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COMPENSATION
FUND 1971

EXECUTIVE COMMITTEE
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Agenda item 3

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INCIDENTS INVOLVING THE 1971 FUND

NAKHODKA

Note by the Director

1 Introduction

Since document 71FUND/EX.51/8 was issued, the developments set out below have taken place in respect of the *Nakhodka* incident. This incident has also given rise to certain financial questions which the Director wishes to bring to the Executive Committee's attention.

2 Clean-up operations

2.1 The operation to remove the oil from the bow section was completed on 10 February 1997. It was reported that some 2 450m³ of oil/water mixture were recovered.

2.2 By 9 February the causeway had been extended 175 metres from the shore. A large crane has been assembled at the seaward end of the causeway with a sufficiently long arm to reach the bow section. The causeway and crane were not used in the removal of the oil from the bow section, but it is proposed that this equipment should be used to remove any small quantities of oil remaining.

2.3 The equipment and personnel supplied by East Asia Response Ltd (EARL) have been returned to Singapore.

2.4 The operations are now being concentrated on shoreline clean-up. The first stage of removing the major accumulations of emulsified oil at the water's edge has been completed. Further cleaning is required to remove oil traces from the shore in fishing and amenity areas. However, severe weather conditions continue to disrupt the clean-up activities.

2.5 It is estimated that, as at 11 February 1997, some 36 000m³ of oily waste have been collected as a result of the onshore clean-up operations, of which 21 000m³ have already been transported by sea, rail and road to final disposal facilities. A further 18 000m³ of oily sand have been collected along one section of the shoreline and await disposal.

3 Claims for compensation

3.1 No formal claims for compensation have been received so far, although some clean-up operators have made requests for provisional payments to mitigate financial hardship. It is clear, however, that the claims relating to clean-up operations and preventive measures will be significant. It has been estimated that the clean-up operations carried out up to 10 February 1997 will give rise to claims in the region of ¥9 000 million (£45 million)¹. Costs for the disposal of collected oily waste are estimated at ¥1 600 million (£8 million). Claims will also be made for costs relating to the removal of the oil from the grounded bow section, and it is not possible at this stage to estimate the amount involved. Claims may be submitted for the costs incurred by the Japanese authorities in the construction of the causeway leading to the bow section. Claims are expected for additional costs incurred by the Japanese Maritime Safety Agency for offshore clean-up operations and for the cost of the assistance given by the several Russian vessels dispatched to the affected area. Members of 173 fishery co-operative associations, in total some 46 000 people, are likely to submit claims for their involvement in the clean-up operations, and claims will also be presented for loss of income in the fishing and aquaculture industries. It is possible that claims will be presented by businesses in the tourism industry in the area. It is believed that claims as submitted will reach at least ¥20 000 million (£100 million), but it cannot be ruled out that the total amount of the claims will be significantly higher.

3.2 In document 71FUND/EXC.52/8 the Executive Committee has been invited to consider whether and, if so, to what extent, it is prepared to authorise the Director to make final settlements of claims arising out of this incident on behalf of the 1971 Fund.

3.3 As stated in the above-mentioned document, the Committee is also invited to consider whether and, if so, to what extent the Director should be authorised to make payments. In this regard, the Director would like to make the following observations.

3.4 It is clear that the total amount of the claims arising out of the *Nakhodka* incident will exceed the amount available under the 1971 Fund Convention, ie 60 million Special Drawing Rights (SDR), (approximately ¥10 200 million or £51 million).

3.5 The Executive Committee has in previous cases taken the position that it is necessary to exercise caution in the payment of claims, if there is a risk that the total amount of the claims arising out of the particular incident might exceed the total amount of compensation available under the 1969 Civil Liability Convention and the 1971 Fund Convention, since under Article 4.5 of the 1971 Fund Convention all claimants have to be given equal treatment. The Committee has also expressed the view that it is necessary to strike a balance between the importance of the 1971 Fund's paying compensation as promptly as possible to victims of oil pollution damage and the need to prevent an over-payment situation from arising (document FUND/EXC.48/6, paragraph 3.4.7).

