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ANY OTHER BUSINESS

APPLICATION OF THE 1992 CONVENTIONS TO SHIP-TO-SHIP OIL TRANSFER OPERATIONS

Note by the Director

***Summary*:** The Malaysian Government has drawn the 1992 Fund's attention to ship-to-ship (STS) oil transfer operations that take place within Malaysian territorial waters in which one of the vessels remains permanently at anchor. This 'mother' vessel, which is a registered tanker, fully manned and insured for pollution liabilities, but is not permitted to trade as a result of the phasing out of single-hulled tankers under the provisions of MARPOL, receives cargoes of heavy fuel oil and gas oil from sea-going ships, which are subsequently transferred to other sea-going ships and bunkering vessels. Some of the received oil is blended on the 'mother' vessel to produce different specifications of fuel oil before being transhipped.

The question arises as to whether the 'mother' vessel falls within the definition of 'ship' under the 1992 Civil Liability and Fund Conventions as interpreted by the 1992 Fund Assembly. The question also arises as to whether the persistent oil received at the 'mother' vessel should be considered as received for the purpose of Article 10.1 (a) of the 1992 Fund Convention and therefore be taken into account for the levying of contributions.

Action to be taken:

(a) decide whether permanently anchored floating storage units involved in STS oil transfer operations of the type taking place in Malaysian waters, which are registered as tankers but may not legally be used for trading, are fully manned and ready to sail and are insured for pollution liabilities, fall under the definition of 'ship' under the 1992 Civil Liability and Fund Conventions;

(b) decide whether all persistent oil received at, or persistent oil received and subsequently modified by blending onboard, such vessels when operating in the territory, including territorial waters, of a State Party to the 1992 Fund Convention, should be considered as received at the 'mother' vessel for the purpose of Article 10.1 (a) of that Convention and therefore be taken into account for the levying of contributions;

(c) if oil received in the circumstances set out under paragraph (b) were to

	be considered as received at the 'mother' vessel for the purpose of Article 10.1 (a), decide whether to revise the wording relating to floating tanks in the explanatory note attached to the 1992 Fund form for reporting contributing oil received; and
	(d) consider whether to instruct the Director to undertake a study of the extent to which registered owners or operators of vessels are engaged in similar STS oil transfer operations globally.

1 Introduction

1.1 The Malaysian Government allows owners of large tankers to conduct ship-to-ship (STS) oil transfer operations whilst permanently at anchor within its territorial waters. One such 'mother' vessel is permanently anchored within the port limit of Tanjung Pelepas, Johor, Peninsular Malaysia for the purpose of conducting STS operations. The owner of this 'mother' vessel buys and sells cargoes of heavy fuel oil and gas oil, which are received from sea-going ships and subsequently transferred to other sea-going ships and bunkering vessels. Some blending of heavy fuel oil and gas oil is carried out on the 'mother' vessel to produce different specifications of fuel oil before being transhipped.

1.2 The conditions stipulated by the Malaysian Marine Department for the conduct of the STS operations include the following:

(a) Vessels are subject to port state control for the purpose of verifying the standard of safety and seaworthiness.
(b) Vessels involved in the STS shall carry certificates attesting that they are insured for pollution liabilities in accordance with the Civil Liability Convention.
(c) Vessels are to be fitted out with additional oil spill response equipment.
(d) Vessels shall be moved within twenty-four hours of notification being received from the Malaysian Marine Department.

