MANAGING OIL SPILL LIABILITY RISKS

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ABSTRACT

Possibly the most costly mistake for companies that transport petroleum and chemicals is the failure to fully understand potential liability for an oil spill. A company that does not understand its legal position may respond to an incident that is not its responsibility, or fail to respond to an incident that is. It may wrongly assume that international conventions (such as the CLC 92) apply, and fail to protect against the liability it will bear if they do not. This failure to understand and manage liability risks has created notorious oil spill headlines in recent months, as companies and corporate officers find themselves prosecuted for actions they thought were innocent – or even helpful – and under laws they never expected to apply.

This paper will consider, through concrete examples provided by oil spill lawyers from all over the world, how this legal liability can arise and particularly how parties who do not expect to be responsible for a spill can become so through well-meaning actions and incomplete understanding of international conventions. This paper will then suggest a variety of practical steps companies can take to manage the risk, including: vetting, contingency planning for non-shipowners, tabletop exercises, liability analyses, and education within the corporate structure.

The oil industry is extremely sensitive to, and well educated about, oil spill risks. Vast amounts of time, effort and money are invested in the prevention of spills and in the development of fair and orderly systems for remediation of those spills that occur. Nonetheless, in the field of oil spill *liability* certain myths persist: the myth that oil spill liability generally is strict and limited; the myth that the risk is largely financial and therefore easily insured against; and, among those not owning or operating ships, the myth that oil spill liability risk is largely uncontrollable. This paper examines those myths and sets out the basic elements of an oil spill liability risk management plan.

MYTH: CLC 92 MAKES SPILL LIABILITY STRICT AND LIMITED

The best-known "rule" of oil spill liability is the strict, limited liability provided for in the International Convention on Civil Liability for Oil Pollution Damage and its Protocol of 1992 (collectively here, "CLC 92"). Under the CLC 92, the vessel owner generally is strictly liable, up to certain financial limits, for oil pollution damage caused by certain kinds of spills.

However, through use and familiarity this legal regime has been reduced to a "rule of thumb" in the minds of many corporate decision makers. This rule of thumb tends to be expressed as, "only vessel owners are liable, and that liability is always limited." Based on this rule of thumb, vessel owners proceed as if all spill liability will be limited; perhaps more importantly, other oil interests – charterers, cargo owners, and investors – proceed as if they will not face any spill liability at all. Executives and other decision makers with broad responsibilities tend to be particularly vulnerable to this over-simplification, perhaps because of the speed at which global operations are growing. The rule of thumb followed is, of course, inaccurate: law and fact demonstrate that in some locations and spill situations, vessel owners and oil interests may face unlimited liability as corporate entities and as individuals.

As a threshold matter, the CLC 92 is not ratified by all coastal nations, nor is there uniformity among the nations that have ratified it. Thailand and the United States, for instance, have never signed or ratified the CLC 92: local law – including, in the United States, state law – will apply to spills in these jurisdictions. Several countries, such as Brazil, Guatemala and Libya, have ratified the original Convention of 1969 but not the Protocol of 1992. More significantly, China, Egypt, Indonesia and others have ratified the CLC 92 but not the Fund conventions: in the event of a catastrophic spill causing damage in excess of the vessel owner's limited liability, injured parties in these jurisdictions might well seek compensation from other oil interests.

Even governments that have signed the CLC 92, with the benefit of a Fund, may choose not to apply it when confronted with a significant spill. We have consulted with legal experts in Algeria, Colombia and other countries who indicate that they expect those governments to apply local law when faced with an oil spill. The January 2008 French decision in the *Erika* litigation deserves particular mention here, as in that trial defendant Total argued, unsuccessfully, that international oil pollution conventions should have precluded charges under local French pollution law (Total has since appealed). Finally, it must be noted that instability and changing governments create uncertainty as to how a government or court will react to a spill: we understand that such is the case in, for instance, Somalia and Eritrea. This uncertainty will become more significant as exploration and production increasingly focuses on unstable regions.

Through this discussion we see that companies with global operations must consider the legal status of the CLC 92, as well as the "political risk" affecting its enforcement, in every jurisdiction their products will traverse. They also must consider whether the CLC 92 will apply at all. Although the CLC 92's relatively long history of enforceability contributes to its image as "the" oil spill

liability rule, it is just one of several international conventions designed to work together to cover all spills and spill damages.

The CLC 92 itself applies only to spills of persistent oil. Therefore, the increasing global trade in nonpersistent products, such as gasoline, does not fall within the CLC 92. Spills of nonpersistent products – as well as chemicals, liquefied natural gas and other products – should in theory be covered by a parallel system of liability channeling and Fund coverage set up in the International Convention on Liability and Compensation for Damage in Connection with the Carriage of Hazardous and Noxious Substances by Sea ("HNS Convention"). Bunker fuel spills from vessels carrying these products should be covered by the International Convention on Civil Liability for Bunker Oil Pollution Damage ("Bunker Convention"). However, at this writing the HNS Convention and Bunker Convention lack sufficient signatures to come into force, and therefore local law will apply to spills of nonpersistent oil and to bunker spills from vessels carrying nonpersistent oil.

