FEDERAL MARITIME COMMISSION

Appeared in FR 5/4/92

46 CFR Part 540

[DOCKET NO. 91-32]

PASSENGER VESSEL FINANCIAL RESPONSIBILITY REQUIREMENTS FOR INDEMNIFICATION OF PASSENGERS FOR NONPERFORMANCE OF TRANSPORTATION -- ADVANCE NOTICE OF PROPOSED RULEMAKING AND NOTICE OF INQUIRY

[DOCKET NO. 92-19]

REVISION OF FINANCIAL RESPONSIBILITY REQUIREMENTS FOR NON-PERFORMANCE OF TRANSPORTATION

AGENCY: Federal Maritime Commission.

ACTION: Notice of Proposed Rulemaking.

SUMMARY: The Federal Maritime Commission discontinues Docket No. 91-32, Notice of Inquiry and Advance Notice of Proposed Rulemaking, and proposes to amend 46 CFR Part 540, Subpart A, which sets forth procedures for establishing passenger vessel financial responsibility for nonperformance of transportation. The proposed rule would: (1) institute a sliding-scale formula for operators meeting certain requirements; (2) provide that operators need meet only existing net worth standards to qualify as self-insurers; (3) require semi-annual rather than annual filing of certain financial statements by self-insurers; (4) provide for certain treatment for "whole-ship" arrangements; and (5) publish a suggested form escrow arrangement as a guideline for the industry.

DATE: Comments on or before [insert date forty-five (45) days after publication in the Federal Register].

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

Joseph C. Polking
Secretary
Federal Maritime Commission
1100 L Street, N.W.
Washington, D.C. 20573
(202) 523-5725

FOR FURTHER INFORMATION CONTACT:

Bryant L. VanBrakle
Director
Bureau of Tariffs, Certification and Licensing
Federal Maritime Commission
Washington, D.C. 20573
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SUPPLEMENTARY INFORMATION:

BACKGROUND

The Federal Maritime Commission ("Commission" or "FMC") administers, inter alia, section 3 of Public Law 89-777, 46 U.S.C. app. 817e ("Section 3"). Section 3 requires certain passenger vessel operators to have sufficient financial responsibility to indemnify passengers for nonperformance of transportation.[1] Operators demonstrating adequate financial responsibility to the Commission are issued a Certificate of Financial Responsibility for

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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.

Indemnification of Passengers for Nonperformance of Transportation ("Performance Certificate").

The FMC's regulations implementing Section 3 are at 46 CFR 540, Subpart A. In general terms, these regulations require certain passenger vessel operators to demonstrate their financial responsibility to indemnify passengers for nonperformance of transportation. Financial responsibility may be evidenced by filing with the Commission a guaranty, escrow arrangement, surety bond, insurance or self-insurance in an amount established by the Commission. This amount, based upon the operator's unearned passenger revenue ("UPR"),[2] must be equal to 110 percent of the operator's highest UPR over a 2-year period. The maximum coverage amount currently required is $15 million.

In early 1990, the Commission realized that higher fares, the increased popularity of passenger cruises and an increase in the size of individual operator vessel fleets had resulted in some operators accumulating UPR substantially exceeding the $10 million ceiling for Section 3 coverage then in effect.[3] The Commission therefore issued a proposed rulemaking in Docket No. 90-1[4] to remove the ceiling, thereby requiring dollar-for-dollar coverage for all

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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]The last previous increase in the ceiling, from $5 million to $10 million, occurred in 1981.

[4]Security for the Protection of the Public, Maximum Required Performance Amount, 55 FR 1850 (January 19, 1990).

UPR. This proposal elicited substantial industry opposition. Docket No. 90-1's Final Rule[5] did not remove the ceiling. Instead, it increased the ceiling from $10 million to $15 million. Current with the issuance of the rule the Commission instituted Fact Finding Investigation No. 19 ("FF-19")[6] to determine whether its passenger vessel regulations required further revision.

