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The New Certificates of Financial Responsibility: Environmental Progress or National Economic Disaster?

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THE NEW CERTIFICATES OF FINANCIAL RESPONSIBILITY: ENVIRONMENTAL PROGRESS OR NATIONAL ECONOMIC DISASTER?

by

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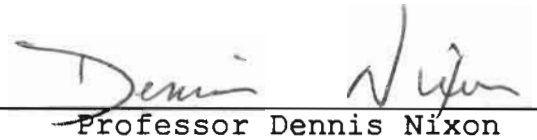
Approved 
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ABSTRACT

The Oil Pollution Act of 1990 (OPA 90) is the first comprehensive oil spill legislation passed in the United States. Included in the law were new provisions governing the liability and financial responsibility of both the company responsible for the spill and the insurer. These provisions, while well intentioned, have created a dangerous situation for both the environment and the economy of the United States.

This paper will examine the financial responsibility and liability regime that was in place prior to the passage of OPA 90, and the provisions of OPA 90 that establish new requirements shipowners must meet to qualify for a Certificate Of Financial Responsibility. In addition, the consequent rejection of these requirements by traditional maritime insurance markets, and the new financial instruments developed to meet the specific needs of vessels trading in the United States, will be explored.

TABLE OF CONTENTS

LIST OF TABLES

INTRODUCTION

In August of 1990, a new comprehensive legal regime for the spillage of oil in the coastal waters and Exclusive Economic Zone of the United States was adopted. Spurred by the public indignation over the *Exxon Valdez* spill in Prince William Sound, Alaska, the *Mega Borg* fire in the Gulf of Mexico, and the *American Trader* incident in California, Congress (which had been debating oil pollution legislation since 1975) quickly passed the Oil Pollution Act[1] (OPA 90). Approved by legislators more intent on impressing constituents rather than with making sound policy, OPA 90 contains provisions that most analysts decry as enormously expensive, both to those in the oil industry, and to the consumer.

The Oil Pollution Act of 1990 gave the United States its first comprehensive legal framework for the handling of oil spills. Its provisions included new rules governing liability and the amount of financial resources required for damages and claims in the event of an oil spill. Most of these rules are contained in provisions for obtaining a Certificate of Financial Responsibility (COFR) from the U.S. Coast Guard. To obtain a COFR, a shipowner must demonstrate

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[1] Oil Pollution Act, U.S. Code, vol. 33, secs. 2701-2761 (1990).

that they have complied with these new laws and regulations.

Unlike many issues examined by Congress, the debate over OPA 90 was characterized by a strong desire to show results quickly. While there were disagreements over several issues, the quick passage of the law demonstrated a unusual resolve and surprising unanimity of thought on the part of Congress. The result was stringent law and regulations which seriously constrains the way that the maritime oil transportation industry does business.

While the predicted cessation of oil imports to the United States (the "trainwreck" scenario) never occurred after the final deadline for obtaining COFRs had passed, there is still the potential for grave damage to the economy of the United States. The ingenuity of insurance companies and shipowners forestalled the disruption of oil delivery to the U.S.; however, the financial plans that have been submitted to and approved by the Coast Guard are untried, and may not be reliable financial cures to oil pollution incident.

Furthermore, several of the new companies formed to provide oil spill insurance are gambling that judicial interpretation of OPA 90 and the Interim Regulations promulgated by the Coast Guard will shield them from incurring potentially ruinous costs well above what they have agreed to pay.

The question remains whether Congress has raised the stakes too high for the oil transportation companies by combining unlimited liability with severely constrained defenses to liability. From December 28th, 1994, on, every trip into U.S. waters by a oil tanker is a gamble for the new marine insurance companies and their untested financial instruments.

PROVISIONS GOVERNING CERTIFICATES OF FINANCIAL RESPONSIBILITY PRIOR TO OPA 90

Requiring oil tankers to obtain COFR's is not recent; shipowners have been required to obtain them since the passage of the Clean Water Act of 1972 (CWA 72)[2]. Subsequent revisions established limits of liability for oil spill removal and clean up costs, promulgated the requirements of evidence of financial responsibility, and enumerated the defenses available to a third party insurer. Criminal sanctions were also available to the government for willful misconduct.

Under the CWA, liability limits for an oil tanker were $150 per gross ton, or $250,000, whichever was greater. For an inland barge, the required amount was $125 per gross ton, or $125,000, whichever was greater. Financial responsibility could be established by showing evidence of insurance, surety bonds, qualifications as a self-insurer, or other evidence of financial responsibility. Significantly, membership in a Protection and Indemnity Club (P&I) qualified as "other evidence of financial responsibility".

These rules remained in effect until December 28th, 1994, when new rules governing financial responsibility were promulgated by the Coast Guard.

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[2] Clean Water Act, U.S. Code, vol. 33, secs. 1251-1376 (1972).

To operate vessels, shipowners must accept that some accidents, whether major or minor, will occur, and prepare accordingly. Oil spills are one of the accidents that requires preparation. In order to financially cover themselves in the event of an accident, shipowners will insure themselves for varying amounts. At the lowest level, shipowners cover the incurred costs themselves. Shipowners can also join "Protection and Indemnity Clubs" (P&I Clubs), which are "associations of shipowners coming together to self-insure."[3] However, because the clubs cannot bear the complete costs and risks, they become members of an international P&I group, where they can buy additional insurance, spreading risk further. For additional coverage, the P&I clubs go to Marine Underwriters such as Lloyds for layers of "reinsurance" in the secondary insurance market.

The P&I clubs and reinsurers operate on an "indemnity insurers" basis. That is, they

> ...promise an insured that we [the insurer] will make good any liability losses he [the insured] sustains within the terms and limits of the contract. The promise cannot be for an unlimited amount, and it is subject to contractual restrictions which the insured ignores at his peril. Moreover, our contract

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[3] Congress, House of Representitives, Committee on Merchant Marine and Fisheries, Subcommittee on Coast Guard and Navigation, Hearings On The Impact On The Country Of Proposed Rules For Evidence Of Financial Responsibility Required By The Oil Pollution Act Of 1990, 102nd Cong., 1st sess., 06 November 1991, 33.

> is with the insured, not with the rest of the world. We cannot agree to be sued directly by unnamed, unknown but widely canvassed third parties."[4]

"Within the terms and limits of the contract" refers to the financial limits agreed upon by the insurer and insured, and which the insurer bases the premiums on. "Contractual Restrictions" refer to obligations the insured incurs, such as paying premiums on time, compliance with safety warrants-regulations, laws required by governments or surveying companies such as ASI, and correct licensing of crewmembers. Insurers could only have claims submitted from the insured, and, in recent legislation such as the Clean Water Act, from the U.S. Government in certain instances.

Insurance is readily available. At present, the P&I clubs offer up to $500,000,000 worth of coverage.[5] Tanker owners can also buy supplemental insurance in the secondary market through the P&I clubs worth between $200,000,000 and $400,000,000.[6]

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[4] Ibid., 32.

[5] Ibid., 30.

[6] Jason A. Garick, "Crisis In The Oil Industry: Certificates of Financial Responsibility And The Oil Pollution Act Of 1990," Marine Policy 17, no. 4: 280, July 1993.

N. Simon of Firstline Program, interview by author, telephone conversation, 29 March 1995.

The P&I clubs have a well-established record for paying claims. Admiral Robert Kramek, the Commandant of the U.S. Coast Guard, stated in testimony before the House subcommittee on Coast Guard and Navigation that

> A few times over the past 24 years, the United States has had to litigate on order to secure payment, but those few cases involved novel issues and do not represent the reliability of P&I Clubs as guarantors. Overall, the Clubs' record is outstanding...The Coast Guard's perception of the Clubs is based on a long-standing relationship of trust and respect,...[7]

There are other funds available to defray the costs of an oil spill. The Tanker Owner's Voluntary Agreement Concerning Liability for Oil Pollution (TOVALOP) became effective in 1969, more recently revised in 1984. It consists of an agreement between two private parties, the oil transportation industries and the oil companies. TOVALOP is international in scope: both parties and claimants are citizens of States, not representatives of governments. It is administered by the International Tanker Owners Pollution Federation, a limited company headquartered in London. Funds are available to signatories whether the CLC is in force or not. TOVALOP can disburse funds without admitting liability.

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[7] Congress, House of Representitives, Committee on Merchant Marine And Fisheries, Subcommittee on Coast Guard and Navigation, The Coast Guard's Interim Final Rule On Requirements For Evidence Of Financial Responsibility Under the Oil Pollution Act of 1990, 103rd Cong., 1st sess., 21 July 1994, 123.

