

INSURANCE AND LIABILITY ISSUES RELATING TO AN OIL SPILL CAUSED BY TERRORISM

The repercussions from the 9/11 attacks continue to deeply affect the way companies do business in the United States. Although the Army no longer patrols the streets of lower Manhattan, one merely has to walk along Broadway to appreciate the devastation caused by the attacks. As I draft this article, United Airlines has just filed for bankruptcy following U.S. Airways. The entire U.S. airline industry has experienced a slump in business due in part to the 9/11 attacks, posting ten billion dollars in losses for 2001, with an expected additional 7 billion dollars in losses for this year¹. These changes spilled over into the marine insurance field, especially to insurance for losses caused by terrorism.

Following 9/11, the U.S. government responded quickly with new laws that patch together some international law concepts with solicitude for U.S. businesses. While the President and Congress have embraced some concepts found in international conventions such as strict or no fault liability², caps on liability³, and a large role for private insurance⁴. The new legislation also features payments to the victims with funds from the United States Government and guarantees by the United States Government for payments to victims of terrorism. The focus of this paper is the effect of these new laws on oil spills caused by terrorist acts.

AIR TRANSPORTATION SAFETY AND SYSTEM STABILIZATION ACT

¹ Reuters - United File's Biggest Airline Bankruptcy – by Kathy Fieweger – December 9, 2002.

² International Convention on Civil Liability for Oil Pollution Damage (CLC) 1969

³ Athens Convention Relating to the Carriage of Passengers and their Luggage by Sea (1974)

⁴ International Convention on Liability and Compensation for Damages in Connection with the Carriage of Hazardous and Noxious Substances by Sea (HMS) 1996

At a rate of speed not seen since FDR's first 100 days, Congress passed and the President signed, the Air Transportation Safety and System Stabilization Act⁵ on September 22, 2001, eleven days following 9/11. Despite the speed at which it was cobbled together, this Act serves as a template for later legislation dealing with liabilities arising from acts of terrorism.

Basically, the Act is designed to get money to the victims and shore up the U.S. aviation industry. Section 408 of the Act⁶ limits the liability of United Airlines and American Airlines⁷ to an amount not greater than the limits of liability coverage maintained by the carriers. This limit applies to all claims, whether for compensation or punitive damages, arising from the terrorist-related air craft crashes of September 11, 2001.

The Act creates an unlimited fund for victim compensation⁸ to be administered by a Special Master appointed by the Attorney General⁹. The Special Master is not to consider negligence or any theory of liability in deciding on compensation for claimants with physical injury or wrongful death claims.¹⁰ If a claimant files a claim with the fund, the claimant waives the right to file a civil action in Federal or State court for damages relating to the 9/11 attacks.¹¹

⁵ Public Law 107-42, 115 Stat. 230

⁶ Id. at Section 408(a)

⁷ These companies owned the airliners involved in the 9/11 attacks.

⁸ Id. at Section 406

⁹ Id. at Section 404(a)

¹⁰ Id. at section 405 (b) (2)

¹¹ Id. at section 405 (c)(3)(i)

For claimants who do not file with the fund, Congress created a special Federal cause of action for damages arising out of the attacks of 9/11.¹² Although the elements of this cause of action were not defined, it is the exclusive remedy for damages arising out of the attacks. Congress also determined that the United States District Court for the Southern District of New York would have an original and exclusive jurisdiction over all actions brought for all claims, including loss of property, personal injury or death relating to the aircraft crashes.¹³

Section 101 of the Act deals with airline stabilization.. It authorized the President to issue up to \$10 billion in Federal loan guarantees and \$5 billion in direct compensation. The \$5 million compensation applies to direct losses arising as a result of any Federal ground stop order and for incremental losses incurred beginning September 11, 2001 and ending December 31, 2001, by air carriers as a direct result of the attacks.¹⁴ Similarly, Section 201 of the Act permits the Secretary to reimburse air carriers for the increase in the cost of insurance for any coverage ending before October 1, 2002, approximately one year after the incident.¹⁵

Finally, Congress limited the liability of air carriers to \$100 million for any acts of terrorism certified by the Secretary of Transportation within 180 days of the enactment of the Act. The United States would be responsible for any liability above \$100 million.

¹² Id. at Section 408(b)

¹³ Id. at Section 408(b)(3)

¹⁴ Id. at Section 101

¹⁵ Id. at Section 201

No punitive damages may be awarded against any air carrier or the government in any such cause of action arising out of the terrorist act with the 180 days.¹⁶

TERRORISM AND NON-MARINE POLICIES

Immediately following 9/11, there was a concern that the property and liability insurers would invoke the war risk exclusion contained in many property and liability insurers. A typical war risk exclusion reads as follows:

“The policy does not cover...:

1. Capture, seizure, arrest, restraint or detention or the consequences thereof, or of any attempt thereat, or any taking of the property insured or damaged to or destruction thereof by any Government or governmental authority or agent (whether secret or otherwise) or by any military, naval or usurped power, whether any of the foregoing by done by way of requisition or otherwise, and whether in time of peace or war or whether lawful or unlawful, this subdivision 1, shall not apply, however, to any such action by a foreign government or foreign governmental authority following the forceful diversion to a foreign country by any person not in lawful possession or custody of such insured aircraft and who is not an agent or representative, secret or otherwise, of any foreign government or governmental authority;
2. War, invasion, civil war, revolution, rebellion, insurrection, or war-like operations, whether there be a declaration or war or not.
3. Strikes, riots, civil commotion.”¹⁷

With the concerted hijackings, large scale loss of life, and physical damage, one could argue that it would have been reasonable for insurers to want to investigate to see if

¹⁶ Id. at Section 201(b)(2)

¹⁷ *Pan American World Air., Inc. v Aetna Cas. & Sur., Co.* 505 F 2d 989, 994 (2d Cir. 1974)

a foreign nation was behind the attacks. Indeed, a spokesman for Chubb alluded to this two days following the attack when he stated that there was a lot to learn about the attacks and if the attacks qualify as an act of war, Chubb could invoke the clause. He went on to state “we’d be sued by our shareholders if we paid and no one else did”¹⁸.

