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MINERALS MANAGEMENT SERVICE

UNITED STATES DEPARTMENT OF INTERIOR

Oil Spill Financial Responsibility	)	
for Offshore Facilities	)	Docket No. RIN 1010-AC33
30 CFR Part 253	)	

COMMENTS OF THE JOINT RIG AND ASSOCIATED BUSINESS COMMITTEE OF LLOYD'S AND THE INSTITUTE OF LONDON UNDERWRITERS

Pursuant to the Notice of Proposed Rulemaking ("NPRM") published March 25, 1997 (62 Fed. Reg. 14052), the Joint Rig and Associated Business Committee hereby submit comments on the proposed requirements for demonstrating oil spill financial responsibility ("OSFR") for oil exploration, production, and associated pipeline facilities under Title I of the Oil Pollution Act of 1990, 33 U.S.C. § 2701 et seq. ("OPA"), as recently amended by the Coast Guard Authorization Act of 1996, Pub. L. No. 104-324.

About The Joint Rig Committee

The Joint Rig and Associated Business Committee (the "Joint Rig Committee") is a standing body comprised of representatives from the two major marine insurance trade associations in the London insurance market, namely, the Lloyd's Underwriters Association ("LUA") and the Institute of London Underwriters ("ILU"). The Joint Rig Committee, as the name implies, is concerned with matters of common interest relating to the insuring of risks arising from offshore exploration, drilling and production facilities and associated lines of insurance. The Joint Rig Committee develops recommended non-compulsory policy wordings and conditions which are available for use by the London marine market and indeed any other insurers. It also has as its purposes to promote educational programmes and to liaise with and respond to enquiries or representations from government bodies and other trade associations on matters relating to offshore rig and associated insurance lines. It is in this latter capacity that the Joint Rig Committee submits these comments on behalf of its members.

Lloyd's Underwriters Association. The LUA has as its members all underwriters in the Lloyd's market which are engaged in marine insurance business. Lloyd's of London itself is a market tracing its beginnings back to 1688 and began initially as insurers of marine risks although for more than a century it has underwritten many other classes of business. Today, the Lloyd's market is comprised of more than 160 underwriting syndicates.

Institute of London Underwriters. The ILU was founded in 1884 and today counts fifty-five insurance companies as members. These companies specialize in marine, energy, aviation and transport insurance, and more than 53% of the ILU members are owned by large international insurers from the United States, Continental Europe and Japan.

Both Lloyd's and ILU maintain systems of survey and claims settling agents worldwide to ensure prompt service to their insured. Together Lloyd's and the ILU companies insure a significant portion of the worldwide exploration and production industry, including a large share of the U.S. rig market. Undoubtedly, the increase in financial responsibility limits from $35 million per facility to, in some cases, $150 million per facility under this proposed rule will increase the need of the U.S. E&P industry to find supporting insurance capacity from the London market as well as any other sources available domestically or worldwide.

The Notice of Proposed Rulemaking

GENERAL COMMENTS

On balance, the Minerals Management Service ("MMS") has produced an easy-to-understand proposal which obviously has been carefully considered. The NPRM fails, however, to give full effect to the 1996 Amendments in several important respects. Unless corrected, these deficiencies potentially affect the ability of conventional marine insurers to participate in the financial responsibility program. The Joint Rig Committee urges MMS to carefully consider these comments and make appropriate modifications to the indicated provisions of the regulations before final promulgation. In the main, the deficiencies stem from the failure to fully reflect that the 1996 Amendments created a specific condition precedent (bankruptcy or insolvency of the responsible party) which must be met before a guarantor can be subjected to third-party direct action or other attendant consequences (such as advertising responsibility). We strongly endorse the comment made by the USCG National Pollution Fund Center in its February 3, 1997 letter on the pre-publication version of the NPRM that the regulation should establish a process for determining whether the conditions precedent have been satisfied, not a process for how or when claims should be presented. Below we suggest specific areas where the NPRM falls short of establishing such condition precedent procedures.

We note the proposed qualification of insurers in Section 253.11(a), under which Lloyd's and ILU members would be eligible to write the insurance contemplated. In respect of foreign insurers, this subsection is essentially identical to the current eligibility criteria which the U.S. Maritime Administration has established for hull insurance of the MARAD-subsidized U.S. flag vessels. **See** 46 CFR Sec. 249.4-.5. The MARAD rule was the result of an extensive rulemaking in recent years. Indeed, we believe all current Federal financial responsibility programs in the fields of aviation, marine transportation, and oil spill liability either explicitly, or as a matter of policy and practice, readily accept the traditional London insurance market comprised by Lloyd's and ILU members. **See,** e.g., DOT aircraft accident liability regulations (14 CFR Part 205); USCG vessel COFR rules (33 CFR Part 135); and FMC non-operating common carrier financial responsibility rules (46 CFR Part 583). Certainly, given the increased financial responsibility limits that will be required for many facilities as a result of this implementation of OPA Section 1016, the active participation of the traditional London marine insurance market can be expected to be needed in order to ensure that sufficient capacity is available.