Dispute resolution is handled through international rules of conciliation and arbitration (for TOVALOP), or the English courts (for Contract Regarding a Supplement to Tanker Owner Liability for Oil Pollution(CRISTAL)). These regimes apply uniformly to the signatory parties for an incident anywhere in the world.[8]

TOVALOP is significant in several ways. Tanker owners are held strictly liable, with a $16,800,000 limit. Tanker owners are liable to "persons generally", [9] citizens, as opposed to being liable to a state. Tanker owners must remove the spilled oil and compensate for pollution damages. Finally, TOVALOP "applies to territory and to the territorial sea of a State."[10]

A TOVALOP supplement has also been approved which "raises tanker owner liability limits to a range from $3,500,000 to $70,000,000, depending on the gross registered tonnage of the tanker."[11] However, the tanker owner must be a party to TOVALOP, and the oil must be owned by an oil

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8 Adrian Ladbury, "Impasse over U.S. oil spill responsibility," Business Insurance 28, no. 40(03 October 1994): 3,

9 Bernadette V. Brennan, "Liability and Compensation for Oil Pollution from Tankers Under Private International Law: TOVALOP, CRISTAL, and the *Exxon Valdez*," The Georgetown International Law Review 2, 1989: 2.

10 Ibid.

11 Ibid., 5.

company party to another international private agreement, the Contract Regarding a Supplement to Tanker Owner Liability for Oil Pollution(CRISTAL).

CRISTAL has also gone through numerous changes since its original inception in 1971. It is administered by CRISTAL Limited, headquartered in Bermuda. It is insurance for the oil cargo owners, as opposed to the shippers, and provides "compensation for oil pollution damage to complement the removal cost compensation assured under TOVALOP."[12] CRISTAL may be utilized after a tanker owner has reached the limits of their financial responsibilities; the tanker owners will use TOVALOP and TOVALOP SUPPLEMENT to their upper limits before CRISTAL funds become available. In fact, the agreements are written so that "The amount the tanker owner must pay before CRISTAL Fund is accessible is, coincidentally, the amount available under the TOVALOP supplement."[13] CRISTAL covers both pollution damage and removal costs; maximum liability payments range from $36,000,000 to $135,000,000. Oil companies who are signatories to CRISTAL own over 90 percent of the crude and fuel oil shipped by tanker.

Governments assist in providing funds for oil spill

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12 Ibid., 7.

13 Ibid., 8.

cleanups also. A public treaty that provides funds is the International Convention on the Establishment of an International Fund for Compensations for Oil Pollution Damage (CLC). Adopted in 1969, and amended in 1981, the purpose of this treaty "is to prevent uncompensated damages";[14] removal costs are not included. This fund is paid for by oil consignees, who pay for their respective states based on "each ton of oil received",[15] and provides up to $260 million for immediate clean up costs. However, on September 29, 1994, "...the transportation ministers of Great Britain, France and Germany joined Japan by agreeing to a new convention that increases the compensation payable to victims of oil pollution for any one incident by up to four times [$104 million] the old convention limits."[16] U.S. tankers are not eligible for funds under this convention, as the U.S. is not a signatory. Furthermore, it is not probable that the U.S. Coast Guard would accept that a oil tanker's flag state is a signatory to the CLC as proof that funds would be available in the event of a spill. However, CLC funds can be used if the tankers' flag country is a signatory, even if the spill is in U.S. waters.

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[14] Ibid.

[15] Ibid.

[16] Ladbury, Pg. 3.

While both the aims and some of the provisions of the public and private international law are the same, there are significant differences:

> Parties to CLC are states, parties to TOVALOP are Tanker Owners. CLC applies only to oil pollution damage, TOVALOP applies to the removal of oil as well as compensation for pollution damage....Under CLC, nothing happens until liability is affixed but under TOVALOP, removal of discharged oil or making of a settlement payment by a Participating Owner is neither admission of nor evidence of liability...if CLC is applied to the damage, TOVALOP will not apply.[17]

One of the most noteworthy differences is that only 60 countries have ratified the CLC (to date, the United States has not ratified any international protocols for oil pollution, and is not eligible for any of the funds), whereas "over 7,000 tanker owners, owners of 98 percent of the world's tanker tonnage, are parties to TOVALOP."[18]

The formation of a substantial body of private law regarding the problem of oil tanker pollution indicates the private sector is attempting to be proactive in dealing with the issue of liability for oil spills. The industry has accepted a strict liability standard. It has insured itself against the possibility of an oil spill, and provided funds for cleanup and restoration. Given that the *Exxon Valdez* spill has cost $5,000,000,000, the insurance limits

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[17] Brennan, 5.

[18] Ibid.

are low, but so are the CLC's. However, all the ocean from the coastline to the EEZ are covered in some way in case of damage.

There were several other funds available for use by the U.S. Government. The National Oil Spill Liability Trust Fund was established by the Clean Water Act. There was also funds established by the Deepwater Port Act of 1974, the Trans Alaska Pipeline Authorization Act, and the Outer Continental Shelf Act of 1978. All of these funds were consolidated by OPA 90.

Table 1 summarizes the resources available for cleanup and compensation of oil spills prior to OPA 90, assuming the spiller signed the TOVALOP/CRISTAL treaties, and that the flag state of the vessel ratified the CLC.

Table 1

SUMMARY OF NON-OPA FINANCIAL RESOURCES AVAILABLE FOR OIL SPILL CLEANUP AND COMPENSATION

	Lower limit	**Upper limit**
P&I Insurance	$500,000,000	$500,000,000
Supplemental P&I Insurance	$200,000,000	$200,000,000
CLC	$260,000,000	$260,000,000
TOVALOP	$16,800,000	$16,800,000
TOVALOP Supplement	$3,500,000	$70,000,000
CRISTAL	$36,000,000	$135,000,000
TOTAL	106,300,000	$1,181,800,000

LEGISLATIVE HISTORY OF OPA 90

Congress attempted to pass a comprehensive oil spill liability law for over fifteen years. In 1975, oil spill liability provisions were attached to Outer Continental Shelf legislation, but the legislation died the following year. The House of Representatives passed oil spill legislation several times after 1975, and the Senate passed legislation in 1987. However, until 1990, Congress was never able to submit a bill for the President's signature.

After the *Exxon Valdez* spill in March of 1989, hearings were scheduled in both the House and Senate to investigate the disaster. The Senate bill, written primarily by the Committee on Environment and Public Works and the Committee on Commerce, Science and Transportation, passed its bill, S. 686, unanimously on August 4, 1989. The speed with which the bill was passed was due largely to the efforts of Senate Majority leader George Mitchell, who had long pressed for oil spill legislation.

The House took longer. Although five different committees had some jurisdiction over various aspect of the legislation, the Committee on Merchant Marine and Fisheries and the Committee on Public Works and Transportation wrote the significant parts of H.R. 1465. In addition, the Foreign Affairs Committee was responsible for implementing two

international oil spill conventions. After intense negotiations, a new compromise bill, H.R. 3394, was agreed to by the committees and sent to the House floor. The bill was passed by a vote of 375-5 on November 9, 1989.

The House and Senate met in conference throughout the spring and summer. There were several divisive issues that delayed the Congressional vote, including liability, federal authority, preemption of state oil spill laws, ratification of international conventions, and natural resource damages. However, the conference report was adopted in early August, by a vote of 99-0 in the Senate, and 360-0 in the House. The President ultimately signed the Oil Pollution Act on August 18, 1990.[19]

OPA 90 is a curious blend of radical proposals and conservative dogma. Ideas concerning liability were extended past traditional boundaries, while the result of the debate pertaining to federal preemption of state laws followed long established precedents on states rights.

The debate over liability is an excellent example. The House originally proposed a bill that would make liability strict, joint and several for the responsible parties, and

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[19] Peter D. Robertson, "Oil Pollution Act of 1990--Aspects Of Its Legislative History", in Oil Pollution Act of 1990 Special Report, by the Government Institutes, Inc. (Rockville, MD: Government Institutes, Inc., March 1991), 51.

in principle the Senate concurred. The defenses to liability were very limited; they follow precisely the guidelines established in the Superfund law, giving the courts a large body of material to draw case law from. In addition, these defenses had been established under section 311 of the Clean Water Act, and upheld in the courts.

However, the House and Senate split over the issue of secondary liability for cargo owners. The House proposal had made cargo owners secondarily liable for up to 50 percent of removal costs. The Senate objected, and in the interests of getting the bill passed, the House dropped its proposal.

Federal authority was enhanced under OPA 90. Older laws "authorized" federal action; OPA 90 mandates it. Because if inadequate removal efforts in the past, The President's authority was expanded to enhance federal response efforts and directions. The president has options to choose from in responding to a spill, but is required to respond.

The issue of awarding natural resource damages received a great deal of attention during the design of OPA 90. The media had focused attention on animal deaths during the *Exxon Valdez* spill; Congress wanted to ensure that the value of natural resources was fully considered and properly paid for by spillers, and that efforts be made to restore and rehabilitate damaged resources. Congress did not want

another Ohio v. Interior Department[20] , where a federal judge ruled that the government had been settling for lesser natural resource damages, weighted heavily towards market values, based on Interior Department regulations.