In response to this, Representative Michael Oxley, Chairman of the Financial Services Committee of the U.S. House, wrote to the National Association of Insurance Commissioners (NAIC) on September 17, 2001 pointing out that it would be unsupportable and unpatriotic if the insurers invoked the war risk exclusion and it would tear at the faith of the American people in the insurance industry.¹⁹ Representatives of the insurers responded that they would not invoke the war risk exclusion. In a press release, the NAIC referred specifically to Chairman Oxley’s letter and stated that all of the insurers they had heard from are treating the losses as covered claims, and that the war risk exclusion was a “non-issue”²⁰.

In addition to being a non-issue, this was also an issue that had been considered by the Second Circuit Court of Appeals in *Pan American World Air, Inc. v. Aenta Cas. & Sur. Co.*²¹. The war risk exclusion clause printed above was at issue in a case involving Pan American flight 083 that was hijacked by two men allegedly acting for the Popular Front for the Liberation of Palestine. The aircraft, a Boeing 747, was flown to Egypt under control of the terrorists and after the passengers were evacuated, the aircraft was totally destroyed.²² The Court was called upon to decide whether the hijacking and

¹⁸ Wall Street Journal, September 13, 2001 p. C2

¹⁹ International Risk Management Institute Inc. Insights, September 2001.

²⁰ NAIC press release, September 2001.

²¹ 505 F 2d 989 (2d Cir. 1974)

²² Id. at 993

destruction of the plane were excluded from the all risk policy by the war risk exclusion. The Court found that there were specific insurance clauses in use at the time that excluded acts of sabotage, hijacking, unlawful seizure and wrongful exercise control of an aircraft. These clauses could have been used by the insurer to specifically exclude the risk.²³ The Court found that for there to be a “war”, there must be hostilities carried out by governments and the argument that the loss resulted from a guerrilla war was wholly untenable. The only evidence of such a war was the self-serving propaganda issued by the PFLP. This “radical rhetoric cannot affect the outcome of this insurance case”.²⁴ In summary, the Court determined that the war risk exclusion did not apply to a hijacking carried out by a terrorist group.

With coverage for the 9/11 incident secured, President Bush and the insurers turned to coverage for terrorist acts that would occur after 9/11. In a meeting held with insurance industry leaders on September 21, 2001, the insurance industry leaders made repeated public assurances that claims for 9/11 would be paid on time and in full.²⁵ However, they offered no assurances for coverage for subsequent acts. Edmond Kelly, Chairman of Liberty Insurance Company made it clear that “they will not pay for terrorist exclusions on a go forward basis”²⁶.

One year after 9/11, the Insurance Information Institute estimated that the total insurance cost for the 9/11 attacks would be \$40.2 billion.²⁷ The House Committee on

²³ Id. at 1000

²⁴ Id. at 1015

²⁵ *Wall Street Journal*, September 24, 2001, pA3.

²⁶ Id.

²⁷ Press release- September 5, 2002

Financial Services in its report on the Terrorism Risk Protection Act²⁸, predicted that such payouts would create uncertainty in the insurance market and affect lenders who would not provide financing for new or existing construction without the certainty that insurance would be available²⁹. When he signed the Act, President Bush stated that more than \$15 billion in real estate transactions were canceled or put on hold because insurance was not available.³⁰

The non-marine insurers paid out substantial sums because of the 9/11 attack and the inability of the insurers to provide coverage for future terrorism acts had a substantial effect on our economy. Thus, Congress passed the Terrorism Risk Protection Act and it was signed by the President on November 26, 2002.³¹

TERRORISM AND SHIPOWNERS' INSURANCE

As set forth above, the 9/11 attacks had a tremendous impact on the American property and casualty insurance industry. However, arguably, the same effect was not felt by the insurers who cover ocean going vessels for risks associated with terrorism. Due to this, one questions whether marine insurance should have been included in the Terrorism Risk Insurance Act.

Shipowners carry two principal types of insurance: the hull policy covers the vessel, her machinery, and certain liabilities for collision, and the protection and indemnity (P & I) policy, which covers liabilities of the shipowner to third parties for

²⁸ The two House Reports refer to the bill as the Terrorism Risk Protection Act. The Senate version is called the Terrorism Risk Insurance Act. Although the Conference report is entitled Terrorism Risk Protection Act, the report states that the Act may be cited as the Terrorism Risk Insurance Act.

²⁹ House of Representatives, Report 107-300. p. 21

³⁰ Remarks of President George Bush- November 26, 2002

³¹ P.L. 107-297

most acts of a shipowner, including personal injuries to crew and passengers, liability for cargo loss or damage, wreck removal, and pollution³². P&I cover is primarily provided by P&I Clubs. These clubs are totally separate, but have set up an International Group (IG) that represents thirteen P&I Clubs that ensure about 90% of the world's ocean going tonnage.³³ Most of the Clubs have web sites where their notices and circulars are available to the public. The notices and circulars cited herein are taken from the sites.

The rules of the P&I Clubs are very similar³⁴. Prior to 9/11, the rules of the Clubs in the IG contained a similar war risk exclusion clause that excluded all liability for any liabilities, costs or expenses caused by “war, civil war, revolution, rebellion, insurrection or civil strife arising therefrom, or any hostile act by or against a belligerent power...”³⁵.

