Section VIII

LIABILITY AND COMPENSATION

Session 2-C—Liability and Compensation

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ABSTRACT: Oil spill cooperatives are generally organized under an agreement that requires a member company to indemnify all other members fully against liability arising from a member company's spill and response actions with cooperative resources. The cooperatives also require the same type of indemnification on the part of nonmembers and third parties.

When a major third-party spill occurs in an area where the cooperative's equipment is required, the cooperative can find itself dealing with representatives of shipping companies who are unable or unwilling to commit to required indemnification. At the same time, it is likely to be in the interest of the cooperative (the oil and gas industry) to ensure an adequate response is made. Reverting to federal response under U.S. Coast Guard direction is an option (Section 311[k] Fund), but not preferred. The Coast Guard has been unwilling or unable to establish contractual arrangements before the fact with cooperatives, thus leading to instances of delayed payments, non-allowable costs, and disputes.

Protection and indemnification (P&I) clubs, which underwrite the liability insurance of the vessels, are accustomed to dealing with marine disasters and have been asked to review the indemnification requirements of Clean Seas, which are similar to those of other industry cooperatives. The clubs are willing to work with the cooperatives' requirements to eliminate an inordinate amount of time in contract negotiations during the early hours or days of a spill and to ensure parties do not have to rely upon a federal response. With the acceptance of these requirements by the clubs, it is hoped shipping companies and representatives will be able to enter into contracts or indemnification agreements with cooperatives with full support from the clubs.

Organization of an oil spill cooperative

Clean Seas is typical of oil spill cooperatives in its organization and the relationships among its members. The cooperative maintains a large inventory of spill response equipment and a limited staff to maintain and operate it. Clean Seas, with a staff of 50, owns or charters three large (130 to 181 ft) oil spill response vessels, which are kept manned and ready 24 hours a day to support the offshore oil industry. These vessels are complemented by equipment positioned at various locations along the coast and stored in a central equipment yard. Each of the other two major cooperatives in California operate a large oil spill response vessel of similar capability and store equipment in a similar manner. The three organizations share the expense of a dedicated DC4 aircraft for dispersant spraying. Throughout the year, each of the cooperatives conducts numerous training sessions to ensure their equipment and staff are fully functional along with personnel supplied by member companies.

The organization has 16 members, all major oil companies or common carrier pipeline companies. Other cooperatives include terminating companies, tanker operators, refineries, and marketing companies. The companies come together as an organization under an operating agreement. In the case of Clean Seas, the agreement is a "tenant in common" membership, so each company has a share of the equity and liabilities of the organization based on its level of participation in the organization. Participation is determined by a formula that combines factors relating to the type and level of activity that increase the risk of oil spills within the cooperative's area of responsibility.

The cooperative has a manager and small full-time staff. The manager reports to an executive committee, which represents the membership as a whole. Various subcommittees, such as those overseeing legal, technical, and accounting activities, assist the executive com-
mittee and manager in developing policy and carrying out responsibilities. When responding to spills of member companies, the manager is generally employed as an advisor to the spill response manager from the company, and the cooperative’s equipment is operated by the staff of the cooperative, contractors, and company personnel. Depending on the situation, the manager may be given much more control over the cleanup operation.

The operating agreements are similar on the subject of liability and indemnification when conducting operations for a member company. Essentially, each participant agrees to fully indemnify all others against any and all losses, injuries, and claims resulting from operations involving that participant. Appendix I is the indemnification article from the Clean Seas Operating Agreement. This article is broad and intended to protect members fully from an action against another.

When dealing with nonmembers, the same philosophy applies. The members are generally willing to lend equipment and resources provided they are fully protected, consistent with the indemnification by member companies.

Most cooperatives have prepared a nonmember spill cleanup agreement for use during nonmember operations. This agreement or contract depicts the terms and conditions under which the cooperative is willing to work. Included are provisions for full indemnification consistent with the operating agreement for member companies. Appendix II is the indemnification clause from the Clean Seas Nonmember Company Oil Spill Cleanup Agreement.

