Oil Pollution in the Australian and New Zealand Region

BY

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A COMMENTARY BY ALISTAIR IRVING

In his paper Michael White comments

> "Australia and New Zealand have been spared major oil spills and the legal profession and the P & I representatives are generally unfamiliar with the details of the extent of the liability which may be claimed and the type of loss which gives rise to a valid claim.

and later

> "the importance of the insurance structure in relation to oil spills is much underestimated. The insurance structure should be supported generally and compulsory insurance should be extended to pollutants other than persistent oil from laden tankers".

Given the few incidents of oil pollution or the threat of pollution which there have been in our part of the world, it is perhaps not surprising that lawyers and P&I Club correspondents such as myself are "generally unfamiliar" with the Conventions and Agreements which deal with pollution in our countries. As I read in Fairplay recently, and as has become clearer as I have prepared

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this commentary, this area is "not for the simple minded", not that I would suggest that that description applies to anyone here today!

What I would like to attempt to do in this commentary is to pick up on Michael White's statements and try to shed some light on the liability and compensation regime which the Conventions and Agreements have come to establish over the years for tanker spills, how liability insurance in form of P&I cover has responded and how the cost and ultimately perhaps even the continuing availability of that insurance is threatened by developments in the USA under the Oil Pollution Act 1990. To relate that approach back to the topic under discussion, it does of course go without saying that these issues have a direct relevance to our part of the world and the way in which any major spill in our region would be dealt with by the international insurance community.

In writing this paper I am conscious of the complexity of the topic which Michael was set and on which this commentary is being given. Fortunately it is unnecessary for me in this commentary to grapple with the detail of the various Conventions and Agreements. It is to be hoped however that what follows will shed a little light on the darkness which Michael identifies.

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First, to deal with the development of the Conventions and Agreements and to set them against the insurance cover available.

Three major casualties involving oil pollution from tankers over the last 25 years can be regarded as landmarks in the development of legislation and insurance. The first was the Torrey Canyon which spilled her entire cargo off the Scilly Isles in March 1967. Although the capacity for pollution damage from the escape of cargo from ever-larger tankers had been recognised before then, the Torrey Canyon provided the first graphic illustration of its problems and of the rapid effect they had both on legislation and on the insurance of shipowners' liabilities for oil pollution risks. Within two years an international convention on a tanker owner's liability for such incidents was produced under the auspices of IMCO, the forerunner of IMO. The Civil Liability Convention 1969 (CLC) provided for strict liability on the tanker owner, subject to certain limited defences, but gave the owner the right to limit his liability to a sum calculated by reference to the size of the ship. Converted into SDR's these figures were 133 SDR's per ton up to a maximum of 14 million SDR's, currently around US$18m. Even at that time it was envisaged that these rights might not be sufficient to provide total compensation for the worst case and the

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groundwork was laid for a supplementary compensation scheme to be funded by cargo interests which translated itself into the 1971 Fund Convention to which Michael refers in his paper.

The impact of the Torrey Canyon on the insurance market was even more abrupt. The P&I Clubs, the insurers of shipowners' liability, isolated the oil pollution risk and for the first time in their long history of giving insurance without financial limit, imposed a limit on their cover for oil pollution. That figure, set at the maximum reinsurance obtainable in the market, was US$14 million.

In his paper Michael White deals with the two voluntary industry agreements, Tovalop and Cristal which run hand in hand with the Conventions and make available to claimants funds over the Convention limits. I need not go into detail on those agreements beyond noting that the maximum available recovery under the Tovalop Standing Agreement, which applies only when CLC does not come into play, is US$16.8 million per incident or under the Tovalop Supplement - which applies worldwide but only when the cargo on board the tanker at the time of the incident is owned by a party to Cristal - a maximum of US$70 million for any incident. So far as Cristal is concerned the maximum available for any one incident - <u>including</u> compensation that will be payable by the tanker owner in terms of the

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Tovalop Supplement - is US$135 million.

The CLC came into force in 1975 with the Fund Convention following in 1978. That all relates back to nearly 25 years ago. What relevance has it today?