In his Report to the Commission ("Report") in FF-19, Commissioner Francis J. Ivancie, the Inquiry Officer, recommended that the $15 million ceiling be retained. He also recommended liberalizing the self-insurance rules; a sliding scale of coverage keyed to UPR levels; greater emphasis on operator experience in setting coverage levels; and a review of the Commission's regulations to explore alternative methods of providing coverage and exempting "whole-ship" contracts. In August 1991, following its review of Commissioner Ivancie's Report, the Commission instituted Docket No. 91-32, Passenger Vessel Financial Responsibility Requirements for Indemnification of Passengers for Nonperformance of Transportation -- Advance Notice of Proposed Rulemaking and Notice of Inquiry ("Inquiry").[7]

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[5] 55 FR 34564 (August [illegible],

[6] Passenger Vessel Financial Responsibility Requirements, Order of Investigation, [illegible] August 23, 1990).

[7] 56 FR 40586 (August [illegible] 1991).

THE INQUIRY

The Inquiry solicited comment on the Report's recommendations[8] and the meaning of section 3(b) of Public Law 89-777.[9] Comments were filed by the Surety Association of America ("SAA"),[10] Diamond Cruise Ltd., Oy. ("Diamond"),[11] Mitsui O.S.K. Passenger Line ("Mitsui"),[12] the International Council of Cruise Lines ("ICCL")[13]

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[8]Comment was not sought on the Inquiry Officer's recommendation that the Commission consider informing Congress of the FMC's (a) lack of authority to extend protection to the land and air portions of cruises; and (b) lack of jurisdiction over foreign-to-foreign cruises marketed in the United States. The Inquiry stated that this recommendation need not be included in an advance notice of proposed rulemaking because the Commission can evaluate the issues within the Agency.

[9]Section 3(b) of Public Law 89-777 states, inter alia: "If a bond is filed with the Commission, such bond . . . shall be in an amount paid equal to the estimated total revenue for the particular transportation." By letter dated February 28, 1992, the Commission advised Congress, in the event that it was believed that a Congressional clarification of the matter is warranted, that the FMC interprets section 3(b) as affording the Commission the discretion to establish a maximum coverage level.

[10]SAA states that it is a trade association supported by more than 650 surety companies which collectively write about 95% of the surety bonds written in the United States. SAA's comments are on behalf of those of its members which write the passenger vessel surety bonds required by 46 CFR Part 540.

[11]Diamond is a Finnish corporation, which intends to specialize in selling all available accommodations on a scheduled cruise to a single corporate customer pursuant to a "whole-ship" contract.

[12]Mitsui's interest focuses on the "whole-ship" issues in the proceeding.

[13]ICCL is the successor organization to the International Committee of Passenger Lines, and is a non-profit trade association. It states that its members are foreign corporations which fly only foreign flags and have about 90% of the deep-sea lower berth cruise capacity in the world, representing over 71,000 lower berths and about 26 million passenger cruise days annually.

and American Hawaii Cruises ("AHC").[14]

The comments generally focus on the burdens passenger vessel operators believe they face due to the Commission's existing regulations, and the previous proposal in Docket No. 90-01 to eliminate the financial responsibility coverage ceiling. The comments also addressed the Commission's self-insurance requirements, the use of a sliding scale to determine Section 3 coverage requirements and the Commission's treatment of "whole-ship" charters by corporate/institutional sponsors.

DISCUSSION

After considering the issues presented in FF-19 and the comments submitted in response to the Inquiry, the Commission proposes to: (1) retain the current $15 million ceiling; (2) consider a factor-based sliding scale in determining individual operators' coverage levels; (3) modify its Section 3 self-insurance rules to eliminate the requirement that operators maintain both working capital and net worth to qualify as self-insurers;[15] (4) require semi-annual rather than annual filing of certain financial statements by self-insurers; (5) consider special provisions in its rules for "whole-ship contracts"; and (6) adopt a draft form escrow arrangement for the guidance of industry

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[14]AHC states that it is the only U.S.-flag cruise line operating large deep-water cruise vessels. It operates in the Hawaiian inter-island trades with the 800-passenger [illegible] vessels CONSTITUTION and SS INDEPENDENCE.

[illegible] the requirement that self-insurers maintain the required [illegible] the United States.

interests requiring greater flexibility to accommodate fluctuating levels of UPR.

1. **The Ceiling**

A further revision in the ceiling appears to be unwarranted at this time.

