INTERNATIONAL OIL POLLUTION COMPENSATION FUNDS	Agenda item: 10	IOPC/OCT09/10/1	
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	1992 Fund Assembly	**92A14**	•
	1992 Fund Executive Committee	**92EC46**	
	Supplementary Fund Assembly	**SA5**	•
	1971 Fund Administrative Council	**71AC24**	

ANY OTHER BUSINESS

FUNDING OF INTERIM PAYMENTS

Submitted by the International Group of P&I Clubs

Objective of document:	To invite the 1992 Fund Assembly to consider the issues raised in this document and to establish a Working Group to examine the funding of interim payments, and the scope for uniform solutions to the issues involved, with a view to ensuring prompt and efficient use of available funds for the benefit of claimants.
Summary:	This document outlines certain legal complications concerning interim payments funded by the P&I Clubs directly to claimants and proposes consideration of possible measures to overcome them.
Action to be taken:	1992 Fund Assembly: Consider whether it would be appropriate to establish a Working Group to examine the funding of interim payments and the issues raised in this document. Supplementary Fund Assembly: Information to be noted.

1 Background

1.1 A number of incidents handled by the IOPC Funds have shown that interim payments can give rise to difficult issues, particularly when there is a risk of admissible claims exceeding the maximum available compensation. The issues involved in estimating the total amount of admissible claims, and ensuring that interim payments are sufficiently conservative, have been addressed by the Funds on a number of occasions. However, as interim payments have normally been funded in the first instance by the Clubs, it has been the Clubs who have had the primary need to address these issues.

1.2 Under the 1992 Civil Liability Convention (1992 CLC) each claimant is entitled to receive a pro-rata share of any limitation fund established by the shipowner in the competent court. In the absence of such a fund, each claimant can enforce that right against any assets of the shipowner and/or directly against its insurer.

1.3 In the case of an incident in a jurisdiction where only the 1992 CLC applies[<1>], any interim payments made by the shipowner would need to be based on an estimate of each claimant's entitlement to compensation under the 1992 CLC alone. In jurisdictions where both the 1992 CLC and the 1992 Fund apply[<2>], the practice has been for interim payments to be based on the estimated rights of claimants under *both* Conventions. Such payments have been made by the Club until the total amount

[<1>] There are 20 States party to the 1992 Civil Liability Convention but not the 1992 Fund Convention.

[<2>] There are 102 States in this group as of the date of submission of this document.

reached the 1992 CLC limit, at which point responsibility for further payments has been taken over by the Fund.

1.4 From the viewpoint of the shipowner and his insurer there are two main legal concerns with this practice.

1.5 First, the shipowner may be obliged to establish a limitation fund in the competent court, either to release his ship or other property from arrest, or as a condition of availing himself of the right of limitation[<3>]. Any interim payments made by the shipowner directly to claimants will not affect this obligation. Moreover, if such payments have been made up to the 1992 CLC limit the shipowner would effectively provide financing for double the limitation amount. Even if the excess over the 1992 CLC limit is subsequently returned following distribution of the limitation fund[<4>], the financing of the limitation fund in the intervening period could still be problematic. This has been highlighted particularly by the *Hebei Spirit* incident, for reasons discussed in further detail below.

1.6 A second cause for concern is that there is often a risk that the shipowner will not in fact recover in full any excess paid over the 1992 CLC limit. One reason for this is that interim payments based on claimants' rights under *both* Conventions involve a departure from one of the key principles of the international regime:

(a) that the shipowner pay all claimants equal proportions of their established claims; and

(b) that the IOPC Funds pay all claimants either the unrecovered balance or equal proportions thereof.

1.7 Generally, the departure from this principle has brought practical benefits, but the possibility exists that claimants or courts insist that all claimants are paid equal proportions of their established claims in accordance with one of the key principles of the regime and that, as a result, the shipowner's legal liability under the 1992 CLC is exceeded in the event that interim payments have been made by the Club.

1.8 In some jurisdictions, however, interim payments made by the shipowners in excess of their liability under the 1992 CLC cannot form part of the subrogation claim which the shipowner may bring against a 1992 CLC limitation fund established in the competent court in that jurisdiction. If it were to be possible in all cases, the shipowner would always be able to recover any excess payment under the 1992 CLC limitation fund.

1.9 Generally it has been assumed that the Funds would make good any shortfall in the shipowner's recovery of interim payments made above the shipowner's limit of liability under the 1992 CLC. However, the Fund Conventions do not clearly provide for this, and any informal arrangement by co-operation between the Clubs and the Funds would not be binding on the claimants or the competent court.