Although the amount of compensation available from the Fund has been increased and now stands at 60 million SDR's, or about US$83m, the amount of the shipowner's liability under CLC remains the same today. By contrast the limit on the P&I Clubs' cover for oil pollution risks has increased in steps over the years to the point where it now stands at US$500 million.

The process by which this evolution took place is illustrated by the other two landmark cases. In 1978 the Amoco Cadiz went aground off Britanny releasing the second largest quantity of oil ever spilled from a marine casualty. By this time CLC was in force but not the Fund and the incident had the effect of increasing the speed of ratification of the Fund Convention and starting the pressure for increasing the limits of shipowners' liability under CLC which culminated in the 1984 Protocol to the convention. The limit on P&I cover at the time was US$50 million, a sum barely adequate to cover the legal costs of the ensuing litigation which finished earlier this year when judgment was given in a USA Court of Appeals for approximately US$220 million, US$150 million of that being interest.

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By 1989 when the Exxon Valdez incident occurred, the P&I Clubs' limit had risen to US$400 million. The Fund Convention was also operative and steps had been taken to increase the level of compensation both in terms of CLC and the Fund through the 1984 Protocols to both Conventions. Despite the agreement in these Protocols to increase the limit of both shipowners' liability - to a maximum of US$62m - under CLC and the Fund's maximum contribution under the Fund Convention - to a maximum of US$208m - neither Protocol had entered into force. The entry into force provisions are difficult to comply with unless the USA ratifies the Protocols and in 1989 the USA was still debating whether to join the conventions scheme.

The Exxon Valdez incident ensured that the debate had to end and that a decision had to be made on legislation for the USA. That decision, as we all know, came down against the conventions approach and resulted in the Oil Pollution Act 1990 (OPA90). Perhaps almost as significant as the impetus it provided for new legislation, the Exxon Valdez also had a dramatic effect on those involved in the tanker business on the insurance side. For the first time it became apparent that a single oil pollution incident, at least in the USA, could really cost more than US$2 billion. It is in the light of this realisation that the provisions of OPA 90 have caused such concern.

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Although the P&I Clubs were able to increase the limit on cover for oil pollution risks to US$500 million in the aftermath of Exxon Valdez, with a further US$200 million available on the market, the Clubs have inevitably felt the pressure of recent developments in the international reinsurance market on which they depend for their ability to offer a limit at this level. As I say above, quite apart from the important aspect of the cost, the question of capacity is critical. It is impossible to predict the extent of the capacity which will be available in the future but it does seem certain that the Clubs will have absolutely no hope of obtaining insurance to the extent of US$2 billion within a reasonably foreseeable time frame.

That then is the way in which the international community has responded to demands for a liability and compensation regime for oil pollution from tankers. It also shows the way in which the shipowning and cargo owning industries have topped up the conventions to provide for much greater levels of compensation. In that regard it should be remembered that some 95% of tankers are entered with Tovalop and the vast majority of oil moving around the world is owned by a Cristal member. Equally it can be taken for granted that oil tankers will have entry either with a P&I Club or ITIA for pollution risks.

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Appendix one shows the limits of financial responsibility under Tovalop, Cristal, CLC and the Fund Convention. Appendix two shows how compensation for oil spills from tankers is provided and appendix three is a flow chart of oil pollution compensation under Tovalop, CLC, Cristal and the Fund Convention.

As adverted to earlier, the 1984 Protocols to CLC and the Fund Convention would raise the limits available in terms of those conventions quite considerably. In addition both Protocols fully adopt the language of the 1976 Limitation Convention thus making the breaking of limitation more difficult than is the case with CLC where limitation can be broken on the basis of the "actual fault or privity" of the shipowner. In terms of the 1984 Protocols the burden shifts to the claimant to prove that the shipowner acted recklessly or intentionally in causing the pollution incident. The entry into force provisions of these Protocols essentially meant that lack of ratification by the USA would leave them languishing in the wings. With the USA now having moved to legislate in terms of the OPA 90 steps have been taken to amend the entry into force provisions of the CLC and Fund Protocols. A diplomatic conference is being held in November of this year in an effort to give some impetus to their ratification.

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I would now like to move on to consider the impact of the OPA 90 on the cost of, and ability of the insurance industry to provide continuing liability insurance for, tanker spills.