3.6 Since the 1992 Fund Convention applies in the *Nakhodka* case, the Director suggests that the level of the 1971 Fund's payments should be determined by also taking into account the amounts available under the 1992 Fund Convention. He considers that in order to prevent an over-payment situation from arising for either the 1971 Fund or the 1992 Fund (or for both), a co-ordinated approach should be taken in respect of the payments by the two Organisations.

3.7 The 1992 Fund does not yet have an Executive Committee. For this reason any decisions in respect of the admissibility or payment of claims by the 1992 Fund can be taken only by the 1992 Fund Assembly,

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In this document, conversion of the Yen has been made on the basis of the rate of exchange as at 10 February 1997, ie ¥201:£1.

except to the extent that the Director is authorised under the 1992 Fund's Internal Regulations to make final settlements of claims and decide on claims payments.

3.8 Even in the absence of any decision on the part of the competent body of the 1992 Fund, ie the Assembly, the 1971 Fund Executive Committee may nevertheless wish to take a decision at this stage on the level of payments arising out of the *Nakhodka* incident. In view of the uncertainty as to the level of the total amount of the claims, the Director proposes that the payments to be made by the 1971 Fund should, for the time being, be limited to 60% of the amount of the damage actually suffered by the respective claimant on the basis of the advice of the experts engaged by the Funds and the shipowner/UK Club at the time when the payment is made. It is also proposed that this percentage should be reviewed at the Executive Committee's 53rd session, to be held in April 1997.

3.9 The Director intends to convene an extraordinary session of the 1992 Fund Assembly, to be held during the week of 14-18 April 1997, to consider the *Nakhodka* incident.

4 Possibility for the 1971 Fund to make payments

4.1 It is expected that a number of claims arising out of the *Nakhodka* incident will be presented within the next few weeks. Some claimants will face considerable financial hardship if they are not paid within a short period of time. The clean-up operations in Japan are mainly carried out by small or medium sized businesses, and for such businesses cash flow is an important element. The Director believes that for this reason payments should be made promptly to these businesses. As a result of the oil spill several thousand fishermen have had to abandon their fishing activities and have instead participated in the clean-up operations. It is important that payments to these fishermen are made promptly.

4.2 The *Nakhodka* incident had not occurred when the 1971 Fund Assembly assessed the 1996 annual contributions at its 19th session, held in October 1996. If contributions to a *Nakhodka* Major Claims Fund are not levied until October 1997, in keeping with past practice, contributions would not be received until 1 February 1998.

4.3 The Director considers that there are two ways in which the 1971 Fund can ensure that it has money available earlier to make prompt payments in this case.

4.4 The 1971 Fund Assembly could, at an extraordinary session which could be held during the week of 14-18 April 1997, make a supplementary levy of contributions to the *Nakhodka* Major Claims Fund, payable say by 1 August 1997.

4.5 If, however, the Assembly were not to levy annual contributions to the *Nakhodka* Major Claims Fund until its ordinary session in October 1997, for payment by 1 February 1998, the 1971 Fund could cover payments before then of claims arising from the *Nakhodka* incident by using funds from a combination of the following sources:

- (i) *The working capital.* It should be recalled that the working capital was reduced by the Assembly at its 19th session from £15 million to £10 million, with effect from 1 February 1997.
- (ii) *Loans from present assets of other existing Major Claims Funds* (other than the *Taiko Maru* and *Toyotaka Maru* Major Claims Funds) (to be repaid with interest from the *Nakhodka* Major Claims Fund in due course): These funds would, however, be insufficient for this purpose, taking into account the need to have funds available for a global settlement of the *Haven* case if such a global settlement is reached.
- (iii) *Loans from the balances on the Taiko Maru and Toyotaka Maru Major Claims Funds* (to be repaid with interest from the *Nakhodka* Major Claims Fund in due course): The Assembly decided in October 1996 that these balances (£3.5 million and £4.7 million, respectively) should be reimbursed to contributors in connection with a deferred levy to be invoiced during the second half of 1997 (document 71FUND/A.19/30, paragraph 25.9). In order to enable the 1971 Fund to take such loans, the Assembly

would have to make a decision to postpone until 1 February 1998 the reimbursement to contributors of these balances.