The most divisive issue was the possible preemption of state laws in favor of one federal law. Ths House was strongly in favor of preemption; the original bill would have preempted state laws in several instances. Proponents argued that having two sets of laws governing a spill would delay the processes of cleanup and compensation. In addition, the proposed federal bill would cover all the costs covered in state laws with the exception of punitive damages.

Opponents, based mainly in the Senate, stated the state laws were necessary, since the proposed federal legislation capped liability in some instances, and that state statutes had posed no problem in the past to recovery of costs and cleanup.

The House proposed a compromise that called for the implementation of international protocols. Further inducement was provided by including the provision that any costs not covered by the international protocols but required by state laws would be paid for out of the federal

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[20] Ohio v. Interior Department, 880 F.2d 432 (D.C. Cir 1989).

fund. However, the Senate was not satisfied, and no federal preemption of state law was included in the final bill.

RAISING THE STAKES: LIABILITY PROVISIONS OF OPA 90

The Oil Pollution Act of 1990 is the first law designed to consolidate all aspects of how the federal government will deal with oil spills. The provisions in the law significantly strengthened liability provisions, criminal sanctions, and federal powers, while weakening defenses to liability.

§2702 of OPA 90 states that

> ...each responsible party for a vessel or a facility from which oil is discharged , or which poses the substantial treat of a discharge of oil, into or upon the navigable waters or adjoining shorelines or the exclusive economic zone is liable for the removal costs and damages...[21]

§2704 states limits to liability for tank vessels is:

> ... the greater of (A) $1,200 per gross ton, or (B)(i) in the case of a vessel greater than 3,000 gross tons, $10,000,000; or (ii) in the case of a vessel of 3,000 gross tons or less, $2,000,000:...[22]

There are few defenses to liability. §2703 allows a responsible party to limit its liability based upon a claim of an Act of God, an Act of War, or

> ...an act or omission of a third party, other than an employee or agent of the responsible party,..., if the responsible party establishes, by a preponderance of the evidence, that the responsible party - (A)

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21 Oil Pollution Act, U.S. Code, vol. 33, sec. 2702(a)(1990).

NOTE: Although the Oil Pollution Act of 1990 (OPA 90) is referred to, all cites reference the U.S. Code.

22 Ibid., sec. 2704(a)(1).

> exercised due care with respect to the oil concerned, taking into consideration the characteristics of the oil and in light of all the relevant facts and considerations; and (B) took precautions against foreseeable acts or omissions of any third party and the foreseeable consequences of those acts or omissions...[23]

However, neither these defenses nor the limits on liability will

> ...apply with respect to a responsible party who fails or refuses - (1) to report the incident as required by law if the responsible party knows or has reason to know of the incident; (2) to provide all reasonable cooperation and assistance requested by a responsible official in connection with removal activities; or (3) without sufficient cause, to comply with an order issued under... the Federal Water Pollution Control act..., or the intervention on the High Seas Act.[24]

Nor do these defenses or the limits on liability work

> ...if the incident was proximately caused by (A) gross negligence or willful misconduct of , or (B) the violation of and applicable Federal safety, construction, or operating regulation by the responsible party, an agent or employee of the responsible party, or a person acting pursuant to a contractual relationship with the responsible party.[25]

If any of the above exceptions apply, then liability becomes unlimited for the responsible party in the federal courts for removal costs and damages to natural resources, real or personal property, subsistence use, revenues, profits and earning capacity, and public services.[26] This is a

[23] Ibid., sec. 2703(a).

[24] Ibid., sec. 2703(c).

[25] Ibid., sec. 2704(c).

significant change from the CWA, which only covered removal and cleanup costs.

In addition, under OPA 90, civil and criminal penalties can also be assessed for spills. For civil offenses, fines run from $10,000 per violation for a maximum of $25,000 to $100,00 and $3,000 per barrel of oil spilled. Criminal penalties run from $25,000 per day and one year in prison for the responsible party to $250,000 per day for individuals or $1,000,000 per day for organizations, plus 15 years in prison. The harsh penalties indicated Congress' intent to deter potential polluters.

OPA 90 also consolidated several spill funds established under previous environmental legislation, namely the Clean Water Act, the Deepwater Port Act of 1974, the TransAlaska Pipeline Authorization Act, and the Outer Continental Shelf Lands Act of 1978, into the National Oil Spill Liability Trust Fund. The fund is generated by a 5% per barrel federal domestic and import excise tax levied on crude oil and petroleum products, and from damage awards. The fund provides up to $1,000,000,000 to pay those responding to oil spills in accordance with the National Contingency Plan. The Fund is allowed to recoup payment from the responsible party for all monies paid out. This

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[26] Ibid., sec. 2702(b).

ensures that funds are easily and quickly available for cleanup operations, and the taxpayer is not paying the bill for cleaning up the mess.

MEETING THE RISING COSTS OF OIL SPILLS

Under OPA 90, to operate in U.S. waters, a vessel must demonstrate that it has the financial backing to absorb all cleanup costs and damage claims when a spill occurs. The Coast Guard is required to issue a "Certificate of Financial Responsibility" to the vessel owner upon the establishment of "evidence of insurance, surety bond, guarantee, letter of credit, qualification as a self-insurer, or other evidence."[27]

On July 1, 1994, the U.S. Coast Guard issued interim regulations specifying the exact conditions under which the Certificates of Financial Responsibility can be issued and how liability will be determined. These regulations became effective December 28, 1994. The three specters of higher liability limits, direct action against the guarantor, and the potential for unlimited federal and state liability for both shipper and insurance company has caused many insurance companies and Protection and Indemnity (P&I) clubs to decline to act as guarantors to any oil tankers utilizing U.S. waters.

OPA 90 changed the rules for the traditional maritime insurers. In the event of a spill, the responsible party is not the only one held liable. Under §2716, the "guarantor"

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[27] Ibid., sec. 2716(e).

(any person, other than the responsible party, who provides evidence of financial responsibility for the responsible party[28]) may also be held directly liable for damages the responsible party allegedly caused.[29] Under this new system, claimants may submit claims directly to the guarantor and the responsible party. The guarantor has available the same defenses available as the responsible party; in addition, willful misconduct of the responsible party also constitutes an absolute defense.

The interim regulations promulgated by the Coast Guard extend this definition further to ..."any person who provides evidence of financial responsibility, under the Act[s], on behalf of a vessel owner, operator, and demise charterer. A vessel operator who can qualify as a self-insurer may act as both a self-insurer of vessels it operates and as a financial guarantor of other vessels,..."[30]

The guarantor is potentially open to unlimited liability from both federal and state laws, leaving a shipowner and its insurance company or P&I club open to

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[28] Ibid., sec. 2701(13).

[30] Dept. of Transportation, Interim Rule, "Financial Responsibility for Water Pollution(Vessels)," Federal Register (01 July 1994) vol. 59, no. 126, p. 344232.

attack in both federal and state forums for unlimited sums of money. Insurers were previously protected to the upper limits of the insurance policy they issued. P&I clubs would only pay out as much in damages as the shipowner had, in effect limiting their liability to the total damages incurred by the shipowner.

At present, P&I clubs and insurance companies refuse to become guarantors for shipowners, because of these provisions in OPA 90. §2716(f) states

> Any claim for which liability may be established under section 1002 may be asserted directly against any guarantor providing evidence of financial responsibility for a responsible party liable under that section for removal costs and damages to which the claim pertains. In defending against such a claim, the guarantor, may invoke (1) all rights and defenses which would be available to the responsible party under this act, (2) any authorized under subsection (e), and (3) the defense that the incident was caused by the willful misconduct of the responsible party. The guarantor may not invoke any other defense that might be available in proceedings brought by the responsible party against the guarantor.[31]

P&I clubs and insurers see OPA 90 as a way of (1) breaching the traditional contractual relationship between insurer and insured by allowing anyone to file a claim against the insurer, and (2) taking away insurance policy

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[31] Ibid., U.S. Code, sec. 2716(f).

defenses that have traditionally protected insurance companies from illegitimate claims, such as fraud, noncompliance with safety regulations, and nonpayment of premiums. Previous U.S. legislation required "willful negligence or willful misconduct within the privity and knowledge of the vessel operator"[32] before liability became unlimited.

The insurance companies maintain this position, regardless of §2716(g), which states:

> Nothing in this Act shall impose liability with respect to an incident on any guarantor for damages or removal costs which exceed, in the aggregate, the amount of financial responsibility required under this act which that guarantor has provided for a responsible party.[33]

The Coast Guard went even further in its interim rule, stating

> A guarantor that participates in any evidence of financial responsibility under this part shall be liable because of that participation, with respect to an incident or a release or threatened release in any proceeding only for the amount and type of costs and damages specified in the evidence of financial responsibility. *A guarantor shall not be considered to have consented to direct action under any other law other than the Act[s], or to unlimited liability under*

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[32] Congress, The Impact on the Country Of Proposed Rules For Evidence Of Financial Responsibility Required By The Oil Pollution Act Of 1990, 29.

