

ALASKA LEGISLATURE COMMITTEE FILES 1983 - 1984 8672

2605 SLC SB 134 - SB 145

(E) The (Commissioner) shall issue a surplus lines license to any qualified holder of a current property and casualty broker's or general agent's license but only when the broker or agent has:

- (1) Remitted the \$_____ annual fee to the (Commissioner);
- (2) Submitted a completed license application on a form supplied by the (Commissioner), and the application has been approved by the (Commissioner);
- (3) Passed a qualifying examination approved by the (Commissioner), except that all holders of a license prior to the effective date of this Act shall be deemed to have passed such an examination; and
- (4) Filed with the (Commissioner), and maintains during the term of the license, in force and unimpaired a bond in favor of this state in the penal sum of _____ dollars, aggregate liability, with corporate sureties approved by the (Commissioner). The bond shall be conditioned that the surplus lines licensee will conduct business in accordance with the provisions of this Act and will promptly remit the taxes as provided by law. No bond shall be terminated unless at least 30 days prior written notice is given to the licensee and (Commissioner). If the (Commissioner) determines that a surplus lines licensee of a sister state is competent and trustworthy then he may, in his discretion, issue a non-resident surplus lines agent's license. A non-resident licensee shall be limited in his authority to servicing of business negotiated elsewhere and filing any appropriate taxes. A non-resident licensee shall not have authority to solicit business.

(C) Corporations, including foreign corporations, shall be eligible to be resident surplus lines licensees. upon the following conditions:

- (1) the corporate license shall list individuals within the corporation who have satisfied all requirements of this Act to become surplus lines licensees; and
- (2) only those individuals listed on the corporate license shall transact surplus lines business.

- (D) Each surplus lines license shall expire on December 31st of each year and shall be renewed before December 2nd of each year upon payment of the annual fee, and compliance with other provisions of this Section. Any surplus lines licensee who fails to apply for renewal of the license before December 2nd shall pay a penalty of _____ dollars and subject to such other penalties as provided by law before his license will be renewed.

Section 16. Surplus Lines Licensees May Accept Business From Other Agents or Brokers.

A surplus lines licensee may originate surplus lines insurance or accept such insurance from any other agent or broker duly licensed as to the kind or kinds of insurance involved, and the surplus lines licensee may compensate such agent or broker therefor.

Section 17. Records of Surplus Lines Licensee.

Each surplus lines licensee shall keep in his office in this state a full and true record of each surplus lines insurance contract placed by or through him, including a copy of the policy, certificate, cover note, or other evidence of insurance showing such of the following items as may be applicable:

- (A) Amount of the insurance and perils insured;
- (B) Brief description of property insured and its location;
- (C) Gross premium charged;
- (D) Any return premium paid;
- (E) Rate of premium charged upon the several items of property;
- (F) Effective date of the contract, and the terms thereof;
- (G) Name and address of the insured;
- (H) Name and address of the insurer;
- (I) Amount of tax and other sums to be collected from the insured; and
- (J) Identity of the producing broker, any confirming correspondence from the insurer or its representative and the application.

The record of each contract shall be kept open at all reasonable times to examination by the (Commissioner) without notice for a period not less than 5 years following termination of the contract. In lieu of maintaining offices in this state, each non-resident surplus lines licensee shall make available to the (Commissioner) any and all records that he deems necessary for examination.

Section 18. Quarterly Reports--Summary of Exported Business.

On or before the end of each month following each calendar quarter, each surplus lines licensee shall file with the (Commissioner), on forms prescribed by the (Commissioner), a verified report in duplicate of all surplus lines insurance transacted during the preceding calendar quarter, showing:

- (A) Aggregate gross premiums written;
- (B) Aggregate return premiums; and
- (C) Amount of aggregate tax remitted.

DRAFTING NOTE: States desiring to have taxes remitted annually may call for monthly detailed listing of business.

Section 19. Surplus Lines Tax.

- (A) Gross premiums charged, less any return premiums, for surplus lines insurance are subject to a premium receipts tax of _____%, which shall be collected by the surplus lines licensee as specified by the (Commissioner), in addition to the full amount of the gross premium charged by the insurer for the insurance. The tax on any portion of the premium unearned at termination of insurance having been credited by the State to the licensee shall be returned to the policyholder directly by the surplus lines licensee or through the producing broker, if any. The surplus lines licensee is prohibited from absorbing such tax and from rebating for any reason, any part of such tax.
- (B) At the time of filing his quarterly report as set forth in Section 18, each surplus lines licensee shall pay the premium receipts tax due for the period covered by the report.
- (C) If a surplus lines policy procured through a surplus lines licensee covers risks or exposures only partially located or to be performed in this state, the tax payable shall be computed on the portions of the premium properly attributable to the risks or exposures located or to be performed in this state, as follows:

- (1) If the risk insured is real or personal property, the percentage of the entire tax that is due to this state is the same as the percentage of the entire risk that is located in this state, computed on the same basis as was employed to calculate the insurable value of the risk.
 - (2) If the risk insured is business operations, general liability, or employee benefits, the percentage of the entire tax that is due to this state is the same as the percentage of the insured business operations or employees that are located in this state.
- (D) This Section shall not apply to insurance of risks of the State Government, its political subdivisions or of any agency thereof.
- (E) If a multistate risk has a portion of that risk located within this state, the surplus lines licensee will remit payment of taxes collected to this state in accordance with the provisions of Subsection (C) (1) and (2).

Section 20. Collection of Tax.

If the tax collectible by a surplus lines licensee under this Act has been collected and is not paid within the time prescribed, the same shall be recoverable in a suit brought by the (Commissioner) against the surplus lines licensee and the surety on the bond filed under Section 15.

Section 21. Suspension, Revocation or Non-Renewal of Surplus Lines Licensee's License.

The (Commissioner) may suspend, revoke or refuse to renew the license of a surplus lines licensee after notice and hearing as provided under the applicable provision of this state's laws upon any one or more of the following grounds:

- (A) Removal of the resident surplus lines licensee's office from this state;
- (B) Removal of the resident surplus lines licensee's accounts and records from this state during the period within which such accounts and records are required to be maintained under Section 17 of this Act;
- (C) Closing of the surplus lines licensee's office for a period of more than 30 business days, unless permission is granted by the (Commissioner);
- (D) Failure to make and file required reports;
- (E) Failure to transmit required tax on surplus lines premiums;
- (F) Failure to maintain required bond;

- (G) Violation of any provision of this Act; or
- (H) For any other cause for which an insurance license could be denied, revoked, suspended or renewal refused under Sections (insert applicable citation).

Section 22. Actions Against Surplus Lines Insurer -- Service of Process.

- (A) A surplus lines insurer may be sued upon any cause of action arising in this state under any surplus lines insurance contract made by it or evidence of insurance issued or delivered by the surplus lines licensee pursuant to the procedure provided in Section (insert applicable section containing Uniform Unauthorized Insurance Process Act). Any such policy issued by the surplus lines licensee shall contain a provision stating the substance of this Section and designating the person to whom the (Commissioner) shall mail process.
- (B) Each surplus lines insurer assuming a surplus lines insurance shall be deemed thereby to have subjected itself to this Act.
- (C) The remedies provided in this Section are in addition to any other methods provided by law for service of process upon insurers.

Section 23. Penalties.

- (A) Any surplus lines licensee who in this state represents or aids a non-admitted insurer in violation of this Act may be found guilty of a misdemeanor and subject to a fine not in excess of \$1,000.00 Dollars.
- (B) In addition to any other penalty provided for herein or otherwise provided by law, including any suspension, revocation or refusal to renew a license, any person, firm, association or corporation violating any provision of this Act shall be liable to a penalty not exceeding \$1,000 for the first offense, and not exceeding \$2,000 for each succeeding offense.
- (C) The above penalties are not exclusive remedies. Penalties may also be assessed under the ("Trade Practices and Fraud") statute of the insurance code of this state.

Section 24. Separability of Provisions.

If any provision of this Act, or the application of such provision to any person or circumstance, shall be held invalid, the remainder of the Act and the application of such provision to persons or circumstances other than those as to which it is held invalid, shall not be affected thereby.

Section 25. Effective Date.

This Act shall take effect (insert appropriate date).

AS. Sec 21.33
From Hartford

NAIC MODEL NON-ADMITTED INSURANCE ACT

Section 1. Non-Admitted Insurance Act - Short Title.

This act may be cited as "The Non-Admitted Insurance Act".

Section 2. Purposes -- Necessity for Regulation.

* Insurance transactions with non-admitted insurers are so affected with a public interest as to require regulation, taxation, supervision and control of such transactions and matters relating thereto, as provided in this Act, in order to -

- (A) protect the insureds and claimants of this state in transactions involving the purchase of insurance from insurers not authorized to transact business in this state;
- (B) provide for the public, to the extent that insurance is not procurable from admitted insurers, or from eligible surplus lines insurers through licensed surplus lines licensees;
- (C) protect the revenues of this state;
- (D) protect regulated, admitted insurers from unregulated and unfair competition by non-admitted insurers;
- (E) regulate and supervise the effectuation of non-admitted insurance in accordance with the laws of this state and Public Law 15, known as the McCarran Act; and
- (F) maintain reliable insurance markets.

Section 3. Definitions.

As used in this Act:

- (A) "Admitted insurer" means an insurer licensed to do an insurance business in this state.
- (B) "(Commissioner)" means the (Commissioner) of Insurance of this state.

- (C) "Eligible surplus lines insurer" means a non-admitted insurer with which a surplus lines licensee may place surplus lines insurance under Section 5 of the Surplus Lines Insurance Law.
- (D) "Export" means to place surplus lines insurance with a non-admitted insurer.
- (E) "Non-admitted insurer" means an insurer not licensed to do an insurance business in this state. This definition shall include insurance exchanges as authorized under the laws of various states.
- (F) "Producing broker" means the individual broker or agent dealing directly with the party seeking insurance.
- (G) "Surplus lines insurance" means any insurance in this state of risks resident, located or to be performed in this state, permitted to be placed through a surplus lines licensee with a non-admitted insurer eligible to accept such insurance, other than reinsurance, wet marine and transportation insurance, insurance independently procured and life and health insurance and annuities.
- (H) "Surplus lines licensee" means an individual (firm or corporation) licensed under Section 15 of the Surplus Lines Insurance Law to place insurance of risks resident, located or to be performed in this state with non-admitted insurers eligible to accept such insurance.
- (I) "Wet marine and transportation insurance" means
- (1) Insurance upon vessels, crafts, gulls and of interests therein or with relation thereto;
 - (2) Insurance of marine builder's risks, marine war risks and contracts of marine protection and indemnity insurance;
 - (3) Insurance of freights and disbursements pertaining to a subject of insurance coming within this subsection; and
 - (4) Insurance of personal property and interests therein, in the course of exportation from or importation into any country, or in the course of transportation coast-wise or on inland waters, including transportation by land, water or air from point of origin to final destination, in connection with any and all risks or perils navigation, transit or transportation, and while being prepared for and while awaiting shipment, and during any delays, transshipment, or reshipment incident thereto.

Section 4. Acting for or Aiding Non-Admitted Insurers Prohibited
- Exceptions.

- (A) No person shall in this state directly or indirectly act as agent for, or otherwise represent or aid on behalf of another, any non-admitted insurer in the solicitation, negotiation, procurement or effectuation of insurance, or renewals thereof, or forwarding of applications, or delivery of policies or contracts or inspection of risks, or fixing of rates, or investigation or adjustment of claims or losses, or collection or forwarding of premiums, or in any other manner represent or assist such insurer in the transaction of insurance.
- (B) This section does not apply to:
- (1) Matters authorized to be done by the (Commissioner) under the Unauthorized Insurers Process Act (cite statutory sections);
 - (2) Surplus lines insurance if it is effected and written under the Surplus Lines Law of this state;
 - (3) Transactions for which a certificate of authority to do business is not required of an insurer under the insurance laws of this state;
 - (4) Reinsurance;
 - (5) The property and operations of railroads or aircraft engaged in interstate or foreign commerce, insurance of vessels, crafts or hulls, cargoes, marine builder's risks, marine protection and indemnity or other risks including strikes and war risks commonly insured under ocean or wet marine forms of policy;
 - (6) Life insurance, health insurance and annuities when solicited solely by mail or when not solicited, negotiated or procured in this state;
 - (7) Transactions subsequent to issuance of a policy not covering domestic risks at time of issuance, and lawfully solicited, written or delivered outside this state.
- (C) Any person who represents or aids a non-admitted insurer in violation of this Section shall be subject to the penalties hereinafter provided. No insurance contract entered into in violation of this Section shall preclude the insured from enforcing his rights thereunder in accordance with the terms and provisions of said contract of insurance.

- (D) If the unauthorized insurer fails to pay a claim or loss within the provisions of the insurance contract, a person who assisted or in any manner aided directly or indirectly in the procurement of the insurance contract, shall be liable to the insured for the full amount under the provisions of the insurance.

Section 5. Suits by Non-Admitted Insurers.

No non-admitted insurer may commence or maintain any action in law or equity in this state to enforce any right arising out of any insurance transaction in this state except with respect to:

- (A) Claims under policies lawfully written in this state;
- (B) Liquidation of assets and liabilities of the insurer (other than collection of new premium), resulting from its former authorized operations in this state;
- (C) Transactions subsequent to issuance of a policy not covering domestic risks at time of issuance, and lawfully solicited, written or delivered outside this state;
- (D) Surplus lines coverages exported in accordance with the Surplus Lines Law of this state;
- (E) Reinsurance;
- (F) The continuation and servicing of life insurance, health insurance policies or annuity contracts remaining in force as to residents of this state where the insurer has withdrawn from the state and is not transacting new insurance therein;
- (G) Servicing of policies written by an admitted insurer in a state to which the insured has moved but in which the company is not licensed until the term thereof expires;
- (H) Claims under policies covering wet marine and transportation insurance.

Section 6. Insurance Independently Procured -- Duty to Report and Pay Tax.

- (A) Each insured who in this state procures or continues or renews insurance with a non-admitted insurer on a risk located or to be performed in whole or in part in this state, other than insurance procured through a surplus lines licensee pursuant to The Surplus Lines Law, or exempted from tax under Section _____ of (cite to surplus lines law), shall, within _____ days after the date such insurance was so procured, continued, or renewed,

file a written report of the same with the (Commissioner), upon forms prescribed by him, showing the name and address of the insured or insureds, name and address of the insurer, the subject of the insurance, a general description of the coverage, the amount of premium currently charged therefor, and such additional pertinent information as is reasonably requested by the (Commissioner).

