ORIGINAL

June 26, 2002

FEDERAL MARITIME COMMISSION

46 CFR Part 540

Docket No. 02-07

Financial Responsibility Requirements For Nonperformance of Transportation - Discontinuance of Self-Insurance and the Sliding Scale, and Guarantor Limitations

AGENCY: Federal Maritime Commission.

ACTION: Final Rule.

SUMMARY: The Federal Maritime Commission ("Commission") is amending its rules on passenger vessel financial responsibility for nonperformance of transportation, by eliminating the availability of self-insurance, limiting guarantees to those Protection and Indemnity Associations approved by the Commission, and discontinuing the existing sliding scale formula for determining the amount of coverage required.

DATES: This rule is effective [INSERT DATE 30 DAYS AFTER PUBLICATION IN FEDERAL REGISTER].

FOR FURTHER INFORMATION CONTACT:

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SUPPLEMENTARY INFORMATION:

On April 23, 2002, the Commission published in the Federal Register a notice of proposed rulemaking, 67 FR 19730, to amend 46 CFR 540, the implementing regulations for Section 3, Pub. L. 89-777, 46 U.S.C. app. 817e, ("section 3")[1]. Section 3 requires that passenger vessel operators ("PVOs") establish financial responsibility to indemnity passengers for nonperformance of transportation. The amendments would eliminate self-insurance as a means of evidencing required financial responsibility, limit guarantors of financial responsibility to those Protection and Indemnity Associations approved by the Commission, and eliminate the availability of a sliding scale that, for some passenger vessel operators,* reduced the amount of coverage required.

The Commission's implementing regulations at 46 CFR Part 540, Subpart A, currently require PVOs to evidence financial responsibility by means of self-insurance, guaranty, escrow arrangement, surety bond, insurance policy, or combination thereof. Financial responsibility must be established in the amount of at least 110% of the PVO's

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[1] Section 3 provides, in pertinent part:

> (a) 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.

[2] For the purposes of section 3, a PVO is considered to be any person in the United States that arranges, offers, advertises or provides passage on a vessel having berth or stateroom accommodations for fifty or more passengers and which embarks passengers at U.S. ports.

highest unearned passenger revenue ("UPR")[3] over the most recent two-year period, subject to a $15 million maximum for those PVOs establishing financial responsibility by means other than self-insurance or escrow agreement. However, under current regulations, those PVOs not qualifying by self-insurance may elect to use a sliding scale formula to compute a reduced amount of financial responsibility required, if they can establish five years operational experience in the US. trades with a satisfactory explanation of any claim for nonperformance. Self-insuring PVOs currently must establish net worth equal to at least 110% of UPR.

In determining to amend its regulations, the Commission cited recent bankruptcies of several PVOs, coupled with the experience of passengers in receiving payment in satisfaction of claims, as causing the Commission to re-evaluate its rules governing PVO coverage for nonperformance. Also, the Commission referred to the lapse of time before the Commission becomes aware of substantial changes in financial and economic conditions, the greater risk to passengers posed by self-insurers under the Commission's program, the current economic uncertainty and its effect on sales of cruises, and the impending substantial increase in cruise ship capacity.

COMMENTS

Comments on the proposed rule were filed by American West Steamboat Company, LLC ("American West"), Carnival Corporation ("Carnival"),[4] West Travel, Inc. d/b/a Cruise

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[3] UPR means "passenger revenue received for water transportation and all other accommodations, services, and facilities relating thereto not yet performed." (46 CFR 540.2(i)).

[4] Carnival's comments were submitted on behalf of Carnival Cruise Lines, Holland America Line, Cunard Line, Seaboum Cruise Line, Costa Cruises and Windstar Cruises, all of which are owned by Carnival.

West and Alaska Sightseeing Tours ("Cruise West"), Glacier Bay Park Concessions, Inc. d/b/a Glacier Bay Cruiseline ("Glacier Bay"), Goldbelt, Incorporated ("Goldbelt"), International Group of P&I Clubs ("P&I Clubs"), and the Passenger Vessel Association ("PVA"). Goldbelt is the sole shareholder of Glacier Bay. The P&I Clubs is an organization of Protection and Indemnity Associations, some of which have provided section 3 guarantees under the Commission's program. PVA is an association of U.S.-flag passenger vessels of all types, including overnight cruise vessels. The remaining commenters are PVOs that participate in the Commission's program.

