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FEDERAL MARITIME COMMISSION

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

AGENCY: Federal Maritime Commission.

ACTION: Advance notice of proposed rulemaking and notice of inquiry.

SUMMARY: The Federal Maritime Commission solicits public comment on its passenger vessel financial responsibility requirements for indemnification of passengers for nonperformance of transportation. The comments received will assist the Commission in determining whether it should amend its regulations at 46 CFR Part 540, Subpart A. The Federal Maritime Commission also invites the public to comment on the meaning of section 3(b) of Public Law 89-777.

DATES: Comments (original and fifteen copies) on or before [45 days after publication in the Federal Register].

ADDRESS: Send comments to:

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

FOR FURTHER INFORMATION CONTACT:

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SUPPLEMENTARY INFORMATION:

I. INTRODUCTION

The Federal Maritime Commission ("Commission" or "FMC") has determined to institute this proceeding as a step in its evaluation of the recommendations contained in the April 11, 1991, Report to the Commission ("Report") by the Investigative Officer in Fact Finding Investigation No. 19, Passenger Vessel Financial Responsibility Requirements ("FF-19"). The Report enabled the Commission to continue the process begun in the Commission's rulemaking proceeding in Docket No. 90-01, Security for the Protection of the Public, Maximum Required Performance Amount, to determine whether additional or alternate means of regulation would be appropriate in the area of financial responsibility under the provisions of section 3 of Public Law 89-777.

By Order of Investigation issued on August 17, 1990, the Commission instituted FF-19 to collect and analyze information "to establish a sound basis for review of current FMC regulations at 46 CFR Part 540, Subpart A, on financial responsibility of passenger vessel operators." These rules enforce the statutory mandate of section 3 of Public Law 89-777, which requires evidence of financial responsibility

to be filed with the FMC that establishes a passenger vessel operator's ability to indemnify passengers for nonperformance. Such evidence is hereinafter referred to as section 3 coverage. As currently provided in 46 CFR Part 540, section 3 coverage may be established by one or a combination of the following methods: insurance, escrow account, guaranty, self-insurance or surety bond.

The Commission's jurisdiction in this regard currently extends to those persons in the United States who 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.

The Investigative Officer, in his Report, made six recommendations, five of which[1] the Commission seeks comment on:

Recommendation No. 1 - Ceiling on Maximum Coverage Required

The Commission should retain the current $15 million ceiling for insurance, escrow, guaranty or surety bonds. Should the Commission feel that some type of coverage above the current ceiling is necessary, two options are suggested:

(1) allow for self-insurance above the current ceiling, following the changes in Recommendation No. 2; or

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[1]The remaining recommendation concerned the Commission's lack of jurisdiction over the land and air portions of cruise packages, and over foreign-to-foreign cruises. This recommendation need not be included in an advance notice of proposed rulemaking, as the Commission could evaluate the issues within the agency.

(2) adopt a sliding scale applicable to the large passenger vessel operators, taking into account an operator's past performance.

Recommendation No. 2 - Liberalize Self-Insurance Requirements

The Commission should liberalize its self-insurance rules. To do so, the Commission should consider the following changes to the regulations:

(1) repeal the requirement that assets be physically located in the United States so long as the operators submit evidence of the whereabouts of these assets;

(2) require that passenger vessel operators maintain resident agents capable of receiving subpoenas and other legal documents in the event of litigation;

(3) require that the countries where these assets are located must not restrict the levying of property as a result of litigation;

(4) require passenger vessel operators to periodically file financial statements following generally accepted U.S. accounting practices, to allow the Commission to monitor the operators' financial health;

(5) require that a cruise line's cash on hand and in banks be enough to cover unearned passenger revenue and, if there is a gap between this amount and the exposure, then consider a company's net worth, assigning a ratio between the net worth and this gap as a multiple of two.

Recommendation No. 3 - Use of a Sliding Scale Formula

The Commission should consider implementing a sliding scale formula which has a high lower-end threshold and gradually rises with higher unearned passenger revenues.