SPECIFIC COMMENTS

A. ***Advertisement Should Not Be Guarantor's Responsibility Absent Bankruptcy or Insolvency of the Responsible Party***. The 1996 Amendments' removal of COF guarantors from third-party direct action other than following RP bankruptcy or insolvency requires that the NPRM adjust how the Designation of Source and Advertisement regulations (33 CFR Section 136.301 et seq. (1996) hereinafter "Subpart D") promulgated by the Coast Guard in 1992 for OPA discharge incidents generally,[1] would apply to offshore facility discharges. Given that a covered offshore facility ("COF") guarantor cannot be sued directly in the first instance by a third party, it would be inappropriate and contradictory to require such a guarantor to be responsible for the initial public advertisement of claims procedures, which would most likely confuse the public and lead to premature presentment demands on the guarantor.

By way of background, OPA Section 1014(b) provides that, following designation of the source of a discharge or threat, the responsible party "or guarantor" shall begin, no later than 15 days after designation, advertisement of the designation and the procedures by which claims may be presented. The Subpart D regulations, like OPA Section 1014(b), state that the responsible party or the guarantor shall advertise the details of the incident and the procedures by which a claim may be presented, the scope, frequency and duration of advertisement to be determined by the United States Coast Guard National Pollution Funds Center ("NPFC") on a case-by-case basis. Subpart D also provides that the advertisement will give the public the names of both the responsible party and its guarantor as well as the details of where and how to submit damage claims.

As MMS recognizes, the 1996 Amendments limited the responsibility of an offshore facility guarantor to respond to third-party claims only in cases where the responsible party has denied or failed to pay a claim because of being insolvent or because it had filed a Title 11 petition of bankruptcy. At least in the case of offshore facilities, it is inappropriate for the guarantor to become involved in public advertisement of claims presentation. The 1996 Amendment to Section 1016(f) was intended to insulate the guarantor from third-party actions unless and until the responsible party

[1] By Executive Order No. 12777, Oct 18, 1991, 56 Fed. Reg. 54757, the President delegated the functions respecting designation of sources of discharges and advertisement under OPA Section 1014 to the Secretary of Transportation, to whom the U.S. Coast Guard reports.

had denied or failed to pay claims as a result of a specified, determinable event (bankruptcy petition) or condition (insolvency). There is nothing in OPA Section 1014(b), moreover, that mandates that a guarantor be simultaneously responsible with the responsible party for advertising. Indeed, the use of the term "or" in OPA Section 1014(b) suggests that the guarantor is, at most, intended to be an alternate advertiser, say in the case of bankruptcy or insolvency of the party originally responsible for advertisement.

Finally, by overlooking this aspect of the claims process MMS would fail to give full effect to new OPA Section 1016(f)(3) which requires that this rulemaking establish a process "that will allow for the *orderly* and expeditious presentation and resolution of claims....." (emphasis added). In the event of a discharge, the general public will not be acquainted with the limitations on direct action specified in the rulemaking. Most likely, their only knowledge of the claims procedure will come from the advertisement. If Subpart D was interpreted to require the guarantor to be the advertiser in the first instance, this would undermine completely the protection for guarantors against initial, competing claims presentations which was the purpose of the 1996 Amendments to OPA Section 1016 (f).

The position that we urge here can be reconciled with the existing Subpart D regulations, and indeed is consistent with the scope of discretion implicit in the original OPA Section 1014(b). An explicit ordering of <u>sequential</u> responsibility for advertising which tracks the sequential responsibility for claims handling between the responsible party and the guarantor is all that is necessary.

The President delegated the implementation responsibility for Section 1014 to the U.S. Coast Guard, not MMS. We submit, however, that the later-enacted responsibility of MMS under OPA Section 1016(f)(3) to provide a process of "orderly... presentation", at a minimum, requires MMS to endeavor to conclude a Memorandum of Understanding ("MOU") with the Coast Guard which provides for guarantor advertising following a COF incident <u>only</u> after insolvency or bankruptcy of the designated applicant has occurred.