Lloyds pioneered marine oil pollution insurance and the Lloyds market is still one of the world's principal sources for such cover for both offshore facilities and tankers. Ironically, in the light of OPA 90, the US insurance market has virtually no capacity for liability insurance for oil pollution from ships. It is self evident therefore that the stress under which the Lloyds market has found itself over recent years, and which has been well documented elsewhere, will lead to pressure both on cost and capacity in the liability area. The P&I Clubs have one of the largest reinsurance treaties negotiated at Lloyds and following the disasters of which we are all aware there has been a marked reduction in the available capacity both at Lloyds and in the non-UK markets. Notwithstanding the pressures on London, the International Group of P&I Clubs obtained cover at the 1992 renewal for 93% of its requirements, albeit at a substantially increased cost. This demonstrates quite clearly that continuing high numbers of high value claims and the pressure which they place on the market will inevitably lead to further reduction of capacity and

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increased cost. I will now move on to demonstrate the scope for such serious claims in the pollution field in the USA following the passing of OPA90. Perhaps the best way to highlight the extreme nature of the legislation is by way of a comparison with the provisions of CLC. In several areas OPA 90 is markedly at variance with the Convention. In all of these areas there is a real risk of cost blow out.

1) **<u>Channelling of Liability</u>**

One of the features of CLC is that the strict liability for an oil spill is concentrated on one party only, the ship's registered owner. "Owner" in the Convention is defined in this way and the convention specifically provides that no claim for pollution damage under the Convention or otherwise can be made against the owner's servants or agents. The 1984 Protocol to the Convention goes further and lists a series of other parties such as pilots, charterers, salvors and persons taking preventive measures who cannot be sued instead of or in addition to the registered owner. By contrast OPA 90 not only provides a much wider definition of responsible party to include "any person owning, operating or demise chartering the vessel" but also that their liability is joint and several. Thus a range of different interests in the ship could be

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held liable for the pollution. From the insurance point of view the channelling of liability on to the registered owner under CLC has the distinct advantage of allowing the bulk of the available insurance capacity to be concentrated on a single entity. Under the OPA system a number of different interests, including even banks in some cases, could incur the liability and therefore require separate insurance protection. The result of course is that more than one policy could have to respond in respect of the same incident.

2 **Pre-emption of other laws**

CLC protects the owner and others from claims for pollution damage under any other law. By contrast OPA makes it abundantly clear that it has no effect on and does not pre-empt the right of the individual American States to enact their own pollution legislation. Again this has an important effect on insurance. Whatever benefits OPA may give to a shipowner and his P&I insurer can be swept away by the relevant State legislation. Many States are seeking not only to impose liability without any limitation on the shipowner but also to include other parties such as the owner of the oil as potential defendants. Quite apart from the need for all these defendants to maintain insurance against

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their potential liability, it seems inevitable that a significant proportion of the available insurance resources will be spent on legal fees and costs in the struggle to make someone else primarily liable or in merely understanding the interaction of Federal and State law on any incident.

3 **Limitation of Liability**

As already noted under CLC the owner's right to limit liability can be broken only if the incident is a result of the owner's actual fault or privity. The 1984 Protocol updates that to bring it in line with the 1976 Convention.

By contrast the owner's limit under OPA can be broken if the incident is caused by gross negligence, as well as wilful misconduct, or violation of any applicable Federal regulation. Gross negligence will result in limitation being broken not only if attributable to the owner but also to any of his servants or agents or even contractors. A tanker owner is thus faced with the possibility of the gross negligence of a pilot or some other contractor depriving him of his right to limitation. Clearly therefore the OPA limitation figure is extremely fragile while, in any event, the States can also impose unlimited liability on the

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owner. Both owners and insurers must live with the obvious conclusion that OPA's limitation rights may not be worth anything.

4 **<u>Definition of Pollution Damage</u>**

From this brief summary of these problem areas it is readily apparent that OPA 90 is going to place a great strain on the capacity on the insurance industry to respond. One last area of contrast between the two systems may have an even more serious impact on the total bill to be paid after a pollution incident. This is in the area of damage to natural resources. The Conventions provide a fairly general definition of pollution damage with the 1984 CLC Protocol tightened up to provide in Article 2.3.