Although neither SAA nor ICCL urges that the current ceiling be reduced, AHC suggests that the previous $10 million ceiling be restored. It also advocates a sliding-scale proposal which would reduce coverage requirements for operators having UPR in the $5 million to $35 million range. AHC is concerned that the $15 million ceiling may have a disproportionate impact on mid-sized operators such as itself.

The current $15 million ceiling does not, in all instances, provide passengers dollar-for-dollar coverage. As a general matter, however, this ceiling appears to strike a reasonable balance between Public Law 89-777's objective of protecting passengers and the requirements this legislation imposes on the cruise line industry. Section 3 arose in response to the stranding of passengers by vessel operators unable or unwilling to perform the transportation that had been paid for. The regulatory scheme that has been in place for the last 25 years has been instrumental in preventing financial loss to passengers, and does not appear to have resulted in undue burdens to the industry as a whole.[16]

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[16]During the nearly 25 years since the enactment of Public Law 89-777, there have been about eight failures requiring claims to be paid by the underwriters of Section 3 performance coverage. The level of coverage was sufficient to fully protect passengers in each instance.

Therefore, the Commission is retaining the present $15 million ceiling. However, to the extent the ceiling may impose a burden on certain operators with UPR at or near the ceiling that could be disproportionate to their potential risks of failure, the Commission is considering the sliding scale discussed below.

2. **A sliding scale**

Although the Commission is continuing the current $15 million ceiling, AHC's suggestion for a sliding scale within the $15 million ceiling appears to have merit, subject to certain safeguards. This rulemaking proposes that the Commission apply a sliding scale to UPR amounts between $5 million and $35 million to determine the appropriate financial responsibility required for a passenger vessel operator. Operators could qualify to use the sliding scale if they demonstrated a minimum of five years' uninterrupted passenger vessel service in the U.S. trades[17] with a satisfactory record of performance, or explanation of any claims for instances of non performance. The Commission will evaluate these explanations on an ad hoc basis. Any operator unable to meet these criteria would become subject to the current requirement to maintain a bond, escrow, insurance, guaranty, or self-insurance (or a combination thereof) equal to 110 percent of its highest UPR within the last two fiscal years, up to the $15 million ceiling.

It is requested that commenters address the standards and structure of the sliding-scale formula proposed herein.

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[17] Breaks in operation due to seasonal schedules would not constitute a break in service.

particular, it is requested that the comments address the issues of (1) the adequacy of the maximum $5 million coverage per vessel; (2) whether other factors/breakpoints/criteria should be used; and (3) any other factors bearing upon the Commission's possible adoption of such an approach.

3. **Self-insurance**

The Commission has decided against proposing that self-insurance assets be permitted to be maintained outside the United States. However, the Commission proposes to eliminate the requirement that both net worth and working capital be maintained by operators wishing to qualify as self-insurers.

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.

However, the Commission proposes to allow an operator to

qualify as a self-insurer based upon its net worth alone. Presently, operators must maintain both working capital and net worth equal to their UPR to qualify as Section 3 self-insurers. It would appear to be inappropriate to allow an operator to qualify as a self-insurer based strictly upon working capital. Working capital is extremely liquid and provides, standing alone, little if any protection for passengers. Indeed, the commenters advised that operators need their working capital for their day-to-day operational expenses.

In proposing this liberalization of the Commission's self-insurance rules, the Commission intends to require more frequent reports concerning the self-insurer's financial standing. Presently, under 46 CFR §§ 540.5(d)(4), (5) and (6), the Commission requires the annual filing of certain financial statements.[18] The proposed rule requires semi-annual rather than annual filing of: current statements 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; and current credit rating reports by Dun and Bradstreet or any similar concern found acceptable to the Commission. The proposed rule also requires a semi-annual filing of the list of all contractual requirements [illegible] relating to maintenance of net worth.

[illegible] Section [illegible] (1), and (2) [illegible] are self-insurers to file quarterly balance sheets and income and surplus statements. Section 540.5(d)(3) requires an annual report of these two documents.

