NEW FEDERAL OIL SPILL LEGISLATION EXPANDS LIABILITY FOR LENDERS

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During the past few years, a series of federal court decisions have dramatically expanded the liability that lenders may face under the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA or Superfund) for the environmental cleanup costs associated with their borrowers' operations. Financial institutions that hold ship mortgages as collateral for loans to owners or operators of oil tankers, though, have suffered little or no impact from these rulings largely because CERCLA does not apply to oil spills.

As a result of the Oil Pollution Act of 1990 (OPA), lenders with existing loans or contemplating participating in new financing transactions involving onshore or offshore facilities as well as vessels that may operate within 200 miles of the United States will have to consider altering their lending practices in order to minimize their risks from oil pollution incidents. Although OPA considerations are particularly significant when oil tankers are involved, lenders to owners of other types of vessels may also be affected, as illustrated by the recent case of an oil spill resulting from a collision between two barges and an oil tanker in Texas's Galveston Bay.

OPA affects lenders in two ways. First, it places potentially overwhelming financial demands on vessel owners or operators which could affect their ability to repay their loan obligations. Second, because OPA adopted certain liability provisions of CERCLA, lenders may now find themselves directly liable for the cleanup costs and other liabilities associated with oil spills for which their borrowers are responsible.

OPA was originally intended to create uniform federal standards for the transportation of oil that would replace the patchwork of state and federal laws. While the law did modify a number of federal statutes, created new liability and imposed costs on oil transporters, the states remain free to impose their own liability schemes. Thus, vessel owners/ operators and their bankers may find their liability largely defined by the fortuity of where an oil spill takes place.

FEDERAL LIABILITY FOR OIL SPILLS

Prior to the passage of OPA, the two principal federal laws of concern to the shipping industry and its lenders were CERCLA and the federal Clean Water Act ("CWA"). CERCLA only addresses releases of hazardous substances since crude oil and related refined products have been excluded from the definition of hazardous substances, CERCLA does not create liability for the cleanup of oil spills. Instead, the primary federal program for responding to oil spills is section 311 of the CWA[2] which was substantially amended by OPA.

Section 311, as amended by OPA, imposes strict liability on owners or operators ("responsible persons") of a vessel[3] or onshore[4] or offshore facility[5] for discharges or threatened discharges of oil into or upon the territorial waters of the United States or upon land from which the oil is likely to reach surface water. The damages that are recoverable from these responsible parties include containment and cleanup costs of the oil as well as damage for economic loss suffered by third parties (eg loss of tax revenue, lost profits of fishermen, damage to personal or real property) and damage to natural resources.[6]

The definition of responsible persons includes owners and operators and demise charterers in the case of vessels, and owners, lessors and anyone who transfers a right of possession or use to another person, in the case of onshore or offshore facilities. Interestingly, the version of OPA that was passed by the United States House of Representatives had provided that the owners of oil themselves would also be liable but this provision was dropped from OPA as enacted.

The term "facility" has been given a liberal interpretation by the courts so that a spill from a tank car located on a rail-road siding adjacent to an onshore facility which was not owned by the facility was nevertheless deemed to be part of the facility and the facility owner was held responsible for the cleanup.[7]

Prior to OPA, there was some question whether the liability provisions of section 311 were capped by the Limitation of Liability Act of 1851 which limits the liability of a shipowner to the value of its vessel.[8] Thus, if a vessel was severely damaged or sank, the liability of its owner could be less than the maximum liability provided in the CWA. However, OPA expressly provides that the 1851 law shall not limit the liability responsible parties face under federal or state laws.[9]

Section 311 contains several important liability limitations for owners or operators of vessels or facilities which were substantially increased by OPA.[10] The maximum liability limitations are based on the size and nature of the vessel or facility. The liability for responsible parties of vessels was raised from $150 per gross ton to $1,200 per gross ton for each spill with a maximum liability of $10 million for oil tankers of 3,000 or more gross tons while the liability limitation for smaller oil tankers is $2 million. All other vessels (eg dry cargo vessels) face a maximum liability of $600 per gross ton. However, the liability limitations will not apply if the spill is caused by the gross negligence, wilful misconduct or violation of federal operating, construction or safety standards in which case a responsible party will face unlimited liability.

Owners or operators of offshore facilities which are not deepwater ports such as oil platforms are now liable for all cleanup costs plus $75 million per spill while the responsible parties for onshore facilities and deepwater ports are liable for up to $350 million per spill.