- (B) Gross premiums charged for such insurance, less any return premiums, are subject to a tax at the rate of ____%. At the time of filing the report required in the first paragraph of this Section, the insured shall pay the tax to the (Commissioner), who shall transmit the same for distribution as provided in Section ____ (of the surplus lines law).
- (C) If an independently procured policy covers risks or exposures only partially located or to be performed in this state, the tax payable shall be computed on the portion of the premium properly attributable to the risks or exposures located or to be performed in this state, as set forth in subsections (C) and (E) of Section 19 of the Surplus Lines Law.
- (D) Delinquent taxes hereunder shall bear interest at the rate of ____% per annum.
- (E) This section does not abrogate or modify, and shall not be construed or deemed to abrogate or modify, any provision of Sections 4 or 5 or any other provision of this Act.
- (F) This Section does not apply to life insurance, health insurance or annuities.

Section 7. Investigation — Production of Policies and Documents.

- (A) Every insured by or as to whom insurance is procured or placed in a non-admitted insurer, upon the (Commissioner's) order shall disclose to the (Commissioner) the net amount of premiums paid for the insurance. In case of a failure of any person to comply with the (Commissioner's) order, the (insert proper title) Court, on application of the (Commissioner), may issue an order requiring the production of the records and information sought by the (Commissioner). Any person failing to obey the court's order may be punished by the courts as for a contempt.
- (B) This section does not apply to life insurance, health insurance or annuities.

Section 8. Penalties.

- (A) Any person other than an insured who in this state represents or aids a non-admitted insurer in violation of Section 4 of this Act may be found guilty of a misdemeanor, and be subject to a fine not in excess of One Thousand Dollars (\$1,000), in addition to other penalties prescribed in Section 4.
- (B) In addition to any other penalty provided for herein or otherwise provided by law, including any suspension, revocation or refusal to renew a license, any person, firm, association or corporation violating any provision of this Act shall be liable to a penalty not exceeding \$1,000 for the first offense, and not exceeding \$2,000 for each succeeding offense, in addition to other penalties prescribed in Section 4.

Section 9. Separability of Provisions.

If any provision of this Act, or the application of such provision to any person or circumstances, shall be held invalid, the remainder of the Act and the application of such provision to persons or circumstances other than those as to which it is held invalid, shall not be affected thereby.

Section 10. Effective Date.

This Act shall take effect (insert appropriate date).

Bill Fact Sheet

Date Received 2/22/83

Bill Number SB134 Title Surety bond reg/insurers-surplus line

Fiscal Note - Date Requested 2/24/83 Date Received 3/14/83

- Of Whom Katherine Wallen

Dept. Position Paper - Date Requested 2/24 Date Received 3/14/83

- Of Whom Katherine Wallen

Resource People

Initial Hearing - Date 4/14/83
People Contacted

- Dick Block - 248-2642 - 4/8
- Joe McClean - 6-3210 - 4/8
- Steve Silver/Mike Thomas - 6-3340 4/8
- Wes Coynes - 4/8

Follow-up Hearing - Date _____

Final Action passed CS Date 4/14/83

Forum

Section of Insurance, Negligence and Compensation Law
American Bar Association Vol. XIV, No. 1

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limitations of state government also apply to the federal government—perhaps to an even greater degree. Instead, the public would be better served if the state and federal regulators and legislators forgot about the jurisdictional issue and focused more on why government, irrespective of its location, can no longer approach problems as it has in the past.

If I am correct in my assessment of future trends, both regulators and the industry will have to do a lot of things differently ten years from now than they do today. While change is painful—and this is especially so for regulators—it is also exciting and challenging. It is also a certainty, so we all had better start learning to cope with it.

the utilization and regulation of the surplus lines markets in the state of alaska

richard l. block

the surplus lines markets are important to alaska

Terry, a personal friend of mine, earns his living in Alaska as a commercial fisherman. He owns a 38-foot vessel, the "Lady of the Night," which represents about a \$40,000 investment. Terry has a now precious limited entry permit which authorizes him to fish, utilizing a gillnet during the very short gillnetting, one day a week, season in the salt waters of the Inside Passage in Southeastern Alaska. Terry's principal catch is the pink and chum salmon, which are the "bread and butter" of the commercial salmon fishing fleet.

The "Lady of the Night" is one of 11,000 vessels which participate in the fishing industry in the State of Alaska, and, while Alaska's fleet pales by comparison with the Japanese, Russian, and Korean fleets which also ply the near-Alaska waters, and may even pale by comparison with the tuna fleets of San Diego, the shrimp fleets in Louisiana, or bottomfisheries fleets off the Eastern Seaboard, it represents a most significant part of Alaska's economy, as well as of its culture and heritage.

It becomes, therefore, a very serious concern when the 11,000 vessels and over 200 fish processing plants, both land based and floating, find it difficult to obtain necessary hull and liability and property coverages, workmen's compensation, where appropriate, or other liability coverages for the vessel employees and other necessary and proper insurance coverages for the owners and operators of the fishing fleet.

The unique characteristics of Alaska's fishing fleet indicate why there is difficulty in obtaining insurance in admitted markets.

First the fishing fleet is large by number, but the unit size is

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small. The Alaska fishing fleet does not universally boast very large vessels staffed by tens of hundreds of shipboard workers, utilizing the most modern techniques in fish harvesting. In this regard it differs from the seiners of San Diego, and the larger multi-gearred vessels of Russia, Korea and Japan.

In many respects the Alaska fishing fleet represents the heritage of the State where individual entrepreneurs singlehandedly man their vessels, including many older boats in the open or only partially enclosed waters of the State, garnering what is, today, considered to be generally a good living but working by their wits and with the aid of their equipment and vessels in which they have singly invested.

There is attached to the paper an Exhibit I which shows the size and limited growth of the fishing fleet since 1969. It is interesting to note from these statistics that, while the number of employees, the number of fish processing plants, and the number of vessels engaged in the commercial fishing activity in this State have not increased markedly through 1976, there has been a tremendous increase in the last year in the wholesale value of the fish harvest.

The Alaska fishing harvest is centered mainly around shellfish and salmon with a growing interest in halibut. There is, however, a growing interest in other bottomfish such as cod, pollock and flounder. It is anticipated that the demand in this new fishery will significantly expand the fishing harvest and, thus, increase the interest in fishing. It is doubtful that this will materially increase the number of vessels in the fleet because of the limited entry program which restricts the number of fishing licenses by type of fishing gear, but it will significantly increase the value of vessels, the size of vessels, and the size of catch.¹

1. *The Alaska Economy*, Vol. 0 (1977), published by the State of Alaska, Department of Commerce & Economic Development, p. 14.

While the Alaska fishing fleet may not be characteristic of fishing fleets around the world, the matters which distinguish it from other fishing fleets is what makes it particularly characteristic of other Alaskan industries and, furthermore, exemplify the characteristics which make insurance placement so difficult.

Consider the concern of the Fergusons who live in Kobuk, Alaska. Kobuk is located about 150 miles east and slightly north of Kotzebue, and Kotzebue is located along the Kotzebue Sound off the Bering Strait in Northwestern Alaska.

Kobuk is the home for about 50 families who have earned their living and support their settlement by fishing, trapping, subsistence hunting and, occasionally, additional income generated by working on the Alaska pipeline. The Fergusons obtained their house, furniture and other large items by the most circuitous transportation route. These items, generally ordered by catalogue, from Seattle, are shipped by barge which arrives in a barge fleet during the short ice-free period in Kotzebue Sound. Generally, the barges are too large to come within Kotzebue harbor and thus, goods are lited in in smaller barges. These items are then carried by small boats up the Kobuk River.

Smaller items may be flown into Kotzebue by the single commercial airline. No commercial airlines fly to Kobuk so the only access is by river during the summer or by light plane which lands at the small airport several hundred yards away from the Fergusons' new home.

Transportation for individuals is only by air.

The Fergusons' life-style in Kobuk exemplifies the life-style of Natives and Caucasians who live in the remote villages and bush communities of Alaska and who represent approximately 20 percent of the population. It is fair to say that many of the communities in Alaska outside of Anchorage, Fairbanks, and the principal cities served by Alaska Airlines in Southeastern Alaska are served by ferry, barge, and light plane in much the same way as the village at Kobuk.

It, thus, becomes apparent that the air taxi fleet in Alaska is one of the vital life links for a large segment of our population and is, thus, an extremely important industry.

Like the fishing fleet, the Alaska air taxi fleet is composed of individual entrepreneurs who own one to ten light and medium sized aircraft. It is not unusual for an air taxi operator to own a Cessna 185 on floats or skis as the sole asset in his air carrier business. Exhibit II to this paper shows the distribution of the air carrier fleet and highlights the extreme difficulty in defining the air carrier industry.

Unfortunately, the air carrier industry has suffered major losses. The Federal Aviation Administration will tell you that Alaska represents one of the worst records for air safety of all of the United States and, while the statistics appear bad, given the terrain, weather and other conditions in this State, the air taxi fleet in this State represents a generally safe and reliable mode of transportation and communication within much of the State.

These two groups, the fishing fleet and the air taxi fleet, represent two significant parts of our economy. Perhaps the most disturbing fact, and the most interesting fact from the standpoint of this presentation, is that the fishing fleet can obtain only limited insurance from the admitted markets, and the air taxi industry can obtain none.

It is this fact that has caused me to devote a great deal of time and attention to study of the surplus lines markets as they exist in the State of Alaska.

While I believe that programs for both industries could possibly be written in the admitted market and that premiums will grow considerably in the next few years for both industries as there is more growth in the State, it is doubtful that the business will flow to the admitted market from the surplus lines market in the next few years. This is particularly true with respect to the air taxi fleet because of the substantially erratic loss results.

I have attached as Exhibit III a showing of the relative size of the surplus lines market to the admitted market in total property-casualty premium writings in the State of Alaska.

While I have introduced this topic by explaining about our fishing and our air taxi fleet, it should be noted that substantial other kinds of risks find their way into the surplus lines market, and, in this regard, there are probably some parallels with the developments in other states.

Exhibit IV shows the substantial volume of property insurance which has found its way into the surplus lines market in the last several years.

This shows one of the interesting characteristics of the surplus lines market which is perhaps true in any state but which is exaggerated and exemplified in a state like Alaska.

It is said that one of the prime functions of the surplus lines market is to absorb the unavailability problems in the admitted market and, indeed, as there were adverse results in the personal lines, homeowners and fire insurance, or at least a perceived problem in these areas, more business gravitated to the surplus lines market which was able to absorb the capacity restrictions of the American insurers.

This alone, however, does not tell the full story and my more thorough examination into the Alaska surplus lines market has revealed many additional factors which bear on the question of the degree to which the surplus lines market should be regulated.

the surplus lines market has an important part in the history of alaska

The history of the distribution of insurance for property and casualty between the admitted and nonadmitted markets is as interesting as the history of Alaska itself.

Remember that, while the study of statehood for continental states is a matter of "ancient" history requiring a certain amount of dedicated attention during review of American history in our grammar school class days then to be forgotten, Alaska became a state only 20 years ago.

Until January 3, 1959, Alaska was a territory owned by the United States but looked upon by many in the "lower 48" as somewhat of a foreign country. Our isolation and somewhat remote and perceived hostile environment gave those in the "lower 48" both a feeling of romance and adventure when coming to or thinking of Alaska, but also generated great concern about the unknown quantities when being considered by underwriters as an insurance risk.

Because of the limited population and very limited economic potential for the State in those early days, there was little to recommend Alaska as a place to make an investment for insurance company operations. Accordingly, insurance was really marketed by agents and brokers who, through dedication and hard work, scrounged for markets in order to see that there was at least minimum protection for such business and personal risks as sought to be covered in the State.

American insurance underwriters traditionally doing business through either their local service offices that know and understand the local environment and could underwrite it locally found that Alaska could not be successfully underwritten using their traditional techniques.

First, no insurance company had established an office in the State and, thus, any underwriting by American companies was done by their closest offices which were in Seattle.

Take a look at a map and you will see that Seattle is as far from Anchorage or Juneau as it is from Chicago, Illinois, and to try to underwrite risk in the traditional way in Alaska from a Seattle service office would be as absurd and as catastrophic in terms of

underwriting risks as trying to determine the propriety of risks in Chicago from the Seattle service office.

There was the beginning of a general agency in Alaska in those days and, in fact, a substantial amount of business was underwritten profitably by the GA's of the day.

By and large, however, agents and brokers found it necessary to place their risks with those underwriters who knew and understood remote class underwriting, and that was, typically, the nonadmitted surplus lines market and, within that, typically, Lloyd's of London.

It is not hard to understand, therefore, why a substantial amount of insurance was written in the surplus lines market, particularly, property and workmen's compensation.

After 1959, statehood created a modicum of interest among the American writers, and brokers in Seattle were able to establish some safety groups particularly for workmen's compensation, and have them successfully placed with American writers.

One such group, written originally through D. K. McDonald & Co., which later was absorbed by Marsh and McClennan, was the Alaska Loggers Association, which was written for both liability and workmen's compensation on a safety group basis and placed at various times in the Argonaut and the Fireman's Fund. This program was successful as an American risk because it was written with the cooperation of the members of the Alaska Loggers Association, all of whom agreed to participate in the program with a substantial retrospective penalty or credit depending on underwriting results, almost guaranteeing a profit to the underwriter. It is interesting to note that this program became the nucleus of business for the first domestic property and casualty stock insurer in the State of Alaska which was chartered in 1969.

As population grew and the economics of the State improved, there was of course a gravitation towards the admitted markets as admitted markets experimented with granting underwriting authority to agents and taking larger shares of coverage in particular lines of insurance.

Remember that from a national perspective, during the period 1959 to 1970 or '71 there was little that could be done that could materially hurt an insurance company.

This was a period of substantial and continued growth allowing for increases in capacity to write insurance, a fair amount of competition, a lack of severe regulation by State regulators and generally a period in which companies could make a profit, or, if they did incur a loss, would be willing to carry the loss forward into more profitable subsequent years.

For this reason it is not hard to understand why there was a certain amount of natural growth of the admitted market in the State. However, it is fair to state that it was not the result of an aggressive marketing posture by the American writers or by any deliberate attempt by American insurers to make major inroads into the State.

The mid '70s, however, saw some marked changes in the way insurance was marketed across the country.

Insurers were to a larger degree being managed by senior executives who reflected the general business ethic of return on investment by quarter and the impact of earnings on the value of the stocks traded on securities exchanges rather than long-term trends of profitability as was the rule during the period when insurance companies were managed exclusively by insurance oriented executives.

Further, there were serious adverse developments in the state of the American economy—rampant inflation, the impact of wage-price controls and invasion of the value of the dollar against foreign currencies tended to rapidly deplete the values of securities owned by insurance companies as investments and, thus, impair the surpluses against which insurance companies were, at that time, aggressively writing.

For this reason, there was a national, "capacity crunch" and insurance companies were making wholesale cuts in the kinds of insurance they were writing and the locations in which they were writing it.