Vessel liability insurance

Protection and indemnity associations (P&I clubs). Liability insurance for vessel owners is traditionally carried by mutual insurance organizations known as protection and indemnity associations or “P&I clubs.” These mutuals, made up largely of shipowning members, were formed in London during the 19th century to provide liability protection for owners when Lloyd’s underwriters and other insurers failed to provide such protection.

Examples of the risks traditionally covered by the P&I clubs are cargo loss and damage; death and injury to longshoremen, crew, and passengers; damages to docks, bridges, and other fixed and floating objects; and part of damages resulting from collisions with other vessels. Since the advent of oil as ships’ fuel and cargo, oil pollution liability has been added to the covered risks. The latter is unique in P&I protection in that it is the only liability for which cover is limited ($400 million).

Liability insurance provided by P&I clubs and similar insurers. The day-to-day operations of a P&I club are carried out by managers or partners employed by the owners for that purpose. Since the cover provided by the clubs is essentially unlimited, a system has been devised to layer and share the risks involved in providing unlimited cover. The operation of this system is administered by the International Group of P&I Clubs, an association formed to represent the common interests of member P&I Clubs and to serve as a vehicle for sharing information.

Compared to most relationships in the insurance industry, the position of the owners and their clubs is somewhat unique. Because the clubs are mutuals and the owners are their members, and because the insurance is in the nature of an indemnity for monies paid out by the owner, the interaction between members and a club when an incident occurs is much closer than is usual between insured and insurers. Furthermore, due to long experience in dealing with casualties on a worldwide basis, the clubs also form a repository of knowledge to which the owners look for guidance in dealing with novel situations.

The shipowner’s position. A shipowner covered by liability insurance from a P&I club must therefore consider the club’s position and advice very seriously when engaging in any action that could affect liability cover. In the absence of specific advice on a particular matter, an owner is expected to react as “a prudent uninsured owner.” Since cover is in the nature of indemnity, the owner usually pays the costs involved in the incident in the first instance. Provided the loss is within cover and in the absence of specific advice from the club the shipowner has behaved as a prudent uninsured, the owner will then be reimbursed or “indemnified” by the insuring club.

The problem when a shipowner is faced with indemnity requirements of a cooperative

When an owner is presented with a contractual indemnification requirement, such as that in the standard Clean Seas agreement, a primary concern is the reaction of the P&I club to provisions involving this somewhat novel extension of liabilities. Since the owner is expected to act as a prudent uninsured, the owner may very well not be indemnified for liabilities incurred under such an indemnification agreement should the club deem that the owner was not prudent in entering into it.

The solution of that problem in a recent incident

Following a recent collision and sinking of a large merchant vessel off the U.S. west coast, Clean Seas responded to a major spill of bunkers resulting from the casualty. Possessing the only offshore spill response capability in the area, Clean Seas was verbally authorized by owners to continue with the response. A nonmember contract, containing an indemnification agreement similar to that of Appendix II, was provided to the owner so that the agreement could be reduced to writing. However, after several days of negotiations, the owner refused to sign the contract because he was wary of the indemnification clause.

Since Clean Seas was reluctant to continue to work without a written contract, the Coast Guard interceded by initiating steps to place the spill under federal control, and took over direction of the response again. After some time in this posture, negotiations between owners and the cooperative on the contract were reopened and, with the owner’s agreement to periodically forward monies covering demonstrated expenditures by the cooperative, Clean Seas agreed to resume work for the owner.

Negotiations on the contract continued as the response effort went forward to a successful conclusion. While the cooperative did agree to modify their indemnity requirements to relieve owners from liability stemming from conduct amounting to gross negligence or willful misconduct on the part of Clean Seas, no contract was ever signed by owners. Although losses of the kind anticipated by the indemnity clause did not occur, the Clean Seas executive committee determined that it would refuse to work for a nonmember spiller in the future rather than risk repetition of this situation.