"Compensation for impairment of the environment other than loss of profit from such impairment shall be limited to costs of reasonable measures of reinstatement actually undertaken or to be undertaken".

Equally the Fund Assembly has passed a resolution in terms of which it

"Confirmed its intention that the assessment of compensation to be paid by the International Oil

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Pollution Compensation Fund is not to be made on the basis of an abstract quantification of damage calculated in accordance with theoretical models".

International Oil Pollution Compensation Fund - Assembly Resolution No 3.

By way of contrast in OPA 90 there is a wide ranging definition of the damages which are recoverable. In addition to the expected damage to property and consequential losses the Act provides for recovery of damages for

"injury to, destruction of, loss of or loss of use of natural resources". S.1002 (b) (2) (A).

Clearly the significance of this provision for an owner's liability and, in the context of our present discussion, for the P&I insurer, is such that it will be worthwhile looking at the area a little more closely.

As has been shown the convention approach is that any compensation for damage to the environment is to be limited to "costs of reasonable measures of reinstatement actually undertaken". In other words damage has resulted from a spill and money has been spent putting that damage right. By way of contrast

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the OPA scheme talks of "injury to, destruction of, loss of or loss of use of natural resources". Take a couple of simple examples of damage to "natural resources".

a) If it can be shown scientifically that fish have suffered in a pollution incident, the effect of that may be felt in a reduced income for the relevant fishermen either while they are unable to fish because of the oil in the water or because of reduced catches for a period. It should be possible to assess how much income the fishermen have lost as a direct result of the effect of oil on their fish. So far so good. But what of the fish species they don't catch or the other marine organisms on which the fish feed? If they suffer as a result of the oil how does one value that damage?

b) Suppose that a number of seabirds unfortunately suffer in the oil spill but those sea birds have no direct commercial value to anyone. Has anyone in a legal sense suffered a loss as a result and, if so, how is that loss quantified?

In terms of the Conventions no damages would be available for the fish which were not to be caught or the unfortunate seabirds. In terms of OPA,

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FIGURE 2: LIMITS OF FINANCIAL RESPONSIBILITY UNDER TOVALOP, CRISTAL, CLC & FUND CONVENTION