[33] Ibid., sec. 2716(g).

> *any law or in any venue, solely because of the guarantor's participation in providing any evidence of financial responsibility under this part. In the event of any finding that liability of a guarantor exceeds the amount of the guaranty provided under this part, that guaranty is considered null and void with respect to that excess* (italics mine).[34]

The Coast Guard is clearly expressing that, in their opinion, even though there may be direct action against an guarantor, the guarantor will only be held liable for the amount specified in the Certificate of Financial Responsibility.

However, the rule does not specifically state these limits will remain in force if any of the policy defenses are breached by the courts. An insurer or guarantor knows that if a spill occurs, and the circumstances that led to the spill fall within the specified defenses, they will only pay claims up to the limits in the insurance policy. However, if the circumstances surrounding the spill fall outside the defenses, the guarantor may still be held to unlimited liability.

What insurers and potential guarantors fear is judicial interpretation of the law that would leave them vulnerable to unlimited liability, despite §2716(g). As Terence G. Coghlin, Chairman designate of the U.K. P&I Club, and

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[34] Federal Register, 34232.

Chairman of the International Group Of P&I Clubs, made clear in his statement before the Subcommittee on Coast Guard and Navigation,

> ...it is generally agreed that the limitation of liability provided in OPA 90 is illusory. OPA 90's liability limit is not available if the incident is proximately caused by the gross negligence of the responsible party of if it is caused by the violation of an applicable federal safety, construction or operating regulation by the responsible party. Given the likelihood of establishing a breach of some applicable federal regulation and the unknown and highly flexible nature of the test for "gross negligence" at the shipboard level, denial of the right to limit liability is a probability in any spill.
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> It may be argued that OPA 90 only requires an insurer to certify up to the fixed amounts stated in OPA 90. However if, as the NPRM proposes [and as the Interim Rule maintained], the insurer is forced to submit to the jurisdiction of the US federal courts as a guarantor (which submission will probably also be construed as defacto submission to the jurisdiction of state courts), he will lose the contractual defenses which are a very important part of the cover given by any insurer and he will become exposed as the deepest available pocket to the risk of having to pay sums in excess of the amount certified, or even insured.[35]

Robert S. Lagattolla, of the Water Quality Insurance Syndicate concurred, stating, "Most spills do occur because

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[35] Congress, The Impact on the Country Of Proposed Rules For Evidence Of Financial Responsibility Required By The Oil Pollution Act Of 1990, 88.

of negligence on the part of vessel personnel, and it would be our view that in most litigation any kind of negligence would be deemed to be gross negligence and, therefore, limitation of liability would not be accorded the vessel operator."[36]

Evidence confirming Mr. Lagattolla's statement is found in a survey conducted by West Of England P&I Club. Their six year survey demonstrated that 65 percent of all shipboard accidents occur as a result of human error. The next highest category was equipment failure, with 10 percent.[37] While these numbers do not deal specifically with how oil spills are caused, they do give credence to the contention that gross negligence could be found in the majority of the cases brought before a U.S. court.

While the P&I Clubs are still insuring tankers using U.S. waters, they are unwilling to become guarantors due to potential exposure to multiple lawsuits from federal, state and private claimants not only for compensatory damages and cleanup, but speculative natural resource damages as well. Previously, under the Clean Water Act, the obligation of a guarantor was solely to the federal government, for clean-up and restoration claims. The federal government was the only

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[36] Ibid., 29.

[37] "On the horns of a bull market," Seatrade Review, December 1992, 59.

entity entitled to use direct action against a guarantor.

Furthermore, OPA 90 has no system for allocating money amongst competing claims, nor any criteria established for determining priorities or prorating claims. For instance, the *Exxon Valdez* spill incurred over $5 billion in claims, cleanup costs, and damages. In light of this amount, most shipowners consider themselves underinsured. No insurance plans offered at this time are written to pay this large amount of money. With multiple claimants among federal, state, and private agencies, a guarantor, if able to maintain liability limits, at best will only be able to provide minimal compensation to each party. This lack of an allocation system leaves the guarantor open to charges that they exercised improper preference both to claimants and to in competing forums. This makes the guarantor's conduct an issue in court, rather than focusing on the conduct of the responsible party. Federal and state courts, lacking guidance from legislatures, may find guarantors liable under theories of "insurance bad faith" (i.e paying claims in a manner considered inequitable by some claimants), in addition to any damages claimed under OPA 90.[38]

Insurers are not willing to risk entering this arena in

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[38] Congress, The Coast Guard's Interim Final Rule On Requirements For Evidence Of Financial Responsibility Under The Oil Pollution Act of 1990, 133.

the absence of any established system for allocating insurance funds. As J. Richard Youell, a marine underwriter at Lloyd's of London, submitted in testimony before a congressional subcommittee,

> Insurers are asked to be alone directly answerable...to a wide-range of claimants for a polluter's conduct, not our own; to advertise the availability of our funds with unknown liability for getting it wrong and no precedents or guidance about how to "get it right." In a recent Clean Water Act suit, Justice Department lawyers alleged that a mere insurer had an affirmative duty, not only to reimburse the government but to have performed its own clean up at a remote site. Further, insurers risk being second-guessed about the distribution of limited funds among multiple claimants each conceivably claiming to stand in the shoes of the original policyholder. Finally, insurers are at risk that any number of State and Federal courts all having jurisdiction over OPA actions...could decide the scope of an "incident" differently to circumvent the per-incident limit that is otherwise supposed to protect a guarantor...against multiple-limits exposure.[39]

In addition to being comprehensive for the federal government, OPA 90 provides for individual states to establish or retain their own liability provisions for spills. §2718 allows these states' provisions to be imposed in addition to liability incurred under federal statutes, resulting in a potential of responsibility for damages under both federal and state laws.

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[39] Ibid., 136.

States were originally preempted from establishing their own liability regimes that would exceed federal limits by the Shipowners' Liability Act of 1851[40]. States could have their own liability schemes, as long as they complied with the 1851 act, which limited a shipowners' liability to " the amount or value of the interest of such owner in such vessel, and her freight pending."[41] After paying for cleanup, removal and damages at the federal level, the owner had very little interest left in a vessel for a state to attack.

This law no longer applies to an oil pollution incident. OPA 90 allows states to bring their own actions against a shipowner. Since liability is not limited, a state can win a judgement in its own courts, regardless of what is left of the ship, or the owners' interest in the ship.

Shipowners, insurers, and guarantors worry that without federal preemption of liability, the states and state residents will make additional claims under their own laws and in their own courts. Even if the responsible party and guarantor are protected from unlimited liability in OPA 90, many states have passed laws that make unlimited liability awards a distinct possibility in the state courts. For

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40 Garick, "Crisis in the Oil Industry", 280.

41 Ibid., 280.

instance, Texas was proposing a law under which, if a insurer files a OPA insurance form with the Coast Guard, a federal agency, "...Texas will assert the right of its citizens to sue that insurer in Texas courts under Texas law possibly for damages in excess of the limit the insurer may have agreed to pay out under the OPA certificate."[42] In other words, by complying with federal law, a operator or guarantor may obligate themselves even further without any choice.

In testimony before Congress, RADM Appelbaum denied any responsibility for state actions. "State liability requirements do not affect OPA 90 financial responsibility requirements. State and federal regulations on the subject of financial responsibility are separate and distinct."[43] In the interim rule, the Coast Guard stated that there was not "sufficient federalism implications to warrant the preparation of a Federalism Assessment."[44] Given that the Coast Guard has no responsibility or authority over the states, and that §2718 specifically gives the states

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42 Congress, The Impact on the Country Of Proposed Rules For Evidence Of Financial Responsibility Required By The Oil Pollution Act Of 1990, 32.

43 Ibid., 61.

44 Federal Register, 34226. A "Federalism Assessment" is a study required by Executive Order 12612 when it appears that there will be substantial overlap between Federal and State law.

authority to devise their own oil spill laws, it is understandable that a hands-off approach was taken. However, no solution is available to a guarantor who is seeking to limit risks.

THE MARKETPLACE RESPONDS: NEW INSURANCE OPTIONS

OPA 90 was enacted largely due to the impetus of the American public shock over the ecological disaster caused by the *Exxon Valdez* in Prince William Sound, Alaska. The unlimited liability provisions mandated in OPA 90 resulted from the perceived failure of the oil transportation industry to adequately calculate the essential preparations, required levels of caution, and financial resources necessary to reduce oil spill risk to a level beyond basic precautions. Congress reasoned that if the costs resulting from oil spills were raised high enough, the oil transport business would ensure that no spills occur.