American West, a U.S. flag PVO, is the only commenter to state that it fully supports the proposed changes. However, American West also supports an in-depth review by the Commission of all of its financial responsibility regulations. In particular, American West supports lifting of the current $15 million maximum coverage requirement, supports reducing the required coverage from 110% of UPR to 1 00%, and believes the Commission should consider the role of credit cards and third-party travel insurance in determining the amount of coverage required. None of those suggestions is within the scope of this proposed rule.

Carnival, one of the larger PVOs, states that the increase in the fleets of the larger PVOs in recent years has increased the shortfall in coverage between the current $15 million maximum coverage requirement and the actual amount of unearned passenger revenues. Carnival believes that eliminating self-insurance while maintaining the current $15 million cap does little to provide the necessary financial security to passengers. Carnival suggests that the Commission's rules should be drawn so as to be "self-adjusting" as cruise lines increase in size. Moreover, Carnival reiterates its comments to proposed rules in 1994 and 1996, namely that the Commission's rules should allow foreign and U.S. companies with investment grade credit ratings and strong balance sheets to qualify for self-insurance and increase the current $15 million cap. In addition, Carnival recommends that the Commission support a change in Public Law 89-777 to extend the financial responsibility requirements to voyages embarking U.S. passengers in foreign ports.

Cruise West, a U.S. flag PVO, believes the Commission should allow itself the flexibility to evaluate particular operators and determine appropriate evidence of financial responsibility as warranted by the particular operator's circumstances. Cruise West states that the proposed rule could jeopardize smaller U.S. operators by putting them at a competitive disadvantage with respect to larger foreign operators. Cruise West points out that, because of the current $15 million ceiling, a major cruise line with hundreds ofmillions of dollars in UPR would be required to cover only a small fraction of its UPR, whereas a smaller operator with a total UPR of only $15 million, would have to cover 100% of its UPR. Cruise West asserts this places smaller companies at a significant competitive disadvantage, and believes that the sliding scale was intended to partially alleviate that disadvantage. Moreover, Cruise West states that self-insurance is one of the few advantages to maintaining a U.S. based cruise line, because self-insurance is expressly tied to ownership of U.S. based assets, an important factor considered in enacting Public Law 89-777. Cruise West suggests that closer scrutiny of self-insured cruise lines, requiring additional coverage as appropriate, is better than eliminating self-insurance. Cruise West therefore believes that the Commission should retain the option to accept self-insurance and sliding scale coverage on a case-by-case basis. Lastly, Cruise West indicates that an immediate and complete transition to the new rule would have significant, potentially devastating, effects on Cruise West. Cruise West asks that sufficient time for transition to the new rules be provided, and that the Commission give itself the latitude to handle this transition on a case-by-case basis.

Glacier Bay and its owner, Goldbelt, indicate that the proposed rule would cause Glacier Bay considerable financial hardship, which could force Glacier Bay to discontinue operations. Goldbelt states that escrowing deposits is not an acceptable alternative, since Glacier Bay begins selling cruises up to nine months before its May through September operating season, and needs those deposits as working capital to prepare for the operating season. Goldbelt states that preliminary quotes from its insurance broker indicate that a bond will cost anywhere from $150,000 to $200,000. Glacier Bay indicates that its prices for next year are in the process of being set, and Goldbelt states that prices are already set for this year, with no way to recapture the additional costs that will be caused by this rule. Goldbelt asks that, should the rule be made final, it be phased in over a period of two years.

PVA claims to be the "national voice" of U.S. flag passenger vessels. PVA acknowledges that recent circumstances warrant review of the Commission's current rules. However, PVA states that the proposed rule (1) puts smaller vessels at a disadvantage, because the $15 million ceiling allows larger vessel operators to cover only a fraction of the UPR, (2) discriminates against U.S. flag operators because the statute's requirements only apply to a vessel embarking passengers at United States ports (the Alaska trade is cited as an example, with most foreign flag operators allegedly embarking passengers at Vancouver, British Columbia), and (3) does not provide affected operators with sufficient time to comply.