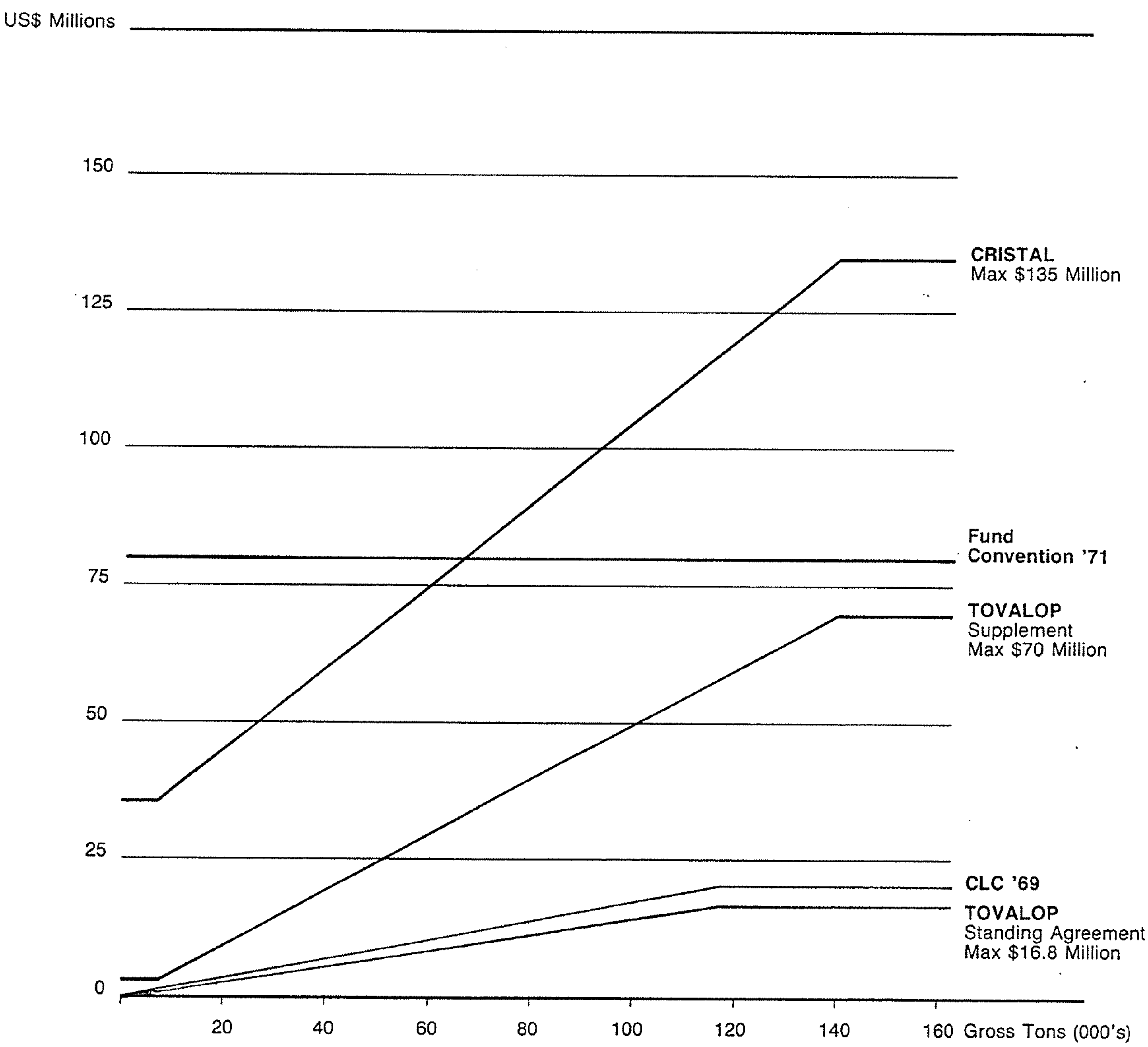

FIGURE 3: COMPENSATION FOR OIL SPILLS FROM TANKERS

	Primary Compensation provided by Tanker Owners			Supplementary Compensation provided by Cargo Owners	
	TOVALOP Standing Agreement	**TOVALOP** Supplement	**CLC, 1969**	**CRISTAL**	**Fund Convention, 1971**
Nature of regime	**Voluntary agreement**	**Voluntary agreement**	**International convention**	**Voluntary agreement**	**International convention**
When does each apply?	When persistent oil threatens to escape or does escape from a participating tanker Tanker is not required to be loaded with cargo and no spill need occur	When persistent oil threatens to escape or does escape from a participating tanker Tanker must be loaded with **CRISTAL**-owned cargo although no spill of cargo need occur	When persistent oil escapes from a laden tanker No liability if tanker is unladen or if no oil is actually spilt	When persistent oil threatens to escape or does escape from a tanker Tanker must be loaded with **CRISTAL**-owned cargo and compensation paid by tanker owner up to **TOVALOP** Supplement limit	When persistent oil escapes from a laden tanker No liability if tanker is unladen or if no oil is actually spilt. Ownership of cargo irrelevant
Where can each apply?	Only when **CLC, 1969** does not apply	Worldwide	In States party to **CLC, 1969**	Worldwide	In States party to **CLC, 1969** and **Fund Convention, 1971**
Limits of Liability	US$160 per limitation ton up to maximum of US$16.8 million	US$3.5 million for tankers up to 5,000 gross tons, rising to maximum of US$70 million	US$181 per limitation ton up to maximum of US$19.1 million (see note below)	US$36 million for tankers up to 5,000 gross tons, rising to maximum of US$135 million, including compensation paid by tanker owner	Total made up to US$81.8 million, including any compensation paid by tanker owner under **CLC, 1969** (see note below)

Note: The limits of liability under the **CLC, 1969** and **Fund Convention, 1971** are based on specified units of account, the US$ equivalents of which vary depending upon exchange rates. Those shown above have been converted, to the nearest round figure, at the rate of conversion of SDR = US$1.364.