Recommendation No. 4 - Factors to be Used in Determining the Amount of Section 3 Coverage

The Commission should consider such items as seasonal variations, past experience, vessel redeployment and other related factors in setting the amount of section 3 coverage. To accomplish this, the Commission could require operators to report their occupancy figures, past history, track record of good performance, and other relevant data on a quarterly basis to allow the Commission to adjust the required coverage; and should consider imposing a filing fee whenever passenger vessel operators request adjustment of their coverage. If the operator is new, the required coverage should be more stringent.

Recommendation No. 6 - Review of Regulations to Determine Alternative Standards of Section 3 Coverage

The Commission should review its regulations to promote a realistic use of all the alternatives available to provide evidence of financial responsibility. To do this, the Commission could:

(1) institute an inquiry to determine alternative methods of providing coverage;

(2) consider fine-tuning its current regulations so as to provide more realistic alternatives to the industry;

(3) consider an exemption for those companies which purchased "whole ship" contracts.

II. DISCUSSION

A. Ceiling on Maximum Coverage Required

With respect to the maximum coverage required, the Commission seeks comment on several issues. In Docket No. 90-01, the Commission amended its regulation that specified a maximum amount of coverage for insurance, escrow, guaranty or surety bond required of passenger vessel operators as evidence of financial responsibility for indemnification of passengers for nonperformance. The amendment raised the ceiling required in 46 CFR 540.9(j) from $10 million to $15 million. The Commission deemed the amendment necessary because of the widening gap between unearned passenger revenues of some operators and the then-$10 million ceiling, and because of inflationary trends which continue to exert pressure on the price of passenger fares. The Investigative Officer, upon an analysis of the record in FF-19 with respect to the ceiling, recommended that the $15 million ceiling for insurance, escrow, guaranty or surety bonds be retained, or, should the Commission determine that some coverage above the ceiling be necessary, recommended allowing for liberalized self-insurance above the ceiling (see further discussion of liberalized self-insurance below) or the adoption of a sliding scale applicable to the large passenger vessel operators, taking into account an operator's past performance.

The Commission has determined, in order to obtain a full range of comments, to widen the scope of this issue to include comment on the appropriateness of lowering the current ceiling.

The Commission solicits comments on the following issues relating to the ceiling on maximum coverage required:

1. Is the current ceiling of $15 million adequate, and should it be retained?

2. In the event that the Commission determines that the current ceiling is inadequate, i.e., that additional coverage above the ceiling is necessary, please comment on the adequacy of either of the alternatives proposed by the Investigative Officer to provide additional coverage above the current ceiling and/or provide another alternative. What would be the impact on passenger vessel operators and on the passenger public should the Commission propose a rule to require additional coverage above the current ceiling?

3. Should the Commission consider lowering the current ceiling of $15 million? If so, at what dollar amount would the ceiling be adequate to protect the shipping public? Why? What would be the impact on passenger vessel operators and on the passenger public should the Commission lower the current ceiling?

B. Liberalize the Self-Insurance Requirements

There are several areas that concern the liberalization of the Commission's self-insurance regulations upon which the Commission is seeking comment. Two of these areas are: repealing the requirement that assets be located in the United States (see previous discussion of Recommendation No. 2), and changing the requirement that net worth and working capital both be sufficient to cover any unearned passenger revenue exposure (providing instead that any gap between a company's cash on hand/in banks and the unearned passenger vessel revenue exposure be covered by its net worth at twice the value of the exposure gap). In connection with the assets-in-the-U.S. issue, the Commission also has determined to seek comment on the viability of allowing passenger vessel operators to use their vessels as U.S. assets while in U.S. ports.