Since the astronomical cost of cleaning up a spill and paying damages to those injured will neither go away nor decrease, the question arises: how will the costs be borne, and by whom? Congress has answered by determining that costs will be borne largely higher financial requirements and through liability: a litigious process that is, at best, cumbersome, antagonistic, unpredictable, and expensive. However, if all or most mandated oil spill costs were borne through insurance, both oil tanker owners and insurance companies would be able to calculate new levels of risk, thus insuring that the cost of cleanup and damages would be available without resorting to the judicial system.

By refusing to become guarantors, the P&I clubs have denied their members the ability to service the U.S. market, as well as the reinsurance that was available to the clubmembers. Several new ideas have been proposed or implemented to fill this void.

§2716(e) states proof of financial responsibility can be proven in one of several ways: (1) evidence of insurance, (2) surety bond, (3) guarantee, (4) letter of credit, (5) qualification as a self insurer, or (5) other evidence of financial responsibility , which would require approval of the National Pollution Funds Center.

Self-insurance is an option for the major oil companies and their tanker fleets. Mobil Corporation has established its own company, Marine Guaranty Corporation, to insure ships in the Mobil Oil Co., and Mobil Shipping and Transportation Co. It is capitalized at 285 million dollars. Chevron, Texaco, and Exxon are also creating their own facilities.[45] The Coast Guard claims another "major U.S. shipowner has [also] registered", although it declined to name the company.[46] As of February 22, 1995, over 443 ships have obtained COFR's through self-insurance[47].

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[45] Ladbury, 4.

[46] Ibid., 6.

[47] S. Spetafore of National Oil Pollution Fund Center, interview by author, telephone conversation, 28 March

However, self-insurance is possible for very few companies. Peter Cooney, the managing director of Acomarit (U.K.) PLC, a ship management firm, states, "Self - insurance is not the answer for many owners, and we are bashing our brokers into a pulp for answers."[48]

One reason that self insurance is not an option for many independent tankers is the requirement promulgated in the interim rule requiring the operator to

> ...maintain[s], in the United States, working capital and net worth each in amounts equal to or greater than the total applicable amount calculated in accordance with §138.80(f)[the section of the rule and OPA 90 detailing total amounts of coverage required],..., *working capital* means the amount of current assets located in the United States, less all current liabilities anywhere in the world; and *net worth* means the amount of all assets located in the United States, less all liabilities in the world.[49]

This means only U.S. working assets can be used as guarantees, and ensures that the assets of a company are available for attaching in the event that an oil company goes bankrupt or refuses to meet its obligations. However, many international shipping lines, or independent tanker owners with single ships or small fleets may simply not have

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1995.

[48] Ladbury, 6.

[49] Federal Register, 34231.

enough assets in the United States to qualify as a self-insurer.

There have been proposals asking to use P&I club membership as an asset for self-insurance purposes. The Coast Guard has denied this request:

> The P&I Club membership-as-an-asset approach is not supported by Generally Accepted Accounting Principles, and allows the P&I Clubs to avoid paying claims by invoking an unlimited number of policy defenses and the pay-to-be-paid rule. Under this rule, a Club only is required to "indemnify" its shipowner-member for payments actually made by the shipowner. In the case of bankruptcy, ...,where the shipowner is discharged from paying removal costs and damages, there would be no obligation for the shipowner's P&I Club to pay claimants.[50]

This ruling is notable, in that under the CWA 72, P&I Club membership could be used for self-insurance purposes. And, as previously noted, the P&I clubs have consistently paid all claims required of them. A cost-benefit analyis performed by the staff of the Subcommittee on Coast Guard and Navigation noted that

> ...the P&I clubs' performance in supporting their members in the United States and worldwide has been outstanding. Consequently, the risk of a shipowner defaulting on its obligations because a P&I club didn't perform are small as well. Combining these probabilities, the risk of the Oil Pollution Fund having to pay the shipowner's share

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[50] Federal Register, 34225.

of a spill is even smaller yet.[51]

However, given Congress' intent to "make the polluter pay", and OPA 90's explicit language, the Coast Guard did not want to risk that a defense to liability would enable a P&I club to escape paying for cleanup and damages.

The Coast Guard's fear that the P&I clubs' would use a shipowner's bankruptcy to avoid payment was analyzed further by the Subcommittee staff. Given the P&I club's outstanding payment record, they assumed "for the sake of argument" that nonpayment would occur at a "very conservative five percent annualized occurrence rate." This was multiplied by the high average limit of liability of $115 million. They concluded that if a shipowner went bankrupt, and the P&I club refused to pay, the potential annualized cost to the Oil Pollution Fund would be $5.75 million a year.[52]

The most popular method of obtaining a COFR is the "financial guaranty."[53] This method permits "a vessel operator to meet the financial responsibility requirement by having any other firm, usually an affiliated company, comply

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51 Congress, The Coast Guard's Interim Final Rule On Requirements For Evidence Of Financial Responsibility Under The Oil Pollution Act Of 1990, 269.

52 Ibid. The method used for this monetization was to multiply the probability of an event by the cost of the event.

53 Federal Register, 34225.

with the self-insurance method on behalf of the vessel operator."[54] This method had proven particularly popular among non-U.S. shipowners who wanted to establish sufficient U.S. assets to cover the requirements of the COFR. Indeed, of the approximately 3,000 COFR's issued so far, 1233 of them used this method.[55]

The Coast Guard has accepted a wide variety of means to implement a financial guaranty. Most of them involve demonstrating the ability to pay for a spill up to the limits required by §2702. For example, one foreign shipowner formed a corporation in Delaware. The shipowner then signed over a note to this corporation, for the amounts necessary to cover the maximum liability limits, payable if the vessel spills any oil. The American corporation then states that it is willing to act as the guarantor for the ship. Under the corporation's auspices, the ship obtained a COFR.[56]

The costs of doing business this way seem to be minimal to the shipowner, and dangerous to the American taxpayer, who, through the oil companies, are paying the five cent a

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54 Congress, The Coast Guard's Interim Final Rule On Requirements For Evidence Of Financial Responsibility Under The Oil Pollution Act of 1990, 121.

55 S. Spetafore of National Oil Pollution Fund Center, interview by author, telephone conversation, 28 March 1995.

56 Ibid.

gallon surcharge to fund the National Oil Liability Trust Fund. If a spill occurs, the shipowner could easily refuse to pay more than the liability limits established by OPA 90, or worse, default on the loan. The American government would pay for the clean up of the spill, then attempt to recover its costs from the Delaware corporation. The corporation, who has sufficient assets on paper to cover the spill, would be stuck with the overcharge or defaulted note. Aside from throwing the corporate officers in jail, there would be little the U.S. Government could do. There are few means of attaching the foreign assets of the shipowner. The provisions of OPA 90 are being complied with; however, the issuance of a COFR in this instance does not guarantee the availability of funds Congress intended when it passed OPA 90.

The use of Surety bonds is also being tried. Surety bonds are bonds issued to cover catastrophe, loss, or damage, and are a commitment to compensate damaged parties if the buyer of the bond cannot or will not pay.[57] They have been used by shipowners who owned large fleets. The fact that only 118 ships have qualified for COFRs using surety bonds attests to the difficulty of obtaining the large amounts of capital required to obtain these bonds.

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[57] Alan Abrams, "Tanker Owners Rush for New Pollution Bonds," Journal of Commerce, 03 October 1994, p. 1A.

Two other organizations have formed to offer alternatives. The first organization is a company called First Line, which the United Kingdom Mutual Steamship Assurance Association (Bermuda) Ltd. (U.K. Club) has endorsed as having "put forward the best plan so far to back the guarantees"[58]. This support is demonstrated by the fact the 494 ships have obtained COFRs through First Line. First Line is a commercial insurance plan, not a mutual association like the P&I clubs and Shoreline. The U.K. club preferred First Line because as originally planned, there would be no duplication of P&I club coverage. First Line was a joint venture, formed by Johnson and Higgins, a commercial insurance company, and Lloyd's broker Nicholson Leslie BankAssure, a subsidiary of Nicholson Leslie Group. First Line has obtained reinsurance from Stockton Reinsurance Limited.[59] Like the other companies, it charges premiums on a per voyage basis, with a $50,000 minimum premium per vessel that remains fixed.

The advantage of First Line for the shipowner is that as a commercial insurer, there is no chance of supplementary premium calls or cash calls, which can occur with P&I clubs. Nor does it require letters of credit, which can tie up a

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[58] Alan Abrams,"UK Club Endorses First Line's COFR Plan," Journal Of Commerce, 24 October 1994, p.1A.

[59] Ibid.

shipowner's equity. From the beginning, First Line has been designed to supplement the $5 million-$7 million P&I club coverage, rather than replace it. It offers a guaranteed contract up to $395,000,000. The only defense it has against payment are the statutory defenses in OPA 90.