It is not hard to understand, therefore, why companies that had never really sought out Alaska as an insurance market would urge their service offices in which Alaska was included as a territory to cut off Alaska as not being a cost-effective market for the companies.

Immediately, there was a resurgence of interest in the surplus lines markets.

This general background partially explains why there was a substantial increase in the percentage of property and casualty market flowing to the surplus line markets between 1974 and 1975; however, there were other factors which should be borne in mind.

competitive forces have an impact on the surplus lines markets

The business in Alaska probably, as in other states, moves from market to market generally at the direction of the producer.

Whatever may be said about competition among insurance

carriers, if the competition is not carried through the producers to the consumers, then the producers will have a natural tendency to move the business to the markets that produce the better level of compensation for them.

This is a matter upon which one can only speculate because the comparison of commission levels between American and surplus line markets is not clear; however, I believe that the level of commission is larger on the surplus lines market given the cost to produce the business than it would be for the American market and often times larger than the commission which is generated through the residual market mechanisms such as the assigned risk pools.

For this reason it is believed that agents and brokers have utilized the surplus lines market not because the business could not have been written in admitted markets but because it was the line of least resistance. Business was accepted in the surplus line market, whereas to place it in the admitted market a substantial amount of work effort by the agents and brokers which to them was not considered cost effective given the only moderate levels of commissions to be earned.

surplus lines insurance may be studied in four categories

There are four identifiable classifications of nonadmitted insurance, all of which have some relevance to the State of Alaska, and, perhaps, relevance in any surplus line market.

alien nonadmitted

Those companies and syndicates which are not licensed or chartered in any state of the United States but licensed or chartered originally and, perhaps, exclusively in a foreign country are the alien nonadmitted market.

Historically the British, French, German, Italian, Norwegian, Russian and Japanese insurers have provided substantial additional levels of insuring capacity; and, when utilized through the very experienced London brokers, have provided underwriting flexibility not heretofore available through the admitted market.

Attached Exhibit V shows the percentage of surplus line markets in Alaska that flow to the alien nonadmitted market.

The alien nonadmitted market may again be subdivided into two subcategories, the Lloyd's Syndicates and the alien companies.

The Lloyd's Syndicates represent a very significant share of the alien nonadmitted market, but must be looked upon from a regula-

tory point of view somewhat differently than the foreign companies.

The alien companies operate very similarly to the American companies in that, while they may share with Lloyd's in accepting portions of risk, by and large, they may be found writing in very much the same way as American companies are found to write.

The regulatory implications are also different.

English alien insurance companies are regulated by the Department of Trade and Industry in England, whereas, the degree of regulation of the Lloyd's Syndicate's is essentially found in the history of self-regulation and self-discipline in the Lloyd's marketplace.

foreign nonadmitted

There is a growing number of insurance companies that are finding, for a variety of reasons, that they can write business in an affiliate or subsidiary company which is domiciled in one state and not admitted to do business in any of the other states of the union. Insurance Company of North America utilizes the California union, Allstate utilizes the Northbrook and numerous other companies utilize subsidiaries in substantially the same way.

These companies are nonadmitted in the state of Alaska, but from a regulatory viewpoint, must be looked upon separately from the alien nonadmitted markets since they are heavily regulated in the American tradition by the state of domicile for each of the separate companies, and, further, are regulated by many states to a more or less degree because they are wholly-owned subsidiaries of insurance conglomerates which are regulated by almost all states of the Union.

captive carriers

There is a growing utilization of captive insurers, insurers which write insurance almost exclusively for their parent company.²

A recent decision to settle an internal revenue investigation questioning the propriety of deducting premiums to a captive insurer will rekindle interest in the utilization of captives by large multinational corporations seeking to reduce their risk management expense.

The utilization of captives, however, is not limited, unfortunately, to writing only for a corporation.

² "Captives—The Future Is Limitless," Barillo, A. J. C.P.C.U., *Risk Management*, Vol. 25, No. 6, June, 1970, p. 22.

For example, some brokers are utilizing the captive vehicle to write industry group programs. They are marketing these as captive insurers and I will discuss later whether they truly are captives. However they should be looked upon as a separate class of nonadmitted writer with different regulatory characteristics.

industry mutuals

One of the more interesting studies that I have been required to make in the last year or so has been the role of the Protection and Indemnity clubs, generally found on the off-shore islands and managed by British brokers, that provide protection and indemnity cover to the fleet of ships carrying cargo around the world.

These companies that seek protection and indemnity coverage for their vessels for liability to others and for protection of the cargos have seen fit to band together in clubs which are essentially self-regulating vehicles for the mutual exchange of indemnities backed by the net worth of the shippers themselves.

My interest in these clubs grew out of the recently adopted tanker legislation in the State of Alaska which required that the ships hauling North Slope oil from Valdez to the "lower 48" meet certain financial responsibility requirements imposed by State law.³

Although there appears to be some doubt as to the constitutionality of such a law, it is inappropriate here to go at any length into a discussion of the constitutionality question. The federal district court in Alaska is wrestling with this problem⁴ as has the U.S. Supreme Court with respect to similar legislation from the State of Washington.⁵

Notwithstanding the possible unconstitutionality of the statute, it is true that the shippers of oil flowing through the new Alaska pipeline did seek the cooperation of the Division of Insurance in qualifying the protection and indemnity clubs under our white list in order to meet the regulations promulgated by the Alaska Department of Environmental Conservation.⁶ In the course of reviewing the nature of P & I clubs it became apparent that they present yet a different regulatory concern.

3. Alaska Oil Discharge Prevention and Pollution Control Act, 1970, SLA Chap. 266, AS 30.25.050.

4. Sohio Pipeline Co. v. Hammond, A 78-147, Civil U.S. District Court, District of Alaska; Chevron v. Hammond, A 77-195, Civil U.S. District Court, District of Alaska.

5. Ray v. Arco, 40 U.S. LW. 4200, Mar. 8, 1970.

6. 18 AAC 20.000.

there are five areas in which this business is regulated

There are essentially five areas of regulation that, in my opinion, either do or could conceivably impact on the surplus lines markets.

jurisdiction

All states for the most part have adopted some statutory authority for establishing jurisdiction over unauthorized insurers doing business in their state.⁷

The general thrust of these laws is to the effect that any insurance company, though not admitted or authorized to do business in this state which allows a policy to be sold covering risks in the state has, by virtue of that fact, submitted to the jurisdiction of the state. The principal consequences of course is that Service of Process on the Director of Insurance or some other State officer constitutes service upon the unauthorized insurer giving a plaintiff in any litigation against the insurer in personam jurisdiction over the unauthorized insurer. Second, it establishes a tax liability under the surplus lines tax law. Generally, where the transaction involves an unauthorized insurer but does not involve a surplus lines broker, the tax may be collected directly from the insured.

The history of the development of the jurisdictional law in the State of Alaska I find to be most interesting.

When the insurance law was first codified, essentially from the Washington law in 1966,⁸ there was adopted the old NAIC Model Unauthorized Insurers Act.⁹

That law essentially adopted the philosophical viewpoint that an unauthorized insurer was not prohibited from insuring in the state but must, by virtue of covering risks in the state of Alaska, recognize that it had created sufficient nexus of activity in the state to enable service of process in any litigation to be achieved by service of process on a statutory officer.

The statutory officer was designated as the Director of the Division of Insurance and the more sale of insurance, whether within the State or from without the state, covering a risk located within the state, created the authority to establish in personam jurisdiction over the unauthorized insurer.¹⁰ The 1966 law also

7. For a complete review of the surplus lines laws of all states, see *Non-Resident and Surplus Lines Laws*, rev. 1970, Published by National Underwriters.

8. Alaska Stat. § 21.33.

9. Vol. II, *Official N.A.I.C. Model Insurance Laws Regulations and Guidelines*, p. 060-1.

10. Model Unauthorized Insurers Process Act, Sec 2(a), Vol. II, *Official N.A.I.C. Model Insurance Laws, Regulations and Guidelines*, p. 060-1.

recognized that such business could be conducted through surplus line brokers.¹¹ Surplus line brokers were licensed as persons doing business within the state and by virtue of the conditions that could be imposed upon the performance of surplus line brokers, jurisdiction could be obtained on the unauthorized insurers utilized by those brokers.¹²

In 1968 the Alaska Legislature totally repealed the unauthorized insurers act,¹³ but kept intact the surplus line brokers provisions and replaced the model unauthorized insurers act with segments of the 1969 version of the NAIC Unauthorized Insurers Model Statute.¹⁴

It should be noted that in 1968 the Legislature adopted an act which did not become an NAIC model until 1969. It should be further noted that much of the language of the model was known in 1968 because of the deliberations then going forward in the several NAIC subcommittees.

A most interesting history of the development of the unauthorized insurers law may be found in the NAIC proceedings.¹⁵ Here may be found the first report of the NAIC Industry Advisory Committee on Unauthorized Insurers which includes, as a supplement, an outline of a report prepared by George Cline, Insurance Research Analyst for the New York Insurance Department, prepared in 1949, together with a summary of NAIC actions with respect to unauthorized insurers from the period 1949 to 1967.

These two summaries, which comprise the addenda to the first report given in 1968, provide an excellent review of the history of the jurisdictional issues surrounding the unauthorized insurer problem.

It should be noted that the NAIC's primary concern in 1968 and apparently in much of the preceding history dealt with mail order disability and life insurance and the consumer abuses that were attendant with that kind of insurance.

As a matter of fact, however, when the law was adopted in Alaska, much of the NAIC model, and particularly that portion dealing with reciprocity of judgments, was not included in the Alaska version. What was included, however, was some language that did not find its way into the model act.

Consider, for example, the following language which is set forth as the purpose of the new provisions:

11. *Alaska Stat.* § 21.33.080, *et seq.*

12. *Alaska Stat.* § 21.33.300.

13. 1968 SLA Chap. 234.

14. Vol. II, *Official N.A.I.C. Model Insurance Laws, Regulations and Guidelines*, p. 050-1

15. *Proceedings of the National Association of Insurance Commissioners*, Vol. II (1968) p. 515.

The Legislature declares that it is a subject of concern, that many residents of this state hold policies of insurance issued by persons and insurers not authorized to do insurance business in this state, thus presenting to these residents the often insuperable obstacle of asserting their legal rights under these policies in forums foreign to them under laws and rules of practice with which they are not familiar. The Legislature declares that it is also concerned with the protection of residents of this state against acts by persons and insurers not authorized to do an insurance business in this state by the maintenance of fair and honest insurance markets, by protecting the premium tax revenues of this state, by protecting authorized persons and insurers, which are subject to strict regulations from unfair competition by unauthorized persons and insurers and by protecting against the evasion of the insurance regulatory laws of this state. [Emphasis indicates portion included in Alaska law, but not found in the model law]¹⁶

The comparison of purposes suggests that a somewhat different emphasis was considered by the Alaska Legislature than was considered by the insurance commissioners when adopting the model. The difference in emphasis would indicate that there was concern not with respect, necessarily, to life and health business sold by mail order, but the substantial amount of all lines of business that was already sold in the state, which must necessarily refer to the substantial volume of property and casualty insurance business and market and claim handling problems which were occurring at that time. It is also clear that the legislative concern dealt with collection of premium taxes that apparently were escaping because of the inadequacies of the 1966 version of the law.

There are other differences between the Alaska version and the model version, which do not deal with jurisdiction, but do indicate the fact that a substantial amount of business in Alaska would necessarily be written in the unauthorized insurance market and thus, would enjoy statutory recognition and protection.

The new version provides that any transaction of the business of insurance in the state of Alaska, and the term "transaction" of insurance is broadly defined, constitutes sufficient nexus in the state to permit service on the director to be service on the authorized insurer.

solvency

The second area of concern deals with assuring some minimum levels of protection for insureds against the insolvency of an unauthorized insurer. The solvency standards for the nonadmitted market, however, are materially different than those imposed upon the admitted market.

16. Model Law, Section 1, *Alaska Stat.* § 21.33.011.

Today, the minimum capital and surplus required of admitted carriers has been raised so that there are much more rigid surplus and capital requirements;¹⁷ however, the capital and surplus requirements at least in Alaska imposed upon surplus lines securities has really not been recently addressed and, thus, remain at levels established very early in the history of development of the insurance code.¹⁸

For example, today, a property and casualty writer must have a minimum of \$1,500,000 in capital and surplus in order to receive a Certificate of Authority. Under our surplus lines law, however, only \$600,000 in capital and surplus is required and if the company does not have \$600,000 in capital and surplus it may meet the requirement by having a deposit in respect of all policyholders in the United States deposited somewhere in the United States in the amount of \$450,000.

There is, of course, a conflict here. On the one hand it is apparent that the Legislature intended that there be minimum capital and surplus requirements to protect policyholders; on the other hand the minimums are set, at least when compared with that required of admitted carriers, so low as to not provide the protection which is regarded as appropriate. The code provides:

A surplus line broker shall ascertain the financial condition of an insurer before placing insurance with him. A broker may not place surplus line insurance with an insurer which he knows to be financially unsound, nor may the broker place surplus line insurance with an insurer which has capital and surplus of less than \$600,000 unless there is, on file with the department, a copy of a trust agreement, certified by the trustee, evidencing an existing trust of at least \$450,000 which is deposited by the insurer in a United States bank or United States trust company and held for the protection of the insurer's United States policyholders.

It is clear that the broker has some responsibility to determine the financial propriety of the securities which he uses but it is also apparent that it is unclear to what extent the broker has the responsibility of actively determining the financial strength of the company.

Because of the division's concern with this matter, in 1976 the division promulgated a proposed revision of the surplus lines law requiring the broker to exercise an affirmative responsibility of checking securities. The early statutory proposals would have required the broker to obtain very recent financial information and assure that the security met, at least, the requirements imposed

17. Alaska Stat. § 21.00.070.
18. Alaska Stat. § 21.33.100.

upon an admitted carrier and, further, would have imposed upon the broker the responsibility for paying claims should he err in the judgment about the financial condition of the company.

Clearly this goes farther than any regulatory scheme I am aware of in any other state, but it may be a very necessary adjunct of proper assurance to policyholders in the State that the securities which they are using are financially adequate to meet the needs of the policies.

Obviously, such legislation requires a great deal of thought, and, for that reason, the proposals have not yet been submitted to the Legislature.

Among the matters which came to the division's attention that would make such legislation impractical is the fact that brokers very rarely have access to meaningful financial information.

I enjoy the privilege of sitting on the NAIC Ex 2 Regulatory Information Subcommittee, which has, as its primary consideration, the matter of reviewing securities utilized by surplus line brokers throughout the country.

Among the lessons learned from participation on this committee is the fact that alien insurers maintain their books in accordance with the accounting standards of the country of their origin, and, thus, reviewing financial information of surplus lines securities involves the problem of understanding the difference between the accounting methods of the foreign country and our own accounting systems, the ability to translate statements in a foreign language into English and the conversion of the currencies in which their statements are stated into American dollars.