Since 1986, the International Group Clubs arranged individually, for the benefit of their Members, additional market war risk cover³⁶. For the year February 20, 2001 – February 20, 2002, the limit of war risk coverage was \$100 million, in excess of amounts recoverable on the members existing hull policy, usually the value of the vessel.³⁷ A few weeks after 9/11, this war risk coverage was cancelled but reinstated immediately on October 24, 2001 with slightly different terms. The reinstatement was limited to the excess of the amount recoverable from underlying war risk underwriter or the proper

³² Schoenbaum, *Admiralty and Maritime Law* vol. 2 p. 450-51(2001)

³³ Submission of the International Group of P & I Clubs to the Third Session of the IMO/ILO ad hoc Expert Working Group on Abandonment and Payment of Contractual Claims..

³⁴ See *Benedict on Admiralty*, vol. 7A 2002

³⁵ See e.g. 2001 West of England Rule 14(1); 1998 Britannia Rule 25(1)

³⁶ Gard Club Circular No. 5/2001, October 16, 2001

³⁷ West of England Circular No. 06/2001/2002, September 2001

value of the vessel, whichever is greater.³⁸ There was no additional premium charged for the reinstatement³⁹.

After 9/11, some of the Clubs reviewed the war risk exclusion and amended the clause to ensure that it covered terrorism. The new clause in many of the Club rules leaves no doubt that liabilities arising from any act of terrorism are excluded from the basic P&I coverage. The exclusion now covers liabilities, costs or expenses caused by “war, civil war, revolution, rebellion, insurrection or civil strife arising therefrom, or any act by or against a belligerent power, **or any act of terrorism.**”⁴⁰

For the policy year 2002-2003, the International Group was able to place additional war risk cover with an increased limit of \$200 million, double the amount provided the prior year. There was no indication in the various Club circulars that the owners paid increased premiums for this \$200 million cover.⁴¹

As this paper is being written, there has been no announcement about the availability of the additional war risk coverage for 2003 or the cost of this insurance. It has been reported that the amount of cover will double from \$200 million to \$400 million with an additional premium of only a few cents per gross ton.⁴² While there is a strong possibility the cost may increase, from the above, it is clear that there was never a crisis situation that limited cover or caused drastic increases of premiums for war risk coverage for vessels. Nonetheless, marine insurance was not excluded from the Terrorism Risk

³⁸ North of England Club Circular October 17, 2001.

³⁹ Id.

⁴⁰ See e.g. Standard Club Notice 2001/11- December 21, 2001; American Club Circular 15/01- December 28, 2001

⁴¹ See e.g. Gard Club Circular 9/2001- February 2002; American Club Circular 3/02- February 12, 2002; Standard Club Circular 2002/3- February 8, 2002

⁴² TradeWinds, January 17, 2003, p.14.

Insurance Act and the marine war risk insurers are bound by it for risks in the United States.

THE LIMBURG INCIDENT AND THE CLC

On October 6, 2002, it was reported that there was a massive explosion that ripped through the side of the tanker Limburg off Yemen. The initial reports indicated that an officer onboard the vessel had seen a small craft approaching the vessel immediately before the collision and it was reported that the small vessel rammed the Limburg⁴³. This occurred a few days prior to the second anniversary of the attack on the USS Cole in Yemen that killed seventeen U.S. Navy personnel.

The vessel was operated by a subsidiary of Compagnie Maritime Belge(CMB)⁴⁴ and entered in the West of England P&I Club for pollution risks. Although it was apparent early on that the casualty was caused by a terrorist attack, the Club took the lead in providing technical assistance in dealing with oil pollution and other claims.

Initially, Yemeni authorities tried to argue that the explosion was caused by an explosion in one of the ship's tanks.⁴⁵ The ship's master, Hubert Ardillon, and the operators, CMB, insisted that the explosion was due to no accident but was deliberately caused by terrorists⁴⁶. As set forth above, the vessel's P&I cover excluded liabilities arising from any act of terrorism⁴⁷. After bits of fiberglass were found inside the vessel

⁴³ *Lloyd's List*, October 7, 2002, p.1.

⁴⁴ *Id.*.

⁴⁵ *Lloyd's List*, October 9, 2002, p. 5.

⁴⁶ *Id.*.

⁴⁷ See note 39 supra.

and an Islamic group claimed credit for the attack, the Yemeni authorities backed away from their claims that the explosion was caused by an accident⁴⁸.

The insurance and liability aspects of the Limburg incident shed little light on what would happen if there was a major oil spill caused by terrorism in the United States, where the exposure could reach hundreds of millions of dollars. From the beginning, it was clear that there was an act of terrorism. Indeed, the vessel's master and operator insisted on it. Thus, there was no issue about whether the liabilities were covered by P&I insurance, and this was not asserted. Secondly, the vessel had substantial war risk cover. The initial layer of war risk cover was \$70 million, the value of the vessel.⁴⁹ In addition, the vessel had \$200 million in war risk coverage arranged through the P&I Club⁵⁰. Finally, Yemen is a signatory to the Civil Liability Convention (1969)(CLC)⁵¹ and the United States has never ratified this convention.

Under the CLC, the Limburg owners should not be liable for any pollution damage. Article 3 of the CLC excludes from liability, pollution resulting from an act of war, hostilities, civil war, or insurrection, but also states that "no liability for pollution damages shall attach to the owner if he proves that the damage...was wholly caused by an act or omission done with intent to cause damage by a third party..."⁵². The latter exclusion would cover pollution caused by terrorists.

It is ironic that Article 3 of the CLC would provide liability protection for U.S. flag vessels and U.S. insurers for acts of terrorism occurring overseas in CLC countries.

⁴⁸ *Lloyd's List*, October 11, 2002, p. 1.

⁴⁹ *Business Insurance Daily News*, October 8, 2002

⁵⁰ See note 40 *supra*.