4. Whole-ship Contracts

Diamond and Mitsui assert that the consumer protection afforded by the FMC's regulations is unneeded in the context of corporate/institutional "whole-ship" charters. They argue that Section 3 was designed to protect individuals and not corporate/institutional purchasers of a whole-ship cruise, because the ultimate user of the transportation (the individual passenger) is not at risk with respect to nonperformance. In essence, their view is that the corporate/institutional sponsor arranging the contract with the operator is nearly equal in bargaining power and possesses more resources in arranging and achieving redress than does an individual passenger in cases of nonperformance.

The Commission finds merit in this position and is proposing to exempt whole-ship revenues from Section 3 UPR coverage. An exemption procedure is being proposed for those operators who wish to exclude whole-ship arrangements from their UPR calculations. This procedure would require the corporate party to the arrangement to (1) join the operator in seeking the exemption; and (2) acknowledge in writing that its rights to recovery for nonperformance under the provisions of Public Law 89-777 may have been affected thereby.[19]

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[19]Depending upon the comments received and its further analysis of the issues involved in whole-ship charters, if the Commission determines to exempt them from the passenger vessel operator's Section 3 UPR calculation, additional conditions could be imposed upon the corporate/institutional sponsor with regard to its assuming the operator's Section 3 responsibility to indemnify passengers/guests in the event of nonperformance.

The Commission recognizes that Public Law 89-777 could be interpreted as not clearly providing for whole-ship exemptions or the consequent abrogation of the rights, if any, of either the corporate entities or the individual passengers. The Commission specifically seeks comment on these issues.

5. **Escrow Arrangements**

The Inquiry noted the Report's finding that a relatively high percentage of passenger vessel certificants use guaranties, and that several other Section 3 coverage options are little-used. Industry participants in FF-19 asked the Commission to consider modifying the current options to provide flexibility in meeting coverage requirements. The Inquiry noted that although such modifications could lessen the financial burden on the industry, they could potentially reduce the amount of financial responsibility coverage available to passengers.[20] It further noted, however, that the record suggests that the industry has not yet fully explored the flexibility already afforded in the current regulations to use a combination of coverage methods. Instead, the industry has traditionally focussed on a single coverage method, e.g., a guaranty or surety bond, for the full amount of coverage.[21] Thus, the Inquiry noted that a high degree of

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[20]56 FR 38588 (August 15, 1991).

[21]In this regard, the Inquiry pointed out that the regulations currently contemplate the following five coverage methods: insurance, escrow account guaranty, self-insurance, or surety bond and that the required format for the guaranty and surety bond may be amended for good cause; that while working capital and net worth are considered in determining

(continued...)

flexibility already exists for passenger vessel operators to customize their coverage.[22]

AHC's comments express concern that the Commission's regulations may not provide sufficient allowance to accommodate fluctuations in an operator's UPR level due to vessel lay-up, seasonal fluctuations, and other factors. AHC's concern might be accommodated by escrow accounts which are permitted under FMC regulations at 46 CFR 540.5(b) and which provide a methodology for operators to obtain relief where UPR levels may fluctuate substantially from season to season. The escrow agreements that the Commission has approved to date typically provide for the escrow amount to fluctuate with the operator's current UPR level.[23]

The Commission has approved escrow arrangements that require the operators to escrow funds equaling their weekly UPR levels. UPR levels are recalculated on a weekly basis and are reported to the escrow agent and the Commission. The agreements require the

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[21](...continued)
qualification as a self-insurer, the working capital requirement may be waived for good cause; and that escrow accounts are unique documents customized to fit particular circumstances.

[22]Here, the Inquiry observed that a certificant seeking to lower costs associated with a $7 million surety bond could reduce its surety coverage to $5 million and qualify as a self-insurer for the remaining $2 million, noting that the potential savings from reduced bond coverage could compensate for the increased reporting requirements for self-insurance.

[23]The escrow agreements previously approved by the Commission have not been subject to the $15 million ceiling. The draft form escrow agreement proposed herein reflects this approach. Given the flow-through nature of the previously approved escrow agreements, the Commission believes that a ceiling would be inappropriate.

operators to deposit additional funds in the account if their weekly UPR levels increase. On the other hand, the operators receive payment if their weekly UPR levels have decreased.[24] Such escrow accounts protect unearned funds, while minimizing the financial burden imposed on cruise line operators who experience significant UPR fluctuations.