- (iv) *Loans from the Keumdong N°5, the Sea Prince/Yeo Myung/Yuil N°1 and Sea Empress Major Claims Funds, by using part of the funds received from the deferred levies to be made to these Major Claims Funds (to be repaid with interest from the Nakhodka Major Claims Fund in due course):* The Assembly decided at its 19th session to make a total levy of £85 million for the 1996 annual contributions, out of which £23 million was due by 1 February 1997 and the balance would be invoiced by the Director during 1997, if and to the extent required. The Assembly's decision is summarised in the following table:

| Fund | Oil year | Total levy £ | Payment by 1 February 1997 | Maximum deferred levy |
|--------------------------------------|----------|-------------------|-------------------------------|--------------------------|
| <i>Keumdong N°5</i> | 1992 | 5 000 000 | 0 | 5 000 000 |
| <i>Sea Prince/Yeo Myung/Yuil N°1</i> | 1994 | 50 000 000 | 13 000 000 | 37 000 000 |
| <i>Sea Empress</i> | 1995 | 30 000 000 | 10 000 000 | 20 000 000 |
| Total | | 85 000 000 | 23 000 000 | 62 000 000 |

It would be possible to invoice the total amount of the deferred levy, £62 million. Any balance not needed for payment before 1 February 1998 of claims arising from those incidents for which the levies were intended (the *Keumdong N°5*, *Sea Prince*, *Yeo Myung*, *Yuil N°1* and *Sea Empress* incidents) could then be made available for the payment of claims arising out of the *Nakhodka* incident in the form of an internal loan which would be repaid with interest after 1 February 1998 from the *Nakhodka* Major Claims Fund, when annual contributions to that Major Claims Fund have been received. The extent to which these deferred levies could be used for the payment of claims arising out of the *Nakhodka* incident would depend upon the payments to be made before 1 February 1998 in respect of the incidents for which these levies were originally intended. It should be noted that, in the Director's view, a decision by the Assembly authorising such a change of use of the deferred levy would be required.

- (v) *External loans* in accordance with Financial Regulation 8: It should be noted that the cost to the 1971 Fund (and therefore to contributors) of taking such loans would be fairly high.

4.6 If the approach set out in paragraph 4.5 were to be preferred by the Executive Committee, and subject to any decisions to be taken by the Assembly as required, the payment of claims arising out of the *Nakhodka* incident might be financed up to approximately £30 million, as follows:

| | | £ |
|--------------|--|----------------------------------|
| (a) | Working capital | Up to: 5 000 000 |
| (b) | Loans from Major Claims Funds balances due for reimbursement | - <i>Taiko Maru</i> 3 500 000 |
| | | - <i>Toyotaka Maru</i> 4 700 000 |
| (c) | Loans from Major Claims Funds by making maximum deferred levy of £62 million to <i>Keumdong N°5</i> , <i>Sea Prince/Yeo Myung/Yuil N°1</i> and <i>Sea Empress</i> Major Claims Funds | Up to: 17 000 000 |
| Total | | 30 200 000 |

4.7 The Director favours the option set out in paragraph 4.4, ie that of a decision by the 1971 Fund Assembly in April 1997 to make a supplementary levy of contributions to the *Nakhodka* Major Claims Fund, due by 1 August 1997, at such level as the Assembly may decide.

4.8 As mentioned above, the options set out in paragraphs 4.4 and 4.5-4.6 both require decisions by the Assembly. If the Executive Committee were to agree that this issue should be submitted to an extraordinary

session of the Assembly, to be held during the week of 14-18 April 1997, the Director would make detailed proposals for consideration by the Assembly at that session.

5 Possibility for the 1992 Fund to make payments

5.1 As regards the possibilities for the 1992 Fund to make payments of claims arising out of the *Nakhodka* incident, the Executive Committee may wish to note the following points.

