

Ten years on

Heinz Gohlish provides an overview of the circumstances surrounding the introduction of Certificates of Financial Responsibility (COFR) and the service providers currently serving the market

The Problem

In the thirty-five years since the Torrey Canyon spill off the Scilly Isles in the UK, few areas of tanker operations have changed as much as the provision of liability insurance. Considering the many fundamental changes to which tanker operators have needed to adapt in recent times, this is a significant statement. Further, these changes are not just in the cost structures of the insurance programme but they also affect the very core of insurance principles and the means by which liability insurance is provided. These can be broadly grouped under four headings.

Three of the headings were covered in earlier editions of Tanker Operator. These were P&I insurance, including the provision of high-level reinsurance; legislative aspects, including developments in international conventions (CLC) and IMO involvement; and the special US Oil Pollution Surcharges pursuant to OPA 90. A fourth component of the liability structure is the provision of financial guarantees in case of an accident in US waters, i.e. the provision of a Certificate of Financial Responsibility (COFR) to meet the requirements of the US Coast Guard (USCG). The OPA 90 provisions and resultant COFR are only required for US trade, recognising the fact that America has the most stringent and wide-ranging marine pollution laws in the world. It is also a two-tier liability regime where individual States have considerable additional powers which are used with impunity if not always with consistency. The total liability equation for international tanker trade, including the USA, is therefore P&I plus CLC plus OPA-90 plus COFR equals, what? "Happiness," Mr Micawber might have said, but it is not that simple for tanker operators. In addition to the considerable cost associated with achieving full compliance with US legal requirements, there is also an interminable paper chase.

OPA 90 was itself a further development of the Water Quality Improvement Act of 1970 which created the original COFR system. The Act introduced the provision of strict liability. However, shipowners were liable only to the extent that the spill was intentional or they were grossly negligent. The P&I Clubs could live with that.

Traditionally, P&I cover and, where necessary, P&I letters were considered adequate proof of financial responsibility by way of insurance. The Clubs however, distanced themselves from extending such guarantees under OPA 90 due to the tougher strict liability provisions, the possibility of direct action against the insurer and the lack of pre-emptive effect whereby individual states can further penalise the shipowner in addition to federal legislation.

The Solution

USCG, charged with the responsibility of enforcing the far more onerous OPA 90 provisions, has deemed four sources to be an acceptable means of complying with their guarantee requirements: a surety bond, a financial guarantee, self insurance and a specialist guarantor. The first three require adequate assets in the US and are therefore not a viable solution for most international shipowners (see Table 1). In addition, the required guarantees apply equally to all shipowners, whether a state fleet, a highly reputable and asset-rich corporate operator or a singleton with a dubious ownership structure.

Therefore the fourth solution, Certificates of Financial Responsibilities as we now know them, were extended in the early 1990s as a direct response to the enhanced requirements under OPA 90 for shipowners to furnish proof of adequate funding within US jurisdiction for strict liability oil pollution claims in US waters.

As a result, specialist providers of guarantees emerged in response to the need to break the P&I Club/OPA 90 deadlock. These providers had one purpose only - to provide the funding on a guaranteed basis for USA oil pollution claims - either federal or state - wherever the Clubs might pull out due to invocation of their own Rules. The likely scenarios for this were threefold: non-payment (or late payment) of premiums to the Club, strict liability with no defence under CLC nor the ability to limit liability and direct action by USCG against the insurer due to the demise of the shipowner or inadequate assets held by the shipowner.

The OPA 90 formula generated a maximum liability of about \$395m although individual state claims may sit on top of that. (In 1970, the maximum compensation amount was \$14m, or about \$60m in present value.) All this is well within the P&I Clubs' limits of cover and would not be a problem under normal circumstances. Yet shipowners and, in particular tanker owners, are required to pay an additional premium for the express purpose of covering a situation where the P&I Club declines to assist. This adds not insignificant costs for tankers trading regularly to the US. The one mitigating factor is that these costs are factored into World Scale and may therefore be passed to charterers to the extent that market conditions allow.

The Cover

The provision of COFR certificates has since become a small sub-industry within the marine insurance market. Providers quickly emerged post-OPA 90 to position themselves to capture the leading share of this new niche. The P&I Clubs assisted this development by cooperating with the administration of the various schemes and were quite happy to work with the COFR providers. This certainly took the heat off the clubs but, of course, the shipowner paid.