These suggestions require the Commission to reexamine long-standing Commission policy. Commission regulations at 46 CFR 540.9(d) currently require that any securities or assets accepted by the Commission as evidence of financial responsibility must be physically located in the United States. This applies to guarantors, insurers, escrow agents, and surety companies, in addition to those wishing to qualify as self-insurers. The Commission has historically required the maintenance of assets in the U.S. so there would be assets

available to passengers obtaining judgments in the event a carrier does not perform.

In order for the Commission to evaluate the viability of the assets-in-the-U.S. requirement for self-insurers, and in order to ascertain the best way to determine how net worth and working capital should be considered when determining how an operator may qualify as a self-insurer, the Commission seeks comments on the following questions:

4. It has been suggested that the Commission liberalize its self-insurance regulations. If it does so, how may this best be accomplished? Include in your comments (but do not limit your comments to these points): what standards and safeguards should be developed to ensure that assets held outside of the U.S. would be attachable; what is an appropriate formula for calculating the net worth required to cover the exposure gap between unearned passenger vessel revenue and a company's cash on hand/in banks; what additional reporting requirements should be imposed to ensure that the Commission understands the complete financial structure and status of an operator, including an operator which is a corporate subsidiary?

5. It has been suggested that the Commission allow passenger vessel operators to use their vessels as U.S. assets while in U.S. ports. Is this feasible? What impact would this have on a passenger vessel operator's decision to try to qualify as a self-insurer? In what ways might this suggestion

best be accomplished? What issues must the Commission resolve should it wish to effect such a change in its regulations? Will the public be protected in the case of carrier nonperformance, i.e., is there any potential for abuse? How can the regulations be crafted to keep a vessel in a U.S. port when the operator is in a financial situation which could trigger nonperformance?

6. What would be the impact on the passenger public should the Commission liberalize its self-insurance rules, including the potential costs to the passenger public for obtaining judgments when assets are held outside of the United States?

C. Use of a Sliding Scale to Determine the Amount of Section 3 Coverage

It has been proposed that the Commission use a sliding scale to determine the amount of section 3 coverage required. One proposal is to replace the current method of computing section 3 coverage (110% of the highest month's unearned passenger revenue over the last two years for certificants; 110% of anticipated highest month's unearned passenger revenue for new applicants) with a sliding scale formula. The following proposed formula was submitted by a participant in FF-19:

CATEGORY	REQUIRED COVERAGE
Unearned revenue of $0-$5,000,000	100% of unearned revenue up to $5,000,000
Unearned revenue of $5,000,000-$15,000,000	$5,000,000 plus 50% of excess unearned revenue over $5,000,000 subject to an overall maximum of $5,000,000 per vessel
Unearned revenue of $15,000,000-$35,000,000	$10,000,000 plus 25% of excess unearned revenue over $15,000,000 subject to an overall maximum of $5,000,000 per vessel and a $15,000,000 overall maximum
Unearned revenue over $35,000,000	$15,000,000 overall maximum

For an applicant with no previous history as a certificant, the sliding scale would be used prospectively, as coverage is currently calculated. For certificants, or applicants with previous history as certificants, certain factors would be worked into the sliding scale formula to allow for adjustment downward of required coverage.

The following are factors which could be considered in developing a sliding scale formula, although they are not all-inclusive: seasonal variations; past experience; vessel redeployments; track record of good performance.

The suggested factors and the sliding scale give rise to the following issues upon which the Commission seeks comment:

7. Should a sliding scale formula be utilized to determine section 3 coverage rather than the current method of determining section 3 coverage?

8. Please comment specifically on the above proposed formula. Is an amended or different formula preferable?

9. Should the Commission adopt factor-based adjustments to a sliding scale formula? If not, why not? If so, what factors should be considered and how should they be considered?

10. It has been suggested that to accomplish a factor-based sliding scale formula, passenger vessel operators should report quarterly, with imposition of a fee for calculation of adjusted coverage. Comments are requested on the efficacy of quarterly vis-a-vis other reporting periods, and the potential additional workload such reporting would impose on certificants.