P&I Clubs is concerned that many vessel operators that have become self-insurers in recent years will look to the P&I Clubs to provide the necessary security. P&I Clubs makes clear that its members would not be willing to increase their current involvement, and asks that the rule be reconsidered or postponed in order to provide more detailed consultation with the cruise industry.

DISCUSSION

A number of comments deal with issues outside the scope of this rulemaking. Several comments indicate a desire that the Commission lift its current $15 million ceiling. American West supports lifting the ceiling, and believes this should be part of a comprehensive review of Commission regulations. PVA and Cruise West indicate that the ceiling creates a competitive disadvantage for smaller U.S. flag operators, as compared to their larger, foreign flag competitors. Interestingly, one of the larger, foreign flag operators, Carnival, also believes that the ceiling should be lifted, and should automatically adjust in line with increasing UPR. The Commission is mindful that the $15 million ceiling is only a fraction of the UPR potentially at risk for some PVOs, and shares the concerns of these commenters. Accordingly, the Commission has directed its staff to undertake a comprehensive review of the Commission's rules, including whether to change the ceiling. Based on that review, the Commission may institute a future rulemaking proceeding. Since the ceiling was not addressed in this proposed rule, however, the Commission is unable to effect any changes through this proceeding.

Another matter beyond the scope of this proceeding is the concern about the lack of protection available to those passengers on cruises not embarking passengers at U.S. ports. Carnival and PVA indicate a desire that the statute be amended to impose financial responsibility requirements on voyages embarking U.S. passengers from foreign ports. We know about the failures of three PVOs within the past two years which affected U.S. passengers embarking from foreign ports. Two of those PVOs participated in the Commission's program by having coverage for certain vessels embarking passengers at U.S. ports (but not for U.S. passengers embarking at foreign ports). Accordingly, those passengers who were to embark from U.S. ports were protected under the Commission's program, while other U.S. passengers had no protection. No passengers of the third PVO were protected by the Commission's program. The Commission has previously supported legislation to require coverage for ticket contracts sold in the United States, even for passengers embarking from foreign ports. The Commission intends to reiterate its concerns to Congress.

The concern of P&I Clubs that many current self-insurers will look to its members for required coverage appears to be unwarranted. Contrary to P&I Clubs' assertion, the elimination of self-insurance and limitation of guarantors will affect only two PVOs currently in the Commission's program. Preliminary indications are that neither of those PVOs would look to Protection and Indemnity Associations for coverage.

Cruise West, Glacier Bay (and Goldbelt) and PVA oppose the proposed rule, expressing concern about its impact on smaller, U.S. flag PVOs, which they claim will be disadvantaged. Cruise West suggests that the Commission maintain the flexibility to approve self-insurance and sliding scale treatment on a case-by-case basis. Should the Commission finalize the proposed rules, all ask for time to phase in their compliance.

The Commission is concerned about the financial protection provided to passengers under its program, and believes that self-insurance is a matter requiring immediate protection. The bankruptcy of a self-insurer leaves many passengers devoid of protection. Cruise West argues that rather than eliminate self-insurance, the Commission should scrutinize more closely the financial condition of self-insurers and require additional coverage as appropriate. While such an approach may appear to have merit in theory, experience has shown that requiring additional coverage is virtually impossible once a PVO's financial condition has deteriorated. Even now, Cruise West and Glacier Bay argue that the Commission should not impose greater requirements because of the financial impact. Once a self-insurer's financial situation has deteriorated, imposition of additional coverage requirements would increase the likelihood of the PVO's failure and expose passengers to the very losses the Commission's program is designed to prevent. Also, experience demonstrates that the lag time in receiving financial data may prevent the Comrnission from knowing about a PVO's financial deterioration until well after it is too late to remedy the lack of coverage.

In support of self-insurance, Cruise West, Glacier Bay (and Goldbelt) and PVA indicate that its elimination would disadvantage small U.S. flag operators, since the qualifying assets currently must be maintained in the United States. This requirement has so far resulted in only U.S. flag PVOs requesting approval as a self-insurers. Yet one small U.S. flag operator, American West, fully supports the changes. Most U.S. flag PVOs do not utilize the self-insurance option. Instead, they provide evidence of financial responsibility with a bond or escrow agreement. Some of these U.S. flag PVOs compete with Cruise West and Glacier Bay, who argue that the costs of a bond or escrow agreement are competitively disadvantageous. However, finalizing the rule as proposed would put all of these operators on equal footing in this regard.