⁵¹ International Convention on Civil Liability for Oil Pollution Damage, 973 UNTS 3 (Brussels 1969)

⁵² CLC Article 2(b)

Over 75 countries have ratified CLC 1969, so this protection for U.S. insurers and vessels exists in most of the world's ports. However, U.S. flag vessels and U.S. insurers would not have the same protection for acts of terrorism occurring in U.S. ports.

Until the Terrorism Risk Insurance Act was enacted, liability for oil spills caused by terrorism was governed by the Oil Pollution Act of 1990 (OPA 90)⁵³. Under the applicable section of OPA 90, 33 U.S.C. §2703, the responsible party has a complete defense if it establishes by a preponderance of evidence that the discharge was caused **solely** by an act of God, act of war or an act or omission of a third party. However, in addition to proving that the discharge was caused solely by an act or omission of a third party, the responsible party must also prove that it:

- “(A.) Exercised due care with respect to the oil concerned, taking into consideration the characteristics of the oil and in light of all relevant facts and circumstances; and
- (B.) Took precautions against foreseeable acts or omissions of any such third party and the foreseeable consequences of those acts or omissions.”

There are no reported cases yet interpreting the above language in OPA 90 for spills intentionally caused by third parties.⁵⁴ However, cases decided under the predecessor statute, the Federal Water Pollution Control Act⁵⁵, show that many courts take an unduly narrow view of what constitutes sole cause by a third party.

⁵³ 33 U.S.C. § 2701 et seq.

⁵⁴ For a decision on the Act of God defense see *Apex Oil Co. v. United States*, 2002 A.M.C. 493 (E.D.La. 2002) granting summary judgment to the Government and finding that the Act of God defense in OPA must be construed as much more limited in scope than traditional common law Act of God defense.

⁵⁵ 33 U.S.C. § 1321

In *Atlantic Richfield Co. v. United States*,⁵⁶ vandals broke into an oil terminal and dumped oil from two tank trucks before stealing the trucks. The terminal was surrounded by a six foot chain link fence and “bathed in artificial light”⁵⁷. In deciding the case, the Court held that the plaintiff did not meet its heavy burden of proving that its own act or omission was so indirect or insubstantial as not to constitute a contributing cause. The parties stipulated that the terminal was located in a low crime area, was adequately lighted, and was surrounded by a security fence. The Court held that it was not necessary that the plaintiff foresee the precise circumstances under which the oil was spilled, but it was sufficient that the plaintiff should have foreseen that an unattended truck left on a premises at night might “through a variety of circumstances (e.g., collision with another vehicle, natural disaster, equipment malfunction, vandalism), cause an oil spill”⁵⁸. After 9/11, a tanker owner’s ability to foresee a means of a terrorist attack is limited only by the owner’s imagination. Under this jurisprudence, there may never be a finding that the act of the third party was the sole cause of the spill.

A similar decision is *Travelers Insurance Co. v. United States*⁵⁹. In this case, the terminal was surrounded by a perimeter fence, and the only non-fenced portion of the property was at water’s edge. The facility was used to store gasoline and heating oil and, during the night, vandals broke into the terminal and opened a valve allowing about 15,000 gallons of oil to leak through a retaining wall and into the navigable waters. The Court found numerous faults by the terminal owner, including failing to completely fence in the facility, not having security personnel on duty at night, there was no lighting in the

⁵⁶ 1 Cl. Ct. 261; 1982 U.S. Cl. Ct. Lexis 2318 (Claims Court 1982)

⁵⁷ Id. at 263

⁵⁸ Id.

⁵⁹ 2 Cl. Ct. 758; 1983 U.S. Cl. Ct. Lexis 1698 (Claims Court 1983)

area where the oil spill originated, and the type of handle on the valve made it easy to open. It is difficult to see how any of these precautions would have necessarily prevented the vandals from breaking into the terminal and opening the valve. In fact, this hind sight and second guessing by the Court makes it almost impossible to ever prove that the acts of a third party were the sole cause of the spill.

TERRORISM RISK INSURANCE ACT OF 2002

The result of the crisis in the American property and casualty insurance markets was the Terrorism Risk Insurance Act of 2002⁶⁰. This Act applies to virtually all insurers who receive direct earned premiums for any type of commercial property and casualty insurance coverage for risks in the United States. In addition to covering all insurers licensed or admitted to engage in the business of insurance in any State⁶¹, the Act also applies to all insurers approved for the purpose of offering property and casualty insurance by a Federal agency in connection with maritime, energy or aviation activity⁶². The Act also covers all eligible surplus line insurance carriers listed on the Quarterly Listing of Alien Insurers of the NAIC. Every entity that meets the above criteria is required to participate in the Terrorism Insurance Program.⁶³

⁶⁰ P.L. 107-297

⁶¹ Section 102(6)i

⁶² Section 102(6)iii. On December 18, 2002, the Department of Treasury issued Interim Guidance on the Terrorism Risk Insurance Act of 2002. The Notice gave examples of insurers that were federally approved and included underwriters for marine hull insurance, approved by the Maritime Administration and U.S. Department of Transportation; aircraft accident liability insurance, approved by the U.S. Department of Transportation; oil spill financial responsibility for offshore facilities, approved by the Minerals Management Service and U.S. Department of the Interior; oil spill financial responsibility for vessels, approved by the U.S. Coast Guard and U.S. Department of Transportation; and Longshoreman's and Harborworker's Compensation Act, approved by the U.S. Department of Labor. *Interim Guidance Concerning Definition of Insurers, Scope of Insurance Coverage and Disclosures Mandated by the Terrorism Risk Insurance Act of 2002, December 18, 2002, p.8.*

⁶³ Section 103(a)(3)

Even before the bill was signed into law, there were strong reactions from the P&I Clubs about one of the sections in the bill. On November 13, 2002, the Conference Report on the bill was issued and it contained a requirement that insurers make terrorism coverage available in all its policies that did not differ materially from the terms, amounts and other coverage limitations applicable to losses arising from events other than acts of terrorism⁶⁴. In other words, the P&I Clubs were required to offer terrorism insurance with the same limits applicable to the coverage for other risks. This presented a significant problem to the Clubs because the limit applicable to other risks is approximately \$4.25⁶⁵ billion and the Clubs' reinsurance and pool programs do not cover terrorism losses.⁶⁶ Thus, a Club would have to the loss out of its own assets.