The division has taken several different approaches to this matter, all on a somewhat informal basis.

The first is the one used typically in many states which is the creation of a "white list."¹⁹ On Alaska's "white list" are listed all those securities which have submitted information for review by the division, and are found to have the minimum capital and surplus or the minimum trust balance.

While we believe it is somewhat of an extension of the literal interpretation of the statute, we have insisted that an alien insurer, even one which meets the surplus requirements, have an American deposit in the minimum amount.

The brokers have been advised not to use companies unless they are on the "white list," however, we are cognizant of the fact that, when rounding out a line slip placement, the London brokers

19. State of Alaska, Division of Insurance, Bulletin 70-1.

will utilize securities not knowing that they are not on our "white list."

There are several matters which concern the division with the "white list" approach. First, the division does not believe that it is any more capable of reviewing foreign or alien financial statements than are the brokers. We have received some valuable information from the newly created NAIC office in Milwaukee, which has undertaken a more professional approach to reviewing alien financial statements; and this, together with information received from other surplus lines associations around the country, enables us to do at least an adequate job of white listing.

The second difficulty, of course, is that white listing removes the primary responsibility of this determination from the brokers where, in my opinion, the ultimate responsibility should rest.

The third difficulty is that there is no adequate enforcement provisions in our law should a broker utilize an unlisted security or should a listed or unlisted security become financially impaired and unable to pay a claim. For the State of Alaska, the matter of rigidity in allowable securities is complicated by the necessity of maintaining available markets.

The legislative concern in this regard is found in the following statutory provision:

The department may waive the financial requirements in this subsection if circumstances in which insurance on risks located in this state cannot be procured under the requirements.

It appears the legislative intent that if securities with adequate financial ability to honor claims cannot be found who will write a particular risk then a person may utilize a loss than adequate security to obtain insurance.

The division has not found it necessary to authorize such insurers in order to assure availability but the possibility exists that the statutory concerns for availability of markets may someday become a reality.

One of the more interesting problems which the Alaska division faced in this connection was whether to list P & I clubs.

Under the regulation promulgated by the Department of Environmental Conservation for the State of Alaska, ship owners hauling oil from Valdez to the "lower 48" were required to show their financial responsibility by posting up to \$20 million of liability insurance for oil pollution exposure.

The ship owners utilize the protection and indemnity clubs located essentially on the offshore islands.

The regulation provided further that the insurance must be by a

company authorized to do business, by the Division of Insurance, or listed on the division's "white list."

The representatives of the P & I clubs earnestly sought to be listed so that they could provide coverage and cause the ship owner members to comply with Alaska law. The division took the position that it would be happy to list the P & I clubs but insisted that they comply with the same provisions as any other company listed on our "white list," which meant that they must post a deposit, submit to the jurisdiction by service of process on the Division of Insurance and provide us with their financial statements.

P & I clubs consider themselves as standing significantly apart from all other insurance mechanisms, and manifestly refused to show us financial statements, to post deposit or to submit to the jurisdiction of the Division of Insurance.

For this reason, even though the P & I clubs probably were more than adequately financed to meet any obligation that could be imposed upon it and certainly provided the financial responsibility which the Department of Environmental Conservation was looking for, the division found that they could not be listed.

The interesting anomaly is that the oil companies owning and shipping the oil being transported, or by indemnity, the ship owners, qualified as self-insurers and have, thus, posted no insurance; but standing behind their self-insured obligations are the P & I clubs which the division would not list.

tax

It is clear that the surplus lines business is intended to be taxed at least as much as if the business were written in the admitted market.²⁰

I suppose the rationale for the surplus lines tax is essentially the same as that for a use or in lieu tax imposed upon the sale of products in those states having a sales tax. Thus, the importation of goods should not be allowed as a means of evading a State tax on the sale of domestic goods. Likewise, persons should not be utilizing the surplus lines market as a vehicle for escaping the tax normally imposed on insurance proposed through the admitted market.

It is the law in the State of Alaska, and probably typical in most states, that the tax is the same as imposed on the writing of insurance by foreign admitted companies plus an additional one-half percent fee to cover the administration of the surplus lines law.²¹

The division's concern here has been to audit surplus line brokers to determine that the proper tax has been paid.

²⁰ Alaska Stat. § 21.33.055, Alaska Stat. § 21.33.230.

²¹ Alaska Stat. § 21.33.220.

The division has really taken no direct action in this regard for several years, however, this summer, the division has started to audit surplus line brokers and has determined that there is a great disparity between the taxes paid and the taxes believed due.

Unfortunately, lack of auditing by the division has permitted laxity among surplus line brokers and it is believed that the brokers' accounting systems have not adequately kept track of the tax obligations. We believe that this will be an area of increased concern by the division.

market conduct and competition

This has hitherto not really been addressed in my opinion by the regulators of the several states; however, it has been necessary for the Alaska Division of Insurance to take a somewhat larger interest in this area of the law.

It is, for example, a requirement that no insurance be placed in the surplus lines market if that insurance can be placed in the admitted market. These laws which may be regarded as statutory preference for the admitted market have effectively precluded the surplus lines market from being utilized as a rate competitor.

In those states which have a prior approval law as does the State of Alaska, it is assumed that rates cannot be charged by any one admitted carrier lower than the approved filings by that admitted carrier. The historical development of rate regulation is born out of the concern that unregulated rates would mean untrammelled price competition jeopardizing the solvency of the admitted market. While I personally question that, today, as a valuable motive for rate regulation, to the extent that there is validity to the argument, it must be said that the surplus lines market ought not to be utilized to undercut the rates in the admitted market and, thus, defeat the purpose of rate regulation. Accordingly, surplus lines securities are not permitted to charge rates lower than that permitted by the admitted markets.

Furthermore, there are ministerial requirements for demonstrating that the risk had been submitted to the admitted markets and rejected before the surplus line markets may be utilized. I discovered very early on in the development of regulations of the surplus line market that that is one of the most difficult areas to effectively enforce.

Generally, these regulations are framed in terms of the surplus line broker submitting to the Division of Insurance an affidavit to the effect that he has attempted to place the risk with admitted carriers in his own office and those carriers have refused. This is a patently self-serving document and any attempt to audit the

propriety of these statements would be fruitless. I have found that it is very easy for a surplus line broker wishing to place the business in the surplus lines market to get the admitted carrier/underwriter to agree to reject the risk and then present the risk to the surplus line market even though some other admitted carrier elsewhere in the State may be quite prepared to accept the risk.

In an effort to correct this problem, the division attempted a regulation by which the surplus line broker was required to obtain from executive officers of admitted carriers two rejections before placing the risk with the surplus lines market.²²

This idea was abandoned²³ when it was pointed out that the surplus line brokers were obtaining blank rejection slips from the admitted carrier executives and storing them in their offices to be utilized whenever they needed to place the risk with a surplus lines market.

Probably one of the most interesting examples of the difficulty of regulating the market conduct and competition aspect of the surplus lines market may be found in the problems which the division has been observing in the placing aviation workmen's compensation insurance.

The air taxi fleet has, from time to time, been insured in the State by one or more of three markets: Lloyds of London through syndicates led by a key aviation syndicate; USAIG, a syndicate of American admitted insurers; and the Workmen's Compensation Assigned Risk Pool.

USAIG was writing air taxis for a period of time, however, in 1976, elected to withdraw from the market because of substantially high losses and an inability to foresee how to profitably write the business without rates that were incredibly excessive.

The Assigned Risk Pool was becoming overloaded with air carrier risks and jeopardizing the general workmen's compensation markets because admitted carriers were fearful that substantial increases in general workmen's compensation writings would expose them to a higher percentage share of the aviation losses in the pool.

For that reason the division dramatically increased the surcharges to air carriers in the Workmen's Compensation Assigned Risk Pool, thus forcing a substantial amount of that business to the last remaining market, Lloyd's of London.

A significant problem with Workmen's Compensation Aviation

22. State of Alaska, Division of Insurance, Bulletin 76-5, February 19, 1973.

23. State of Alaska, Division of Insurance, Bulletin 76-6, March 31, 1976, Bulletin 76-8, October 1, 1976.

was the inability to obtain adequate statistics concerning the history of losses. One of the characteristics of the surplus line market is that there are no statistics on losses maintained anywhere which are accessible to the Division of Insurance.

Essentially the workmen's compensation rate, in early 1976, which nominally is established by the National Council on Compensation Insurance, was arrived at arbitrarily by the Division of Insurance after some discussion with surplus line brokers as to what rate the London markets felt it had to have in order to accept the risk.

By establishing the negotiated rate, and then surcharging the pool above that amount, an effective accommodation with London was reached and a substantial amount of the Workmen's Compensation Aviation business moved to the London markets:

In order to permit this to occur in an orderly fashion and in order to start building statistics for future use, the division promulgated some regulations stipulating the conditions under which the aviation business could go to the workmen's compensation market in London.²⁴

This took place about the same time the division, together with the air carriers association and others in the State, moved vigorously to obtain some changes in the Workmen's Compensation Law in order to normalize benefits and reduce the cost, particularly to the air carriers.

Upon the adoption of the meaningful reform legislation which was effective September 1, 1977,²⁵ the air carriers association began looking to establish some form of safety incentive program in combination with a group workmen's compensation insurance program, and has been substantially frustrated because of either the inability or the unwillingness of forces in the London market to accommodate to such a safety program.

In reviewing the situation the division came to the realization that, because of the structure of the London markets, the London market had a virtual monopoly on the business and that, while there was substantial competition among brokers within the State of Alaska to obtain aviation accounts, all the brokers were utilizing the same London syndicate as a lead for their workmen's compensation aviation programs.

It must be observed, therefore, that, while the surplus line markets provide needed markets where the admitted market fails to respond and where the statutory residual market such as the Assigned Risk Pool is an undesirable market alternative, regulators

must face up to the fact that dependence upon Lloyds carries with it some substantial drawback akin to the kinds of drawbacks that may be found where there are domestic monopolies of market availability.

regulation of brokers

The most effective form of regulation of the surplus lines market comes through the regulation of the surplus line broker.

The statute recognizes that, notwithstanding the general proposition that no business may be placed by a broker except with a carrier authorized to do business in the State, there is a general recognition that the surplus lines business has a place in the insurance marketplace provided it is performed by persons with more than the usual level of expertise in marketing insurance.

Surplus line brokers are generally required to have bonds, additional experience as a broker, and other criteria for their higher level of expertise.

Because the surplus line securities are, by definition, not admitted, they are also, by definition, incapable of being regulated directly. Any regulation of the surplus line market, therefore, must be by virtue of regulation of the surplus line broker.

An interesting example of the need for public protection in the surplus market was in connection with the fishing fleet program.

A broker had developed a concept by which those vessel owners who agreed to participate in a safety program initiated and administered through the University of Alaska could be insured through nonadmitted carriers which, in turn, would be reinsured by a Bermuda captive administered by the broker but "owned" by the participating fishermen.

The immediate response to this program was highly favorable among the fishing fleet and when the brochure that the broker was circulating was reviewed by our division, we could see why.

Our law, as does the law of most states, exempts marine insurance from the purview of the surplus lines law. Alaska law, however, regulates insurance covering risk or exposure of a marine vessel engaged in commercial fishing or fish processing in the state for a period of 30 or more consecutive days in a year.²⁶

We certainly had no jurisdiction over the proposed captive.

The division took the view that the proposal was really not for the creation of a captive since the entity would be insuring risks for other than a single owning entity. We further took the view that soliciting participation in such a program constituted soliciting for

24. State of Alaska, Division of Insurance, Bulletin 70-4, February 17, 1970.

25. Alaska Stat. § 21.33.310(f).

investment in an insurer which is subject to the requirement of a solicitation permit.²⁷

Accordingly, we urged the broker to modify substantially the contents of the brochure to keep it from being misleading. That program is providing coverage at competitive rates but the so-called captive has yet to be formed.

A further example of achieving a better result for the consumer by regulation of the broker may be found in our rural property placement program.

Owners of bush dwellings were finding it particularly difficult to obtain coverage in the admitted markets. The division created a voluntary admitted market for these risks but, in order to achieve high utilization of this program, prohibited brokers from using the surplus lines market for these risks without adequate evidence that the admitted alternatives have been approached.²⁸ Our Bulletin 73-3 details the background and details of the plan.

conclusion

It may be seen from the exhibits which are attached to this report that surplus lines markets in the State of Alaska play an extremely important role in Alaska. Terry, the fisherman, has good coverage for "Lady of the Night" and the Fergusons of Kobuk insure their home at more reasonable rates and the air taxis have workmen's compensation coverage at more realistic rates. Nothing ought to be done that would in any way limit the ready availability of the surplus lines markets to solve insurance needs in the State. By the same token, the surplus lines market needs to be monitored for solvency and discharge of statutory obligations which are imposed on admitted markets other than the statutory obligations for maintaining rigidity in rates and policy forms, in order that the surplus line markets not be utilized as a means of circumventing legitimate statutory requirements and, thus, jeopardizing the need for growth in the admitted markets in the State.

This regulation comes through effective statutory and regulatory provisions and effective administrative implementation.

I believe that in Alaska we have moved considerably forward in achieving this balance, but continued effort needs to be exerted and we will probably find the proper balance of regulation and regulatory freedom in a manner different than will be found in any other state because of the unique situations which are faced in the Alaska insurance marketplace.