1.3 One vessel of the type referred to in paragraph 1.1 has the following general particulars:

Flag:	Malaysia
Classification:	American Bureau of Shipping (ABS)
Gross tonnage (GT)	127 300
Net tonnage (NT):	100 009
Deadweight:	266 590 metric ton
Length:	323.77 meters
Breadth:	54.25 meters
Depth:	26.21 meters

1.4 When the vessel in question, which is a single-hulled tanker, began operating as a 'mother' vessel, the Malaysian Government (Flag State), in conjunction with the American Bureau of Shipping, issued the vessel with a full set of statutory certificates entitling it to operate as a sea-going tanker. However, when the provisions in MARPOL concerning the phasing out of single-hulled tankers entered into force for tankers of the size of this vessel, the Malaysian Marine Department stipulated that the vessel should no longer be used for trading as a tanker. Nevertheless, the

vessel is still required to maintain a full complement of deck officers, engineers and crew and comply with the safe manning certificate issued by the Malaysian Marine Department. The vessel's propulsion machinery is operational and the vessel is maintained in a condition of readiness to sail at short notice. The owner of the vessel holds a certificate of insurance pursuant to Article VII of the 1992 Civil Liability Convention by a P&I Club belonging to the International Group of P&I Clubs.

1.5 It is reported that the 'mother' vessel conducted an average of 44 STS operations per month during the first seven months of 2005 during which time a total of some 1.4 million tonnes was transhipped. Approximately 25% of the heavy fuel oil received by the mother vessel was blended with gas oil before being transhipped.

1.6 The question arises as to whether the 'mother' vessel in question and other such vessels engaged in similar STS operations, which are acting essentially as floating storage units (FSUs), fall within the definition of 'ship' under the 1992 Civil Liability and Fund Conventions as interpreted by the 1992 Fund Assembly.

1.7 The question also arises as to whether the persistent oil received at the 'mother' vessel should be considered as received for the purpose of Article 10.1 (a) of the 1992 Fund Convention and therefore taken into account for the levying of contributions.

2 The question of whether the 'mother' vessel would fall within the definition of 'ship' in the 1992 Conventions

Previous consideration by the 1992 Fund as regards FSUs

2.1 In October 1998 the 1992 Fund Assembly established an intersessional Working Group to study *inter alia* whether, and if so to what extent, the 1992 Conventions applied to offshore craft, namely floating storage units (FSUs) and floating production, storage and offloading units (FPSOs).

2.2 The definition of 'ship' in Article I.1 of the 1992 Civil Liability Convention reads:

> 'Ship' means any sea-going vessel and seaborne craft of any type whatsoever constructed or adapted for the carriage of oil in bulk as cargo, provided that a ship capable of carrying oil and other cargoes shall be regarded as a ship only when it is actually carrying oil in bulk as cargo and during any voyage following such carriage unless it is proved that it has no residues of such carriage of oil in bulk aboard.

This definition is incorporated in the 1992 Fund Convention.

2.3 The Working Group drew the following conclusions (document 92FUND/A.4/21, paragraph 7.5):

(i) Offshore craft should be regarded as 'ships' under the 1992 Conventions only when they carry oil as cargo on a voyage to or from a port or terminal outside the oil field in which they normally operate.

(ii) Offshore craft would fall outside the scope of the 1992 Conventions when they leave an offshore field for operational reasons or simply to avoid bad weather.

2.4 After the Working Group's meeting some companies operating in the offshore sector wrote to the Director expressing concerns as to the restrictive interpretation recommended by the Working Group. These companies expressed the view that there was no support in the text of the 1992 Civil Liability Convention for a distinction between offshore craft and trading tankers.

2.5 The 1992 Fund Assembly considered the Working Group's report at its 4th session, held in October 1999.

2.6 When the Working Group's report was considered by the Assembly, a number of delegations expressed their surprise at the late intervention of some members of the offshore industry, given that wide consultations had taken place prior to and during the intersessional Working Group, and that no new legal arguments were being presented. Those delegations stressed that any final decision regarding the applicability of the 1992 Conventions to offshore craft was a matter for national courts, but that it was expedient for the 1992 Fund to adopt a policy before an incident involving such a craft occurred in a 1992 Fund Member State. For this reason those delegations were of the view that the Assembly should not defer its decision on the issue, recognising that such a decision was always open to revision in the light of new information.