Under a guaranty, the underwriter's exposure is based on the operator's maximum UPR, although actual offseason UPR might be far less. In addition, the operator might be required to deposit countersecurity at the maximum amount with the underwriter. With an escrow account, revenues not needed to support UPR during the offseason could be released to the operator. Therefore, it would appear that an escrow account could address the concerns expressed by AHC in its proposal for an average UPR standard.[25]

The rule proposed herein includes a draft "form" of an escrow arrangement of a nature the Commission has previously found acceptable for Section 3 purposes. The Commission evaluates escrow

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[24]The escrow agreements which the Commission has previously approved require the operators to place a certain amount in the escrow account as a "cushion" to protect those funds that may not have been included in the weekly summary, such as those amounts held by travel agents and not yet reported.

[25]There appears to be increasing industry interest in escrow accounts. Nevertheless, based on the comments received in the Inquiry, some cruise operators may not favor escrow accounts because they use funds placed in these accounts as working capital to support current and future sailings. Given the flow-through nature of an escrow agreement, this should not be a significant impediment. However, the Commission would have some concerns about an operator that does not have sufficient funds to maintain an escrow account and the funds necessary to support current and future sailings, at least on a short term basis.

accounts on a case-by-case basis. However, this form provides a guideline that should clarify the characteristics of the instrument the Commission generally considers acceptable.[26] Also, the Commission wishes to point out that escrow accounts can be used in combination with other evidence of financial responsibility.[27] This would appear to provide a wide scope of arrangements which can be precisely tailored to meet a particular operator's Section 3 requirements. However, a review of the Commission's records indicates that few passenger vessel operators utilize escrow accounts as a method of establishing financial responsibility. The Commission therefore seeks comment on the feasibility of using escrow accounts to satisfy the requirements of Section 3.

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

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[26]The form published in the Appendix contains broad language. Interested parties may upon request obtain a redacted version of agreements previously approved by the Commission.

[27]The introductory paragraph of 46 CFR 540.5 provides that evidence of adequate financial responsibility may be established by one or a combination of the methods set forth in sections 540.5 and 540.6.

(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 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. The additional public reporting burden for this collection of information is estimated to average 60.91 hours per response, 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.

IT IS ORDERED, That Docket No. 91-32, Passenger Vessel Financial Responsibility Requirements for Indemnification of Passengers for Nonperformance of Transportation -- Advance Notice of Proposed Rulemaking and Notice of Inquiry, is hereby discontinued.

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. A new § 540.2 (l) is added to read as follows:

(l) Whole-ship charter means an arrangement between a passenger vessel operator and a corporate or institutional entity: (i) which is filed with the Commission for review pursuant to § 540.5(f) of this part;

(ii) which provides for use of the full reach of the passenger

accommodation of a vessel for an entire voyage or voyages; and

(iii) whereby the involved corporate or institutional entity provides such accommodations to the ultimate passengers free of charge.

3. Section 540.5 is amended by revising its introductory text, paragraph (b), the introductory text of paragraph (d), and subparagraphs (d)(4),(5) and (6), and by adding new paragraphs (e) and (f) reading as follows:

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

Except as provided in § 540.9(j), the amount of coverage required under this section and § 540.6(b) shall be in an amount determined by the Commission to be no less than 110 percent of the unearned passenger revenue of the applicant on the date within the 2 fiscal years immediately prior to the filing of the application which reflects the greatest amount of unearned passenger revenue, unless the applicant qualifies for consideration under § 540.5(e). The Commission, for good cause shown, may consider a time period other than the previous 2-fiscal-year requirement in this section or other methods acceptable to the Commission to determine the amount of coverage required. Evidence of adequate financial responsibility for the purposes of this subpart may be established by one or a combination (including § 540.6 Surety Bonds) of the following methods:

(b) Filing with the Commission evidence of an escrow account, acceptable to the Commission, for indemnification of passengers in

the event of nonperformance of water transportation. Parties filing escrow agreements for Commission approval who wish to facilitate such approval may execute such agreements in the form set forth in Appendix A of Subpart A of this Part.