27. Alaska Stat. § 21.60.060.

28. State of Alaska, Division of Insurance, Bulletin 78-2, April 20, 1978, Bulletin 78-3 April 26, 1978.

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Exhibit I

**State of Alaska
Alaska Fishing Industry**

Year	No. of Licensed Commercial Fishing Vessels	No. of Alaska Fish Processing Plants	No. of Employees In Fish Processing	Wholesale Value of Fish Products
1969	9,972	208	8,584	\$144,200
1970	10,877	219	11,223	213,932
1971	10,710	192	8,502	198,660
1972	10,791	223	8,391	202,951
1973	11,777	227	10,546	307,587
1974	11,338	239	8,842	254,366
1975	11,630	221	9,947	293,192
1976	11,813	N/A	N/A	452,267

Source: "Alaska Catch and Production," Commercial Fisheries Statistics (for each year), published by State of Alaska, Department of Fish and Game.
"The Alaska Economy," Vol. 6 (1977), published by State of Alaska, Department of Commerce and Economic Development, Division of Economic Enterprise

Exhibit II

State of Alaska
Aircraft Registry with
Alaska Transportation Commission*

	1975	1976	1977
Rotary Wing			
Gross Take-Off Weight			
Less Than— 4,000	222	188	194
8,000	2	7	2
12,500	30	26	26
27,000	5	7	7
50,000	1	0	0
75,000	0	0	0
Over 75,000	0	0	0
Total—Rotary Wing	260	228	229
Fixed Wing			
Gross Take-Off Weight			
Less Than— 4,000	643	662	638
8,000	156	131	147
12,500	105	91	98
27,000	13	11	12
50,000	18	16	11
75,000	2	2	2
Over 75,000	39	41	36
Total—Fixed Wing	976	954	944

*Includes Scheduled Airline Aircraft
Source: Annual Reports, Alaska Transportation Commission

Exhibit III

State of Alaska
Property & Casualty Premiums Admitted and
Surplus Lines Premiums Written
1968-1977*

Year	Surplus Lines Premium	Admitted Property & Casualty Premium	Total	Admitted	Nonadmitted
1968	\$3,301,858	\$39,469,711	\$42,771,569	92.29%	7.72%
1969	3,653,923	46,145,012	49,798,935	92.66%	7.34%
1970	5,637,539	52,712,620	58,350,159	90.33%	9.66%
1971	7,621,022	62,896,053	70,517,075	89.19%	10.87%
1972	8,872,382	70,583,526	79,455,908	88.83%	11.16%
1973	7,347,470	76,501,223	83,848,693	91.23%	8.76%
1974	5,120,386	83,751,479	88,871,865	94.23%	5.76%
1975	12,774,972	97,526,155	110,301,127	88.41%	11.58%
1976	14,810,796	142,196,498	157,727,294	90.60%	9.39%
1977	29,844,544	269,800,813	299,735,357	90.04%	9.96%

*Figures taken from Division of Insurance, State of Alaska, Annual Reports

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**Exhibit IV
State of Alaska
Fire & Homeowners Premiums**

	<i>Total (Admitted and Surplus)</i>	<i>Surplus Lines</i>	<i>Surplus As % of Total</i>
1972	\$ 8,817,563	\$ 976,882	11.1%
1973	8,521,343	648,959	7.6
1974	9,523,474	965,537	10.1
1975	10,639,320	2,865,449	26.9
1976	13,796,608	4,552,479	32.8
1977	15,540,928	6,206,282	39.9
Total	\$66,839,236	\$16,185,588	24.2%

Source: Annual Reports, Division of Insurance, State of Alaska

**Exhibit V
State of Alaska**

The Division of Insurance has one hundred twenty-seven (127) companies on their eligible unauthorized insurer's list. The total premiums written by these companies through surplus lines brokers are:

I. Alien Companies			
a. This includes policies underwritten 100% Lloyds'	\$ 2,394,637.14		
Policies underwritten Lloyds' and Companies	\$10,887,615.62		
Policies underwritten by Several Aliens	\$ 2,526,420.85		
Policies underwritten 100% by One Alien	\$ 1,873,657.64	\$17,682,331.50	
b. Foreign Companies (American)			11,289,465.26
c. Alien companies not on Alaska's list of eligible unauthorized insurers			872,748.00

a defense of meaningful pre-trial discovery

stanley j. levy

All too frequently in our efforts to streamline the judicial system, we tend to lose sight of the fact that the primary purpose of the system and its major reason for existing is to ensure that all disputes are fairly and justly decided and that justice is achieved for the litigants. We have sometimes become overly concerned by the statistical numbers game played by court administrators who are often more concerned with how much it costs to run the system than they are by whether the rights of the parties are protected. And all too often, we permit the primary objective of the system, justice for the parties, to be submerged by judicial pressure to "move the cases."

Since promulgation of the Federal Rules in 1938, with their liberal pre-trial discovery, it has generally been accepted that properly directed pre-trial discovery makes a substantial contribution toward turning trials into a search for truth and justice rather than a game of skill and chance. Document discovery, interrogatories, depositions, and other formal discovery devices, when properly used by a skilled lawyer, are valuable tools in the lawyer's workshop. No one would seriously suggest that we abandon the progress of forty years and return to the prehistoric technical, legalistic battleground that existed before the Federal Rules went into effect.

But the Rules are being attacked, and unfortunately, the current assault in large part represents exactly the type of alleged reform which will unnecessarily sacrifice the rights of the litigants under the guise of "streamlining" the system. There have been abuses in the use of pre-trial discovery procedures in some cases, and to the extent the discovery rules have been abused, complaint about the litigation system may be justified. However, before we tinkered with the Federal Rules, we should be certain that it is the language of the Rules, and not how they have been administered, that is the problem, that the proposed changes in fact are necessary, and that they will not sacrifice existing benefits and rights. Unfortunately the proposed amendments not only fail to satisfy any of the



Official Business

Alaska State Legislature

Senate

Pouch V
State Capitol
Juneau, Alaska 99811

Marine Insurance:

- 1) Broker goes to underwriters
- 2) Underwriters are first set of risk takers; they in turn spread the risk among re-insurers;
- 3) Reputable re-insurers in Europe have begun to drop out; (heavy loss
- 4) Underwriters are spreading the risk among unreliable foreign and domestic re-insurers
- 5) When a claim is made, payments begin at the lowest level of the pyramid; Some companies are not more than "store fronts",

INSIDE INSURANCE

Big losses raise question of 'moral hazards'

'Most people are not in a position to make money off of sinking their vessel'

by Robert Mann

Millions of dollars worth of fishing vessel losses in 1982 have broken over Seattle's marine insurance community like a rogue wave at sea. The result, according to brokers and underwriters, could be that fishermen will be paying higher deductibles and premiums in the very near future.

Although the Coast Guard does not keep track of the total number of fishing vessels and processors lost in a given year, some worried underwriters are drawing up lists of their own. The 1982 numbers look pretty grim to companies that are insuring Alaskan fishing vessels.

According to one list, there have been over \$48 million worth of total losses of crabbers, seiners, draggers, processors and gillnetters through November of 1982. Five processors, three of which burned and sank within a six week period,

accounted for \$29 million worth of the total; the *Al Ind-Esk-A-Sea*, which burned and sank off Everett on October 22, was perhaps the most spectacular of the losses. Another underwriter said over \$22 million worth of crabbers sunk, burned, or ran aground this year.

Bad times seem to bring an increase in the number of reports of vessel owners burning or deliberately sinking their boats to collect the insurance money so they can get out of the business. The fact is, though, that not much is usually gained from that kind of act, according to several underwriters.

"When people are going broke, it seems that the friction of the mortgage against one's wallet seems to heat up the back of the boat, and away she goes," quipped John Adams. Adams manages Pacific General Agency, Inc., a company that insures millions of dollars worth of fishing vessels throughout the U.S.

Adds Adams: "It really does a fisherman no good to file a claim or

have a convenient loss, if he is going to lose his ability to make a living. Most people are not in a position to make money off of sinking their vessel. At best, they usually get the mortgage paid off."

Maurice Oaksmith, an insurance broker, agrees with Adams for different reasons. "I really don't think that 'moral hazards' (intentional sinkings and burnings) are a factor right now, even with the depressed state of some of the fisheries. I've got great faith in human nature, particularly in the fishing industry."

Others in the insurance business, however, do not share Oaksmith's "faith" in human nature in the fishing fleets. One president of an insurance company here instructed his underwriters not to carry any more lines on converted processors, which he labeled, "floating fire hazards." Another marine insurance underwriting firm, Mathews & Livingston, Inc., bailed out of the fish vessel business in 1981 because "it is a volatile market and we were

looking at doubling our rates from our London connection," says a company spokesperson.

"My friends at Lloyd's say the Northwest and Alaska losses have just about destroyed their marine underwriting syndicate," says a former British underwriter who has worked in the U.S. marine insurance industry for two years.

Lloyd's and other western European companies that assume part of the risk on American fishing vessels are quoting prices that many U.S. brokers and underwriters are finding hard to sell to customers. An understanding of why the European insurers are shying away from the fishing vessel business requires a brief explanation of how marine insurance works.

Imagine a pyramid with the broker or underwriter sitting at the top. The fisherman comes into the office, and tells the broker or underwriter what kind of policies he wants and what he is willing to pay. (Most fishermen are covered for losses or damage to the hull and

machinery. A fisherman, no matter what his past record, can usually find someone to insure him.) The broker then goes to his underwriters—the first set of risk-takers, who usually carry only a small percentage of risk themselves. The risk on expensive fishing vessels is always spread out among re-insurers.

The most reliable re-insurers are in London at Lloyd's or the Institute of London Underwriters and other western European countries. Those companies, though, may spread the risk even further down the pyramid. At the bottom of the pyramid, you might find that a company you never heard of in Latin America might be assuming a fraction of a percentage of the total risk on an Alaskan fishing vessel. When claims are made, payment starts at the pyramid's bottom and works its way up.

According to Adams and others, North Pacific fishing vessels have a bad reputation in the European re-insurance market, hence the doubling and tripling of rates in the last two or three months. As a result of the increases, some smaller companies have been forced to seek reinsurance with unproven foreign security firms.

"The London and Western European reinsurance markets have just dried up," says Adams. "It's imprudent for a company like ours to hold all the risk on a crabber with a high degree of hazard. We have to have re-insurers and as these re-insurers drop out, there goes the market."

In the competitive marine insurance business, some companies are so hungry for premium dollars they are re-insuring through companies in South Africa, the Bahamas, and Hong Kong. "You have to realize that there are over 600 companies based in Hong Kong alone, and most of them are only a name in the phone book," said Adams, who adds that many claims go unpaid. "Many of the foreign securities firms will disappear before the claims can get in."

Says Maurice Oaksmith, "Insurance companies and syndicates make money from underwriting and investment income. Now that interest rates are lower on short-term money, the competition for insurance premium dollars is getting even heavier. Some people want to make a quick killing by buying their reinsurance as cheaply as possible so that they can keep most of the premium. They tend to stray into left field re-insurers."

Oaksmith says that "If underwriters are selective, and properly re-insured, they can make money writing fish boats at or near the level of where premiums are today."

John Adams knocks on his desk and says his firm has made money. "We have tried to be cautious with those people that we suspect." But Adams feels that most marine insurance underwriters and brokers today do not know their market. "In the past few years we've seen the inundation of the marine insurance market with inexperienced people with all kinds of capacity. There have been more and more companies coming in and diving right out again after a few hard licks."

He says there are a few "damn good salesmen who are very gullible because they don't want to know the truth about the security they're representing. If it's an undesirable risk, it will usually end up with what we consider to be the less inquisitive underwriters who fail to ask the questions they should ask."

Adams maintains that there are very few underwriters who truly understand the fishing business well enough to know when to ask if a person is a "known troublemaker with a poor record in the past. Some people, though, are not crooked, they're just doggone unlucky," says Adams.

Adams feels most underwriters insuring fish boats should know how machinery operates so that they can know if a claim is legitimate or not. "Most underwriters don't know anything about claims. Unfortunately, the claims people think the underwriters know everything," says Adams.

Although Adams has worked around fishing boats a long time, he says he's often too busy to get the chance to visit the docks to inspect fishing vessels he insures, although he says he tries to as often as possible. Like others, he relies on marine surveyors, the eyes and ears of every underwriter or broker. (See accompanying story.)

Marine surveyors perform condition and valuation (C&V) surveys for vessel owners, insurance companies, and banks. They check a vessel's wiring, construction, deck equipment, rigging, navigation equipment, electronics, cabin arrangements, safety and life saving equipment, hydraulics, engine room, and even the vessel's housekeeping and appearance. They also note any recommendations for improving the vessel before reaching what they feel is a fair market value for the boat.

"Surveyors have a pretty good feeling for what a boat's value is, and they understand replacement costs," says Oaksmith. "But there can be honest differences of opinion between a surveyor and a boat owner."

Some surveyors say they are pressured to keep boat values high even though their market values might be depressed in a weak market. According to one surveyor who ran a C & V survey on a large

floating processor in 1979, the vessel's owners pressured him to keep the value high because the bank had loaned them a lot of money on processing equipment. The surveyor says he told the owners that the boat had no track record and needed more work, so he valued it substantially less than what the owners had wanted.

"I gave them two legal-sized sheets of repair and safety recommendations, and two months later they had somebody else doing the survey. They obviously wanted someone who would agree with their value," the surveyor says. He asked to remain anonymous. "I have quit one job before because the guy hasn't done what I've asked him to do. But within a week he's got insurance from somebody else."

"What's happening in the present market is that a lot of people are not insuring market values. They're insuring investment value," says another veteran surveyor. "A lot of money had to be put into that processor to get her operable, and



Maurice Oaksmith

BOAT INSURANCE

continued from page 31

the company wanted to insure that investment."

However, other surveyors say they are rarely pressured into inflating vessel values. John Adams, for instance, says "Sometimes the vessel owner wants surveyors to deflate the value because he doesn't want to pay the money on high insurance premiums on boats that are fully paid for."

"Most surveyors know what they're doing," says one claims investigator, "but some have great gaps in their experience and training. Some surveyors specialize in cargo only, others in tug boats, others in yachts, and some in crab boats. Frequently their expertise is limited to their specialty class of vessels, and they're not able to adapt well to new classes."

Adams adds, "The jam is that many people will accept a surveyor's

report on a matter for which he is not truly qualified."

Surveyors have already formed their own national association fifteen years ago in an effort to police their own trade. In order to join the National Association of Marine Surveyors an applicant must have at least five years full-time surveying experience and he must pass an exam on his specialty class of vessel. "It's still in its infancy," says one member.

Whether an underwriter or vessel owner decides to hire, fire or believe a surveyor does not diminish the importance of their C & V surveys. When claims are paid, they are the most important records available, because foul play is almost impossible to prove. Underwriters rarely go to the bother and expense of trying to prove arson or intentional sinking; they simply pay the claims based on a vessel's surveyed value. Raising the vessel and re-surveying it is the only way to change the surveyed value.

Adams jogs his memory back to 1958 when a wooden seiner sank in the Puget Sound and the underwriters raised the vessel. "There were funny ax holes in the bottom of the boat that were made from the inside. These rapid termite jobs are good for some people, but when an owner gets caught with evidence like that, it is a federal crime and the punishment can be severe. From an underwriter's standpoint, you have to look at how much a mortgage is on a vessel before thinking about deliberate sinkings.

"It's easy to say that when the mortgage is high and the values are dropping beneath the mortgage, it

becomes advantageous to have an accident. But that's only part of the story," says Adams.

"The other part is that people are working harder and pushing their crews harder and harder trying to make a profit. Everybody gets tired."

Maurice Oaksmith, who grew up on Alaskan fishing boats, says, "I think fishing vessels in many ways are a better risk today than they were four years ago. There are many more alarms, detection devices, and better navigational equipment. But one thing you've got to guard against, as technology advances, is complacency."

Adams blames accidents involving some crabbers on "electronic creature comforts" along with drug use by younger crew members who doze during their wheel watch.