2.7 The 1992 Fund Assembly decided to endorse the conclusions of the Working Group regarding the applicability of the 1992 Conventions to offshore craft as set out in paragraph 2.3. The Assembly emphasised that in any event the decision as to whether the 1992 Conventions applied to a specific incident would be taken in the light of the particular circumstances of that case. It was noted that the issue could be considered if new information were to come to light (document 92FUND/A.4/32, paragraph 24.10).

Slops incident

2.8 In July 2000 the 1992 Fund Executive Committee considered the applicability of the 1992 Conventions in respect of the *Slops* incident (Greece, 15 June 2000). This Greek-registered waste oil reception facility, laden with some 5 000 m³ of oily water, of which 1 000 - 2 000 m³ was believed to be oil, suffered an explosion and caught fire at anchor in the port of Piraeus resulting in a spillage of an unknown but substantial amount of oil.

2.9 The *Slops* had no liability insurance in accordance with Article VII.1 of the 1992 Civil Liability Convention, having been exempted by the Greek authorities. The *Slops* was originally designed and constructed for the carriage of oil in bulk as cargo, but in 1995 it underwent a major conversion, in the course of which its propeller was removed and its engine deactivated and officially sealed. It was indicated that the purpose of the sealing of the engine and the removal of the propeller was to convert the status of the craft from a ship to a floating oily waste receiving and processing facility. Since the conversion the *Slops* had remained permanently at anchor where it had been used exclusively as a waste-oil storage and processing unit, the product being sold as low-grade fuel oil.

2.10 The Executive Committee recalled the decision by the 1992 Fund Assembly that FSUs and FPSOs should be regarded as ships only when they were carrying oil as cargo on a voyage to or from a port or terminal outside the oil field in which they normally operated. The Committee noted that although the Working Group that had been set up to study this issue had mainly considered the applicability of the 1992 Conventions in respect of craft in the offshore oil industry, there was no significant difference between the storage and processing of crude oil in the offshore industry and the storage and processing of waste oil derived from shipping. A number of delegations expressed the view that since the *Slops* was not engaged in the carriage of oil in bulk as cargo it could not be

regarded as a 'ship' for the purpose of the 1992 Conventions. The Committee decided that, for the reasons set out above, the *Slops* should not be considered a 'ship' for the purpose of the 1992 Civil Liability and Fund Conventions and that therefore the Conventions did not apply to this incident (document 92FUND/EXC.8/8, paragraphs 4.3.6 to 4.3.8).

2.11 In February 2002 two Greek companies that had undertaken clean-up operations in response to the incident took legal action against the registered owner of the *Slops* and the 1992 Fund claiming £1.5 million in respect of the costs of clean-up and preventive measures.

2.12 The Court of first instance held that the *Slops* fell within the definition of 'ship' laid down in the 1992 Civil Liability Convention and the 1992 Fund Convention. In the Court's opinion, any type of floating unit originally constructed as a seagoing vessel for the purpose of carrying oil was and remained a ship, although it might subsequently be converted into another type of floating unit, such as a floating oil waste receiving and processing facility, and notwithstanding that it might be stationary or that the engine might have been temporarily removed or the propeller sealed (document 92FUND/EXC.24/6, paragraph 3.2).

2.13 In February 2003, the Executive Committee considered the question of whether to appeal against the judgement. During the discussion a number of delegations pointed out that the decision by the Committee that the *Slops* should not be considered a 'ship' for the purposes of the 1992 Conventions was based on a policy decision by the Assembly regarding the conditions under which floating storage units should be considered 'ships' for the purpose of the Conventions, namely only when they were carrying oil in bulk, which implied that they were on a voyage. Those delegations referred to the preamble to the Conventions, which specifically referred to the transportation of oil. The Committee decided that the 1992 Fund should appeal against the judgement (document 92FUND/EXC.20/7, paragraph 3.5.15).