Prior to OPA, any costs due the US government constituted a maritime lien on the vessel which could be enforced in an action in rem in any district court where the vessel was located.[11] While this provision was deleted by OPA, it is still possible that the government and third parties may be able to assert a maritime lien that would have priority over a lender's security interest. Under the US Ship Mortgage Act, damages arising out of maritime torts are given preferred maritime lien status with priority over ship mortgages and certain other maritime liens. There is no statutory definition of what constitutes a maritime tort; instead it is an evolving concept of case law. In general, however, a maritime tort is one occuring on navigable waters which has some connection with traditional maritime activities. In adopting OPA, Congress did not indicate whether the strict liability under the statute would also constitute a maritime tort that would be afforded preferred maritime lien status. Thus, this issue will probably have to be resolved on a case-by-case basis by the courts.

The liability limitations do not limit the amount of recovery an owner or operator may obtain from a third party whose acts may have caused or contributed to the discharge nor do they limit the recovery of the United States against such third parties.[12]

There are three defenses to liability that a discharger may assert.[13] A discharger may avoid liability if it can demonstrate that the discharge occurred because of an act of God, an act of war or act of some third person. These defenses may also be raised to seek reimbursement from the $1 billion revolving trust fund established for funding oil cleanups[14] or to assert a recovery claim against a third party.[15]

The third party defense is only available if the third party was the sole cause of the discharge.[16] Thus, it will be available only when the owner or operator is free of any negligence. Since the discharger "must be totally free of fault", the slightest contributory negligence on the part of the discharger will preclude such a defense.[17] This defense will also not be available if the third party was contractually related to the discharger. Examples of such contractual relationship included employees or contractors such as tugboat operators or a firm that designed an ineffective Spill Prevention Control and Countermeasure Plan (SPCC).[18] The most common third party defense that is asserted is for discharges resulting from vandalism. However, in order to prevail, the owner or operator will have to show that it took all reasonable precautions to prevent vandalism. Inadequate security, particularly during a strike, or an ill-conceived SPCC would also deprive the owner or operator of the defense.[19]

OPA also establishes dates when single-hulled vessels that are constructed or put into operation prior to 2015 must be retrofitted with double hulls or retired.[20] The dates are based on the ages of the vessels as well as their tonnage category. If a particular vessel is younger than the age specified on the particular date for its weight class, it can remain in service for either: (1) the maximum age set for that tonnage category of vessel or (2) 2010, whichever occurs first. The significance of the double hull provisions to lenders is not only that the value of their security interest will be impaired by a vessel that must be retrofitted or retired but also that their borrowers will face unlimited liability if they continue to operate vessels failing to conform to the double hull design standards.

LIABILITY OF LENDERS FOR OIL SPILLS

In enacting OPA, Congress adopted the CERCLA concept of imposing strict and joint liability for owners and operators of facilities or vessels. However, OPA does not contain CERCLA's secured creditor exemption which provides that a lender who holds indicia of ownership in a facility or vessel subject to a cleanup will not be liable so long as the lender does not participate in the management of the facility or vessel. Interestingly, the House of Representatives version that was not adopted by Congress contained the CERCLA secured creditor's exemption.

In the absence of this exemption, a court may narrowly read OPA and conclude that the mere holding of a mortgage interest in a vessel is sufficient ownership to trigger liability. Creditors acting as financial owners in leasing transactions would be particularly vulnerable under such a reading since the creditor would literally be the owner of the vessel. However, in all of the cases that have imposed liability on lenders under CERCLA, the lenders have had some threshold of involvement in the management of the facility. Thus, it would appear unlikely that a lender holding a mortgage on an oil tanker would incur liability solely on the basis of its status as a mortgage.

A more likely scenario for imposing liability on a holder of a ship mortgage would be if a lender forecloses and takes title to a vessel that is carrying a cargo of oil which subsequently leaks from the vessel while in the territorial waters of the United States. Many CERCLA cases have concluded rather strongly that a lender who takes title to a secured asset upon foreclosure will be deemed the owner of the collateral regardless of the reason or the length of time it is in the chain of title. However, lenders recently received a ray of hope when a federal court of appeals decision in the 9th Circuit held in *In re Bergsoe Metal Corporation* that a lender who foreclosed in order to protect its security interest should not be liable under CERCLA.[21]

The greatest risk of exposure for a lender, though, is the possibility that it exercises such control over its borrower so that it would be named a responsible party in the event that the borrower had insufficient funds or insurance to pay for the cleanup costs and other liabilities associated with the oil spill. The line between prudent oversight of loans and excessive entanglement in the affairs of a borrower has become exceedingly fine. Indeed, in *U.S. v. Fleet Factors*,[22] a federal court of appeals ruled that a lender could be liable for the cleanup costs of its borrower even when its actions fell below that of an owner or operator if the lender has the mere capability of influencing the borrower's business. However, the *Bergsoe* case mentioned above held that a lender must exercise actual management authority before it can be held liable.