B. ***<u>An Objective and Well-Defined Test of Insolvency Is Required for Condition Precedent</u>*.** The NPRM, in establishing when a guarantor is subject to direct action for third party claims, fails to include all of the statutory terms of new OPA Section 1016(f)(2). As a consequence -- and contrary to the intention of Congress in enacting the 1996 Amendments -- it threatens to reduce to a nullity that subsection's stated purpose of imposing a "further requirement" on any direct action. That subsection, as amended, provides in relevant part:

> "(2) FURTHER REQUIREMENT. -- A claim may be asserted ... directly against a guarantor ... with respect to an offshore facility only if --
>
> (A) the responsible party ... has denied or failed to pay a claim ... *on the basis of being insolvent, as defined under 101(32) of title 11, United States*

Code, and applying generally accepted accounting principles;

(B) the responsible party ... has filed a petition for bankruptcy under title 11, United States Code; or

(C) the claim is asserted by the United States ..., including costs incurred by the Fund for processing compensation claims." (emphasis added).

Conditions (B) and (C) are incorporated virtually verbatim in subparagraphs (b)(2) and (a), respectively, of Section 253.61 of the proposed rule. The same cannot be said for condition (A) above. Proposed 253.61 provides merely that a guarantor is subject to direct action if the designated applicant:

"(b)(1) Denied or failed to pay a claim because of being insolvent; "

This prescription omits the important statutory conditions shown in italics above. In so doing, MMS has impermissibly deviated from the statutory text. Since Congress has directly spoken on this issue (by providing the appropriate standards for determining insolvency) , MMS is not free to depart from the plain meaning of the statute. Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 842-43 (1984) ("Chevron"). MMS has no discretion under the OPA to ignore these Congressionally-mandated conditions for determining insolvency. Proposed Section 253.61 must be modified accordingly.

Assuming arguendo that the departure from the statutory test is permissible, MMS still must administer the insolvency requirement in accordance with the statute. On the one hand, the proposed regulation allows for a direct action if the designated applicant has not paid a claim "because of being insolvent." Yet, in the NPRM itself, MMS describes this provision as applying to situations where claims are not paid "on grounds of insolvency." NPRM, at 14056. In the first instance, insolvency is the cause of the denial or failure to pay; in the second, insolvency is the reason given for denial for failure to pay.

MMS cannot have it both ways. New OPA Section 1016(f)(2) allows for direct claims against the guarantor only if a claim is denied or not paid "on the basis of being insolvent . . .." (emphasis added). Such language clearly indicates more than a simple assertion of insolvency. It requires rather a causal nexus between the insolvency and failure to pay on the part of the designated applicant that must be demonstrated before the claimant can proceed against the guarantor. The final rule must be modified to reflect this statutory intent.

Condition (A) poses some practical difficulties as well. Unlike (B) and (C), in which the determining factor (bankruptcy petition filing or U.S. government claimant) is easily identifiable, the insolvency condition must be established by an up-front objective test or procedural criteria if it is not to be rendered meaningless. Otherwise, the claimant can allege that the designated applicant is insolvent, and the insolvency determination will be an after-the-fact exercise. Under the proposed rule, condition (A) would allow the claimant immediate access to a guarantor under a "sue now, ascertain later" condition. This result cannot be reconciled with the 1996 Amendments.

Analysis of the two statutory criteria shows that the determination of insolvency was intended to be more than a mere self-serving assertion by the claimant. The statutory definition of "insolvent"[2] incorporated into the provision is not subjective, but rather an objective balance sheet test (as opposed to a cashflow or liquidity test) requiring a "fair valuation" of property.[3] Moreover, recognition of a liability under generally accepted accounting principles ("GAAP") as that which is "due and owing"[4] suggests that the determination of insolvency is not to be casual or self-interested. It instead requires an independent or professionally qualified application of GAAP rules.

These statutory conditions reasonably require MMS, as part of its rulemaking responsibility under OPA Section 1016(f)(3) to provide a "basis" for the insolvency determination, and in particular, guidance to the parties, on how the "applying" of GAAP principles is to be accomplished consistent with the "orderly and expeditious" presentation and resolution of claims.

The most legitimate means by which MMS can both satisfy the statutory conditions for

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[2] 11 U.S.C. 101(32) provides that

(32) "insolvent" means --

(A) with reference to an entity other than a partnership and a municipality, financial condition such that the sum of such entity's debts is greater than all such entity's property, at a fair valuation, exclusive of-

- (I) property transferred, concealed, or removed with intent to hinder, delay, or defraud such entity's creditors; and
- (ii) property that may be exempted from property of the estate under 522 of this title;

(B) with reference to a partnership, financial condition such that the sum of such partnership's debts is greater than the aggregate of, at a fair valuation--

- (I) all of such partnership's property, exclusive of property of the kind specified in subparagraph (A)(I) of this paragraph; and
- (ii) the sum of the excess of the value of each general partner's nonpartnership property, exclusive of property of the kind specified in subparagraph (A) of this paragraph, over such partner's nonpartnership debts; and

(C) with reference to a municipality, financial conditions such that the municipality is--

- (I) generally not paying its debts as they become due unless such debts are the subject of a bona fide dispute; or
- (ii) unable to pay its debts as they become due;

[3] This test does not apply to municipalities.