* * * * *

(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. 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) Semi-annual 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) Semi-annual current credit rating report by Dun and Bradstreet

or any similar concern found acceptable to the Commission;

(6) A list filed semi-annually 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) In the event that an operator 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 record of performance or satisfactory explanation of any claims for instances of nonperformance, the following schedule may be applied to determine the minimum coverage required for indemnification of passengers in the event of nonperformance of water transportation:

UNEARNED PASSENGER REVENUE ("UPR")	**REQUIRED COVERAGE**
$0-$5,000,000	100% of UPR up to $5,000,000
$5,000,001 to $15,000,000	$5,000,000 plus 50% of excess UPR over $5,000,000 subject to an overall maximum of $5,000,000 per vessel
$15,000,001 to $35,000,000	$10,000,000 plus 25% of excess of UPR over $15,000,000 subject to an overall maximum of $5,000,000 per vessel and a $15,000,000 overall maximum
over $35,000,000	$15,000,000 overall maximum

(f) Revenues derived from whole-ship charters, as defined in [illegible] may be exempted from consideration as unearned passenger revenues, on condition [illegible], in the case of a new

operator or within 30 days of the execution of the whole-ship charter if the operator has a Performance Certificate for the vessel in question: (1) a certified true copy of the contract or charter is furnished with the application; (2) the chartering party attests that it will redistribute the vessel's passenger accommodations without charge; and (3) a document executed by the chartering party's Chief Executive Officer or other responsible corporate officer is submitted by which the chartering party specifically acknowledges that its rights to indemnification under section 3 of Public Law 89-777 may be affected by the reduction in section 3, Public Law 89-777, financial responsibility coverage attributable to the exclusion of such funds from the operator's UPR.

4. An Appendix A is added to Part 540, Subpart A, reading as follows:

Appendix A - Example of Escrow Agreement for use under 46 CFR 540.5(b)

ESCROW AGREEMENT

1. Legal name(s), state(s) of incorporation, description of business(es), trade name(s) if any, and domicile(s) of each party.

2. Whereas, [name of the passenger vessel operator]("Operator") and/or [name of the issuer of the passenger ticket]("Ticket Issuer") wish(es) to establish an escrow account to provide for the indemnification of certain of its passengers utilizing [name vessel(s)] in the event of nonperformance of

transportation to which such passengers would be entitled, and to establish the Operator's and/or Ticket Issuer's financial responsibility therefor; and

3. Whereas, [name of escrow agent]("the Escrow Agent") wishes to act as the escrow agent of the escrow account established hereunder.

4. The Operator and/or Ticket Issuer will determine, as of the day prior to the opening date, the total amounts of U.S. unearned passenger revenues ("UPR") which it had in its possession. Unearned passenger revenues are defined as [incorporate the elements of 46 CFR 540.2(l)].

5. The Operator and/or Ticket Issuer shall on the opening date deposit an amount equal to UPR as determined above, plus a cash amount equal to [amount equal to no less than 10% of the Operator's and/or Ticket Issuer's UPR on the date within the 2 fiscal years immediately prior to the filing of the escrow agreement which reflects the greatest amount of UPR, except that the Commission, for good cause shown, may consider a time period other than the previous 2-fiscal-year requirement or other methods acceptable to the Commission to determine the amount of coverage required]("initial deposit").

6. The Operato[illegible]nd/or Ticket Issuer may at any time deposit additional funds to the account.

7. The Operator and/or Tic[illegible]ssuer shall, at the end of each busi[illegible]ess week, reco[illegible]R by first computing:

A. the amount by [illegible] UPR has decreased due to: (1)

refunds due to cancellations; (2) amount of cancellation fees assessed in connection with (1) above; and (3) the amount earned from completed cruises; and

B. the amount by which UPR has increased due to receipts from passengers for future water transportation and all other related accommodations and services not yet performed.

The difference between the above amounts is to be the amount by which UPR has increased or decreased ("new UPR"). If the new UPR plus the amount of the initial deposit exceeds the amount in the escrow account, the Operator and/or Ticket Issuer shall deposit the funds necessary to make the account balance equal to UPR plus the initial deposit. If the account balance exceeds new UPR plus the initial deposit, the balance shall be available to the Operator and/or Ticket Issuer. The information computed in paragraph 7 shall be furnished to the Commission and the Escrow Agent in the form of a recomputation certificate signed and certified by a competent officer of the Operator and/or Ticket Issuer. Copies sent to the Commission are to be addressed to the Director, Bureau of Tariffs, Certification and Licensing, Federal Maritime Commission, Washington, D.C. 20573.