2.14 In its appeal the 1992 Fund argued that the Court of first instance had erroneously considered that the *Slops* was at the time of the incident carrying oil, regarding the mere existence on board of oil residues as 'carriage', ie transportation. It also argued that although the Court had considered that the 2 000 m^3 of oil on board was carried in the sense that it was intended to be transported to the oil refineries, there was no evidence that this would be the case. The Fund drew attention to a document issued by the Ministry of Merchant Marine proving beyond doubt that the *Slops*, which constituted a floating industrial unit for the processing of oil residues and separating them from water, had operated continuously as such a unit from May 1995 and had been permanently anchored since that date without any propulsion equipment. The Fund maintained that the *Slops* had not been intended to carry oil residues by sea to oil refineries and had never carried out such operations during the time it served as a floating oil residue processing facility, such carriage having been performed by the use of barges owned by third parties, which went alongside the *Slops* to receive the oil residues and transported them to the refineries for further processing. The Fund further argued that the *Slops* did not have the liability insurance required in accordance with Article VII.1 of the 1992 Civil Liability Convention and that this requirement had never been imposed by the Greek authorities upon the *Slops*. It was pointed out that the Greek authorities were obliged under Article VII.10 not to permit a vessel flying the Greek flag to carry out commercial activities without such a certificate of insurance. The Fund concluded that in view of these facts, the *Slops* could not be considered to fall within the definition of 'ship' in the 1992 Conventions.

2.15 The Court of Appeal rendered its judgement in February 2004. The Court held that the *Slops* did not meet the criteria required by the 1992 Conventions and rejected the claims. The Court interpreted the word 'ship' as defined in Article I.1 of the 1992 Civil Liability Convention as a

seaborne unit which carries oil from place A to place B. The Court of Appeal took into consideration evidence submitted by the Fund, which clearly showed that, at the time of the incident, the *Slops* did not operate as a seagoing vessel or a floating unit for the purpose of transporting persistent oil in its tanks. The Court accepted the Fund's position that the *Slops*, which had originally been built as a tanker, had performed its last voyage as an oil-carrying vessel in 1994. The Court also noted that the *Slops* had been subsequently sold to Greek interests, who had converted it into a floating waste oil storage and processing unit and to this effect had removed its propeller and sealed its engine and that the Pireaus Central Port Authority had confirmed that the *Slops* had remained permanently at anchor since May 1995 without propulsive equipment. The Court also referred to the fact that the relevant Greek authorities had not required that the *Slops* be insured in accordance with Article VII.1 of the 1992 Civil Liability Convention and that this also indicated that the *Slops* could not be considered as a 'ship' under the 1992 Conventions.

2.16 The claimants have appealed against this judgement to the Greek Supreme Court. The Supreme Court's judgement is expected in late 2005 or early 2006.

Director's considerations

2.17 During the intersessional Working Group's discussions in April 1999 (document 92FUND/A/4/21) on the applicability of the 1992 Conventions to offshore craft one delegation stated that although the criterion of construction was essential in establishing whether such craft fell within the scope of the Conventions, it was insufficient by itself and that the concept of 'carriage' was equally fundamental. A number of delegations referred to the fact that offshore craft generally operated in national and territorial waters and that as such were not regulated by international conventions such as the International Convention for the Prevention of Pollution from Ships, 1973, as amended by the Protocol of 1978 relating thereto (MARPOL 73/78) and the International Convention for the Safety of Life at Sea (SOLAS), 1974, but by local laws and regulations. Those delegations argued that unless the offshore craft were engaged in the carriage of oil that was subject to the payment of contributions to the 1992 Fund, such craft should not fall within the scope of the 1992 Conventions. The observer delegation of the International Group of P&I Clubs sought to distinguish between the different purposes for which offshore craft might be constructed or adapted, apart from being used for conventional carriage. In the view of that delegation, a typical FPSO differed to a relatively large extent from a conventional tanker, not only in design and construction, but also in its ordinary intended use. That delegation stated that the distinctions were less clear in the case of storage, which Clubs belonging to the International Group did not exclude from the ambit of their mutual reinsurance arrangements unless there was some additional production element, such as the transfer of oil directly from the producing well and/or the operation of equipment to separate oil from gas. That delegation therefore proposed that the 1992 Conventions should generally not apply to FPSOs but that FSUs should be regarded as 'ships', recognising the need in both cases for flexibility to deal with exceptional cases.