[4] See, e.g., Elements of Financial Statements, Statement of Financial Accounting Concepts No. 6, § 36 (Financial Accounting Standards Bd. 1985). ("A liability has three essential characteristics: (1) it embodies a present duty or responsibility to one or more other entities that entails settlement by probable future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand, (b) the duty or responsibility obligates a particular entity, leaving it little or no discretion to avoid the future sacrifice, and (c) the transaction or other event obligating the entity has already happened.") (emphasis added).

determining insolvency, and enable parties to resolve claims consistent with the spirit of the 1996 Amendments, is through requiring the claimant to prove insolvency. Although MMS appears to endorse this view,[5] it has not provided a sufficient "roadmap" for claimants to follow. In addition, MMS has also failed to address the timing of the insolvency determination. The final rule must contain the requirement that the designated applicant be shown to be insolvent both on the date of the denial or failure to pay, and on the date that the direct action is commenced. Without such a requirement, the designated applicant could be temporarily insolvent when it denies the claim, and then, prior to direct action, regain its solvency. Under these circumstances, direct action against the guarantor should not be permitted to go forward.

An objective mechanism by which insolvency could be determined should include the following principles. Applying traditional agency exhaustion principles, MMS should be the initial forum in which such determinations would be made. As the party required to establish insolvency, the claimant should bear the burden of proof in any procedure developed by MMS. The insolvency determination process should begin with the claimant first submitting its claim to the designated applicant. The designated applicant should then deny or fail to pay the claim. The claimant should then file a notice with MMS and formally request an insolvency determination. This notice should also be served upon the designated applicant and the guarantor.[6] If the designated applicant fails to respond to the claimant's notice, MMS can make a determination of insolvency by default. If the designated applicant denies insolvency, then MMS can conduct a limited hearing in which discovery is permitted on the parties, and the insolvency determination is subsequently made on the basis of the record. This procedure would ensure that direct action against the guarantor will occur only after MMS makes an official determination of insolvency.

Finally, the final OSFR rule should contain measures designed to discourage frivolous filings. For example, claimants that file notices of insolvency determinations with MMS in bad faith should be subject to consequential and punitive damages.

C. ***Insolvency or Bankruptcy Must Be of the Responsible Party (or Parties) In Addition To Any "Designated Applicant."*** Proposed Section 253.11(c), allows lease participants to designate a rig owner/operator as the "designated applicant," and provide financial responsibility even though such facility owner/operator is not a "responsible party" under OPA. So far as that goes, there is no problem. However, if the insolvency of the designated applicant triggers presentment of a claim against a guarantor without a showing that all responsible parties are insolvent (by some objective

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[5] In concluding that among the responsible parties, only the designated applicant need be insolvent under proposed Section 253.61, MMS stated "it should be sufficient for the claimant to demonstrate only that the designated applicant is insolvent before it could pursue the guarantor." NPRM, at 14057 (emphasis added).

[6] Service upon the guarantor will not make it an official party to the proceeding. Thus, while the claimant and the designated applicant will be required to respond to the other's evidence, the guarantor will not. Its participation in the insolvency proceeding will be strictly voluntary.

standard), clear Congressional intent will have been ignored.[7] This intent is evident in OPA's definition of responsible party which includes its plural, "responsible parties." Additionally, proposed Section 253.11(a)(2) acknowledges the "joint and several" status shared by each responsible party. A showing of insolvency by less than all of the responsible parties provides a "back door" by which responsible parties may escape the presentment scheme contemplated by the 1996 Amendments. The recent legislation would be otherwise rendered useless if vulnerable to manipulation by the responsible parties. The Congressional intent of the 1996 Amendments clearly and logically requires a showing of insolvency by all "joint and several" parties--in this instance, the responsible parties. As articulated by the Supreme Court in Chevron, "if the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect the unambiguously expressed intent of Congress." Id., at 842-43; see also, Bowen v. Georgetown University Hospital, 488 U.S. 204, 208 (1988) (holding "[i]t is axiomatic that an administrative agency's power to promulgate legislative regulations is limited to authority delegated by Congress.").

