds that are paid to passenger vessel operators who qualify as self-insurers. Although the Commission wishes to liberalize its Section 3 requirements in a manner which eases unnecessary burdens on passenger vessel operators, it also must maintain a regulatory regime that provides adequate protection of the travelling public. Therefore, the Commission has determined to re-publish the self-insurance revisions originally proposed in Docket No. 92-19, subject to certain conditions.

Comments in Docket No. 92-19 in connection with self-insurance revisions were filed by: Delta Queen Steamboat Company ("Delta Queen"), an intercoastal waterway U.S.-flag passenger vessel operator;[4] American Hawaii Cruises ("AHC"), a deep-water U.S.-flag passenger vessel operator; District 2 of the Marine Engineers Beneficial Association ("MEBA"), a maritime labor union representing the officers of AHC's vessels; and the International Council of Cruise Lines ("ICCL"), an association of foreign-flag passenger vessel operators.

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[4]Delta Queen filed two comments, a June 16, 1992 submission by David W. Kish, Vice President, Administration, and a June 17, 1992 submission by S. Cody Engle, Chairman of the Board.

1. **Self-insurance Qualification Requirements**

Delta Queen supports the NPR's self-insurance proposal. It suggests that net worth be required at a level of 110 percent of an operator's greatest amount of UPR during the prior two fiscal years, with the operator having the option of valuing its assets at fair market value. It argues that fair market value, as compared to the historical cost less depreciation carried on an operator's books, more accurately identifies the assets available to satisfy nonperformance claims.

AHC also supports the NPR's approach, asserting that the current regulations are largely unworkable for mid-sized companies such as AHC, that have to use more financially onerous methods to meet their Section 3 requirements. Also, while it is not concerned with the physical location of an operator's assets, AHC suggests that the Commission consider allowing some reliance on foreign-based assets, either on a case-by-case basis or through a regulatory format.

MEBA urges the Commission to adopt the NPR's liberalized self-insurance criteria.

ICCL supports the proposed approach on self-insurance, but opposes the requirement that an operator's assets must be located in the United States in order to qualify as a self-insurer. It notes that the nature of its members' business is international and by definition the assets are mobile. ICCL states that adequate legal process is available to attach those assets when and if required.

ICCL contends that the specific location of an operator's net worth has no bearing on the operator's financial responsibility, yet current requirements are the primary reason that large cruise operators, which are financially stable and ought to be able to qualify as self-insurers, would be unable to self-insure under the NPR. ICCL urges the Commission to allow operators to self-insure if they have net worth of at least two times the difference between UPR and cash on hand.[5] ICCL also requests that the Commission allow a company to self-insure its entire cruise fleet, including its affiliates, through the issuance of guaranties by the operator or its parent company with respect to its affiliates' performance.[6]

The Commission is considering adopting the self-insurance proposal tendered in Docket No. 92-19, with two conditions: (1) operators qualifying for self-insurance would not be permitted to use the sliding scale adopted by the Commission in the final rule in Docket No. 92-19; and (2) to qualify as a self-insurer, an applicant must also demonstrate a minimum of five years of operation in the United States trades with a satisfactory

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[5]ICCL would define "cash on hand" as cash, plus short-term investments, plus undrawn lines of credit from established financial institutions; "UPR" as monies paid to the carrier by passengers, less payments made by the carrier to purchase airline tickets and/or other payments directly related to the passenger booking; and "net worth" as the company's shareholders' equity in accordance with generally accepted accounting principles.

[6]It would appear that the Commission's present rules with respect to self-insurance and guaranties may accommodate ICCL's suggestion. Nothing in the Commission's rules would preclude a parent from acting as a guarantor with respect to its affiliates' performance if the Commission determined the parent to be "acceptable" pursuant to its rules. (46 CFR 540.5(c)).

explanation of any claims for nonperformance of transportation.

In terms of the security ultimately provided to the travelling public, the Commission must consider self-insurance in a considerably different light from other methods of establishing Section 3 coverage. The rules set forth in 46 CFR Part 540 Subpart A are designed to assist the Commission in determining the amount and type of coverage necessary to protect the public. In most cases, the operator acquires the financial instrument that actually provides that coverage from a recognized institution, which must independently assess the actual risks and costs associated with providing the coverage. With self-insurance, the operator itself -- not an independent entity -- makes those assessments and undertakes to provide the necessary coverage. This means that when the operator presents a proposal for self-insurance to the Commission, such a proposal is essentially presented without benefit of an independent entity's endorsement of the operator's risk-worthiness. To assure the adequacy of the self-insurance proposal, the Commission therefore must evaluate the financial probabilities and risks based upon the applicant's own assessment of its financial health.

Self-insurance presents a greater risk of loss to the travelling public than do other forms of coverage that are backed by independent interests holding sums of money for the protection of the public. Consequently, while the Commission believes that it is appropriate to ease the burden on the passenger vessel industry, it does not wish to expose the travelling public to undue

risk. Accordingly, the Commission proposes to allow operators to qualify for self-insurance on the basis of their net worth alone, but without the benefit of the sliding scale provisions of the final rule in Docket No. 92-19. Liberalized sliding scale provisions will be available only where coverage is provided through independent interests. As an additional safeguard, the Commission also proposes to require operators wishing to qualify for self-insurance to provide evidence (in the form of an affidavit by the operator's Chief Executive Officer or other responsible corporate officer) of a minimum of five years' operation in United States trades, with a satisfactory explanation of any claims for nonperformance of transportation.