Although the relevance is only within the narrowly defined circumstances of the Club declining to cover the pollution incident by proper application of its own Rules, the actual cover is quite wide. This includes removal costs and expenses as required by both federal and state laws, costs incurred due to avoiding or mitigating further damage, legal costs related to CERCLA (Comprehensive Environmental Response, Compensation and Liability - for hazardous substance cleanup and resource damage), approved miscellaneous costs, administrative penalties and defence costs. The cover also includes an element of spill management.

The COFR guarantees do not cover wilful misconduct or contractual obligations not required by law or punitive damages other than a limited form of administrative penalties noted above. Otherwise the normal insurance provisos with respect to war, nuclear incidents, specialist operations, subrogation, policy interest and time bars also apply.

The Guarantors

Among tanker operators, the majority have opted for the 'insurance' route. Of 6,547 tankers and tank barges covered, the breakdown is as shown in Table 1.

The 'Tanker' category covers a wide spectrum: crude, products, chemical, gas and combined. It is clear that relatively few international tanker operators have the resources to obtain US-based guarantees and therefore the more costly insurance route is the only option available. The tank barges are primarily US-flagged 'brown water' vessels and hence the greater proclivity for domestic solutions.

For deepsea tanker operators there are three principal guarantors. Another four guarantors are primarily concerned with tank barges. There are a further twelve guarantors worldwide specialising in various non-tanker craft. Some specialise in a specific vessel type. The main providers relevant to tankers and tank barges are as shown in Tables 2 and 3.

Of the main providers for tanker operators, WQIS is a New York-based guarantor acting as a Syndicate for other American insurers; SigCo is a fixed-cost non-assessable programme backed by three major P&I Clubs; Shoreline is a Bermuda-

based mutual guarantor, with supplementary calls estimated at nil, underwritten by Centre Re of Bermuda; and Arvak is a Bermuda-based guarantor formerly a joint venture between a broker and a P&I club but now managed separately by Shoreline.

The Result

Finally, with all this activity over the course of the last decade, from the sound and fury of the original OPA 90 legislation to the relative calm of the current procedures, what has been the overall result? The surprising answer is that not a single claim has been made on any guarantor. The guarantors have therefore been able to build up a reasonable reserve and premium levels have been falling.

But considerable good has come out of all this. First, and probably most importantly, pollution claims in America have reduced noticeably, from about 400 in 1989 to about 240 twelve years later (according to WQIS figures). Secondly, despite initial misgivings, marine pollution incidents in US waters have been covered by local insurers or P&I Clubs in the intended manner, thereby obviating the need for a guarantor. Thirdly, the collective mind of the international marine insurance industry has been duly concentrated and a workable, albeit complicated, solution has emerged.

The principal downside to the tanker owner is cost and administration. Perhaps these are issues the insurance market will address in light of the continuing increases in liability premiums.

Table 1 - Guarantee Types (by number of vessels)

<u>Method</u>	<u>Tanker</u>	<u>Tank Barge</u>	<u>Percentage</u>
Insurance	2135	1790	85.0/44.5
Financial Guaranty	357	1452	14.0/36.0
Self-Insurance	13	728	0.5/18.0
Surety Bond	21	51	0.5/1.5
Total	2526	4021	

Source: US Coast Guard, March 31, 2002

Table 2 Guarantee Providers (by number of vessels)

<u>Insurer</u>	<u>Tanker</u>	<u>Tank Barge</u>	<u>Percentage</u>
SigCo	1344	47	63/2.6
Shoreline	671	4	31.5/0.2
Arvak	93	34	4.4/1.9
WQIS	15	853	0.6/47.6
Lloyd's	7	663	0.3/37
Great American	1	187	- /10.5
Total	2131*	1788**	

*Four vessels covered elsewhere ** two vessels covered elsewhere

Source: US Coast Guard, March 31, 2002

Table 3 Guarantee Providers (Tankers only, by GT)

<u>Insurer</u>	<u>Tanker</u>	<u>Percentage</u>
SigCo	64,631,076	67.5
Shoreline	26,724,644	27.9
Arvak	4,203,200	04.4
Total	95,558,920*	99.8

*173,650 GT covered by 5 other providers

Source: US Coast Guard, March 31, 2002

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