The Commission is sensitive to the impact of an abrupt change to its rules. For this reason, at its meeting of January 30, 2002, the Commission directed its staff to begin discussions with affected PVOs about alternative means of coverage. All affected PVOs were apprised of the Commission's intentions during the first week of February 2002. Currently, the introductory paragraph to 46 CFR § 540.5 provides:

> 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 two 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 nrevious two-fiscal-year reauirement in this section or other methods acceptable to the Commission to determine the amount of coverage reouired.. . . (Emphasis added)

Thus, Commission rules already provide for case-by-case consideration of differing circumstances. The Commission will give consideration to special circumstances caused by issuance of this amendment to its rules, and allow some flexibility during a transition period. Accordingly, it is not necessary to modify the proposed rule to provide for such a transition period.

Commission staff have contacted those affected by this rule and will continue to be available to discuss an effective transition. However, this should not be seen as a willingness on the part of the Commission to allow continuation of self-insurance, even for a short time period. All affected parties have been on notice of the Commission's intention in this regard since at least early February. The Commission has determined that self-insurance provides inadequate coverage, and that it must undertake to make sure that passengers achieve the protections contemplated by the governing statute. Accordingly, while some flexibility in timing may be allowed, affected parties will be expected immediately to begin the transition with adequate safeguards in place to protect passengers. The Commission's staff will be available to discuss means of doing so.

The rule contains no additional information collection or record keeping requirements and need not be submitted to OMB for approval under the Paperwork Reduction Act, 44 U.S.C. 3501 et seq.

The Chairman has certified, pursuant to 5 U.S.C. 605, that the rule will not have a significant impact on a substantial number of small entities.

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); and section 17(a) of the Shipping Act of 1984, as amended (46 U.S.C. app. 1716(a), and for the reasons stated above, the Federal Maritime Commission amends 46 CFR part 540 as follows:

PART 540 -- PASSENGER VESSEL FINANCIAL RESPONSIBILITY

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. 317(e, 817d); sec. 17(a) of the Shipping Act of 1984 (46 U.S.C. app. 1716(a)).

2. Section 540.5 is amended as follows:

a. Revise the heading and introductory text;

b. Revise paragraph (c);

c. Remove paragraphs (d) and (e);

d. Redesignate paragraph (f) as paragraph (d).

The revisions read as follows:

§ 540.5 __Insurance, maranties. and escrow accounts.__

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 two fiscal years immediately prior to the filing of the application which reflects the greatest amount of unearned passenger revenue. The Commission, for good cause shown, may consider a time period other than the previous two-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:

* * * * *

(c) Filing with the Commission a guaranty on Form FMC-133A, by a Protection and Indemnity Association with established assets, reserves and reinsurance acceptable to the Commission, for indemnification of passengers in the event of nonperformance of water transportation. The requirements of Form FMC-133A, however, may be amended by the Commission in a particular case for good cause.

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3. Amend Form FMC- 13 1, Part II, as follows:

a. Revise Item 10;

b. Remove Item 15.

The revision reads as follows:

Part II – Performance

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10. Items 11 - 14 are optional methods; answer only the one item which is applicable to this application. Check the appropriate box below:

[ ] Insurance (item 11).
[ ] Escrow (item 12).
[ ] Surety bond (item 13).
[ ] Guaranty (item 14).

* * * * *

15. [Removed]

By the Commission.

Bryant L. VanBrakle,
Secretary.

02-07

FEDERAL MARITIME COMMISSION

46 CFR Part 540

[Docket No. 02–07]

Financial Responsibility Requirements for Nonperformance of Transportation-Discontinuance of Self-Insurance and the Sliding Scale, and Guarantor Limitations

AGENCY: Federal Maritime Commission.

ACTION: Final rule.

SUMMARY: The Federal Maritime Commission ("Commission") is amending its rules on passenger vessel financial responsibility for nonperformance of transportation, by eliminating the availability of self-insurance, limiting guarantees to those Protection and Indemnity Associations approved by the Commission, and discontinuing the existing sliding scale formula for determining the amount of coverage required.

DATES: This rule is effective August 5, 2002.