1.10 In particular it would not avoid the risk of courts concluding that interim payments by the owner were at least partly of a voluntary nature, or were made to avoid the risk of courts enforcing guarantees for amounts additional to the maximum compensation available under the international regime.

1.11 In February 1999 the Clubs submitted a document to the Executive Committee of the 1971 Fund expressing general concerns about the legal status of interim payments and the risk that these may not be taken fully into account in the distribution of a limitation fund (document 71FUND/EXC.60/12/1, 92FUND/EXC.2/6/1). The possibility was considered of apportioning interim payments between the

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<3> In some but not all contracting states a guarantee is acceptable, without the need for a cash deposit, but commonly the guarantee must contain an undertaking to deposit the cash equivalent if and when required to do so by the court.

<4> For example, as a result of informal arrangements with the Funds or through a co-operation agreement with the State along the lines agreed between the shipowner, Club and Korean Government in the *Hebei Spirit* incident – cf page 3 of this document.

shipowner's insurers and the Fund, but this was rejected as administratively inconvenient, and because it was felt that any problems resulting from the current practise could normally be avoided by co-operation between the Clubs and the Fund. The Clubs recognise the administrative challenges of this approach.

1.12 The Clubs hope that it will remain possible for the current practise to continue for the benefit of all concerned and in particular for the benefit of potential claimants but, at the same time, the Clubs believe it is important that these issues be reviewed, that a common understanding be reached on the intended policy and legal effects of interim payments made by the Clubs in excess of the limitation amounts established under the 1992 CLC.

1.13 Arrangements for the current practise as between the Clubs and the Funds are informal, do not reflect the terms of the Conventions, and therefore are not binding on claimants or courts, and are subject to some uncertainty as to their precise effect.

1.14 The *Hebei Spirit* incident has highlighted the possible scale of potential problems and the unsatisfactory implications which this uncertainty may have for all parties concerned. So far as shipowners and insurers are concerned, their own immediate concerns can normally be met by taking account of the absence of any obligation in the 1992 CLC to make interim payments and by establishing a fund for distribution as the court sees fit. This indeed is the course they may feel bound to take in the absence of satisfactory alternative arrangements. However they do fully appreciate that this may result in the funds they provide being unavailable to claimants until a considerable time after the incident, and that the compensation regime operates more effectively if adequate safeguards can be found for them to pay claimants directly. The *Hebei Spirit* highlights the scope for such safeguards which the Assembly may wish to examine in greater depth than has generally been necessary hitherto.

1.15 In the *Hebei Spirit* incident the need for such safeguards was met by the Co-operation Agreement concluded in July 2008 between the owners, Skuld Club and the Korean Government (cf Annex I for further information). This is believed to set a valuable precedent which governments of other contracting states may wish to follow in future incidents.

2 Relevant incidents

Appended to this document in Annex I are details of various incidents, which provide examples of situations where legal issues arose in relation to interim payments. Although problems were for the most part avoided, the incidents may be regarded as demonstrating the potential for them to arise in other cases, particularly where the 1992 CLC limit is high.

3 Conclusions

3.1 The Assembly is invited to consider whether it would be appropriate to establish a Working Group to examine the funding of interim payments and the issues raised in this document, with particular reference to these issues:

a) How best to benefit from the experience of the *Hebei Spirit* incident with a view to maintaining and possibly improving arrangements for interim payments in future incidents.

b) Whether the Co-operation Agreement concluded in that incident between the shipowner, Skuld Club and the Korean Government could assist in the consideration of this issue and, if felt appropriate, provide the basis for a model agreement that could assist member governments in making similar arrangements in response to incidents within their jurisdiction.

c) What role, if any, the Funds should have in relation to any such arrangements.

d) Whether the Memorandum of Understanding between the Funds and the Clubs should be amended to include provisions giving effect to such arrangements.

3.2 In the event that the 1992 Fund Assembly decides to establish such a Working Group, draft terms of reference are contained in Annex II of this document which may provide a useful basis for the 1992 Fund Assembly to consider.

4 Action to be taken

1992 Fund Assembly:

The 1992 Fund Assembly is invited to consider whether it would be appropriate to establish a Working Group to examine the funding of interim payments and the issues raised in this document.

Supplementary Fund Assembly:

The Supplementary Fund Assembly is invited to take note of the information contained in this document.