APPENDIX 3

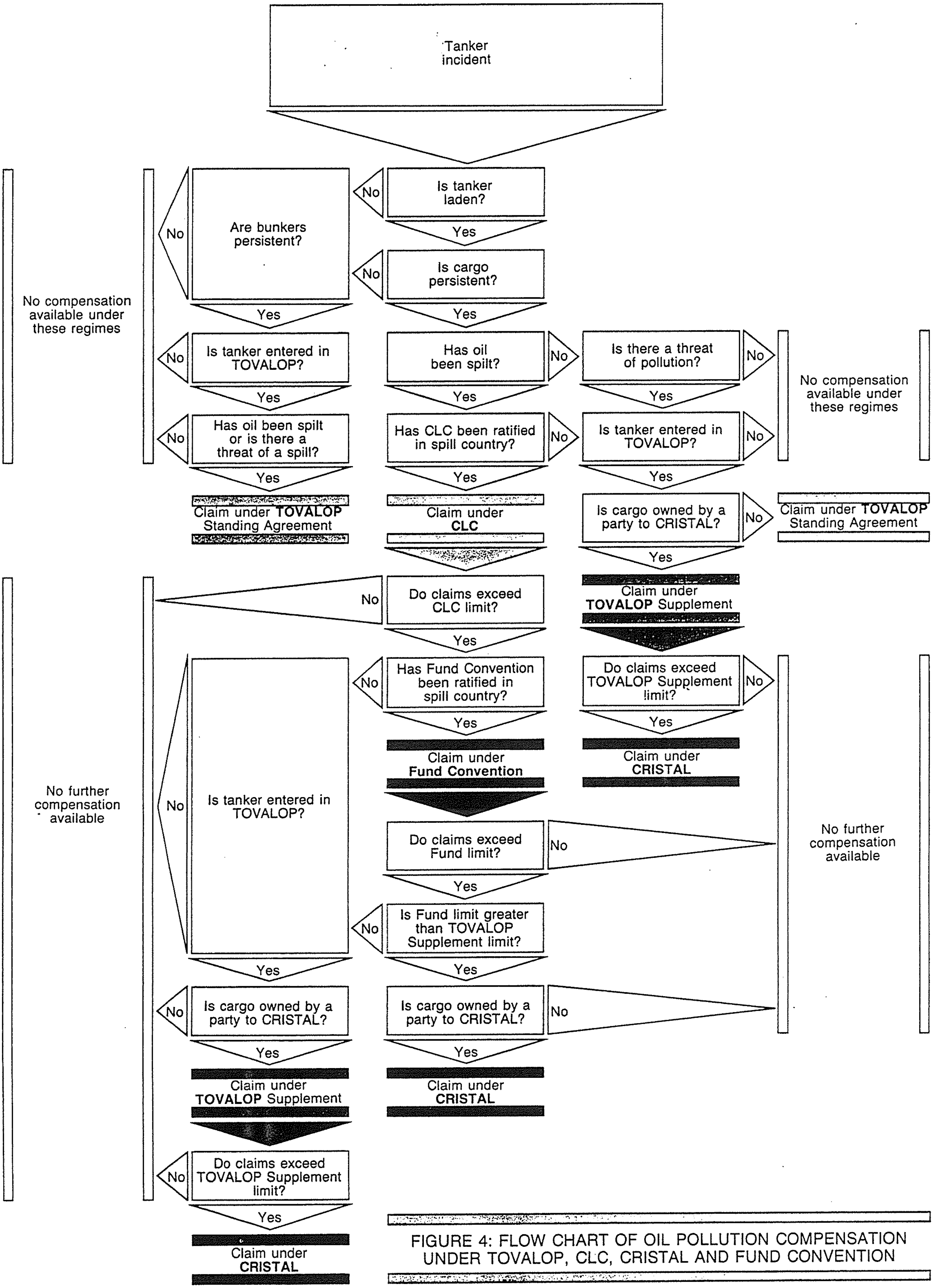

FIGURE 4: FLOW CHART OF OIL POLLUTION COMPENSATION UNDER TOVALOP, CLC, CRISTAL AND FUND CONVENTION

INTERNATIONAL GROUP OF P AND I ASSOCIATIONS - GENERAL EXCESS LOSS REINSURANCE 1970-1991 - OIL POLLUTION LIMIT