In some cases, though, he says accidents are not due to overwork, drugs, or high-tech instruments. "In Bristol Bay we never have a total loss prior to the season unless it's truly accidental. It always seems to happen just before the end of the season, and "Oh, my god, the fire started," or "I hit a rock." There aren't very many rocks in Bristol Bay, so they either swamp or burn.

"It always happens where it's hard to recover the boat, in the dark of night; a friend just happened to be coming along and he saw the fire, and I got off without getting my tennie runners wet."

Adams admits that he is speaking somewhat facetiously; he knows that Bristol Bay permits can cost up to \$100,000. Yet he sincerely feels that 'moral hazards'— "sinking the damn boat"— are higher these days,



John Adams

and the way to prevent them is to make sure the owner starts accepting some of the risk.

He looks back to the 1930's during the Great Depression when there were a lot of similar vessel losses occurring. According to Adams, an underwriter would co-insure the vessel, assuming only part of the risk in case of partial losses; the owner would pick up the rest. The other alternative he sees is charging very high deductibles.

Adams thinks strict Coast Guard enforcement of safety regulations helps reduce risk, too. Under Section 46, Parts 24 through 26 of the Code of Federal Regulations, the Coast Guard can board uninspected fishing vessels and check for safety and fire fighting equipment violations. But Coast Guard spokespeople say they do not have the manpower to check fishing vessels unless they receive a specific See **BOAT INSURANCE** page 45

BOAT INSURANCE

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complaint.

Maurice Oaksmith, one of the founders of the National Council of Fishing Vessel Safety and Insurance, says the "industry ought to consider self-regulation. The principal reason for forming this national group was that insurance costs were high, and the only way to bring them down was to decrease the severity and frequency of accidents. I would say that about 90% of all accidents and fatalities are avoidable. Usually they result from somebody doing something they shouldn't do."

There is a general consensus among marine surveyors, underwriters, and claims investigators

that human error, due to lack of adequate training, is responsible for many legitimate accidents. In the case of converted floating processors, however, there are other dangers.

During the conversion process, bulkheads and cofferdams are usually removed to make more room for processing equipment, forklifts, and elevators. "They cut out watertight bulkheads so it's easier to move cargo down to the freezing holds and along the processing leek," explains surveyor Jim Goldade.

"In the case of one processor," says another surveyor, "all three holds had been cut through all the way back to the engine room. You can pump such a vessel full of water,

but you've got no way to pump it out again. There are no subdivisions to control flooding or fire in these vessels."

Highly flammable polyurethane foam is also an acknowledged fire hazard aboard such processors.

"We've glossed over these problems in the last few years because of a very competitive insurance market, due to excess capacity and underwriters seeking premiums at any cost," says one concerned claims investigator. "Now that interest rates are declining and losses are continuing to accelerate, the conditions are set for a scarcity of insurance and possibly a recognition that standards will be necessary if losses are to be controlled." □

INSIDE INSURANCE

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Maurice Oaksmith

BOAT INSURANCE

continued from page 31

the company wanted to insure that investment."

However, other surveyors say they are rarely pressured into inflating vessel values. John Adams, for instance, says "Sometimes the vessel owner wants surveyors to deflate the value because he doesn't want to pay the money on high insurance premiums on boats that are fully paid for."

"Most surveyors know what they're doing," says one claims investigator, "but some have great gaps in their experience and training. Some surveyors specialize in cargo only, others in tug boats, others in yachts, and some in crab boats. Frequently their expertise is limited to their specialty class of vessels, and they're not able to adapt well to new classes."

Adams adds, "The jam is that many people will accept a surveyor's

report on a matter for which he is not truly qualified."

Surveyors have already formed their own national association fifteen years ago in an effort to police their own trade. In order to join the National Association of Marine Surveyors an applicant must have at least five years full-time surveying experience and he must pass an exam on his specialty class of vessel. "It's still in its infancy," says one member.

Whether an underwriter or vessel owner decides to hire, fire or believe a surveyor does not diminish the importance of their C & V surveys. When claims are paid, they are the most important records available, because foul play is almost impossible to prove. Underwriters rarely go to the bother and expense of trying to prove arson or intentional sinking; they simply pay the claims based on a vessel's surveyed value. Raising the vessel and re-surveying it is the only way to change the surveyed value.

Adams jogs his memory back to 1958 when a wooden seiner sank in the Puget Sound and the underwriters raised the vessel. "There were funny ax holes in the bottom of the boat that were made from the inside. These rapid termite jobs are good for some people, but when an owner gets caught with evidence like that, it is a federal crime and the punishment can be severe. From an underwriter's standpoint, you have to look at how much a mortgage is on a vessel before thinking about deliberate sinkings.

"It's easy to say that when the mortgage is high and the values are dropping beneath the mortgage, it

becomes advantageous to have an accident. But that's only part of the story," says Adams.

"The other part is that people are working harder and pushing their crews harder and harder trying to make a profit. Everybody gets tired."

Maurice Oaksmith, who grew up on Alaskan fishing boats, says, "I think fishing vessels in many ways are a better risk today than they were four years ago. There are many more alarms, detection devices, and better navigational equipment. But one thing you've got to guard against, as technology advances, is complacency."

Adams blames accidents involving some crabbers on "electronic creature comforts" along with drug use by younger crew members who doze during their wheel watch.

In some cases, though, he says accidents are not due to overwork, drugs, or high-tech instruments. "In Bristol Bay we never have a total loss prior to the season unless it's truly accidental. It always seems to happen just before the end of the season, and "Oh, my god, the fire started," or "I hit a rock." There aren't very many rocks in Bristol Bay, so they either swamp or burn.

"It always happens where it's hard to recover the boat, in the dark of night; a friend just happened to be coming along and he saw the fire, and 'I got off without getting my tennie runners wet.'"

Adams admits that he is speaking somewhat facetiously; he knows that Bristol Bay permits can cost up to \$100,000. Yet he sincerely feels that 'moral hazards'—"sinking the damn boat"—are higher these days,



John Adams

and the way to prevent them is to make sure the owner starts accepting some of the risk.

He looks back to the 1930's during the Great Depression when there were a lot of similar vessel losses occurring. According to Adams, an underwriter would co-insure the vessel, assuming only part of the risk in case of partial losses; the owner would pick up the rest. The other alternative he sees is charging very high deductibles.

Adams thinks strict Coast Guard enforcement of safety regulations helps reduce risk, too. Under Section 46, Parts 24 through 26 of the Code of Federal Regulations, the Coast Guard can board uninspected fishing vessels and check for safety and fire fighting equipment violations. But Coast Guard spokespeople say they do not have the manpower to check fishing vessels unless they receive a specific See **BOAT INSURANCE** page 45

BOAT INSURANCE

continued from page 34
complaint.

Maurice Oaksmith, one of the founders of the National Council of Fishing Vessel Safety and Insurance, says the "industry ought to consider self-regulation. The principal reason for forming this national group was that insurance costs were high, and the only way to bring them down was to decrease the severity and frequency of accidents. I would say that about 90% of all accidents and fatalities are avoidable. Usually they result from somebody doing something they shouldn't do."

There is a general consensus among marine surveyors, underwriters, and claims investigators

that human error, due to lack of adequate training, is responsible for many legitimate accidents. In the case of converted floating processors, however, there are other dangers.

During the conversion process, bulkheads and cofferdams are usually removed to make more room for processing equipment, forklifts, and elevators. "They cut out watertight bulkheads so it's easier to move cargo down to the freezing holds and along the processing leek," explains surveyor Jim Soldade.

"In the case of one processor," says another surveyor, "all three holds had been cut through all the way back to the engine room. You can pump such a vessel full of water,

but you've got no way to pump it out again. There are no subdivisions to control flooding or fire in these vessels."

Highly flammable polyurethane foam is also an acknowledged fire hazard aboard such processors.

"We've glossed over these problems in the last few years because of a very competitive insurance market, due to excess capacity and underwriters seeking premiums at any cost," says one concerned claims investigator. "Now that interest rates are declining and losses are continuing to accelerate, the conditions are set for a scarcity of insurance and possibly a recognition that standards will be necessary if losses are to be controlled." □

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145

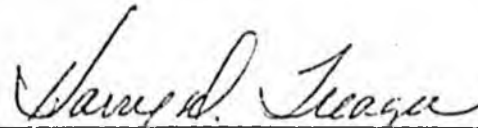
DEPARTMENT OF COMMERCE AND ECONOMIC DEVELOPMENT
POSITION PAPER
SB 145; HB 218
BOARD OF MARINE PILOTS

The department has consistently agreed with the Division of Legislative Audit that the Board of Marine Pilots should continue to regulate and license the marine pilot profession. For the protection of human life and property, shipping and the environment, it is imperative that marine pilots be licensed and regulated and that vessels operating in the inside waters be required to have a licensed pilot in command.

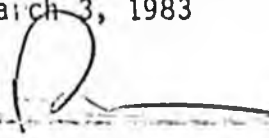
The board has continued to operate in the interest of the public, the licensees and the applicants. It has addressed issues such as the licensing vessel agents and the adoption of regulations to clarify standards and misconduct, held tariff hearings for southeast ports, reviewed and updated examinations and worked toward training for marine pilots through participation in the WICHE program.

There has been no complaint filed against this board.

The Department of Commerce and Economic Development endorses the continuation of the Board of Marine Pilots.



Harry D. Treager, Director
Division of Occupational Licensing
Department of Commerce and
Economic Development
March 3, 1983



3/9/83

Richard A. Lyon, Commissioner
Department of Commerce and
Economic Development

STATE OF ALASKA
PRELIMINARY STATEMENT OF FISCAL IMPACT

Bill No: Senate Bill No. 145 Date on Bill: February 24, 1983
 Title: "An Act relating to the Board of Marine Pilots."
 Sponsor: Labor and Commerce Committee
 Requestor: _____

1. Estimated fiscal impacts on:

a. Expenditures:

(Thousands of Dollars)

	FY 83	FY 84	FY 85	FY 86
Capital				
Operating	-0-	-0-	-0-	
Total				

b. Revenues:

Revenue				
---------	--	--	--	--

2. Source of funds to offset fiscal impact of bill:

3. Assumptions: No additional fiscal impact will be incurred with this Senate Bill.

~~Funding to be continued and provided for in the
Department's FY-84 Budget.~~

4. Disclaimer:

This statement has not been reviewed by the OMB in the Office of the Governor. It therefore does not represent the final estimate of fiscal impact.

Prepared By: *Darrell Miller* Darrell Miller Phone: 465-2535
 Division: Occupational Licensing Date: March 2, 1983
 Approved by Commissioner: Richard A. Lyon Date: 3/9/83
 Department: Commerce & Economic Development

5. Distribution:

- Original to Legislative Finance
- Copy to OMB
- Copy to Sponsor
- Copy to Requestor

2/15/83

BOARD OF MARINE PILOTS

Current Number of Licensees - Marine Pilots - 56
 Registered Agents - 12

FY '82

Revenues	1.8	
Expenditures	15.1	
**Personal Services		8.3
*Contractual		1.7
*Commodities		0
Board Travel and Per Diem		5.1
	TOTAL	<u>15.1</u>

FY '83 - Allocated (board travel & per diem only) - 7.5

Revenues (7/1/82 to 3/1/83)	18.8	
Expenditures	9.5	
**Personal Services (7/1/82 to 3/1/83)		5.3
*Contractual		.5
*Commodities		-0-
Board Travel and Per Diem		3.7
	TOTAL	<u>9.5</u>

FY '84 - (Board Component - Division Budget) Total 201.5
 Board of Marine Pilots Allocation 7.9

*The above items are funded in the Administration component of the division's budget.

**Personal services are 1/3 of 1 licensing examiner position.

A PERFORMANCE REVIEW OF THE
ALASKA STATE BOARD
OF MARINE PILOTS

August 4, 1982

Audit Control Number

08-1078-83-R

Commissioner, Department of
Commerce and Economic
Development

Richard A. Lyon

Deputy Commissioners, Department
of Commerce and Economic
Development:

Edward Eboch
Vacant

Members of the
Board of Marine Pilots

Chairperson
Member
Member
Member
Member
Member
Member

Charles R. Webber
Captain Donald Oldow
Captain Jack Maroni
David V. George
Marvin Taylor
William H. Barrington
Kenneth Peavyhouse

STATE OF ALASKA

AUDIT DIVISION
POUCH W
JUNEAU, ALASKA 99811

THE LEGISLATURE

BUDGET AND AUDIT COMMITTEE

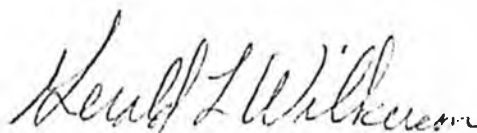
October 11, 1982

Members of the
Legislative Budget and Audit Committee:

In accordance with the intent of Title 24 and 44 of the
Alaska Statutes, the attached report is submitted for your
review.

A PERFORMANCE REVIEW OF THE ALASKA STATE BOARD OF MARINE PILOTS

August 4, 1982



Gerald L. Wilkerson, CPA
Legislative Auditor
Division of Legislative Audit

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PURPOSE AND SCOPE OF THE REVIEW

Purpose

In accordance with the intent of Alaska Statutes 24.20 .271(1) and 44.66.050 (sunset legislation), an audit of the Board of Marine Pilots was conducted to review Board activities and accomplishments to determine if the Board has operated in an effective, efficient, and economical manner.

As required by legislative intent, this report shall be considered during the legislative oversight function in determining whether the Board of Marine Pilots should be reestablished. The law currently specifies that this Board will terminate on June 30, 1983, but will continue until June 30, 1984, for the purpose of concluding its affairs.

Scope

The major areas reviewed were the Board's operations and its licensing, administration, complaint and affirmative action functions. Our review consisted of analyzing and evaluating the following:

- (1) Applicable statutes and Board regulations;
- (2) tests of records and documents of the Board and the Division of Occupational Licensing (OL), Department of Commerce and Economic Development;
- (3) interviews with OL employees;
- (4) complaints filed with OL and the Attorney General's Office; and
- (5) interviews with personnel from the U.S. Coast Guard.

ORGANIZATION AND FUNCTION

Responsibility for the regulation of marine pilotage is shared by the federal and state governments. The federal government, through the U.S. Coast Guard (USCG), regulates pilotage on enrolled vessels, while the individual states are given the right, in the United States Code, to regulate pilotage on registered vessels. Enrolled vessels are vessels registered in the United States and engaged in commerce between American ports; registered vessels are those vessels engaged in foreign trade. The individual states have the right to regulate pilotage on vessels engaged in foreign trade.

The Alaska Board of Marine Pilots was created under Alaska Statute 08.62 to carry out the State of Alaska's responsibility of regulating pilotage on registered vessels. The Statute became effective in 1970.