Because of the progress made in developing means of insuring tankers, American marine underwriters are willing to provide reinsurance,[60] a function that London based insurance markets such as Lloyd's and the Institute of London Underwriters previously filled. However, this has not been necessary, as First Line has obtained reinsurance from Stockton Reinsurance Limited.

Stockton Reinsurance[61] is ostensiby a new player in the marine insurance markets, having only recently obtaining its insurance license in October of 1994. However, its history demonstrates the manner in which OPA 90 has moved the insurance markets away from traditional practices. It is a Bermuda based company; the parent company Commodities Corporation is incorporated in the Grand Cayman Islands, and has been in business for 25 years. The headquarters for Commodities Corporation are located in Princeton, New

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60 Margo D. Beller, "US Insurers Will Back Ship Pollution Certificates," Journal of Commerce, 14 September 1994, p. 7A.

61 M. Casio of Commodities Corporation, interview by author, 02 May 1995, telephone conversation.

Jersey. When Commodities Corporation decided to become involved in the marine insurance markets, it obtained a Bermuda insurance license for a subsidiary, Commodity Trading Corporation, and changed the name to Stockton Reinsurance Limited. As of October 1994, it was capitalized at $217 million.

Shoreline Mutual (Bermuda) Ltd. has been described as a "new specialist protection and indemnity club created specifically to meet the needs of vessel owners carrying oil to and from the United States".[62] Many shipowners who did not trade in the U.S. objected to having to pay higher rates to their P&I clubs due to other shipowners who did do business in the U.S.

The rates Shoreline charges are high; premiums are determined for oil tankers on a per voyage basis, based on the type of oil, age and size of the ship, and any ecological enhancements, such as double hulls. One Shoreline spokesman said that the ill-fated *Exxon Valdez* would have cost $200,000 for coverage.[63] These premiums will provide up to $300 million dollars worth of coverage. Shoreline was intensely criticized for making shipowners pay twice for

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[62] Gary Taylor, "Shoreline Mutual Plans to Launch Oil-Spill Coverage," Journal of Commerce, 22 September 1994, p. 11A.

[63] Ibid.

their first $300 million worth of insurance, once through their club, then once again to Shoreline.[64] However, Shoreline recently announced a change in policy that would allow the Shoreline insurance to be used as an excess, or "top-up", policy that would not duplicate club coverage at reduced premiums.[65] This would allow a shipowner to purchase the usual $700 million dollars insurance policy through the P&I club, then the added $300 million through Shoreline, giving over $1 billion dollars worth of coverage. In addition, Shoreline agrees to become a guarantor. Shoreline has been negotiating intensely with P&I clubs to gain their approval for this plan. The clubs had withheld approval because of the double payment.

Shoreline's history also provides an interesting example of how entrepreneurial daring is reshaping the insurance picture. COFR backing for vessels is provided, but the fluidity and uncertainty of the situation gives indications that stability has not been completely achieved in these markets.

Shoreline had been formed specifically to provide guarantees to ships using U.S. waters. It was originally set

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[64] Alan Abrams, "Shoreline's Oil-Spill Coverage Clears Coast Guard Hurdle," Journal Of Commerce, 21 October 1994, p. 1B.

[65] Alan Abrams, "Coast Guard Optimistic COFR Deadline Will Stick", Journal of Commerce, 07 November 1994, p. 9B.

up as a mutual insurance organization. The Coast Guard had approved Shoreline's organizational plans in late 1994. Shoreline still needed to float a $300 million bond that would capitalize the venture; however, this was not expected to be a problem, as demand rose for a solution to the insurance impasse.

The Coast Guard had also approved an organization called OPACLUB, which would bring the use of surety bonds to small shipowners by pooling their collateral requirements. As has been pointed out, surety bonds are an expensive way to provide the COFR's, limiting their use to large companies; however, OPACLUB would have brought these instruments to smaller companies.

> Willis Corroon Americas and Sedgwick Marine & Cargo Ltd. have teamed up with leading U.S. surety bond broker C.A. Shea & Co. Inc. to create OPACLUB, a proposed solution for shippers not big enough to follow the example of the big oil companies.
> OPACLUB will issue surety bonds underwritten by a panel of U.S. surety insurers. Those bonds will enable shipowners to gain COFRs as long as they also are members of one of the 15 International Group of P&I Clubs, which [already] provide U.S. oil pollution coverage up to $ 500 million.
> Premiums will range from $250,000 for small organizations to $2 million for bigger operators, and members of OPACLUB will be required to issue letters of credit 10 times the value of their premium.[66]

OPACLUB floated a $350 million bond, to be financed through

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[66] Ladbury, 6.

the annual premiums. The premiums applied for all ships in a fleet, rather than a per ship basis. Both tankers and dry cargo ships were eligible, although dry cargo ships would have lower premiums. Rates were expected to be set on a voyage-by-voyage basis, making it easier for shipowners to pass costs onto customers. As a mutual association, members of OPACLUB would have been liable for spills by other members.[67] One expert stated that the plan would only be viable if "it received the support of about 50% of world tanker tonnage."[68]

Obtaining letters of credit had not been an alternative for shipowners in the past. While it has been a option allowed by law (including OPA 90), Admiral Richard Appelbaum, U.S. Coast Guard, testified before the subcommittee on Coast Guard and Navigation, that "...over the last 20 years...no-one has ever used a letter of credit as evidence of financial responsibility. It does not appear to be a viable method...I suspect that it may have something to do with regulations that are imposed upon lending institutions." [69] Letters of credit are usually issued by

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[67] Alan Abrams, "Oil Tanker Insurers Race To Achieve 'Critical Mass'", Journal of Commerce, 07 October 1994, p. 1A.

[68] Ibid.

[69] Congress, The Impact On The Country Of Proposed Rules For Evidence Of Financial Responsibility Required By

the bank holding the ship's mortgage. While banks may do this to keep the ship operating and profitable, it cannot be doubted that the increased exposure to risk, and the contraction of credit, would have some negative effects.[70]

However, as the December 28 deadline drew near requiring ships to have COFR's to operate in U.S. waters, OPACLUB realized that it would not have the "critical mass" to get fully financed. At the same time, Shoreline was still seeking reinsurance. The two companies were not competing well against First Line, which had received the endorsement of the International P&I Club, and whose rates were generally recognized as being cheaper. Shoreline and OPACLUB merged in January of 1995. Shoreline got the critical mass it needed, and on March 6 announced that it had obtained reinsurance from Centre Re (Bermuda) Limited, placed by Willis, Faber & Dumas and underwritten 100% at Lloyds.

Many concerns have been expressed over the new company's ability to effectively provide coverage. In hearings before the Congressional Subcommittee of Coast Guard and Navigation in July of 1994, many doubts were expressed as to the Coast Guard's ability to assess the financial health of these new organizations. Chairman Billy

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The Oil Pollution Act Of 1990, 18.

[70] J. Gorham of Johnson& Higgins/OPACLUB, interview by the author, telephone conversation, 29 November 1994.

Tauzin and five other members of Congress sent a letter to President Clinton asking for a delay in the Coast Guard implementation of the Final Rules that implemented the OPA 90 standards for obtaining the COFRs.[71] In the Interim rules published on July 1, 1994, the Coast Guard established December 28, 1994, as the deadline for tanker vessels to comply with the new standards.

However, the Coast Guard has maintained its position that the companies that have been formed can provide the needed insurance and financial coverage. It has received support from the Department of Energy, despite concerns of a "train wreck", a repeat of the 1973-74 oil embargo.

As a result of the merger between Shoreline and OPACLUB, First Line and Shoreline are the major competitors in the OPA 90 guarantor market. For smaller, independent shipowners who are unable to afford self-insurance or surety bonds, they are the only alternative available to obtain a COFR. Trying to compare the two companies is difficult, but the contrast between them demonstrates markedly different approaches.

First Line is a commercial insurance company that bases its premiums on "...the type of operation and vessel, as

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[71] Alan Abrams, "Tauzin Raises Concerns On COFRs with Clinton," Journal Of Commerce, 04 November 1994, p. 1B.

well as the operators prior record. Oil tankers will be assessed a higher premium than other types of vessels."[72] First Line considers itself to be a supplement to P&I insurance.

Shoreline is a mutual insurance company, or P&I Club. It is designed specifically to serve vessels trading in United States waters. Its premiums are based on"...prior United States oil pollution claims data, rather than on the oil pollution spill record of an individual owner or operator."[73] Both companies consider factors such as the age of the ship, whether the ship is single or double-hulled, whether the ship has any other safety features, and the number of voyages that will be made into United States waters.