5.2 The 1992 Fund Assembly decided at its first extraordinary session, held in October 1996, to levy contributions to the General Fund for a total of £7 million, out of which £4 million was due for payment by 1 February 1997 and the balance of the levy was deferred. The Director was authorised to decide whether to invoice all or part of the deferred levy for payment during the second half of 1997.

5.3 As mentioned above, there is a considerable risk that the total amount of the approved claims will significantly exceed the amount available under the 1969 Civil Liability Convention and the 1971 Fund Convention. If the amount to be paid by the 1992 Fund were to exceed £7 million, the 1992 Fund would not have sufficient assets to meet such payments. In that situation it would be necessary for the 1992 Fund Assembly to consider what solutions could be found in order to ensure the prompt payment of claims. As mentioned above, the Director intends to convene an extraordinary session of the 1992 Fund Assembly during the week of 14-18 April 1997, and this issue would be considered at that session.

6 Purchase of Japanese Yen

6.1 In view of the estimated level of the potential claims arising out of the *Nakhodka* incident, the question arises whether the 1971 Fund should at this stage purchase Japanese Yen to be used for the payment of these claims. In this regard reference is made to Financial Regulation 10.4. Under that Regulation, the 1971 Fund's asset shall be held in Pound Sterling or, if the Director considers it appropriate, in the currencies required to meet claims arising out of a specific incident which have been settled or are likely to be settled in the near future. Subject to the prior approval of the Assembly or the Executive Committee, investments may also be made in currencies other than Pound Sterling to meet payments in respect of a particular incident which has given rise to significant claims against the 1971 Fund.

6.2 At present the Pound is very strong in the currency market, whereas the Yen is comparatively weak. For example, as at 31 December 1995 £1 corresponded to ¥160, whereas at 31 December 1996 £1 would purchase ¥199. As at 10 February 1997, the exchange rate was ¥201 to the Pound. It is impossible to predict how the Pound:Yen exchange rate will develop in the near future. Nevertheless, in view of the significant amounts involved, the Director considers that it would be prudent for the 1971 Fund to purchase immediately, or in the next few weeks, a significant amount (say £10 or £20 million) in Yen in order to protect the 1971 Fund against a strengthening of the Yen vis-à-vis the Pound. It should be noted, however, that there is a considerable difference in the rate of interest on investments in Yen and in Pound Sterling. At present investments in Pound Sterling of such amounts in London give a yield of approximately 6.5% per annum, whereas Yen investments give a rate of approximately 0.5% per annum. The Director considers that in spite of this difference in interest rates it would be justified to purchase Yen as suggested above.

6.3 If the Executive Committee were to approve the Director's proposal to purchase Yen for a significant amount at this stage, the Committee may also consider whether it would be prudent for the 1971 Fund to buy Yen for further amounts as and when required, if the Director would consider that the exchange rate situation justified such purchases.

7 Action to be taken by the Executive Committee

The Executive Committee is invited:

- (a) to take note of the information contained in this document;
 - (b) to give the Director such instructions in respect of the handling of this incident and of claims arising therefrom as the Committee may deem appropriate;
 - (c) to decide whether to authorise the Director to make final settlements of claims (paragraph 4.2 of document 71FUND/EXC.52/8);
 - (d) to decide whether to authorise the Director to make payments and, if so, at what level (paragraph 3.8 of document 71FUND/EXC.52/8/Add.1);
 - (e) to give the Director such instructions as the Committee may consider appropriate in respect of the use of the Fund's assets in order to enable it to pay claims arising out of this incident as soon as possible (paragraph 4 of document 71FUND/EXC.52/8/Add.1);
 - (f) to take a position in respect of certain issues relating to the applicability of the 1969 and 1992 Civil Liability Conventions and the 1971 and 1992 Fund Conventions (paragraphs 5.2-5.5 of document 71FUND/EXC.52/8); and
 - (g) to give the Director such instructions in respect of the purchase of Japanese Yen as the Committee may deem appropriate (paragraph 6 of document 71FUND/EXC.52/8/Add.1).
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