The Board is made up of seven members - two marine pilots, two agents or managers of vessels, two public members and the Commissioner of the Department of Commerce and Economic Development. Per the Statutes (08.62), the purposes of the Board of Marine Pilots are to license qualified pilots; to take disciplinary action against negligent or incompetent pilots; and to regulate pilotage fees.

Once a marine pilot has received a license from the Board, he is authorized to pilot registered vessels within the established boundaries of inside waters of the State. The inside waters are defined by regulations as all of Southeastern Alaska, Prince William Sound, Cook Inlet and Resurrection Bay. Alaska Statute 08.62 requires registered vessels to carry State licensed pilots when inside these boundaries. It is the pilot's job to direct a vessel safely through the inside waters; dock and undock the vessel.

To obtain an unlimited pilot's license an applicant must first obtain both a pilot's license and a master's license issued by the U.S. Coast Guard. In addition, he must perform ten to twenty dockings and undockings and pass written and oral examinations administered by the Board.

The Board also issues limited pilot's licenses and channel pilot's licenses. The holders of limited pilot's licenses may pilot vessels of 2,000 gross tons or less. Channel pilots may pilot vessels in main ship channels only, and can perform dockings and undockings under the direct supervision of pilots holding unlimited pilot's licenses. Proof of dockings and undockings is required to obtain all classes of licenses. Applicants for any of the three licenses can obtain temporary licenses by meeting all the licensure

requirements and taking a temporary license examination. A second examination is required for permanent licensure.

To obtain license renewal, a pilot must show that he has worked at least two months in each area for which he holds a license. The two months' time must have been worked within two years prior to the renewal date. License renewal is required biennially.

Another function of the Board is regulating fees for pilotage services. Any increases of the fees charged by pilots for their services must be approved by the Board.

The Board is assisted in performing its licensing and other administrative functions by staff support from the Division of Occupational Licensing (OL). OL processes applications, maintains files, answers correspondence dealing with the Board and provides other administrative support as needed by the Board. In addition, OL investigates any complaints or accident reports involving marine pilots.

REPORT CONCLUSION

In our opinion, the Board of Marine Pilots should continue to regulate and license the marine pilotage profession. The regulation and licensing of marine pilots by a State agency is necessary to assure the protection of shipping, human life and property, and the environment from potential dangers caused by registered vessels sailing in Alaskan waters.

We recommend that the Board of Marine Pilots: (a) define terms as they are used in the regulations and (b) require that a procedures manual be completed as soon as possible.

We recommend that the Department of Commerce and Economic Development, Division of Occupational Licensing: (a) ensure that public notices of examinations are sufficiently and timely advertised and (b) review their applications for licensure and delete any questions which could lead to discrimination against applicants.

FINDINGS AND RECOMMENDATIONS

Recommendation No. 1

The Board of Marine Pilots should recommend regulatory changes to make the license renewal requirements less vague.

The regulation which sets down the requirements for the renewal of State pilot's license is vague. Alaska Administrative Code (AAC) 12.56.080 requires applicants for the biennial renewal of State pilot's licenses to submit proof of having worked at least two months in each area for which they are requesting renewal. The two months must have been worked in a licensed deck officer capacity during the two years prior to the date of renewal of the license.

The regulation is vague in that the terms and phrases used are not defined. For example, "two-months" can mean 60 days or 60 days less week-ends or one trip a week for eight weeks. "Licensed deck officer capacity" can mean any position from third mate to pilot. The regulation states the pilot must have worked "in the area for which he was licensed during the last biennial period" (emphasis added). A person licensed for all of Southeastern or Southwestern Alaska could spend two months in only one of many ports in the area and still fulfill the "in the area" requirement.

The Board should define or clarify the following terms or phrases:

- A. Does the term "licensed deck officer capacity" include or exclude time as a pilot?
- B. How does a pilot calculate the two month period required by 12 AAC 56.080(b)?
- C. What exactly is meant by "in the area"?
- D. How does the Board determine what is sufficient knowledge and experience?

Recommendation No. 2

The Board should establish formal procedures to conduct its business more effectively and promote better communication with supporting personnel.

The Board members and licensing examiner for the Board should develop a procedures manual to be used by the Board members and the examiner. Many misunderstandings between the licensing examiner and the Board members can be cleared

up this way. In addition, a procedures manual would provide continuity between licensing examiners--this would help alleviate the problems caused by the rapid turnover of license examiners.

Recommendation No. 3

The Department of Commerce and Economic Development, Division of Occupational Licensing should ensure that public notices of examinations are sufficiently and timely advertised.

The Department is required by statute to publish notices of examinations, and it is each board's responsibility to notify the Department of upcoming examinations well enough in advance to permit proper advertisement.

During our review of examination advertisements, we found that four out of six notices did not allow adequate time for individuals interested in taking the examination to submit applications within the advertised deadline. Regulations for the Board of Marine Pilots, 12 AAC 56.070(a), say in part, "all applications for examination must be submitted to the board at least 60 days before the date of examination."

Advertisements should be published early enough to allow adequate time for all interested candidates to submit applications before the required deadline.

Recommendation No. 4

The Department of Commerce and Economic Development, Division of Occupational Licensing, should review their application forms for licensure and delete any questions which could lead to discrimination against applicants.

One of the public need criteria for the continued existence of a board is the extent to which State personnel practices, including affirmative action requirements, have been complied with by the board in its area of activity.

In reviewing the applications for licensure of the Board of Marine Pilots, we noted that the applications contain questions which could lead to discrimination by Board members against applicants. The applications request information on sex, age, height, weight, color of eyes and hair. We did not find any evidence of discrimination against an applicant based on the answers to these questions. However, the potentiality for discrimination exists.

We recommend that the Board of Marine Pilots and the Division of Occupational Licensing consult with the State Equal Employment Opportunity Office or the Human Rights Commission on the makeup of the applications for licensure. These two

agencies could help the boards make a determination as to whether or not the questions asked are of a discriminatory nature. Then, any discriminatory-type questions should be analyzed to determine if a real need for the information exists. If not, the questions should be deleted.

This is a problem common to many boards. Basically the same recommendation was made in "A Performance Review of the Division of Occupational Licensing," dated October 30, 1978.

ANALYSIS OF PUBLIC NEED

Limited Analysis

The following analysis of Board activities relates to the public need factors defined in the "sunset" law. This analysis is not intended to be all inclusive, but addresses those areas we were able to cover within the scope of our review.

- I. The extent to which the board, commission or program has operated in the public interest.
 1. The Board of Marine Pilots has operated in the public interest by promulgating regulations which help assure that a State-licensed marine pilot has the experience, knowledge and skill required for safe pilotage. The qualifications required for licensure as a State pilot exceed the requirements for a U.S. Coast Guard issued pilot's license as follows:
 - a. Applicant must possess a U.S. Coast Guard issued master's license;
 - b. applicant must document having completed 10 to 20 dockings and undockings under the supervision of a State licensed pilot; and
 - c. applicant must be at least 25 years old.
 2. The Board is protecting the public by providing a mechanism to help assure the protection of shipping, human lives and property and the environment from the dangers posed by vessels in Alaskan waters.
- II. The extent to which the operation of the board, commission, or agency program has been impeded or enhanced by existing statutes, procedures, and practices which it has adopted, and any other matter, including budgetary, resource, and personnel matters.

The following enhanced the performance of the Board of Marine Pilots.

1. The Governor, when making appointments to a board or commission, requests that the appointee attend at least 75% of the meetings.

From 01/30/79 through 12/15/81, three board members had 100% attendance, one had 93%, one had 90% and one had 86% attendance of all scheduled meetings.

2. The Board receives administrative services support from the Division of Occupational Licensing (DOL).
3. The Board receives legal assistance from the Attorney General's Office.
4. The Board has established a working relationship with the U.S. Coast Guard and with industry representatives.

III. The extent to which the board, commission or agency has recommended statutory changes which are generally of benefit to the public interest.

1. During the 1979 Legislative session, a bill was passed that increased the maximum fine payable by violators of the statute, which required pilots aboard registered vessels, from \$1,000 to \$5,000. This is in the public's best interest because it should have more of a deterrent effect on potential violators than the \$1,000 maximum penalty did.
2. In 1980, AS 08.62.150 was amended by adding paragraph (7) which includes a provision to allow the Board to revoke or suspend a license based on the revocation or suspension of a U.S. Coast Guard pilots license.

IV. The extent to which the board, commission or agency has encouraged interested persons to report to it concerning the effect of its regulations and decisions on the effectiveness of service, and availability of service which it has provided.

1. The public is invited, by notices in the four major newspapers throughout the State, to the Board's meetings. However, in many cases, the notices are not published timely enough to allow a person interested in attending a meeting time to prepare for the meeting.
2. At each of the meetings of the Board there have been at least four industry representatives other than the Board members or support staff in attendance at the meetings.

- V. The extent to which the board, commission or agency has encouraged public participation in the making of its regulations and decisions.
1. As stated in Criteria IV, Number 1, the public is invited to the Board of Marine Pilots' meetings to give input about Board business.
 2. The public also has a chance to give input about proposed regulations, since proposed regulations have to be published in the newspapers before they can become effective. In the public notices, the public is invited to make testimony on the proposed regulations.
- VI. The efficiency with which public inquiries or complaints regarding the activities of the board, commission or agency filed with it, with the department to which a board or commission is administratively assigned, or with the office of the ombudsman have been processed and resolved.
1. There were no complaints filed with the Office of the Ombudsman, State E.E.O., Human Rights Commission, or the Attorney Generals' Office.
- VII. The extent to which a board or commission which regulates entry into an occupation or profession has presented qualified applicants to serve the public.
1. Based on the requirements for licensure as a State marine pilot, the applicants should be qualified to pilot vessels in the inside waters of Alaska.
 2. Since 1978, there were 24 licensed pilots who were eligible to have their licenses renewed. All 24 pilots, voluntarily did not apply for license renewal. However, licenses have been issued to 15 newly qualified applicants.
- VIII. The extent to which state personnel practices, including affirmative action requirements, have been complied with by the board, commission or agency to its own activities and the area of activity or interest.
1. Applicants for State pilot's license must by regulation be at least 25 years old. It is recommended by the State Division of Equal Employment Opportunity (E.E.O.) that on the Application/Renewal Forms, instead of asking

for the "date of birth," the question should be; "are you at least 25 years of age?"

2. The Board of Marine Pilots Application/Renewal Forms require: place of birth, weight, height and sex. According to E.E.O. guidelines, this information is not necessary for licensing and should be deleted from the forms.

IX. The extent to which statutory, regulatory, budgeting or other changes are necessary to enable the agency, board or commission to better serve the interests of the public and to comply with the factors enumerated in this subsection.

1. See Recommendations No. 1 through No. 4.

APPENDIXES

APPENDIX A

BOARD OF MARINE PILOTS
REVENUES COMPARED WITH EXPENDITURES
 Fiscal Year 1982
 (UNAUDITED)

Revenues (see Schedule 1 and Note 1)	\$ 10,072
Expenditures (see Note 2)	<u>51,138</u>
Excess of Expenditures over Revenues	<u>\$ (41,066)</u>

Schedule 1
 Types of Revenue

<u>Revenues</u>	<u>Amount</u>	<u>Time of Collection</u>
Application and Examination Fee	\$ 10.00	With submittal of application.
Temporary License Fee	\$ 50.00	With submittal of application
License Fee	\$300.00	Biennially

Note 1

Most of the revenues collected by this Board are comprised of license renewal fees. These fees (\$300) are collected once every two years, which causes revenues in one year to be much greater than the revenues collected in the next year. Therefore, the revenue figure reported above is an average of the revenues collected in fiscal years 1980 and 1981, in order to obtain an accurate representation of collected revenues.

Note 2

Expenditures includes those made by Board members, such as travel and per diem, and an allocated percentage (estimated) of total administrative expenses of OL. They do not include expenditures for the efforts of other departments, such as the Department of Law, in assisting the Board and OL.

STATE OF ALASKA

DEPARTMENT OF COMMERCE & ECONOMIC DEVELOPMENT

OFFICE OF THE COMMISSIONER

JAY S. HAMMOND, GOVERNOR

POUCH D
JUNEAU, ALASKA 99911
PHONE: 465-2500

October 28, 1982

RECEIVED
OCT 28 1982

LEGISLATIVE
AUDIT

Mr. Gerald L. Wilkerson, CPA
Legislative Auditor
Division of Legislative Audit
Pouch W
Juneau, Alaska 99811

Dear Mr. Wilkerson:

Re: Board of Marine Pilot Audit Report

We have reviewed your preliminary audit report on the Performance Review of the Board of Marine Pilots. The Department of Commerce and Economic Development concurs with your findings that the board has operated in the public interest.

Thank you for the opportunity to comment on your findings. We concur with Recommendations 1, 2 and 3 and concur, in part, with recommendation 4. We have addressed each recommendation in our response. The board is tentatively scheduled to meet on December 6, 1982 in Anchorage. If additional comments are developed at that time, we will inform your office.

The following is our immediate response to the recommendations as they appear in your report:

Recommendation #1

The Board of Marine Pilots should recommend regulatory changes to make the license renewal requirements less vague.

We concur with the recommendation that the terms "two months," and "licensed deck officer" are vague and should be further defined. The term "in the area" is further explained in 12 AAC 56.080(b)(2) by the continuation of the sentence "... for which his license was originally issued." The answer to part D of your recommendation the board determines sufficient knowledge and experience by written examination of the knowledge for the subjects listed in 12 AAC 56.070 and the oral interview administered by no less than three board members on subjects noted in 12 AAC 56.070(c)(1)(2) and (3).

Recommendation #2

The board should establish formal procedures to conduct its business more effectively and promote better communications with supporting personnel.

The department concurs in general with the idea in this recommendation. However, we have no knowledge of problems in communicating with board members. Due to the board members being in private business and unavailable for immediate responses has caused only minimum delay. Board members frequently visit the division office when in Juneau.

In 1981, a manual for the board chairpersons of all the boards and commissions was completed. A portion of the manual is for effective operations between the boards and support staff. The division is in the final drafting stage of desk manuals for the examiner staff in each licensing occupation. The final manuals should be completed by December 1982.

Recommendation #3

The Department of Commerce and Economic Development, Division of Occupational Licensing, should ensure that public notices of examinations are sufficiently and timely advertised.

We concur public notices should be made in a timely manner. The Division of Occupational Licensing has attempted to give notice throughout the State. A list of radio, television and other media outlets has been compiled, and copies of notices are sent to 82 different agencies and media offices. Additional support staff has been hired in the clerical field and this will be an assigned function under the guidance of the examiner staff. This should eliminate this problem and comply with your recommendation. Procedures have been developed for the examiner's desk manual addressing this issue.

Recommendation #4

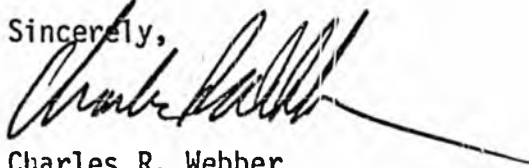
The Department of Commerce and Economic Development, Division of Occupational Licensing, should review their application forms for licensure and delete any questions which could lead to discrimination against applicants.