The reaction from the P&I Clubs was swift. Before President Bush signed the Terrorism Act, many of the Clubs sent circulars to their members stating that they were required to offer terrorism cover under the Act, but could charge any premium the Club deemed appropriate⁶⁷. They expected the premium to be several million dollars per vessel. The circulars pointed out that while the Club was obliged to offer the cover, the members were not obliged to accept it and the policy exclusion would be reinstated if they did not pay the additional premium by the due date.⁶⁸

President Bush signed the Act into law on November 26, 2001. On that day, or on the following day, many of the P&I Clubs sent notices to their members for the additional terrorism risk premium necessary to ensure liabilities under the Act. The

⁶⁴ Conference Report accompanying H.R. 3210 Section 103(c)(1)(B)

⁶⁵ Britannia Club Circular November 21, 2002

⁶⁶ Shipowner Club Circular November 2002

⁶⁷ See e.g. West of England Notice 6 2002/2003

⁶⁸ Id.

quotes were termed “farcical”⁶⁹ and “Alice in Wonderland”⁷⁰ but they underscore the exposure that the Clubs thought they could face under the Act. Steamship Mutual quoted the rate of \$8 million a vessel.⁷¹ This might have been a bargain compared to the \$12 million a vessel quoted by Skuld⁷². Gard quoted a rate of \$25 million per vessel⁷³. One would suspect that at those rates, there would be very few takers. However, under the Act, an insurer may not reinstate the terrorism exclusion unless it has received a written statement from the assured authorizing the reinstatement or the insured does not pay the additional premium for the terrorism cover within thirty days.⁷⁴ Thus, if the members of the Clubs did nothing, the terrorism exclusions would not be reinstated until thirty days after November 26-29 and, theoretically; there could be coverage for any acts of terrorism occurring during those thirty days provided the member paid the premium. Although there was exposure for the Clubs during these thirty days, there were no incidents of terrorism covered by the Act during that time.

a. When the Act applies

The coverage of the Act is triggered when the Secretary of Treasury, in concurrence with the Secretary of State and Attorney General, certifies that an act is an act of terrorism.⁷⁵ There are four prerequisites for this. The Act must be: (a) an act of terrorism; (b) which is a violent act that is dangerous to human life, property or the infrastructure; (c) resulting in damage within the United States or outside the United

⁶⁹ Tradewinds November 30, 2002 p.22

⁷⁰ Lloyd’s List, November 26, 2002 p2

⁷¹ Steamship Mutual Club Notice- November 26, 2002

⁷² Skuld Club Circular November 29, 2002

⁷³ Gard Club Notice- November 27, 2002

⁷⁴ P.L. 107- 297 §105

⁷⁵ Id. at Section 102(1)(A)

States in the case of a U.S. air carrier or flag vessel or the premises of a United States mission; and (d) committed by an individual or individuals acting on behalf of any foreign person or foreign interest as part of an effort to coerce the civilian population of the United States or to influence the policy of the United States government⁷⁶. An act of terrorism does not include an act committed as a part of a Congressional declared war or an act which results in property or casualty losses that do not exceed \$5 million in the aggregate.⁷⁷ The \$5 million threshold is far less than the House version of the Act which required industry wide losses exceeding \$1 billion or industry wide losses greater than \$100 million if the losses for a single commercial insurer exceeded 10% of its capital surplus or 10% of the commercial property and casualty premiums written by such insurer⁷⁸.

The \$5 million figure includes the aggregate of property and casualty losses.⁷⁹ In the case of an oil spill, it would include the damage to the vessel normally covered by the hull underwriters, clean up expenses, and NRDA damages, as well as damages for any injuries or deaths. Thus, the Act should cover most sizeable spills in the United States.

b. Who is covered by the Act

Basically, the program is a risk sharing program that allocates the risk of loss from acts of terrorism among the Federal Government, insurers and insureds.⁸⁰ The Federal government's share is 90% of the insured losses that exceed the applicable

⁷⁶ Id.

⁷⁷ Id. at Section 102(1)(B)

⁷⁸ Terrorism Risk Insurance Act- House Rept. 107-300p2, Section 5

⁷⁹ P.L. 107-297 Section 102(1)(B)

⁸⁰ Id. at Section 101(b)

insurance deductible for the transition year or each program year⁸¹. The Act refers to insured losses⁸² and the insurer deductible⁸³, but it makes no mention of the insured's deductible. Since the program is designed to provide “compensation for insured losses resulting from acts of terrorism⁸⁴”, it appears that uninsured losses or losses covered by deductibles would not be covered in the program. Insured loss is defined⁸⁵ as any loss that is covered by primary or excess property and casualty insurance issued by an insurer if the loss occurs within the United States or to certain U.S. air carriers or U.S. vessels anywhere in the world.⁸⁶

The air carriers covered are those defined in 49 U.S.C. 40102. These are citizens, partnerships and corporations of the United States undertaking by any means to provide air transportation⁸⁷. For corporations, at least two thirds of the Board of Directors and other managing officers must be U.S. citizens and 75% of the voting interest must be owned or controlled by U.S. citizens.⁸⁸ Foreign air carriers would be covered if the insured loss occurred in the United States.⁸⁹

