Maritime

Alert

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Oil Pollution Act Of 1990 – New Limitations On Lessor Liability

Nancy L. Hengen
Svein Christoffersen

The risk of oil pollution liability for financial lessors under the Oil Pollution Act of 1990 (OPA 90), 33 U.S.C. §2701 et seq., has been substantially ameliorated under new U.S. legislation, thereby restoring leasing as a more lessor-friendly financing option for vessels that trade in U.S. waters.

The Coast Guard and Maritime Transportation Act of 2004 (the New Act) became law on August 9, 2004. Section 703 of the New Act amends OPA 90 to provide for exemption from liability of certain financing lessors. The New Act imports into OPA 90 the terms of the so-called "Secured Creditor Exemption" found in the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA), 47 U.S.C. §9601.

A ship financing lease is normally based on a demise charter (the maritime equivalent of a triple net lease) from the lessor to the demise charterer, who is thereby the lessee and operator of the vessel. The demise charter usually shifts all vessel maintenance, repair and other operational responsibility to the lessee/demise charterer. The lessor retains legal title, status as documented vessel owner and, depending on lease structure, the residual value of the vessel at the end of the lease term.

Original OPA 90

The original text of OPA 90 provides that each "responsible party" is liable for all damages in connection with an oil pollution incident. In the original OPA 90 text, "responsible party" is defined as any entity owning, operating or demise chartering a vessel. Under OPA 90 as originally adopted, a passive financial institution lessor holding title to a vessel had a significant risk of joint and several liability with the operator and the demise charterer for all pollution damages that occurred in U.S. waters.

The likelihood of liability of a passive financial lessor was greatly increased by the various cases involving the tug M/V EMILY S in which MetLife Capital Corporation, a lessor, was held to be an "owner" under OPA 90. In those cases, the court held that the entity that was the legal title holder and documented owner of a U.S. flag vessel was an "owner" and therefore a "responsible party" under OPA 90.

Of course, the lease documentation always could provide that between the lessor on one hand and the operator and/or demise charterer on the other hand, the lessor was protected by a full operational indemnity provided by the demise charterer and/or operator. Such an operational indemnity would certainly give comfort to a lessor but only to the extent the indemnitor had sufficient assets, including insurance, to pay damages in connection with a pollution event. Many potential lessors stopped doing vessel lease transactions for vessels that operated in U.S. waters, simply because those potential lessors were not willing to entertain the risk of pollution liability if the demise charterer and/or operator were bankrupt and insurances were unavailable or insufficient.

The OPA 90 Amendment

Section 703 of the New Act amends OPA 90 by redefining "owner" to exclude passive financing entities who are lessors in vessel lease financing transactions. Section 703 of the New Act accomplishes this by both parroting certain CERCLA text and incorporating by cross reference some relevant definitions and other provisions in CERCLA, thereby making the definition of "owner" the same under both OPA 90 and CERCLA. Section 703(a)(26)(B)(ii) of the New Act states that owner or operator does *not* include a lender "that holds indicia of ownership primarily to protect the security interest of the person in the vessel ..." This principle is taken from, and conforms with, CERCLA.

The CERCLA Secured Creditor Exemption

There are two points in the definition of "owner and operator" in CERCLA, now incorporated in OPA 90 by the New Act, that are particularly relevant to lease structures.

The first of these is whether a lessor is a "lender" within the meaning of CERCLA. This is answered by CERCLA in the affirmative – the term "lender" includes passive financial lessors. Under CERCLA, specifically included in the definition of "lender," are entities not only affiliated with banks but also leasing companies and any person "that makes a *bona fide* extension of credit to ... a non-affiliated person." These definitions are broad enough to encompass most financial lessors, whether or not such lessors are affiliated with banks.

The second issue raised by the Secured Creditor Exemption text in CERCLA is whether a lessor holds "indicia of ownership [*e.g.* title] primarily to protect the security interest" of the lessor in the vessel. This issue is not answered quite so clearly as the first, but a broadly affirmative view seems more in keeping with the purpose of the Secured Creditor Exemption. The legislative history of the 1996 amendments to CERCLA, which enacted the CERCLA Secured Creditor Exemption, and case law suggest that a passive financial lessor who holds legal title for multiple reasons, including in order to achieve the parties' desired tax and accounting treatment, may nevertheless enjoy the Secured Creditor Exemption if at least one of the reasons it holds legal title is to protect its security interest. The statutory text of the 1996 CERCLA amendment specifically includes within the definition of "lender" an entity that holds title "in connection with a lease financing transaction." The legislative history has a useful example of a typical lease situation. It stated that a financial institution that held title but "also received tax benefits as a result of holding title would not be an "owner" for liability purposes." The 1996 CERCLA amendment also defines "security interest" to include a "lease and any other right accruing to a person to secure the repayment of money, the performance of a duty or any other obligation by a non-affiliated person" (42 U.S.C. §9601(20)(G)(vi)).

No Participation in Management or Operations

One important caveat is that the Secured Creditor Exemption covers only lessors who do not participate in management or operations. Under the 1996 CERCLA amendment and Section 703 of the New Act, the existence of, inter alia, financial covenants, environmental compliance covenants and the normal lease remedies does not constitute participating in management or operations. However, lessors should exercise care prior to taking any active role, whether before or after default.

Conclusion

The 1996 CERCLA amendment, now incorporated into OPA 90 by the New Act, provides a broad passive financial lessor exemption to pollution liability. Since the passage of the 1996 CERCLA amendment, there has not been extensive litigation with respect to the CERCLA Secured Creditor Exemption. The absence of litigation should be interpreted as a very positive sign for the vessel leasing industry by taking the issue of passive financial lessor pollution liability off the table. The few cases that have considered the Secured Creditor Exemption in the context of CERCLA since the 1996 CERCLA amendment confirm this view.

Section 703 of the New Act should provide incentive for passive financing lessors to look again at vessel lease financing. Because of other substantive provisions in OPA 90 that are forcing the mandated phase-out of single hull vessels, lease financing should prove to be an increasingly attractive mechanism for financing replacement double hull tonnage.

For more information, contact any of the following Holland & Knight attorneys via e-mail or by calling toll free, 1-888-688-8500.

New York

Nancy L. Hengen • nancy.hengen@hklaw.com

Jovi Tenev • jovi.tenev@hklaw.com

San Francisco

Thomas Zimmer • thomas.zimmer@hklaw.com

Audrey Sung • audrey.sung@hklaw.com

Washington, D.C.

Stuart Dye • stuart.dye@hklaw.com

Michael Cavanaugh • michael.cavanaugh@hklaw.com