In an attempt to resolve this problem, the proposed indemnity clause was submitted to a subcommittee of the International Group of P&I Clubs in London for their review. It was felt that approval by the group would serve to remove potential objections on the part of shipowners on this score and enable Clean Seas to work directly for them in the future.

As of the date of this paper, the proposed clause continues to be reviewed, with the only remaining point of discussion being a dollar limit on liability.

Conclusions

Contractual difficulties, such as those encountered during this response, constitute a serious management distraction that can threaten the success of a response. Facing and solving these problems in advance should prove mutually beneficial to all parties and ensure unhindered response in the future.

Appendix I. Indemnification information from Clean Seas agreement

Article VIII
Indemnities and Insurance

A. Indemnity for use of equipment and material. Participants using equipment and material owned or leased jointly by the Participants shall exercise due care and diligence in the care and protection
of such equipment and material. Such equipment and material shall be returned in the same serviceable condition as when called into service, ordinary wear and tear excepted. Equipment and material consumed, lost or damaged shall be, at the option of the Participants, repaired or replaced by the using Participant(s) or the replacement cost thereof shall be paid by the using Participant(s) into the treasury of Clean Seas for the credit of all Participants.

B. Indemnity for injury or property loss. Each Participant shall indemnify, defend and save harmless the other Participants, their affiliates, agents and employees ("Indemnitees"), from and against any and all loss, damage, injury, liability and claims thereof for injury to or death of any person, including any employee of the Participant or an Indemnitee, or for loss of damage to property, including property of the Participant or Indemnitees, resulting directly or indirectly from such Participant initiating operations hereunder, including, but not limited to, the use of such Participant or its affiliate or designee or equipment, material or personnel provided by such Participant, the Indemnitees or others, regardless of the negligence of, and regardless of whether liability without fault is imposed or sought to be imposed on, one or more of the Indemnitees, except where such loss, damage, injury, liability or claim is the result of active negligence or willful misconduct of an Indemnitee and is not contributed to by any act of, or by any omission to perform some duty imposed by law or contract on such Participant or its agent or employee. A Participant shall promptly pay to any Indemnitee all costs and attorneys' fees incurred by such Indemnitee resulting directly or indirectly from any and all loss, damage, injury, liability and claims for which the Participant is obligated to indemnify such Indemnitee.

C. Nonparticipant indemnity form. Indemnities in a form to be agreed to by the Representatives shall be obtained from each non-participant to whom equipment or material belonging to the Participants is furnished or to whom services are furnished, unless waived by the Executive Committee.

D. Insurance. The Representatives shall arrange for insurance in forms and types, and with companies and in amounts which the Representatives deem necessary to protect the Participants.

Appendix II. Non-member contract indemnification clause

Non-Member agrees to indemnify, defend and hold Clean Seas, each of its members, its employees, and agents harmless from and against any and all claims, demands, actions, causes of action, losses or liabilities for injury to or death of persons, or for damage to or destruction of real or personal property, or for civil penalty (but not criminal penalty) including injury to or death of any personnel furnished by Clean Seas or Non-Member or of any other persons, and including damage to or destruction of property of Clean Seas, Non-Member or third parties, arising out of or in any way connected with Clean Seas' performance of this agreement. Such indemnification shall include such injury, death, damage or destruction as may be caused, directly or indirectly, solely or contributorily by the active as well as passive negligence of Clean Seas, its employees, agents, members or independent contractors, and shall include, but shall not be limited to, any claim, demand, action, cause of action, loss or liability arising out of the use or nonuse, transporting and handling of any equipment, materials or personnel furnished by Clean Seas, Non-Member or any other persons, or the termination of performance as provided in this agreement. In the event any claim is asserted or action instituted against Clean Seas, its members, employees or agents to which this indemnity applies, Non-Member shall immediately upon receipt of notice of such claim or action assume and pay for the defense of the indemnified party, and shall satisfy any judgment against the indemnified party that may be rendered. In the event of damage to or destruction of property of Clean Seas, Non-Member shall forthwith restore or replace such property, or at Clean Seas' option shall pay to Clean Seas the replacement value of such property.