Another contrast is the premiums charged for coverage. For instance, First Line, as a commercial insurer, will charge fixed premiums; it is the "fixed cost solution". These are the only payments that need to be made by a vessel owner. However, Shoreline, as a mutual insurance company, can issue supplementary premium calls and cash calls to its members, in addition to its regular premiums, in the event

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[72] Congress, The Coast Guards Interim Final Rule On Requirements For Evidence Of Financial Responsibility Under The Oil Pollution Act Of 1990, 97.

[73] Ibid.

that funds are needed. These calls for additional funds can be made any time that liquidity becomes an issue. For instance, if a member of Shoreline causes an oil spill that requires Shoreline to pay out more funds than are available, the rest of the club must make up the difference. Or, if any member of a club defaults on an obligation, again the club must make up the difference.

Because of the different ways that the two companies are structured, it is difficult to comprehensively compare costs. While First Line has more expensive premiums, it will not subject the shipowner to unplanned calls for additional funds. In addition, what the P&I clubs charge for insurance can affect the overall price that a shipowner pays. Prior to First Line and Shoreline becoming operational, the P&I Clubs charged a $.29 per GRT per voyage surcharge (For a hypothetical 134,000 GRT tanker, this charge would be $194,000; for a 137,000 GRT tanker, it would be $198,650. See Table 2.)[74]. Some theorize that with First Line and Shoreline assuming the major risks, P&I Club premiums may even decrease. However, some comparison can be made, as can be seen in Table 2.

What both companies have in common is faith in

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[74] Congress, The Coast Guards Interim Final Rule On Requirements For Evidence Of Financial Responsibility Under The Oil Pollution Act Of 1990, 107.

Congressional and Coast Guard assurances that as guarantors under OPA 90 guidelines, they will not be subject to unlimited liability claims from parties injured by an oil spill. Mr. Hugh Bryant, testifying before the House subcommittee For Coast Guard and Navigation on behalf of Shoreline, stated

> ...there is simply no basis for believing that a guarantor might somehow find itself subject to claims that exceed the limit of its guarantee... While OPA 90 makes it easier to break a shipowner's liability limit than was the case under prior law and under the 1969 CLC, it does not create any possibility of breaking the limit applicable to the guarantor.[75]

Both companies are gambling that U.S. courts will abide by the guidance contained in OPA 90 and the final rule, regardless of whether the defenses contained in OPA 90 are breached; they read OPA 90 and the final rule to mean that the guarantor will pay up to the limits of the assigned policy

policy. The responsible party will be liable for any claims that exceed the guarantors financial limits.[76]

There are other proposals that have not fared as well

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[75] Ibid., 143.

[76] S. Hannon of Shoreline Mutual Insurance, interview with author, telephone conversations, 28 March 1995.

N. Clemens of First Line Program, interview with author, telephone conversation, 02 April 1995.

Table 2 [77]

COMPARITIVE COSTS OF FIRST LINE AND SHORELINE ANNUAL INSURANCE PREMIUMS

TYPE OF SHIP **GRT** **DWT** **NUMBER OF VOYAGES PER YEAR** **AGE**	**COMPANY**	**COST OF ANNUAL PREMIUM**	**AMOUNT OF COVERAGE**
1974-BUILT MOBIL TANKER 134,000 GRT 275,000 DWT 5 VOYAGES 20 YEARS	FIRST LINE	$386,400	UP TO $300,000,000 IN ADDITION TO P&I COVERAGE
	SHORELINE	$265,375	UP TO $395,000,000 IN ADDITION TO P&I COVERAGE
1986-BUILT NYK TANKER 137,000 GRT 239,000 DWT 5 VOYAGES 8 YEARS	FIRST LINE	$313,200	UP TO $300,000,000 IN ADDITION TO P&I COVERAGE
	SHORELINE	$191,200	UP TO $395,000,000 IN ADDITION TO P&I COVERAGE

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[77] Alan Abrams, "COFR Issuers Wary of Edge Held by Rival First Line," Journal of Commerce, 15 November 1994, p. 1A.

NOTE:The ships presented in this example were used in the cited article. However, all costs presented are based on formulas from the most recent Shoreline (December 1994) and First Line (March 1995) information packets.

as First Line or Shoreline. Tindall, Riley & Co., the underwriting manager for Brittania Steam Ship Insurance Association. Ltd, had received approval from International Association of Independent Tanker Owners (INTERTANKO) and the International Chamber of Shipping for the establishment for a mutual insurance fund that would tentatively handle any oil spill in the United States, including the unlimited liability provisions. This plan was never submitted to Coast Guard for approval, but it should be examined to show the wide range of options that were considered as a result of OPA 90.

This plan required the formation of a new shipowners mutual that would provide cover for ships trading in the United States. This new fund, called the Oil Pollution Act Qualified Underwriting Enterprise (OPAQUE), "would give coverage up to the limits set in the Oil Pollution Act of 1990 and then be reimbursed by an oil industry-backed fund for the difference between the OPA limits and lower limits set by the Civil Liability Convention."[78]

Most shipowners, including INTERTANKO, favored this proposal, because it requested contributions from the oil companies, as well as shipowners. Oil companies do assist

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[78] Janet Porter, "Tanker Owners Back Liability Sharing Proposal," Journal Of Commerce, 21 September 1994, p. 8B.

with insurance through CRISTAL, but under OPA 90, they are not held liable for any spills. However, major oil companies have so far resisted getting involved in any insurance liability schemes.[79]

One option still being pursued is the establishment of a Mandatory Excess Insurance Facility, first proposed in 1992 by the Greek Shipping Cooperative Committee, the Union of Greek Shipowners, the Norwegian Shipowners Association, and the Swedish Shipowners Association. Under this proposal, "Congress would create a non-profit, government -sponsored entity that would raise $2 billion through a bond issue. The MEIF would then offer coverage for oil pollution liability up to $2 billion(or $1.5 billion above OPA limits)[80] and charge tankers coming into the United States a premium of $1 per ton of cargo."[81] This would be a separate fund established solely to "alleviate shipowners' concerns about operating under insured in a climate of unlimited

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[79] Alan Abrams, "Coast Guard Issues 1st Spill Cleanup Certificate," Journal Of Commerce, 14 September 1994, p. 1A.

Janet Porter, "COFR to Spark Mergers, Tanker Operator Predicts," Journal of Commerce, 07 October 1994, p. 7B.

[80] Ladbury, 6.

[81] Gavin Souter, "U.S. issues oil spill guidelines," Business Insurance 28, no. 29 (18 July 1994): 89.

liability."[82] This option is highly favored by independent tanker owners who import approximately 70 percent of all imported petroleum to the United States.[83] They are unable to obtain insurance, or other financial guarantees, in the same way the larger fleets would be able to. This option would require Congress to pass further legislation establishing such a fund. It would also require the U.S. taxpayer to provide funding in the initial years until the premiums built up enough equity to cover liabilities. However, Congress made it very clear that one of the primary thrusts of OPA 90 is that the polluter pays, not the U.S. taxpayer. The Coast Guard, in its interim rule, made it clear that the MEIF is not a viable option for the near future.[84]

The last proposal is a variation on the idea of using P&I Club membership as an asset for self-insurance purposes. Originally proposed by a group of shipowners, the "loss-payee" concept was endorsed by the P&I Clubs. This suggestion would make the National Pollution Funds Center(NPFC) the beneficiary of an insurance policy. In the

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82 "COFRS: The crunch has come," Marine Log 99, no. 8 (August 1994):5.

83 Congress, The Impact On the Country Of Proposed Rules For Evidence Of Financial Responsibility Required By The Oil Pollution Act Of 1990, 157.

84 Federal Register, 34225.

event of a spill, the proceeds of the policy would be paid to the NPFC for distribution to third party claimants. The insurance companies favor this proposal because it removed them from becoming involved in direct action, and dealing with multiple claimants.[85]

However, the Coast Guard did not approve the concept, claiming it isolated the insurance company from paying legitimate claims. Under this proposal, the P&I Clubs would retain policy defenses. Also, the "pay-to-be-paid" rule, requiring that claims be paid prior to reimbursement by the P&I Club, would still be in force, and any liabilities the owner or operator owed to the P&I Club would be deducted prior to payment. The Coast Guard also claims that without direct action, the P&I clubs would be under "no legal obligation to reimburse...for the payment of private third party oil pollution claims that the Fund has paid."[86]

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[85] Congress, The Coast Guard's Interim Final Rule On Requirements For Evidence Of Financial Responsibility Under The Oil Pollution Act Of 1990, 119.

[86] Ibid.

UNFORESEEN CONSEQUENCES OF OPA 90

The consequences of OPA 90, delayed for four years of debate prior to the issue of the final regulations, are starting to unfold. There have been few surprises. What is still uncertain is whether this new system will work when the next major spill occurs.