FOR FURTHER INFORMATION CONTACT: Sandra L. Kusumoto, Director, Bureau of Consumer Complaints and Licensing, Federal Maritime Commission, 800 North Capitol Street, NW., Room 970, Washington, DC 20573-0001, 202-523-5787, E-mail: *sandrak@fmc.gov*.

SUPPLEMENTARY INFORMATION: On April 23, 2002, the Commission published in the **Federal Register** a notice of proposed rulemaking, 67 FR 19730, to amend 46 CFR part 540, the implementing regulations for section 3, Pub. L. 89–777, 46 U.S.C. app. 817e, ("section 3").[1] Section 3 requires that passenger vessel operators ("PVOs") establish financial responsibility to indemnify passengers for nonperformance of transportation. The amendments would eliminate self-insurance as a means of evidencing required financial responsibility, limit guarantors of financial responsibility to those Protection and Indemnity Associations approved by the Commission, and eliminate the availability of a sliding scale that, for some passenger vessel operators,[2] reduced the amount of coverage required.

The Commission's implementing regulations at 46 CFR part 540, subpart A, currently require PVOs to evidence financial responsibility by means of self-insurance, guaranty, escrow arrangement, surety bond, insurance policy, or combination thereof. Financial responsibility must be established in the amount of at least 110% of the PVO's highest unearned passenger revenue ("UPR") [3] over the most recent two-year period, subject to a $15 million maximum for those PVOs establishing financial responsibility by means other than self-insurance or escrow agreement. However, under current regulations, those PVOs not qualifying by self-insurance may elect to use a sliding scale formula to compute a reduced amount of financial responsibility required, if they can establish five years operational experience in the U.S. trades with a satisfactory explanation of any claim for nonperformance. Self-insuring PVOs currently must establish net worth equal to at least 110% of UPR.

In determining to amend its regulations, the Commission cited recent bankruptcies of several PVOs, coupled with the experience of passengers in receiving payment in satisfaction of claims, as causing the Commission to re-evaluate its rules governing PVO coverage for nonperformance. Also, the Commission referred to the lapse of time before the Commission becomes aware of substantial changes in financial and economic conditions, the greater risk to passengers posed by self-insurers under the Commission's program, the current economic uncertainty and its effect on sales of cruises, and the impending substantial increase in cruise ship capacity.

Comments

Comments on the proposed rule were filed by American West Steamboat Company, LLC ("American West"), Carnival Corporation ("Carnival"),[4] West Travel, Inc. d/b/a Cruise West and Alaska Sightseeing Tours ("Cruise West"), Glacier Bay Park Concessions, Inc. d/b/a Glacier Bay Cruiseline ("Glacier Bay"), Goldbelt, Incorporated ("Goldbelt"), International Group of P&I Clubs ("P&I Clubs"), and the Passenger Vessel Association ("PVA"). Goldbelt is the sole shareholder of Glacier Bay. The P&I Clubs is an organization of Protection and Indemnity Associations, some of which have provided section 3 guarantees under the Commission's program. PVA is an association of U.S.-flag passenger vessels of all types, including overnight cruise vessels. The remaining commenters are PVOs that participate in the Commission's program.

American West, a U.S. flag PVO, is the only commenter to state that it fully supports the proposed changes. However, American West also supports an in-depth review by the Commission of all of its financial responsibility regulations. In particular, American West supports lifting of the current $15 million maximum coverage requirement, supports reducing the required coverage from 110% of UPR to 100%, and believes the Commission should consider the role of credit cards and third-party travel insurance in determining the amount of coverage required. None of those suggestions is within the scope of this proposed rule.

Carnival, one of the larger PVOs, states that the increase in the fleets of the larger PVOs in recent years has increased the shortfall in coverage between the current $15 million maximum coverage requirement and the actual amount of unearned passenger revenues. Carnival believes that eliminating self-insurance while maintaining the current $15 million cap does little to provide the necessary financial security to passengers. Carnival suggests that the Commission's rules should be drawn so as to be "self-adjusting" as cruise lines increase in size. Moreover, Carnival reiterates its comments to proposed rules in 1994 and 1996, namely that the Commission's rules should allow foreign and U.S. companies with investment grade credit ratings and strong balance sheets to qualify for self-insurance and increase the current $15 million cap. In addition, Carnival recommends that the Commission support a change in Public Law 89-777 to extend the financial responsibility requirements to voyages embarking U.S. passengers in foreign ports.