11. What would be the impact of potentially reduced required coverage with respect to the adequacy of the protection of the public?

D. The Flexibility of Current Regulations and Alternate Standards for Determining Financial Responsibility

The Commission wishes to obtain comments on the flexibility of its current regulations and wishes to examine alternate standards of coverage in an effort to fine-tune the Commission's regulations with respect to section 3 coverage.

The Report pointed out the relatively high percentage of passenger vessel certificants which qualified based on guaranties, and the fact that several options available for section 3 coverage are little-used. The Investigative Officer concluded that, in spite of the wide variety of methods

theoretically available to the industry to qualify, the industry is not taking advantage of them, for various reasons. Industry participants in the fact finding process asked the Commission to consider modifications to the current options, in order to provide flexibility in meeting Commission requirements. These modifications could have the effect of lessening the financial burden on the industry and potentially reducing the amount of financial responsibility coverage available to the public. The record suggests, however, that the industry has not yet fully explored the flexibility available within the current regulatory scheme to provide a combination of evidences of financial responsibility to meet the required coverage. Rather, it appears that the industry traditionally has been focusing on a single method of coverage to provide evidence of financial responsibility, e.g., providing a guaranty or a surety bond for the full amount of necessary coverage.

Currently, Commission regulations implementing section 3 of Public Law 89-777 allow for five acceptable methods of providing evidence of adequate financial responsibility: insurance, escrow account, guaranty, self-insurance, or surety bond. Evidence may be established by one or a combination of such methods. See 46 CFR 540.5. Also, within the self-insurance option, the Commission regulations provide that, while working capital and net worth are to be considered in determining qualification as a self-insurer, the Commission

may waive the requirement as to the amount of working capital for good cause shown (46 CFR 540.5(d)). Further, 46 CFR 540.5(c) and 46 CFR 540.6(a) allow the required format of the guaranty and the surety bond respectively to be amended by the Commission in a particular case for good cause.

Escrow accounts, by their nature, are unique documents customized to fit particular circumstances, which are submitted to the Commission for approval prior to acceptance as evidence of financial responsibility. Thus, there is a high degree of flexibility extant within current regulatory parameters for a passenger vessel operator to "customize" coverage, should that be necessary. For example, a certificant seeking to lower costs associated with its current required coverage of $7 million might explore the option of reducing its surety bond coverage from $7 million to $5 million and qualifying as a self-insurer for the remaining $2 million; the potential savings regarding the bond coverage might compensate for the increased reporting requirements for self-insurance.

The Commission also has determined to explore the issue of the establishment of alternate standards for financial responsibility. Section 3(a) of Public Law 89-777 provides, in pertinent part, that persons must file with the Commission "such information as the Commission may deem necessary to establish financial responsibility, . . . or in lieu thereof a copy of a bond or other security . . ." to qualify for a

Certificate (Performance). In its regulations at 46 CFR Part 540, Subpart A, the Commission specifies the methods for establishment of financial security (see previous paragraph). The issue is whether the Commission may define a standard for "financial responsibility" other than that which exists in its current regulations.

In order to evaluate the flexibility of the relevant current Commission regulations, and to create a public record on alternate standards for financial responsibility, the Commission requests comment on the following issues:

12. Is the flexibility provided in the Commission's current regulations adequate to allow for creative ways to provide evidence of financial responsibility? Why has the passenger vessel industry not taken advantage of the flexibility of the current regulations? If the flexibility in the current regulations is not adequate, why not?

13. Should the Commission develop alternative methodologies for passenger vessel operators to establish their financial responsibility through self-insurance -- for example, through the use of: a) operating ratios; b) the relationship of net worth to unearned passenger revenue; c) the difference between unearned passenger revenue and cash reserves; d) any other methodology that commenters believe to be appropriate? Please provide specific examples and formulas. What would be the best method to effect this alternative, i.e., what financial records should be submitted

to the Commission, how often, how can the Commission guaranty that the passenger public has immediate access to recovery of funds in the event of nonperformance, etc.? These standards and submissions should be sophisticated enough to allow for decision-making, but should be as succinct and straightforward as practical, keeping in mind the Commission's limited staff resources for the passenger vessel program.