Several commenters have suggested that the Commission reconsider the requirement that the assets used to qualify as a self-insurer be physically located in the United States. As explained in Docket No. 92-19, the Commission is particularly concerned that the underlying purposes of Public Law 89-777 could be defeated if operator assets sufficient to indemnify passengers are not readily available in the United States:

> A judgment against an operator who has failed to perform becomes meaningless if the assets in the United States are insufficient to satisfy the judgment. Passengers may not have the ability or resources to pursue foreign-domiciled assets. Such efforts would probably not be cost-effective in the majority of instances. This view is supported in some measure by comments received in this proceeding. For instance, ICCL suggested that it would be inappropriate to consider an operator's vessels as assets in the United States since these vessels are outside of United States waters most of the time. SAA, a major surety association, also opposes removing the U.S.-based asset requirement.

Docket No. 92-19 NPR, p.9. The record developed in that proceeding has not dissuaded the Commission from this view.

2. **Semiannual financial statements by self-insurers**

In connection with the liberalization of the self-insurance requirements in Docket No. 92-19, the Commission proposed more frequent reports concerning the financial standing of self-insurers. While Delta Queen believes that reporting by self-insurers would be appropriate, it suggests that semiannual filings would be unnecessary and unduly burdensome for operators which are "public" companies subject to the quarterly reporting requirements of the Securities Exchange Act of 1934, because their financial state is already a matter of public record.

Notwithstanding the fact that the reports of certain companies may be publicly available, the discrete elements subject to reporting in Docket No. 92-19 focus on those matters of greatest relevance to the Commission's administration of its Section 3 program with regard to self-insurers. On the basis of the present record, the Commission is not convinced that the proposed reporting requirements would be excessive for those operators wishing to avail themselves of liberalized self-insurance standards. Accordingly, the semiannual reporting requirements are retained.

Although the Commission, as an independent regulatory agency, is not subject to Executive Order 12291, dated February 17, 1981, it has nonetheless reviewed the rule in terms of this Order and has determined that this rule is not a "major rule" 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 Federal Maritime Commission certifies, pursuant to section 605(b) of the Regulatory Flexibility Act, 5 U.S.C. 605(b), that this Proposed Rule, if adopted, will not have a significant economic impact on a substantial number of small entities, including small businesses, small organizational units, and small governmental organizations. The passenger vessel operators impacted by the rule are generally not small businesses.

The collection of information requirements contained in this rule have been submitted to OMB for review under section 3504(h) of the Paperwork Reduction Act of 1980, as amended. Public reporting burden for this collection of information is estimated to be 3 hours per respondent, including time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. Send comments regarding the burden estimate or any other aspect of this collection of information, including suggestions for reducing this burden, to Norman W. Littlejohn, Director, Bureau of Administration, Federal Maritime

Commission, Washington, D.C. 20573 and to the Office of Information and Regulatory Affairs, Office of Management and Budget, Attention: Desk Officer for the Federal Maritime Commission, Washington, D.C. 20503.

List of Subjects in 46 CFR Part 540

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

Therefore, pursuant to 5 U.S.C. 553; section 3 Pub. L. 89-777, 80 Stat. 1356-1358 (46 U.S.C. app. 817e); section 43 of the Shipping Act, 1916 (46 U.S.C. app. 841a); and section 17 of the Shipping Act of 1984 (46 U.S.C. app. 1716), the Federal Maritime Commission proposes to amend Part 540 of Title 46 of the Code of Federal Regulations as follows:

Part 540 - [AMENDED]

1. The authority citation to Part 540 continues to read:

Authority: 5 U.S.C. 552, 553; secs. 2 and 3, Pub. L. 89-777, 80 Stat. 1356-1358 (46 U.S.C. app. 817e, 817d); sec. 43 of the Shipping Act, 1916 (46 U.S.C. app. 841a); sec 17 of the Shipping Act of 1984 (46 U.S.C. app. 1716).

2. Section 540.5 is amended by revising the introductory text of paragraph (d) and paragraphs (d)(4),(5) and (6), and the introductory text of paragraph (e) to read as follows:

§ 540.5 Insurance, guaranties, escrow accounts, and self-insurance

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(d) Filing with the Commission for qualification as a self-insurer such evidence acceptable to the Commission as will

demonstrate continued and stable passenger operations over an extended period of time in the foreign or domestic trade of the United States. Such evidence must include an affidavit by the operator's Chief Executive Officer or other responsible corporate officer of a minimum of five years of operation in United States trades, with a satisfactory explanation of any claims for nonperformance of transportation. In addition, applicant must demonstrate financial responsibility by maintenance of net worth in an amount calculated as in the introductory text of this section. The Commission will take into consideration all current contractual requirements with respect to the maintenance of such net worth to which the applicant is bound. Evidence must be submitted that the net worth required above is physically located in the United States. This evidence of financial responsibility shall be supported by and subject to the following which are to be submitted on a continuing basis for each year or portion thereof while the Certificate (Performance) is in effect:

* * * * *

(4) Semiannual current statement of the book value or current market value of any assets physically located within the United States together with a certification as to the existence and amount of any encumbrances thereon;

(5) Semiannual current credit rating report by Dun and Bradstreet or any similar concern found acceptable to the Commission;

(6) A list filed semiannually of all contractual requirements or other encumbrances (and to whom the applicant is bound in this

regard) relating to the maintenance of net worth;

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(e) The following schedule may be applied to determine the minimum coverage required for indemnification of passengers in the event of nonperformance of water transportation for those operators who (1) have not elected to qualify by self-insurance; and (2) can provide evidence (in the form of an affidavit by the operator's Chief Executive Officer or other responsible corporate officer) of a minimum of five years of operation in United States trades, with a satisfactory explanation of any claims for nonperformance of transportation:

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By the Commission

Ronald D. Murphy
Assistant Secretary