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[a) No person in the United States shall arrange, offer, advertise, or provide passage on a vessel having berth or stateroom accomodations 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

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[3] UPR means "passenger revenue recieved for water transportation and all other accomodatmns, services, and facilities relating thereto not yet performed " (46 CFR 540 2(i))

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warranted by the particular operator's circumstances. Cruise West states that the proposed rule could jeopardize smaller U.S. operators by putting them at a competitive disadvantage with respect to larger foreign operators. Cruise West points out that, because of the current $15 million ceiling, a major cruise line with hundreds of millions of dollars in UPR would be required to cover only a small fraction of its UPR, whereas a smaller operator with a total UPR of only $15 million, would have to cover 100% of its UPR. Cruise West asserts this places smaller companies at a significant competitive disadvantage, and believes that the sliding scale was intended to partially alleviate that disadvantage. Moreover, Cruise West states that self-insurance is one of the few advantages to maintaining a U.S. based cruise line, because self-insurance is expressly tied to ownership of U.S. based assets, an important factor considered in enacting Public Law 89–777. Cruise West suggests that closer scrutiny of self-insured cruise lines, requiring additional coverage as appropriate, is better than eliminating self-insurance. Cruise West therefore believes that the Commission should retain the option to accept self-insurance and sliding scale coverage *on* a case-by-case basis. Lastly, Cruise West indicates that an immediate and complete transition to the new rule would have significant, potentially devastating, effects on Cruise West. Cruise West asks that sufficient time for transition to the new rules be provided, and that the Commission give itself the latitude to handle this transition on a case-by-case basis.

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Discussion

A number of comments deal with issues outside the scope of this rulemaking. Several comments indicate a desire that the Commission lift its current $15 million ceiling. American West supports lifting the ceiling, and believes this should be part of a comprehensive review of Commission regulations. PVA and Cruise West indicate that the ceiling creates a competitive disadvantage for smaller US. flag operators, as compared to their larger, foreign flag competitors. Interestingly, one of the larger, foreign flag operators, Carnival, also believes that the ceiling should be lifted, and should automatically adjust in line with increasing UPR, The Commission is mindful that the **$15** million ceiling is only a fraction of the LJPR potentially at risk for some PVOs, and shares the concerns of these commenters. Accordingly, the Commission has directed its staff to undertake a comprehensive review of the Commission's rules, including whether to change the ceiling. Based on that review, the Commission may institute a future rulemaking proceeding. Since the ceiling was not addressed in this proposed rule, however, the Commission is unable to effect any changes through this proceeding.

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The concern of P&I Clubs that many current self-insurers will look to its members for required coverage appears to be unwarranted. Contrary to P&I Clubs' assertion, the elimination of self-insurance and limitation of guarantors will affect only two PVOs currently in the Commission's program. Preliminary indications are that neither of those PVOs would look to Protection and Indemnity Associations for coverage.

Cruise West, Glacier Bay (and Goldbelt) and PVA oppose the proposed rule, expressing concern about its impact on smaller, U.S. flag PVOs, which they claim will be disadvantaged. Cruise West suggests that the Commission maintain the flexibility to approve self-insurance and sliding scale treatment on a case-by-case basis. Should the Commission finalize the proposed rules, all ask for time to phase in their compliance.

The Commission is concerned about the financial protection provided to passengers under its program, and believes that self-insurance is a matter requiring immediate protection. The bankruptcy of a self-insurer leaves many passengers devoid of protection, Cruise West argues that rather than eliminate self-insurance, the Commission should scrutinize more closely the financial condition of self-insurers and require additional **coverage** as appropriate. While such **an** approach may appear to have merit in theory, experience has shown that requiring additional coverage is virtually impossible once a PVO's financial condition has deteriorated. Even now, Cruise West and Glacier Bay argue that the Commission should not impose greater requirements because of the financial impact. Once a self-insurer's financial situation has deteriorated, imposition of additional coverage requirements would increase the likelihood of the PVO's failure and expose passengers to the very losses the Commission's program is designed to prevent. Also, experience demonstrates that the lag time in receiving financial data may prevent the Commission from knowing about a PVO's financial deterioration until well after it is too late to remedy the lack of coverage.