The department and division would agree with the theory of this recommendation. However, in practice, assurance is a must in licensing those individuals who file documentation are the same individuals who are tested. Personal data insures this. The division has experienced a situation where a son attempted to gain a professional license by use of his father's documentation. The use of personal data assisted in the discovery of this attempt. The division does and will continue to review applications to protect the applicants and delete unnecessary information requirements. As stated in your review, there have been no complaints against the board.

October 28, 1982

In closing, I would like to thank you and your staff for the constructive evaluation contained in your review, and for the opportunity to respond. Your staff should be commended on their professional approach, and the manner they go about their audit task. Their recommendations are well taken.

Sincerely,

A handwritten signature in cursive script, appearing to read "Charles R. Webber", with a long horizontal flourish extending to the right.

Charles R. Webber
Commissioner

CRW/wfs 1/10

SB 145 TITLE & SPONSOR SUMMARY 14:14 5/22/84 PAGE 1 OF 2
AMENDED TITLE:
AN ACT RELATING TO THE BOARD OF MARINE PILOTS

PRIME SPONSOR: SENATE LABOR&COMM COMMITTEE.
CO-SPONSORS:

CURRENT STATUS: 2/24/83 IN (S) LABOR & COM

SB 145 SENATE ACTION 14:14 5/22/84 PAGE 2 OF 2
DATE SEQ PAGE LEGISLATIVE ACTION

02/24/83 01 0253 FIRST READING --- COMMITTEE REPORTS
LABOR & COMMERCE
RULES

*** ** ** *** ** *



OFFICIAL BUSINESS

ALASKA STATE LEGISLATURE - SENATE

COMMITTEE ON LABOR AND COMMERCE

SENATOR RICHARD I. ELIASON
CHAIRMAN

POUCH V • JUNEAU, ALASKA 99811
(907) 465-3844

March 14, 1983

The Honorable Jalmar Kerttula
President of the Senate
Alaska State Legislature
Pouch V
Juneau, Alaska 99811

Dear Mr. President:

The Senate Labor and Commerce Committee has had under consideration for "Sunset Review" the Board of Marine Pilots pursuant to your referral under AS 44.66.050 and AS 08.03.010.

In accordance with the statutory requirement, a public hearing was held on the review of this board. The Committee considered the proposed budget of the board and examined the performance audit of the activities of the board prepared by the Legislative Audit Division.

Guided, in part, by the report prepared by the Legislative Audit Division, the Committee took into consideration the factors required to be considered under AS 44.66.050(c). The Board of Marine Pilots has operated in the public interest by pronulgating regulations which help assure that a state licensed marine pilot has the experience, knowledge and skill required for safe pilotage. The public is encouraged to attend the Board meetings and express any concerns regarding the Board's activities. In the past, the Board has taken an active role in recommending statutory changes which would help assure safe pilotage of registered vessels sailing in Alaskan waters. The attendance rate of the Board members at the scheduled meetings is excellent, and should be commended.

The Senate Labor and Commerce Committee recommends that the Board of Marine Pilots be continued for another four years, i.e. until June 30, 1987.

Sincerely,

A handwritten signature in cursive script, appearing to read "Dick Eliason".

Senator Dick Eliason, Chair
Senate Labor and Commerce Committee

STATE OF ALASKA

Bill Sheffield, Governor

DEPARTMENT OF LAW

OFFICE OF THE ATTORNEY GENERAL

POUCH K - STATE CAPITOL
JUNEAU, ALASKA 99811
PHONE: (907) 465-3600

May 2, 1983

Mr. Richard D. Pennington
Aglivetti & Pennington
733 W. Fourth Ave., Suite 206
Anchorage, AK 99501

Re: Board of Marine Pilots
License Qualification
Regulations 12 AAC56.030(5)
and 040(7)

Dear Mr. Pennington:

This is a response to your April 11 letter concerning the anticompetitive effect of the supervised docking and undocking requirements of 12 AAC 56.030(5) and 040(7).

As indicated by the enclosed notice, the board is currently proposing to amend or repeal those regulations. Hopefully, any problems will be eliminated by whatever action the board ultimately determines to take. Meanwhile, I urge your continued persistence in making these problems known to the board by submitting a statement and argument in response to the notice.

Sincerely yours,

NORMAN C. GORSUCH
ATTORNEY GENERAL

By: 
Peter B. Froehlich
Assistant Attorney General

PEF:eja

Enclosure:

cc: Harry Treager
Senator Richard Eliason ✓
Ms. Mary Levan
Representative Walt Furnace
Mr. Jefferson Barry

STATE OF ALASKA

NOTICE OF PROPOSED CHANGES IN THE REGULATIONS OF
THE DEPARTMENT OF COMMERCE & ECONOMIC DEVELOPMENT
BOARD OF MARINE PILOTS

Notice is hereby given that the Department of Commerce and Economic Development, Board of Marine Pilots, under authority vested by AS 08.62.040(a) and (b), proposes to amend and adopt regulations in Title 12 of the Alaska Administrative Code, dealing with qualifications for licensure (dockings and undockings) for unlimited, limited and channel pilot's licenses and further clarify boundaries for inside Southwestern Alaska waters to implement AS 08.62.030, AS 08.62.040, AS 08.62.050 and AS 08.62.100 as follows:

1. 12 AAC 56.030 is amended to amend or delete the docking and undocking requirements as a qualification for an unlimited pilot's license.
2. 12 AAC 56.040 is amended to amend or delete the docking and undocking requirements as a qualification for a limited pilot's license.
3. 12 AAC 56.050 is amended to amend or delete the docking and undocking restriction imposed on channel pilots.
4. 12 AAC 56.100(b) is amended by adding a new paragraph to clarify what waters are included as inside waters for Southwestern Alaska.

Notice is also given that any person interested may present written or oral statements or arguments relevant to the actions proposed at a public hearing to be held in the Main Conference Room of the Department of Commerce and Economic Development, 9th Floor, State Office Building, Juneau, Alaska, starting at 9:30 a.m., Monday, May 23, 1983.

Notice is also given that any person interested may present written statements or arguments relevant to the actions proposed by mailing or delivering them so they are received by 5:30 p.m., Friday, May 20, 1983 to:

Department of Commerce & Economic Development
Division of Occupational Licensing
Board of Marine Pilots - Regulations
Pouch D-LIC
Juneau, Alaska 99811

This action is not expected to require an increased appropriation.

Copies of the proposed regulations may be obtained by writing the above address, or by calling (907)465-2535.

The Department of Commerce & Economic Development, Division of Occupational Licensing, Board of Marine Pilots, upon its own motion or at the instance of any interested person, may thereafter adopt the proposals substantially as described above without further notice or may decide to take no action on them.



Richard A. Lyon, Commissioner

Date: April 14, 1983

STATE OF ALASKA

BOARD OF MARINE PILOTS

NOTICE OF FORTHCOMING MEETING AND EXAMINATION:

The Alaska Board of Marine Pilots will hold a meeting May 23-25, 1983, beginning at 9:30 a.m., each day, at the State Office Building, Department of Commerce and Economic Development, 9th Floor Commissioner's Conference in Juneau, Alaska.

Notice is also given that the board will conduct a marine pilot examination for licensure (temporary permits, and extension of routes) on Tuesday, May 24, 1983. The exam will be at the Alaska Office Building, Health and Social Services Conference Room #6, Juneau, Alaska, beginning at 9:00 a.m.

Anyone desiring further information on the meeting or the examination may contact the Division of Occupational Licensing, Pouch D, Juneau, Alaska 99811-0800, (907) 465-2542.



Richard A. Lyon, Commissioner

Date: 4-15-83

CAPTAIN EDWARD MURPHY
COMMITTEE TESTIMONY ON SUNSET
REVIEW OF THE BOARD OF MARINE PILOTS
FEBRUARY AND MARCH, 1983

Mr. Chairman and ladies and gentlemen of the committee, thank you for this opportunity to testify in favor of retaining the Alaska Board of Marine Pilots. My name is Edward Murphy and I am appearing today as a representative and spokesman from the Southwest Alaska Pilots Association. Southwest Pilots is one of the two associations of state and federally licensed marine pilots in Alaska and provides state pilots to shipping from Cape Spencer north.

I would like to acknowledge the assistance of Captain George Quick and the American Pilots Association in the preparation of this testimony.

I would first like to give an historical overview of pilotage from colonial times to the present to provide a meaningful context for my comments.

All maritime nations since ancient times have offered inducements for mariners to become pilots and maintain pilotage systems for the protection of shipping. We may not be the oldest profession but we are certainly the oldest regulated profession. The colonial legislatures had pilotage laws in effect prior to our becoming a nation. The first congress assembled after the adoption of the Constitution in 1789 realized the federal government's constitutional right to regulate interstate and foreign commerce would interfere with pilotage systems and state regulations and quickly passed an act that left pilotage under state control.

The state laws generally provided for a system of regulated public pilots who conducted ships to and from the sea and whose terms and conditions of service were established by law. Pilotage remained exclusively a public service under state control until 1871 when congress acted to provide for the federal licensing

of pilots on steam vessels engaged in coastwise or interior commerce of the country. At that time steam vessels were considered inherently dangerous and many laws were being passed to protect the public from this new threat created by the industrial revolution. Since many states exempted ships engaged in strictly coastwise or interior commerce from the requirement of taking aboard a public pilot, congress felt that there was a need to insure that these new and dangerous vessels driven by steam employ someone familiar with the waters over which the vessel was navigating.

This new act of congress created a different category of federally licensed pilots who were employees of the ship and who often were actually the master or other officer acting as pilot by virtue of additional endorsement on his license. This new category caused confusion in defining the term pilot and in defining the role and function of a pilot.

The term pilot in the United States today is used to describe two entirely different sets of relationships:

1) It can refer to a federally licensed employee of the ship who is subject to the selection and control of the ship owner and whose terms and conditions of employment are determined by mutual agreement. The relationship is common law one of employer and employee.

2) It can refer to the state licensed publically regulated pilot who is not subject to the control and selection of the ship owner and whose terms and conditions of service are established by statute and not subject to negotiation. The relationship is created by compulsion of law and defined by the state compulsory pilotage statute and decided court cases applying principles of maritime law.

In simple terms, the federally licensed pilot is acting in a private capacity on privately agreed terms and conditions, and the state licensed pilot is exercising a public function on publically regulated terms and conditions.

The legal text writers and the court decisions attempt to avoid confusion by generally referring to the pilot acting in a private capacity as a voluntary pilot and referring to the pilot exercising a public function as a compulsory pilot.

In the voluntary pilot situation the employment contract is by mutual agreement between the ship owner and the employee pilot, even though the ship owner is naturally compelled to select his employee from among a class, i.e., federally licensed pilots. In the compulsory pilot situation the pilot is forced on the ship owner by compulsion of law and under terms and conditions established by law. The concept of compulsory pilotage excludes any right of the ship owner and pilot to mutually agree on the terms of their relationship. The right of selection and control, as well as the terms and conditions of service are not properly the subject of negotiations, they are established by the state to serve the state's superior interests.

There is a vast difference in the training, experience, perceived duties and responsibilities, working relationships, legal relationships and attitudes that separate the federally licensed employee pilot and the state licensed public pilot. An understanding of the differences is necessary.

The state licensed pilot is regulated by state statutes creating compulsory pilotage. His state license is both a certificate of competency and a franchise as a public servant requiring him to assume public obligations in maintaining pilot stations and operating a pilotage system. The rights, duties, and obligations of the owner, the ship, the master and the pilot are created by law and not by mutual agreement between the parties. Common law principles governing the usual employment contract have no application.

The general scheme in effect throughout most of the world is one in which a vessel approaching the coast with the intent of making port has a compulsory

obligation to accept a local pilot skilled in navigating those waters and knowledgeable as to local hazards, place him in charge of the navigation of the ship, and pay the fee for his services prescribed by local law. The purpose is to protect the safety of shipping by assuring a complement of pilots will be available when needed at designated locations (pilot stations) and placing navigational control of the ship in the hands of a qualified local expert when the ship is in a high risk area.

As part of their franchise as a public service it is compulsory for the pilot to maintain pilot boats on established stations known to all mariners, to keep a complement of qualified pilots available to render services at all times, to go to any ship needing his service without discrimination or choice and to provide his services under legally established terms and conditions, and for a fee prescribed by law and published in a tariff.

Compulsory pilotage is a creation of law, not a contract. It is regulated in much the same manner as a public service company and charged with the public responsibility of rendering pilotage services to vessels. The pilot is in no sense the employee or servant of the ship owner or the vessel he pilots. He is required to be accepted by the vessel and placed in charge of her navigation to serve the state's interest in protecting life and property--and in today's world, the environment--from the hazards of navigation. He sees his duty and obligation as being owed to local political authority and to the public, rather than to the ship owner in the role of an employer. The public nature and regulation of the terms and condition of his service protect and insulate him from the demand and pressures that can be placed on an ordinary employee to compromise the margins of safety.

In contract, the federally licensed pilot is a common law employee of the ship owner serving in a private capacity. The ship owner has the right of

selection and the right to exercise control over his employees in the performance of their duties. The terms and conditions of employment are privately agreed to with the ship owner. The prospects of future employment are dependent on how well the employee satisfies the demands placed on him by his employer. The master and the federally licensed pilot work for and are answerable to the same employer and are licensed by the same federal agency, the Coast Guard. In some cases the master and pilot may in fact be the same person serving in a dual capacity. This lack of independence and the absence of checks and balances should give the public cause for concern when they consider that the sea-going coastwise tankers are largely exempt from the protection of state compulsory pilotage laws. Many of them are navigated on our inland waters by company employee pilots or masters serving in the dual capacity of pilot.

So, compulsory state pilotage operating under the authority of the state Board of Marine Pilots functions to protect and insulate independent decision making affecting the safety of ships from commercial pressures by placing navigational control in high risk areas in charge of a compulsory public pilot who does not belong to the ship, i.e., free of the ship owner's interest and control. That independent pilot who is aboard the vessel for one reason, safety, is licensed and regulated by the state board.

In light of this state's continuing need to protect the lives and property of its citizens from the inherent hazards of navigation under high risk conditions in Alaskan waters, it is essential to maintain state licensed public pilots under the control of the Alaska Board of Marine Pilots.

In conclusion, I urge the committee to recommend the retention of the Board in its present form. Qualified independent Alaska licensed pilots are necessary for the safe and efficient flow of commerce in Alaskan waters. Only a properly constituted licensing and regulatory body, such as the Board, is capable of assuring the maintenance of professional standards essential to the piloting profession in a state so dependent on waterborne commerce.