The vessels covered include U.S. flag vessels or vessels based principally in the United States on which U.S. income tax is paid and whose insurance coverage is subject

⁸¹ Id. at Section 103(e)

⁸² Id. at Section 102(5)

⁸³ Id. at Section 102(7)

⁸⁴ Id. at Section 101(b)

⁸⁵ Id. at section 102(5)

⁸⁶ Id. at Section 102(5)(B)

⁸⁷ 49 U.S.C. 40102(a)(2)

⁸⁸ 49 U.S.C. 40102(a)(15)

⁸⁹ P.L. 107-297 Section 102(5)(A)

to regulation in the United States regardless of where the loss occurs.⁹⁰ Foreign flag vessels are covered for losses occurring in the United States.⁹¹

On January 28, 2003, The Department of the Treasury issued additional guidelines that illustrate some of the ambiguities in the Act.⁹² The Department clarified that insured losses under §102(5)(b) would not include losses incurred by third parties associated with losses incurred by U.S. flag vessels or U.S. air carriers unless the losses occurred in the United States. Assume that a U.S. flag vessel was blown up off a foreign coast and the resulting oil spill caused damage to the foreign fishery. Since this is a loss incurred by third parties associated with a loss incurred by the U.S. flag vessel, the guidelines would indicate that this loss would not be considered an insured loss under the Act. While this might make sense in CLC countries where the vessel owner would not be liable for damages caused by acts of terrorism,⁹³ the vessel's insurer may face considerable exposure in any country that adopted a stricter, OPA-90 type regime.

C. Government and Insurers payments under the Act

The Government's share is 90% of the loss that exceeds the applicable insurer deductible.⁹⁴ The Act defines insurer deductible as a percent of the value of the insurer's direct earned premiums for a given year.⁹⁵ For the transition period, the period from the date of enactment to December 31, 2002, the insurer deductible is 1% of the direct earned premiums for the calendar year immediately preceding the date of the enactment of the

⁹⁰ Id. at Section 102(5)(B)

⁹¹ Id. at Section 102(5)(A)

⁹² Interim Guidance Concerning Certain Conditions for Federal Payment, Non-U.S. Insurers and Scope of Insurance in the Terrorism Risk Insurance Act of 2002, 68 Fed Reg. 4544, January 29, 2003.

⁹³ See text accompanying footnotes 43-53.

⁹⁴ Id. at Section 103(e)(1)(A)

⁹⁵ Id. at Section 102(7)

Act.⁹⁶ For program year 1, calendar year 2003, the insurer deductible is 7% of the insured's direct earned premiums for 2002.⁹⁷ For program year 2, calendar year 2004, the insurer deductible is 10% of the insurer's direct earned premium in 2003⁹⁸ and in 2005, the insurer deductible is 15% of the insurer's direct earned premium for the year 2004.⁹⁹ The program is scheduled to terminate on December 31, 2005.¹⁰⁰

Direct earned premium is the premium earned for property and casualty insurance issued by the insurer for insurance against losses occurring within the United States or to the U.S. air carriers or U.S. vessels described above, anywhere in the world.¹⁰¹ This definition may be particularly troublesome for marine insurers who insure objects that are not stationary. Obviously, a building will stay in the city where it is built 365 days a year. A ship will not. U.S. flag vessels are covered 365 days a year,¹⁰² but foreign flag vessels are covered by the Act only when the vessel is in the United States.¹⁰³ An insurer may insure a ship for 365 days a year, but a foreign flag vessel may be in the United States only ten days a year. It may be possible to pro rate the premium charged to foreign flag vessels to compute the direct earned premium on that vessel for the preceding calendar year for the time the vessel was at the locations specified in the Act, i.e. within the United States. It is much more difficult to calculate "direct earned premium" for an insurer that may insure hundreds of foreign flag vessels, many of which never call in the United States, and others that may spend varying times in the United States waters from

⁹⁶ Id. at Section 102(7)(A)

⁹⁷ Id. at Section 102(7)(B)

⁹⁸ Id. at Section 102(7)(C)

⁹⁹ Id. at Section 102(7)(D)

¹⁰⁰ Id. at Section 108(a)

¹⁰¹ Id. At Section 102(4)

¹⁰² Id. At Section 102(5)(B)

¹⁰³ Id. At Section 102(5)(A)

five days a year to 90 days a year. The problem is compounded because owners do not routinely tell their war risk insurer where a vessel has been trading. Assuming an act of terrorism occurs to an insured vessel, it may be near impossible for the insurer, who may insure hundreds of vessels, to try to reconstruct what vessels were in the United States and for how many days during the prior year in order to calculate the direct earned premium for insurance against losses that could occur in the United States.

The Department of Treasury realized this difficulty and issued interim guidance on December 18, 2002 on various subjects included in the Act¹⁰⁴. The Department recognized that marine insurers may not have specifically allocated that portion of the premium income that would be attributable to risks within the geographic region covered by the Act. The Guidelines suggested that these insurers use the same allocation methods that are included in the National Association of Insurance Commissioners, “Allocation of Surplus Lines and Independently Procured Insurance Premium Tax on Multi-State Risk Model Regulation” for allocating premiums between coverage within the geographic scope of the Act and all other coverage in order to estimate the appropriate percentage of premium income for such policies that apply to such risks.¹⁰⁵ For risks that are located or performed in different states, the NAIC proposes the following:

“On an insurance policy covering properties, risks or exposures located or to be performed in various states, the tax to be paid to the commissioner of each state shall be computed on that portion of the policy premium that is

¹⁰⁴ Department of Treasury – Interim Guidance Concerning Definition of Insurers, Scope of Insurance Coverage and Disclosure Mandated by the Terrorism Risk Insurance Act of 2002, December 18, 2002.