In support of self-insurance, Cruise West, Glacier Bay (and Goldbelt) and PVA indicate that its elimination would disadvantage small U.S. flag operators, since the qualifying assets currently must be maintained in the United States. This requirement has so far resulted in only U.S. flag PVOs requesting approval as a self-insurers. Yet one small U.S. flag operator, American West, fully supports the changes. Most U.S. flag PVOs do not utilize the self-insurance option. Instead, they provide evidence of financial responsibility with a bond or escrow agreement. Some of these U.S. flag PVOs compete with Cruise West and Glacier Bay, who argue that the costs of a bond or escrow agreement are competitively disadvantageous. However, finalizing the rule as proposed would put all of these operators on equal footing in this regard.

The Commission is sensitive to the impact of an abrupt change to its rules. For this reason, at its meeting of January 30, 2002, the Commission directed its staff to begin discussions with affected PVOs about alternative means of coverage. All affected PVOs were apprised of the Commission's intentions during the first week of February 2002. Currently, the introductory paragraph to 46 CFR 540.5 provides:

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 two 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 two-fiscal-year requirement in this section or other methods acceptable to the Commission to determine the amount of coverage required.*** * * * (Emphasis added)

Thus, Commission rules already provide for case-by-case consideration of differing circumstances. The Commission will give consideration to special circumstances caused by issuance of this amendment to its rules, and allow some flexibility during a transition period. Accordingly, it is not necessary to modify the proposed rule to provide for such a transition period.

Commission staff have contacted those affected by this rule and will continue to be available to discuss an effective transition. However, this should not be seen as a willingness on the part of the Commission to allow continuation of self-insurance, even for a short time period. All affected parties have been on notice of the Commission's intention in this regard since at least early February. The Commission has determined that self-insurance provides inadequate coverage, and that it must undertake to make sure that passengers achieve the protections contemplated by the governing statute. Accordingly, while some flexibility in timing may be allowed, affected parties will be expected immediately to begin the transition with adequate safeguards in place to protect passengers. The Commission's staff will be available to discuss means of doing so.

The rule contains no additional information collection or recordkeeping requirements and need not be submitted to OMB for approval under the Paperwork Reduction Act, 44 U.S.C. 3501 *et seq.*

The Chairman has certified, pursuant to 5 U.S.C. 605, that the rule will not have a significant impact on a substantial number of small entities.

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); and section 17(a) of the Shipping Act of 1984, as amended (46 U.S.C. app. 1716(a)), and for the reasons stated above, the Federal Maritime Commission amends 46 CFR part 540 as follows:

PART 540—PASSENGER VESSEL FINANCIAL RESPONSIBILITY

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. 317(e, 817d), sec 17(a) of the Shipping Act of 1984 (46 U S C app 1716(a)).

2. Section 540.5 is amended as follows:

a. Revise the heading and introductory text;

b. Revise paragraph (c);

c. Remove paragraphs (d) and (e);

d. Redesignate paragraph (f) as paragraph (d).

The revisions read as follows:

5540.5 Insurance, guaranties, and escrow accounts.

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 two fiscal years immediately prior to the filing of the application which reflects the greatest amount of unearned passenger revenue. The Commission, for good cause shown, may consider a time period other than the previous two-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:

* * * * *

(c) Filing with the Commission a guaranty on Form FMC–133A, by a Protection and Indemnity Association with established assets, reserves and reinsurance acceptable to the Commission, for indemnification of passengers in the event of nonperformance of water transportation. The requirements of Form FMC–133A, however, may be amended by the Commission in a particular case for good cause.

* * * * *

3. Amend Form FMC-131, part II, as follows:

a. Revise Item 10;

b. Remove Item 15.

The revision reads as follows:

Part II-Performance

* * * * *

10. Items 11-14 are optional methods; answer only the one item which is applicable to this application. Check the appropriate box below:

☐ Insurance (item 11).

☐ Escrow (item 12).

☐ Surety bond (item 13).

☐ Guaranty (item 14).

* * * * *

15. [Removed]

By the Commission

Bryant L. VanBrakle,

Secretary

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