The Commission also wishes to consider a "whole ship" contract exemption with respect to section 3 coverage. Under the "whole ship" contract exemption concept, a corporate sponsor purchases all of the passenger accommodations on a ship, and distributes accommodations as incentive awards or uses them for business meetings without charge. Such sales would not be considered as unearned passenger revenue under the exemption. In order to evaluate the "whole ship" contract exemption, the Commission requests comment on the following questions:

14. Should unearned revenue from "whole ship" contracts be exempt from calculation in determining section 3 coverage, i.e., should it be excluded from unearned passenger revenue? If so, why, and how should the Commission's regulations be amended to effect such a change? If unearned revenue from "whole ship" contracts should continue to be considered unearned passenger revenue, why?

15. Does current industry practice allow for other ways to handle unearned revenue from "whole ship" contracts which

effectively remove such revenues from consideration as unearned passenger revenue, and what are they?

The issues above arose from the recommendations which came out of FF-19 and the subsequent consideration of same by the Commission. The Commission also takes this opportunity to solicit comment on an issue that either now or at some point in the future may require legislative or administrative clarification. By addressing the following issue in this Advance Notice of Proposed Rulemaking and Notice of Inquiry, the Commission intends to provide a forum to the industry and the public in order to develop a public record upon which to base such review.

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." The legislative history of Public Law 89-777 contains no discussion on, or explanation of, this provision in the text of section 3(b). Therefore, the Congressional intention on this point is unclear.[2]

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[2]Some of the passenger vessel operators commenting in Docket No. 90-01, Security for Protection of the Public, Maximum Required Performance Amount, argued that the Commission's proposal to abolish the bonding ceiling was inconsistent with the legislative intent of Public Law 89-777. They argued that the legislative history evidences an intent to impose reasonable financial responsibility requirements which would not overburden the "regular liner passenger operators." They particularly noted the written testimony of then Commission Chairman Harllee, much of which was incorporated verbatim into the Congressional reports on the bills. However, the "sliding scale" financial

(continued...)

The Commission's implementing regulations, at 46 CFR 540.9(j), provide that the amount of a surety bond "shall not be required to exceed 15 million dollars (U.S.)." The cap of $15 million need not be exceeded, regardless of the amount of unearned passenger revenue held by a passenger vessel operator. There is nothing in the Commission's rulemaking proceedings which sheds light on the seeming discrepancy with respect to the language of Section 3(b).

Therefore, the Commission seeks comment on the following question:

16. What is the interpretation to be given to the statutory provision at section 3(b) of Public Law 89-777 which 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" as it relates to the provisions of 46 CFR 540.9(j)?

III. CONCLUSION

The issues discussed above are significant and complex. In order to provide the Commission with the most complete information available and enable it to make an informed judgment in these matters, interested persons are invited to comment on the specific issues listed above. Commenters are

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[2](...continued)
responsibility provisions of the statute and his testimony focused on the "smaller, less substantial vessel operators" rather than the larger, well-established lines as they relate to section 2, the casualty provisions, not section 3, the nonperformance provisions, and so provide no guidance in this instance.

requested to refer to the item numbers when discussing the various issues. Commenters may suggest alternative approaches to the issues presented. All comments or suggested alternatives should, where appropriate, be accompanied by draft language which might become part of a proposed rulemaking. Should the Commission determine to propose any modifications to 46 CFR Part 540, Subpart A after receiving comments, it will do so by a separate rulemaking proceeding.

Finally, the Commission would remind the passenger vessel industry that it is incumbent on the industry to demonstrate that any changes in the regulatory scheme which it is advocating would not result in a failure to provide the statutorily required protection to the passenger public.

By the Commission.

Joseph C. Polking
Secretary