Proponents of OPA 90, such as Senator George Mitchell, U.S. Senate Majority leader, said that the law will

> ...serve to prevent oil transporters from making business judgements that insurance is sufficient to cover the potential costs of any spill. Thus, oil transporters factor into their business decisions regarding handling and transportation of oil the steps necessary for providing a high standard of care.[87]

Senator Mitchell's implication is that by keeping the "potential costs" of a spill unknown, fear of astronomical speculative damages will keep vessel owners and operators in line.

However, the traditional insurers of the maritime industry have made it clear that they will not accept the high potential risks involved in becoming a guarantor. While they will insure, they will not expose themselves to what they see as financial ruin, and so have left the arena. Consequently, the field has been left open to unknown

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[87] George J. Mitchell, "Preservation of State and Federal Authority Under the Oil Pollution Act of 1990," Environmental Law 21, no. 237 (1991): 243.

entities who have assumed what they see as limited liability.

Insurance companies are not the only ones distancing themselves from responsibility. The major oil companies are ridding themselves of their tanker fleets.[88] From a high of 600 tankers in 1974, the combined fleets of British Petroleum, Chevron/Gulf, Exxon, Mobil, Shell, and Texaco/Getty have fallen to 180 tankers. The major reason is the liability risks. This decrease is attributable to attrition, tanker sales, and the use of independents to operate what is left of the fleet. The overall rate of independent tanker ownership has increased. Significantly, the number of tankers owned by oil-producing nations is growing.

The oil companies hope to distance themselves from the liability risk imposed by OPA 90. As cargo owners, they have no federal liability. However, some state laws do hold cargo owners partly liable. CRISTAL has been an obvious attempt to help transporters, but the failure of OPAL/OPAQUE clearly demonstrates that cargo owners will only expose themselves in a limited way.

Even as the large oil companies divest themselves of

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[88] Alan Abrams, "Oil Companies Shed Tankers To Reduce Liability Risks," Journal of Commerce, 28 February 1995, p. 1A.

their vessels, small and medium sized tanker operators may find it necessary to form larger companies by merging. This would enable them to more easily afford the high insurance premiums required to service the United States, to qualify for high priced guarantees such as surety bonds, and to take advantage of economies of scale.

Tanker operations are also being affected. Many tankers are conducting lightering operations over 200 miles off the coast, instead of the 60 miles that has been the norm.[89] Many tankers will now offload in Caribbean transshipment centers. Operators could probably expect to see greater use of the Louisiana Offshore Oil Port (LOOP). The reason for this shift is that the bigger tankers are much more expensive to insure, compared to the smaller ships that will receive the oil.

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[89] Janet Porter, "US Rules May Force Oil Transfers Out to Sea," Journal of Commerce, 09 December 1994, p. 12B.

RETURNING TO REALITY: PROPOSALS TO RATIONALIZE THE SYSTEM

Ultimately, the oil business is full of uncertainty. Unlimited liability is not something a shipowner or oil company can prepare for financially, except by stashing huge amounts of money away in anticipation of the next spill, and the costs of cleaning up oil are high, as demonstrated in many recent accidents. Therefore, what is required is a scheme whereby the money is available for use, while at the same time allowing the oil transportation industry to rationalize and plan its risk.

The best method may be the elimination of unlimited liability at both the federal and state level, ending the cost uncertainty. At the same time, the liability limits must be raised to levels ensuring, within experience and best estimates, the coverage of oil spill damages and claims. This proposal, while controversial, would enable the insurance markets to calculate new policies that would cover spills based on the higher premiums. Even though the premiums would rise significantly, the price of insurance would become a predictable cost factored into the price of oil in the marketplace. This is already being done to a small extent when First Line and Shore Line charge vessels on a per voyage basis. In addition, "guarantors" should have traditional indemnity protections reestablished.

Those who would object to passing the cost on to the

consumer would argue that the oil and oil transportation companies should sacrifice profits. However, a grocery store or a landlord who carries liability insurance passes the cost of the insurance on to the customer, even though the insurance is protection against the customer. Likewise, oil customers reap benefits from the oil supplied to them and from a cleaner environment, and should not object too strongly to having costs passed on. Furthermore, the uncertainty of unlimited liability will cause greater price fluctuations in the cost of oil transportation. Neither business nor consumers can be satisfied with this consequence. In addition, a higher tariff could be imposed to increase the size of the National Oil Spill Liability Fund.

The distrust and suspicion that federal legislators and the Coast Guard are directing towards traditional marine insurers and underwriters must stop. It is commonly acknowledged by the Coast Guard and by Congress that the P&I Clubs have consistently honored their commitments to cover claims, within the limits of their policies. However, the Coast Guard, attempting to enforce OPA 90 in the spirit in which Congress passed it, has consistently turned down innovative proposals, such as "loss-payee", that would make it possible for these companies to stay in the market. Their continued justification is that if these proposals are

implemented, an insurer might not fulfill its obligations.

As the guarantor market has been abandoned by responsible companies, new untried companies are taking their place. It is significant that of the approximately 3,000 COFRs issued so far, 1233, almost half, are for "financial guarantees", many of which are paper corporations with dubious financial arrangements. 746 COFRs have been issued through the new and untried First Line and Shore Line companies. In the event of a major spill, these arrangements may cause the NOPF to be depleted rapidly. Independent tanker owners, who are rapidly becoming the major means of transporting oil, do not have the financial backing that Exxon did when the *Exxon Valdez* ran aground.

Furthermore, if a U.S. court rules that a guarantor is liable for damages above the specified limits, it is certain that vessels covered by means other than self-insurance will lose their COFRs, and be unable to enter U.S. waters. No financial institution will be agreeable to assuming guarantor status when it is conceivable that a bill comparable to the $5 billion *Exxon Valdez* spill would be presented. The forestalled "trainwreck" of the U.S. economy would occur.

Bankruptcy is inevitable for these small companies, a possibility U.S. legislators considered and dismissed. As

Senator George Mitchell stated,

> It is true that the bankruptcy laws of the United States may ultimately impose limits on the amount that can be recovered from a polluter or any other person in our society. That fact, however, does not diminish the value of federal and state laws that hold polluters liable for the costs and damages incurred from some or all of their actions.[90]

The "trainwreck" may have been avoided, but it is still possible.

Despite our objections to the way other countries do business, the United States should join the international conventions, and attempt to persuade the members to raise the liability limits available under the CLC. By remaining out of the CLC, the United States loses any and all bargaining leverage. Also, there should be greater funding for the CLC cleanup fund from the member states or the United Nations, or higher contributions from oil tariffs.

Federal law should be the sole regulator of liability schemes for oil spills, supplanting states' powers' in this arena. The prospect of the federal government and the 36 coastal states all promulgating separate legislation, regulations, and standards could only be appealing to a bureaucrat's bureaucrat. It is a confusing nightmare for any business attempting to transport oil. OPA 90 could be revised making states plaintiffs in federal courts against

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[90] Mitchell, 243.

polluters, an affected party with everyone else hurt by a spill.

OPA 90 should be revised to emphasize the financial responsibility aspects of pollution control. In emphasizing litigation as the primary means of paying for oil pollution damage, Congress has ensured that our court system will be clogged and backlogged with lawsuits requiring enormous amounts of time and money to resolve. Instead, Congress should mandate that oil transporters and cargo owners develop financial plans to deal with an oil spill, including details on how the cleanup will be paid for and by whom. TOVALOP, the TOVALOP SUPPLEMENT, and CRISTAL demonstrate that the oil companies are capable without government supervision.

The Coast Guard could insert contractual reasons into its interim and final regulations so that a guarantor will not be held to unlimited liability; however, it has steadfastly refused to do this, saying it would undermine congressional intent to make the polluter pay, and pay quickly for any cleanup. The Coast Guard sees the unlimited liability issue as separate from the issue of providing financial guarantees required for the Certificates of Financial Responsibility.

It is interesting to note that despite some efforts by Congress, there are no provisions in OPA 90 to hold the

owner of the oil responsible or liable for any of the oil spill. The oil production industry will undoubtedly continue to resist any efforts to be held responsible for a spill. However, to resist getting proactively involved in ventures such as OPAQUE/OPAL is shortsighted, and contrary to the logic that lead to CRISTAL.

CONCLUSION

The Oil Pollution Act of 1990 is a good starting point for comprehensive legislation dealing with oil pollution. It serves notice that a "high standard of care" will be expected of oil importers who bring their product to the United States. However, there must be recognition of problems the oil transportation industry faces. Present law contains no such acknowledgement; instead, it is a "knee-jerk" reaction that seems to emphasize exacting vengeance on a polluter, rather than creating a comprehensive plan to clean up spilled oil, preserve the environment, and ensure that the polluter is held responsible for wrongdoing. The oil transportation industry has demonstrated its willingness to provide funds and insurance (through TOVALOP and CRISTAL) to clean up and preserve the environment. This attitude should be fostered through Congressional legislation, with corresponding direction provided by the Coast Guard, if needed.

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