2.18 The Director notes that the 'mother' vessels engaged in STS operations of the type being carried out in Malaysian waters, although permanently at anchor and operating as FSUs, are, unlike the *Slops* (cf paragraphs 2.8-2.16 above), registered as tankers and are fully manned and ready to sail. The Director also notes that these vessels carry certificates attesting that insurance or other financial security is in force in accordance with Article VII of the 1992 Civil Liability Convention.

2.19 The Director notes that, notwithstanding the fact that the 'mother' vessels engaged in STS oil transfer operations in Malaysian waters may no longer legally be used for trade and therefore may not legally be engaged in the carriage of oil at sea in bulk, they remain sea-going vessels constructed for the carriage of oil in bulk as cargo, are registered as tankers, are fully manned and

able to sail at 24 hours notice and are insured for pollution liabilities. Having considered all the specific facts of these operations, the Director therefore takes the view that such vessels fall within the definition of 'ship' under the 1992 Civil Liability and Fund Conventions.

3 Ship-to-ship transfers and contributing oil

Previous considerations by the 1971 Fund Assembly

3.1 Article 10.1 (a) of the 1992 Fund Convention provides that annual contributions to the 1992 Fund shall be made in respect of each Contracting State by any person who, in the relevant calendar year, has received in total quantities exceeding 150 000 tonnes in the ports or terminal installations in the territory of the State contributing oil carried by sea to such ports or terminal installations.

3.2 As reflected in the Official Records of the Conference on the Establishment of an International Compensation Fund for Oil Pollution Damage, 1971, which adopted the 1971 Fund Convention, the Rapporteur of the Conference, in explaining the general principle of the system of contributions set out in Article 10, stated *inter alia* that contributions had to be made every time there was a movement, for example, when a delivery of crude oil was followed by a delivery of fuel oil produced from that crude oil (CONF.2/C/SR.13, page 404).

3.3 At its 1st extraordinary session in October 1980 the 1971 Fund Assembly considered the circumstances under which contributing oil should be considered as 'received'. The Assembly examined the report of an intersessional Working Group, which had met in June 1980 to discuss *inter alia* this issue. The Assembly approved the following interpretation of 'received' (document FUND/A/ES.1/13, paragraph 10).

(a) Discharge into a floating tank within the territorial waters of a Member State (including its ports) constitutes a receipt of oil, irrespective of whether the tank is connected with onshore installations via pipeline or not. Ships are considered to be floating tanks in this connection only if they are ‘dead’ ships, ie if they are not ready to sail.

(b) Traffic within a port area shall not be considered as carriage by sea.

(c) Ship-to-ship transfer shall not be considered as receipt, irrespective of where this transfer takes place (ie within a port area or outside the port but within territorial waters) and whether it is done solely by using the ships' equipment or by means of a pipeline passing over land. This applies for a transfer between two sea-going vessels as well as for a transfer between a sea-going vessel and an internal waterway vessel and irrespective of whether the transfer takes place within or outside a port area. When the oil, after having been transferred in this way from a sea-going vessel to another vessel, has been carried by the latter to an onshore installation situated in the same Member State or in another Member State, the receipt in that installation shall be considered as receipt of oil carried by sea. However, in the case where the oil passes through a storage tank before being loaded to the other ship, it has to be reported as oil received at that tank in that State.

3.4 The above interpretation is reflected in the explanatory notes attached to the 1992 Fund form for reporting contributing oil received (which constitutes an Annex to the Internal Regulations), the current version of which was approved by the 1992 Fund Assembly at its extraordinary session in March 2005 (document 92FUND/A/ES.9/28, paragraph 16.2).