8. A monthly report shall be prepared by the Escrow Agent and provided to the Operator and/or Ticket Issuer and the Commission within 15 days of the end of each month and shall list the investment assets of the account, their original

cost, their current market value, and the beginning and ending balance of the account.

9. The Operator's and/or Ticket Issuer's independent auditors shall prepare quarterly reports, such reports to be furnished to the Escrow Agent and the Commission, and any shortfall is to be covered within one business day.

10. The Escrow Agent shall invest the funds of the account in qualified investments as directed by the Operator and/or Ticket Issuer. Some examples of qualified investments are, to the extent permitted by law:

(a) Government obligations of the United States or its agencies;

(b) Certificates of deposit, time deposits or acceptances of any bank, savings institution or trust company whose debt obligations are in the two highest categories rated by Standard and Poor's or Moody's, or which is itself rated in the two highest categories by Keefe, Bryette and Woods;

(c) Commercial paper similarly rated;

(d) Certificates or time deposits issued by any bank, savings institution or trust company when fully insured by the FDIC or the FSLIC;

(e) Money market funds utilizing securities of the above quality and/or

Corporate bonds of the above highest categories, as rated by Standard and Poor's or Moody's.

11. Income derived from the investments shall be credited to the escrow account.

12. The purpose of the escrow agreement is to establish the financial responsibility of the Operator and/or Ticket Issuer pursuant to section 3 of Public Law 89-777, approved November 5, 1966, and the account is to be utilized to discharge the Operator's and/or Ticket Issuer's legal liability to indemnify passengers for nonperformance of transportation via the [name of vessel(s)]. The Escrow Agent is to make such payments on instructions from the Operator and/or Ticket Issuer, or, in the absence of such instructions, 21 days after final judgment against the Operator and/or Ticket Issuer in a U.S. Federal or State court having jurisdiction. The Operator and/or Ticket Issuer will pledge to each passenger holding a ticket for future passage on the Operator's/Ticket Issuer's vessel(s) an interest in the Escrow Account equal to the Fares amount shown on the face of such ticket. The Escrow Agent agrees to act as nominee for each passenger until transportation is performed or until passenger has been compensated.

13. Escrow Agent shall waive right to offset.

14. The Operator and/or Ticket Issuer will indemnify and hold Escrow Agent harmless.

15. Statement of the parties' agreement concerning warranty of <u>bona fides</u> by the Operator and/or Ticket Issuer and Escrow Agent.

16. Statement of the parties' agreement concerning fees to be paid

by the Operator and/or Ticket Issuer to Escrow Agent, reimbursable expenses to be paid by the Operator and/or Ticket Issuer to Escrow Agent. A statement that fees for subsequent terms of agreement are to be negotiated.

17. Statement of the parties' agreement concerning the term of agreement and renewal/termination procedures.

18. Statement of the parties' agreement concerning procedures for appointment of successor Escrow Agent.

19. Statement that disposition of funds on termination shall be to the Operator and/or Ticket Issuer, if evidence of the Commission's acceptance of alternative evidence of financial responsibility is furnished; otherwise, all passage fares held for uncompleted voyages are to be returned to the passengers. The Operator and/or Ticket Issuer shall pay all fees previously earned to the Escrow Agent.

20. The agreement may be enforced by the passengers, the Escrow Agent, the Operator and/or Ticket Issuer or by the Federal Maritime Commission.

21. All assets maintained under the escrow agreement shall be physically located in the United States and may not be transferred, sold, assigned, encumbered, etc., except as provided in the agreement.

22. The Commission has the right to examine the books and records of the Operator and/or Ticket Issuer and the Escrow Agent, as related to the escrow account, and the agreement may not be modified unless agreed in writing by the Operator and/or

Ticket Issuer and Escrow Agent and approved in writing by the Commission.

By the Commission

Joseph C. Polking
Secretary