Even if MMS adheres to its view that it is sufficient that only one party be the designated applicant, in order to be consistent with the 1996 Amendments, MMS must require the designated applicant be a "responsible party" within the meaning of the statute. Otherwise, the insolvency of a non-responsible party could permit a claim against a guarantor, contrary to Congressional intent, even though responsible parties are solvent. If "Congress ha[s] an intention on the precise question at issue, that intention is the law and must be given effect." Chevron at 843 n.9. Therefore, either MMS must require that a designated applicant be a "responsible party" within the meaning of Section 1001(32) of OPA or that all other responsible parties be presented the claim before it can be presented to the guarantor.

D. *The 90-Day Trigger For Suits Against A Guarantor Is Inappropriate and Will Cause Needless Litigation.* Proposed Sections 253.60(b), (c), (d) and (f) appear to contemplate (correctly we believe) that a third party claim should be first presented to a guarantor, following a failure of the responsible party to pay a determination of insolvency or bankruptcy, in a non-judicial context. Yet, proposed Section 253.60(g) provides that a claimant may "[s]tart a court action against the guarantor" if the guarantor fails to pay a claim (and for which the insolvency/bankruptcy condition has been satisfied) "within 90 days after it was first presented to the designated applicant..." This proposed Section however fails to provide any procedural guidance for the 90-day trigger. In fact, it contradicts the spirit of the 1996 Amendments by encouraging, rather than discouraging, needless litigation. This provision presents three (3) difficulties:

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[7] The use of the singular "responsible party" in §1016(f)(2) of OPA does not justify a determination that a claim against a guarantor is permitted if only the designated applicant is insolvent. Rather, in construing statutes, the use of the singular includes the plural unless Congress indicates otherwise. 1 U.S.C. §1 (1947), see also Delpro v. Bhd. Ry. Carmen of the U.S. and Can., 676 F.2d 960, 964 (3rd Cir. 1982) ("1 USC § 1 . . . permits singular words to be read to include the plural unless there is some contrary indication in the context.")

1) it presumes that the insolvency or bankruptcy petition condition will have been met within the 90-day period; as noted above, MMS has not provided for a clear method of establishing insolvency absent litigation;

2) since the time period runs from submission to the applicant there is no assurance that the guarantor will have had a reasonable time (or any time) to examine the claim before being sued; and

3) there is no reference to the adequacy or sufficiency of the proof of claim which must be met before such time periods begin to run.

These defects should be rectified in any final rule. Otherwise, guarantors could be faced with a situation which is tantamount to the potential litigation free-for-all which Congress sought to avoid with the 1996 Amendments.

Administrative recognition needs to be given to the Congressional mandate reflected in the 1996 Amendments. Because claimants have direct and immediate access to the Trust Fund under OPA Section 1013, and because the Trust Fund in turn has direct and immediate access to the guarantor, irrespective of the responsible party's financial condition, there is no basis for creating arbitrary deadlines which unfairly prejudice guarantors' ability to respond to claims reasonably. Moreover, since the Fund is expressly authorized by new OPA Section 1016 (f) (2) (C) to recover from a guarantor the costs of processing third-party compensation claims, a guarantor already has every incentive to deal efficiently and promptly with all valid claims presented to it.

E. For Consistency, Insurance Certificate Form MMS-1019 Should Incorporate Replacement as Well as Other Methods of Termination. Section 3 of Form MMS-1019 provides for specification of the inception and expiration dates of insurance coverage. This section also roughly paraphrases the provisions of Section 253.41 of the proposed regulations regarding termination by expiration or otherwise. The certificate form, however, only refers to "cancellation" in advance of expiration, whereas the proposed subsection 253.41(c)(2) and (3) also contemplate termination of the certificate by, respectively, replacement with other acceptable OSFR and permanent abandonment of all covered facilities, Both these forms of termination should be expressly incorporated in Section 3 of the certificate.

We suggest that the first sentence of Section 3 be modified to read as follows:

> "The termination date and time shall be the date and time this instrument expires, or if prior thereto, the date cancellation, replacement or abandonment is effective." (Added words underscored.)

F. The Effective Date of The Final Rule Should Allow An Adequate Period for Compliance and Not Be Immediately Effective. When MMS ultimately promulgates the final rule, the effective date imposed should afford parties sufficient time to arrange compliance. Insurers, for example, will require some time to analyze, for example, the final terms and conditions on which they will be subjected direct action, in order to determine their exposure under the new rule and to ensure that pre-existing related coverages for the same clients are properly coordinated. We respectfully suggest that a minimum of six months is an appropriate compliance period.

Conclusion

The Joint Rig Committee respectfully requests that MMS modify its proposed rule in accordance with the comments set out above.

Respectfully submitted,

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