STATE OIL SPILL PROVISIONS

In addition to federal liability, many coastal states have enacted their own oil spill legislation which may have broader liability provisions that the federal statute. Some state oil spill laws hold owners and operators of vessels strictly liable for personal injury as well as for cleanup costs and damages for economic loss and injury to natural resources. Some of these states have also enacted "Superlien" provisions which grant a first priority lien to a state for the amount of cleanup expenditures incurred by the state that may be superior to previously perfected mortgages or security interests. The relative priorities of such state Superliens and preferred mortgages under the US Ship Mortgage Act may well prove to be the source of future litigation. Some Superlien laws contain forfeiture provisions which allow state environmental authorities to take possession of the vessel that caused the discharge. Furthermore, some of these laws allow the states to attach a superpriority lien to all of the personal property and business revenues of the owner or operator located or derived from within the state.

CONCLUSIONS

OPA imposes new potential liabilities and capital and operating costs on the shipping industry which may exceed commercially available insurance and which could jeopardize the financial viability of small or single-vessel companies. In addition, lenders holding ship mortgages may find themselves directly liable for the oil spill liability of their borrowers. In view of these risks, prudent lenders should consider taking the following actions to minimize their direct and indirect liability under OPA.

First, lenders should rigorously apply the traditional classification society and insurance requirements found in existing loan documents. New loan commitments should be conditioned on a demonstration that all vessels owned or operated by the borrower are in compliance with the relevant classification society requirements and recommendations, and that adequate insurance coverage is maintained. Lenders should consider specialist mortgage insurance now available to insure against pollution claims taking priority over ship mortgages.

Second, loan documents should be reviewed and revised if necessary to make sure that they require all covered vessels to meet the various requirements of OPA (eg maintainance of adequate financial responsibility, spill response plans, manning and safety requirements and double hull requirements where applicable).

Finally, lenders might consider requiring environmental audits similar to those required by lenders for financing transactions involving real property in United States. Such an audit would involve an investigation by an independent environmental consultant that would assess the past regulatory and operational history of the vessel and borrower as well as conduct a physical inspection of the vessel. If the borrower owns or operates any onshore or offshore facilities within the territorial jurisdiction of the United States, these facilities should also be examined.

Although an environmental audit requirement would mark a radical departure from present business practice and would result in an unwelcome expense for the borrower, such an audit would serve to alert lenders to potentially troublesome loans and could provide lenders with a defense in the event that they are named as a responsible party for an oil spill that they should not be liable because they did all that was commercially reasonable to ensure that the vessel was in compliance with all applicable standards. □

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2 33 U.S.C. 1251 et seq. Additional federal oil spill provisions are contained in the Trans Alaska Pipeline Authorization Act, 43 U.S.C. 1651 et seq; Deepwater Ports Act of 1974, 33 U.S.C. 1517(c) and the Outer Continental Shelf Lands Act, 43 U.S.C. 1313(b).
3 33 U.S.C. 1321(a)(4). A "vessel" includes any watercraft or artificial contrivance used or capable of being used for water transportation but does not include vessels that are owned or bareboat chartered by the United States, state, political sub-division or sovereign that is not used in commerce.
4 33 U.S.C. 1321(a)(10). An "onshore facility" is any facility located on, in or under any land and includes motor vehicles and rolling stock.
5 33 U.S.C. 1321(a)(11). An "offshore facility" includes any facility that is not a vessel or public vessel which is found in the waters of the United States or any waters subject to the jurisdiction of the United States.
6 OPA, section 1002(b).
7 *Union Petroluem Corporation v. United States*, 651 F.2d 734 (Ct. Cl. 1981).
8 46 U.S.C. 183.
9 OPA, section 1018.
10 33 U.S.C. 1321(f)(1), as amended by OPA section 1004.
11 Id.
12 33 U.S.C. 1321(h).
13 33 U.S.C. 1321(f)(1).
14 33 U.S.C. 1321(i).
15 33 U.S.C. 1321(h).
16 33 U.S.C. 1321(f)(l).
17 *United States v. Bear Marine Services*, 509 F.Supp. 710 (E.D. La. 1980); *Reliance Insurance Co., v. United States*, 677 F.2d 844 (Ct. Cl. 1982).
18 *St. Paul Fire & Marine Insurance Co., v. United States*, 4 Ct. Cl. 762 (Cl. ct. 1984); *United States v. LeBeouf Brothers Towing Co.*, 621 F.2d 787 (5th Cir. 1980).
19 *Union Petroleum Corp. v. United States*, 651 F.2d 734 (Ct. Cl. 1981).
20 OPA, section 4115(a).
21 No. 89-35397 (9th Cir. Aug. 9, 1990).
22 901 F.2d 1550 (11th Cir. 1990).