Other than the CLC 92, one liability limiting convention is in force and could apply to oil spills: the Convention on Limitation of Liability for Maritime Claims ("LLMC"). Under the LLMC, the shipowner – defined to include the "charterer" – is entitled to limit his liability for claims in respect to loss of life, personal injury, or damage to property occurring in direct connection with operation of the ship, explicitly excluding any claims for oil pollution damage falling within the CLC 92. Although when read literally the LLMC could limit liability for pollution damage caused by nonpersistent oil spills, legal experts in various jurisdictions differ as to whether the LLMC should be read to cover any oil pollution damage.

We see, therefore, that liability for a nonpersistent oil spill from a tank ship, or a bunker spill from such a ship, will not be channeled or limited by international convention – with the possible exception of the LLMC – but will be subject to local law. Although nonpersistent spills are likely to dissipate more quickly than persistent spills, lessening the problems of oiled beaches, boats, and animals, these spills may still be treated as pollution by local law. Several jurisdictions impose fines on the spill of any pollutant into water, regardless of whether environmental damage occurs, and most will require spill reporting and response measures. In addition, the increasing number of oil cargos that contain chemical additives, and the increasing ability to measure and track the impact of chemicals on the environment, makes a finding of environmental harm more likely than in the past.

Together, these issues create a large category of spills subject to the local law of the place where the pollution occurs. Identifying the risks posed by that local law may be straightforward or quite complicated, depending on the location. We have had the opportunity to work with lawyers in over eighty different countries to understand how their pollution laws may affect various oil interests. Many countries have very sophisticated pollution liability regimes, which may be straightforward or complex; in other countries the law is less well developed, often because oil traffic is new, uncommon, or controlled by the state. In both cases a local lawyer can provide a practical analysis of liability exposure. In the next two sections of this paper, we identify additional oil spill liability myths and facts we have discovered through our work with these local lawyers.

MYTH: CRIMINAL PENALTIES ARE MINOR OR UNLIKELY TO APPLY

The focus of the international spill liability conventions, and of most liability risk management, is civil damages: that is, the cost of spill cleanup and of compensation to those harmed by the spill. Certainly, the possibility of large financial payments by those involved in the oil trade is a risk worth analyzing and managing. Monetary damages are not the only risk that oil interests should consider, however: criminal penalties, both personal and corporate, are increasingly employed to combat pollution.

The criminalization of seafarers is a topic much written about and of vital importance to the industry. However, the criminalization of corporations and corporate officers also is on the rise. Most local laws allow for criminal fines against the corporation, and we understand from local counsel that the laws of Canada, Guatemala, India and others allow imprisonment of responsible corporate officers. Additionally, some jurisdictions seem inclined to hold individual officers personally liable for penalties incurred by the corporation.

In some circumstances prison may also be a real concern: at one point early in the *Erika* proceedings, Total was instructed by the magistrate to nominate a corporate officer who would go to prison should the company violate certain operational restrictions (the requirement was later dropped). More recently, senior officers of a Dutch oil trading company were imprisoned for over five months in the Ivory Coast after journeying there to help response to pollution attributed to the alleged dumping of poisonous chemicals from a ship they chartered, despite evidence that they had no involvement in, prior knowledge of or even warning of the illegal activity.

The ability to apply criminal penalties should not be ignored simply because the potentially liable corporation is based overseas. A government may seek to seize assets or otherwise recover unpaid criminal fines; it may make business in that country impossible for the convicted entity, whether by law – as provided for in, for instance, Brazil – or in the day-to-day details that cannot be accomplished without government goodwill. And of course, criminal penalties damage the company's public image, and adversely affect business in a variety of ways.

MYTH: LIABILITY RISK IS NEGLIGIBLE FOR NON-SHIPOWNERS AND NON-OPERATORS

Vessel owners and operators may be aware of the risks set out above and take steps to mitigate them, ranging from physical maintenance and crew training to increased insurance and legal protections. However, vessel time and voyage charterers, cargo owners and other oil interests traditionally have considered spill liability risk minor or outside their sphere of concern. This is not an illogical conclusion given that, even where the CLC 92 does not channel strict liability to the vessel owner, one would expect liability to be based on causation. As these entities have no control over vessel navigation, crewing, maintenance or operation, they would seem unable to "cause" a spill or to fall within the CLC 92 exceptions for negligence.

However, strict or explicit liability does in fact exist in various locations for cargo owners, charterers, "transporters," "senders," "importers," and others. Several jurisdictions hold these entities strictly liable under local law, and many others name them as entities that could be considered to cause a spill. Moreover, many governments have signaled their willingness to take a broad view of "causation" or wrongdoing. Causation may include traditional grounds for liability such as the nomination of an unsafe port, the inadequate selection or supervision of an employee, or inappropriately controlling involvement in vessel operations. It also may include decisions made during the vessel vetting, as was the case for Total SA in the *Erika* litigation; such decisions likewise were the basis for criminal charges against charterer and cargo owner Petron after the *Solar I* spill in the Philippines. Oil interests may therefore find themselves deemed the "cause" of a spill by dint of their involvement in the commercial underpinnings of the voyage.