Director's considerations

3.5 The Director understands that in the case of the STS oil transfer operations in Malaysian waters the oil is subsequently sold to third parties, sometimes after modification through onboard blending. It is also understood that similar STS oil transfer operations are undertaken in other countries.

3.6 The Director is of the view that the oil that is modified by onboard blending as referred to in paragraph 3.5 is analogous to the example of fuel oil produced from crude oil referred to by the Rapporteur of the 1971 Conference as set out in paragraph 3.2 above. The Director therefore considers that oil carried by sea after modification by blending onboard the 'mother' vessel represents a separate movement to the carriage by sea of the original oil received at the 'mother' vessel. The Director therefore concludes that oil that is modified through onboard blending before being transhipped should be regarded as received at the 'mother' vessel for the purpose of Article 10.1 (a) of the 1992 Fund Convention and therefore be taken into account for the levying of contributions.

3.7 The Director is also of the view that the ship-to-ship oil transfer operations such as those carried out in Malaysian waters are somewhat different to those of the type referred to in sub-paragraph 3.3(c) above, since the 'mother' vessel is operating more like an oil terminal or a floating tank than a conventional ship engaged in ship-to-ship oil transfer operations. For this reason the Director considers that all persistent oil received through STS operations by ships permanently anchored in the territory or territorial sea of a State Party to the 1992 Fund Convention, irrespective of whether or not it is blended, should be regarded as received at the 'mother' vessel for the purpose Article 10.1 (a) of the 1992 Fund Convention and therefore be taken into account for the levying of contributions.

3.8 The Director notes, however, that neither of the interpretations set out in paragraphs 3.6 and 3.7 is compatible with the current interpretation of the concept of 'received' set out in sub-paragraph 3.2(a) above, namely that ships are considered to be floating tanks in this connection only if they are 'dead' ships, ie if they are not ready to sail. If the Assembly were to agree with either of the Director's interpretations it would therefore be necessary to amend the wording relating to floating tanks in the explanatory note attached to the 1992 Fund form for reporting contributing oil received. The Director proposes the following revised text for consideration by the Assembly (amendments highlighted; the text in square brackets should only be included if the Assembly were to decide that only modified oil should be regarded as received for the purpose of Article 10.1 (a)):

> 'Received in the ports or terminal installations in the Member State' includes discharge into a floating tank within the territorial waters of the Member State (including its ports), irrespective of whether the tank is connected with onshore installations via pipeline or not. Ships are considered to be floating tanks in this connection[<1>] if they are 'dead' ships, ie if they are not ready to sail**, or if they are permanently at anchor [and the oil is modified onboard by blending].**

3.9 If the Assembly were to concur with the views of the Director, it may wish to invite him to investigate the extent to which operations similar to those described in paragraph 3.5 are being

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[<1>] The word 'only' deleted

undertaken worldwide, since this could have a significant impact on the number of contributors to the Funds and the quantities of contributing oil.

4 Action to be taken by the Assembly

The Assembly is invited:

(a) to take note of the information in this document;

(b) to decide whether permanently anchored floating storage units involved in STS oil transfer operations of the type taking place in Malaysian waters, which are registered as tankers but may not legally be used for trading, are fully manned and ready to sail and are insured for pollution liabilities, fall within the definition of 'ship' under the 1992 Civil Liability and Fund Conventions;

(c) to decide whether all persistent oil received at, or persistent oil received and subsequently modified by blending onboard, such vessels when operating in the territory, including the territorial waters, of a State Party to the 1992 Fund Convention, should be considered as received at the 'mother' vessel for the purpose of Article 10.1 (a) of that Convention and therefore be taken into account for the levying of contributions;

(d) if oil received in the circumstances set out under paragraph (c) were to be considered as received at the 'mother' vessel for the purpose of Article 10.1(a), to decide whether to revise the wording relating to floating tanks in the explanatory note attached to the 1992 Fund form for reporting contributing oil received; and

(e) to consider whether to instruct the Director to undertake a study of the extent to which registered owners or operators of vessels engaged in similar STS oil transfer operations globally.