¹⁰⁵ Id. At p.9

attributable to properties, risks or exposures located or to be performed in each state¹⁰⁶.”

The Department of Treasury will be proposing regulations that treat the federally approved insurers in a manner consistent with eligible alien surplus line carriers. For eligible surplus line carriers, the Department “expects to propose that the premium for insurance coverage within the geographic scope of “insured loss” [for purposes of the Act] must be priced separately by eligible surplus line insurers for policies issued after January 1, 2002”¹⁰⁷. For marine insurers, this may be unworkable as the marine insurer will not know in advance how many days in the subsequent year that a vessel will be in a location covered by the Act.

d. Litigation and substantive law

The Act provides that there shall be an exclusive Federal cause of action for property damage, personal injury or death arising from an act of terrorism certified by the Secretary of Treasury. that will preempt all state causes of action for property damage, personal injury or death arising from a certified act of terrorism unless the claim is against one who knowingly participates in, conspires to commit, aides and abets or commits the act of terrorism.¹⁰⁸

The two House bills contained substantive law provisions including the prohibition of punitive damages and a limitation on non-economic damages.¹⁰⁹ Similar provisions were not included in the Senate bill. These limitations were not contained in

¹⁰⁶ NAIC Allocation of Surplus Lines and Independently Procured Insurance Premium Tax on Multi-State Risks Model Regulation - §2(B).

¹⁰⁷ Interim Guidance, supra note, P. 7-8.

¹⁰⁸ Id. At Section 107(a)(1)

¹⁰⁹ Committee on Financial Services, Rpt 107-300p1, Section 15(b); Committee on Ways and Means, Rpt 107-300p2, Section 14(b)

the Conference report¹¹⁰ and the Act provides that punitive damages awarded under the new cause of action shall not be counted as insured losses.¹¹¹ Thus these damages will not be reimbursed by the Government.

There is little in the Act or legislative history explaining this new cause of action for terrorism. There is a cryptic explanation in the Conference Report on this section that merely states: “the Conferees agree to a provision on litigation management”.¹¹² There is nothing else in the joint explanatory statement of the Committee of Conference that expands on this Federal cause of action or explains how the substantive law would be applied.

The language setting forth the new cause of action and the substantive law to be applied is very similar to the language contained in the Air Transportation Safety and System Stabilization Act. Indeed, the sections on substantive law in both are almost identical. Normally, one would have the benefit of the legislative history of the earlier act to fill in or flesh in the meaning of the subsequent act, in this case the Terrorism Risk Insurance Act. However, as the Air Transportation Safety and System Stabilization Act was signed into law 11 days after 9/11, the legislative history for this Act is virtually non-existent.

As set forth earlier, under the Stabilization Act, claimants could file a claim with the special master and receive payment from the Victim Compensation Fund without proving negligence or any theory of liability. The other alternative is to file a lawsuit

¹¹⁰ Conference Report to accompany H.R. 3210

¹¹¹ P.L. 107-297 at Section 107(a)(5)

¹¹² Conference Report to accompany H.R. 3210 p.22.

under the newly established federal cause of action for damages arising out of the hijacking.¹¹³ For the cause of action set forth in the Terrorism Risk Insurance Act, Congress did not state that the Court should not consider negligence or any other theory of liability as was set forth for claims on the Victim Compensation Fund under the Stabilization Act. Therefore, it would appear that there would be a requirement to prove negligence or some other theory of liability for a cause of action under the Terrorism Risk Insurance Act..

The Act states that the substantive law in any action shall be derived from the law, including the choice of law principles, of the state in which the act of terrorism occurred “unless such law is otherwise inconsistent with or preempted by Federal law”¹¹⁴ Since most admiralty law is Federal statutory or judge-made law, there will be issues arising in the future on what law governs an oil spill caused by terrorism. OPA 90 does not preempt state law,¹¹⁵ but it may be inconsistent with some state laws. Do these inconsistencies require that the substantive law for pollution caused by terrorism be derived from OPA 90 and not the inconsistent state laws¹¹⁶.

The Judicial Panel on Multidistrict Litigation shall designate one or more district courts that will have original and exclusive jurisdiction not later than 90 days after the act

¹¹³ See notes 7 -12 supra.

¹¹⁴ P.L. 107-297 at Section 107(a)(3)

¹¹⁵ 33 U.S.C. 2718(a)

¹¹⁶ Two major areas of inconsistency between state laws and OPA 90 are the liability of charterers and the owners of cargo. Some state statutes can be read to impose liability on charterers, e.g., under California law, the definition of owner or operator includes any person who leases the vessel. Cal. Gov't Code §8670(s)(1)(a). Under OPA 90, the definition of responsible party for a vessel includes only the person owning, operating or demised chartering the vessel. 33 U.S.C. §2701(32)(A). The same is true for cargo owners. In Oregon, the owner of oil entering the waters of the state is strictly liable, without regard to fault, for the damages to persons or property caused by the spill. Or. Rev. Stat. §468B.310. This is also inconsistent with OPA 90. These inconsistencies should require that the new Federal cause of action be derived from OPA 90 and not contain exposures for charterers and cargo owners.

of terrorism. This selection should be based on the convenience of the parties and for purposes of personal jurisdiction, the designated court or courts shall be deemed to sit in all districts in the United States.¹¹⁷

e. Conditions for Federal payment

The Secretary of Treasury may not reimburse an insurer unless the person that suffers the insured loss or someone acting on behalf of him files a claim with the insurer and the insurer processes the claim for the insured loss in accordance with appropriate business practices and any reasonable procedures that the Secretary may prescribe.¹¹⁸ The insurer must provide a clear and conspicuous disclosure to the policy holder setting forth the premium charge for insured losses covered by the program. For policies issued before the enactment of the Act, the disclosure must be issued not later than 90 days after the Act was signed. For policies issued within 90 days of the enactment, the disclosure must be made at the time of offer, purchase and renewal. Policies issued more than 90 days after the effective date must contain a separate line item in the policy for terrorism insurance coverage.¹¹⁹