Moreover, such a finding could, in theory, fall within the "negligence and wrongdoing" exception usually attached to any statute

limiting liability, and thereby nullify the limitation. For example, as of this writing authorities are understood to be carefully evaluating the possibility that gross negligence was at the root of the 2007 *Cosco Busan* spill in San Francisco Bay. Cleanup costs associated with that incident are expected to significantly exceed the vessel owner's liability limits under the U.S. Oil Pollution Act of 1990, but a finding that the spill was caused by gross negligence could lift those limits.

MYTH: SPILL LIABILITY RISK CANNOT BE MANAGED BY NON-SHIPOWNERS

While some spills arguably are unavoidable, many can be prevented through proper maintenance, experienced masters, well-trained crews, and good operational practices. In large part these are the domain of shipowners and operators, and for the purposes of this paper we leave the many technical details to experts in those areas. However, even investors, vessel charterers and cargo owners may take steps to avoid involvement with ships that pose a spill risk.

Ordering a physical inspection is one such step, although non-operators must take care to refrain from interfering in the ship's maintenance. Physical inspection is not always possible for charterers and cargo owners, however, and companies should create internal policies as to the circumstances in which they will require such an inspection. A vigorous virtual vetting is a good alternative in many cases, as it will provide information on the quality of the ship and operating company. Corporate vetting programs should consider age limits, double hull requirements, and other internal standards to avoid hiring riskier vessels. Compliance with these internal guidelines is important, however, as failure to do so will provide evidence against the company should the issue go to trial.

Oil spill contingency plans and oil spill training exercises are required for certain shipowners and operators, but their use is good practice for all oil interests. Every entity involved in the transport of oil should have an emergency plan in place, tailored to its likely role. The plan should include procedures for notifying designated decision makers within the company, and may also address appropriate public statements. The plan-holder should consider whether it will be in a position to offer assistance in the event of a spill, and what form that assistance should take. To the extent any oil interest is able to encourage or participate in regional or international spill response planning it should assist the government in these efforts, which will benefit all parties in the event of a spill.

All emergency plans should be exercised regularly, and those personnel likely to be involved should receive training in oil spill risks, liability issues, and even public relations management. Although physical drills are unnecessary for those not owning or operating vessels, tabletop drills and other virtual exercises are important for all oil interests. Such exercises should be taken just as seriously as required spill drills. During the chaos of an actual spill, cargo interests or other parties not legally responsible may nonetheless feel compelled to involve themselves in spill response efforts, sometimes creating liability where none would otherwise exist. Practicing spill scenarios through drills and exercises helps well-meaning employees avoid such mistakes.

From a legal standpoint, the extension of avoiding a spill is avoiding a spill in a jurisdiction where liability exposure is great. Oil interests should analyze the kind and likelihood of liability for a spill not only in the ports they frequent but in the jurisdictions through which the ship will pass. This information will allow for appropriate preparedness measures, including additional insurance, and may also prompt decisions as to which jurisdictions are "too risky" in terms of liability. Acquiring this information often will involve the retention of local counsel; such counsel should also be able to represent the company in the event of a spill. Quick access to local counsel can be invaluable in the event of a spill, ensuring the receipt of good intelligence about the spill and the response, and managing popular or official attitudes toward the incident.

The need to conduct a jurisdiction-by-jurisdiction review of oil spill liability exposure and response requirements is due in part to the incomplete international spill liability regime discussed above. Some of the uncertainty and inconsistency of application described in this paper would be alleviated were the complete "suite" put in place. Together the international spill conventions described above – the CLC 92, HNS and Bunker Conventions – would, when widely in force, shift many spill liability discussions away from unpredictable local laws and toward a more uniform and predictable liability regime. To the extent they are able, therefore, oil interests would be wise to promote the ratification and enforcement of these conventions.

CONCLUSION

As set out above, international oil spill liability risks are more complex, and less clear, than usually assumed by corporate decision makers. Oil interests other than the vessel owner or operator may be liable for spills, and for all parties liability may be local and unlimited. Prison, as well as fines and damages, may threaten. However, all oil interests may take concrete steps to ensure the availability of liability risk management information before the ship ever enters a given country's waters. Moreover, every party can and should take steps to prepare for oil spills and thereby mitigate the risks.

BIOGRAPHY

Peter Rodgers leads the Energy and Environmental Practice Group at Sutherland Asbill & Brennan in Washington, D.C. He and associates Susan Grymes and Rebecca Day help clients evaluate and minimize the risks associated with movement of oil and petroleum products. Working with local counsel in over fifty different countries, Sutherland's spill risk management team assists national oil companies, refiners, and traders in understanding their legal responsibilities. The team also counsels clients in the development of vessel vetting programs, emergency response plans, and other risk management tools for cargo owners, vessel charterers, and other oil interests.