In order to obtain federal reimbursement, the insurer must submit to the Secretary a claim for federal reimbursement with a written certification of the underlying claim and of all payments made for insured losses resulting from the act of terrorism and a further certification of its compliance with the provisions of the Act.¹²⁰

¹¹⁷ P.L. 107-297 at Section 107(a)4

¹¹⁸ Id. At Section 103(b)

¹¹⁹ Id. At Section 103(b)(2)

¹²⁰ Id. At Section 103(b)(4)

It will be very difficult for marine insurers to disclose to the policy holders in advance the premium charge for insured losses covered by the Terrorism Risk Insurance Act. The prospect of receiving a 90% re-payment by the American government may make the program attractive to some foreign insurers. Since the applicable deductible will be based on the premiums charged for risks covered by the Act, there may be a temptation for an insurer to set a low or nominal premium rate for this coverage. On its face, this may be reasonable as the insurer would be reimbursed for 90% of its insured losses for an act of terrorism in the United States and thus would be truly insuring only 10% of the risk. There may be no reimbursement from any government for an act of terrorism occurring in Yemen or other countries so the exposure outside the United States would be much greater for an insurer.

f. Recoupment

The program is set up to have the United States government give temporary financial compensation to insurers while the industry develops the products and programs to provide private terrorism risk insurance.¹²¹ Thus, the Act provides for mandatory recoupment from policy owners to spread the risk of loss and offset the cost of the program to the Federal government. The Act sets up mandatory surcharges (not to exceed 3% of premium)¹²² that will be imposed on all property and casualty insurance policies up to a maximum recoupment of \$10 billion through 2003, \$12.5 billion for 2004, and \$15 billion for 2005. These recoupment amounts are reduced by the total insurer deductibles and the insurer's payments of the 10% not covered by the

¹²¹ Id. At Section 101(a)(6)

¹²² Id. At Section 103(e)(8)

government. The insurers are to collect the terrorism loss risks spreading premiums and remit the premiums to the Department of Treasury.¹²³ The Secretary of the Treasury has the discretion to seek to recoup additional amounts if the federal government has paid out more than the mandatory recoupment amount.

g. Civil Penalties

The Secretary may assess fines against insurers who have failed to charge, collect or remit the risk spreading premiums discussed above, intentionally provide the Secretary with erroneous information, submit fraudulent claims, fail to provide premium information, or otherwise fail to comply with the Act or regulations issued pursuant to it¹²⁴. The fine may not exceed the greater of \$1 million, or the amount that the insurer failed to pay charge, collect or remit under the Act. The Act has no provision for criminal penalties.

h. Timing of Payment to Insurers

The Act is silent about when the payments to the insurers should be made. Unfortunately, based on experience in other maritime disasters, it may be years before insurers receive anything from the Government. Under OPA 90, the responsible party may assert a claim against the National Pollution Fund to recover amounts the responsible party paid for clean up, claims etc. in excess of the vessels limitation amount.¹²⁵ In one of the larger spills occurring under OPA 90, the National Pollution

¹²³ Id.

¹²⁴ Id. at Section 104(e)

¹²⁵ 33 U.S.C. §2708, 2713

Funds Center did not make its initial offer until 33 months after the initial claim was submitted and 43 months after the spill.¹²⁶

It is hoped that the Department of Treasury will consider making sizable partial payments to insurers while the auditors deal with some of the thornier issues in the Act such as deductibles and the total earned premium for the risk.

TERRORISM CAUSED SPILLS UNDER \$5 MILLION

Under the Act, the Secretary cannot certify an act as terrorism unless the insurance losses in the aggregate exceed \$5 million¹²⁷. For spills with total damages under \$5 million, OPA 90 and state law will still govern. In many oil spills, the largest claim may be the claim for natural resource damage (NRDA) asserted by the federal and state governments. It will be interesting to see if the specter of the Terrorism Risk Insurance Act affects the size of natural resource damage claims. If the total claims stay under \$5 million, the Act does not apply and the insurer pays in full. However, if a government entity asserts a NRDA claim that pushes the total above \$5 million, under the Act, the federal government pays 90%. If there are any smaller spills caused by terrorism, one may find that the government representatives may be interested in keeping the total claim under the \$5 million and this may affect the cleanup and perhaps payment of third party claims.

¹²⁶ See *Julie N OPA 90 in Action*, Shipping and Transport Lawyer, Vol. 3, No. 3, p.18. The Julie N spill occurred on September 27, 1996, The responsible party filed claims the initial claim for \$7.4 million in March 1999 and the NPFC made an initial offer in December 2001.

¹²⁷ P.L. 207-197 at Section 102(1)(B)(ii).

CONCLUSION

Many of the questions engendered or left unanswered by the Act may be answered in regulations and guidelines that will be put out over the next few months. To date, The Department of Treasury has issued three separate sets of guidelines on the Act. One hopes that the Act represents a change in the attitude of the Government regarding responsibility for acts caused by third parties. The earlier Federal Water Pollution Control Act cases discussed herein make it very difficult for a responsible party to escape liability for acts done by vandals. OPA 90 supported this by requiring a responsible party to prove that it exercised due care and took precautions against foreseeable acts and omissions of any third party. The Terrorism Risk Insurance Act includes no such restrictions and the insurer and insured do not have to prove that they did anything to prevent or avoid the act of terrorism. This would be a major benefit for shipowners.