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Annex I

Braer incident (UK, 1993)

In the *Braer* incident the Skuld Club began making interim payments within a few weeks of the incident, particularly to private individuals and small businesses suffering financial hardship as a result of the pollution. Payments continued up to an amount equivalent to the 1969 Civil Liability Convention (1969 CLC) limit of approximately £4.88 million. Subsequently the owners brought limitation proceedings in the Court of Session in Edinburgh, and as a condition of a limitation decree they were required to make a cash deposit of the full limitation amount in court. The deposit of £4.88 million remained in Court for nearly ten years until the final claim was dismissed.

Sea Empress incident (UK, 1996)

In the *Sea Empress* incident threats were made on behalf of a group of claimants from the fishing industry to arrest the vessel as security for their claims. If this threat had been carried out, and security had been provided to those claimants, the ship would have remained exposed to further arrests and security demands by other claimants. The shipowner could avoid this only by establishing a limitation fund in order to release the ship and protect it from further arrest under 1969 CLC Article VI. In the UK a fund could be established only by making a cash deposit. It was explained to the claimants that the provision of security would not materially improve their position (having regard to their rights against the Club and the 1971 Fund), and that the Club could not fund interim payments if it were effectively compelled to deposit the limitation amount in court. They withdrew their threat and interim payments were made by the Club up to the 1969 CLC limit.

Subsequently the owners sought a limitation decree from the High Court in London. These proceedings were brought at a time when most claims had already been settled and it was clear that sufficient compensation remained available to pay any outstanding claims in full. The owners' right of limitation was not contested by any party and the proceedings were a formality. In these circumstances the court was persuaded to grant a decree and to postpone any order for the establishment of a limitation fund until any party applied to it to make such an order. No such application was ever made. The need to fund a cash deposit was therefore avoided, but the court's ruling was unusual and it may be expected that in other jurisdictions a deposit would need to be made.

Nissos Amorgos incident (Venezuela, 1997)

In the *Nissos Amorgos* incident the shipowner established in 1997 a limitation fund by bank guarantee in order to release the ship from detention. The Gard P&I Club funded interim payments up to the 1969 CLC limit. Claims for compensation by the Venezuelan Republic remain pending and the bank guarantee establishing the limitation fund is still in effect. The 1971 Fund has raised a time bar defence to the outstanding claims. If these claims are held by the competent court to be admissible, the shipowner will incur liability for a proportion of them in accordance with 1969 CLC. This will result in the Club making payments exceeding the 1969 CLC limit. To redress this imbalance the Club may seek an equivalent adjusting payment from the Fund, reflecting the fact that the interim payments it made to claimants whose claims were not time-barred included compensation due under the Fund Convention.

Erika incident (France, 1999)

In the *Erika* incident the shipowner established a limitation fund under the 1992 CLC by means of a bank guarantee. The Steamship Mutual P&I Club has also funded interim payments up to the 1992 CLC limit. Informal discussions subsequently took place between the Clubs and the Fund Secretariat as to whether there was a risk in such a case of payment being required under a guarantee in addition to the payments which they both made, even if these had reached the maximum amount under the 1992 Conventions. Consideration was given to a legal analysis to be presented by the Club to the court to prevent this outcome if the problem should arise. It was suggested that interim payments funded wholly by the Club or by the Fund should be treated as including amounts paid on behalf of the other, and that this was to be taken into account in assessing whether their respective legal liabilities had been fully satisfied. In the event the issue did not arise in the legal proceedings relating to the *Erika* case.

***Prestige* incident (Spain, 2002)**

In the *Prestige* incident it was obvious at an early stage that admissible claims were likely to exceed the maximum amount of compensation available under the international regime, which at the time was 135 million SDR. The limitation amount under 1992 CLC was approximately 18.9 million SDR. The shipowner's P&I Club was advised by its Spanish lawyers that there was a high risk that any interim payments made by it would not be taken into account by the Spanish courts when a fund was established and distributed under the 1992 CLC, with the result that the Club might eventually pay double the limitation amount. Despite lengthy discussions on the subject between the Club's legal advisers and lawyers representing the Spanish State, the Club was not satisfied that a double payment situation could be avoided and it decided that it had no alternative but to deposit the limitation fund with a competent court. It was recognised that this was a departure from the usual practice and that it could result in the money becoming unavailable for the payment of claims for several years. However it was also accepted that there was no obligation on the shipowner or his insurer to make interim payments out of court, and that the incident had highlighted a major problem which they might have in making such payments in the absence of adequate safeguards against the risk of double payment.

***Hebei Spirit* incident (Republic of Korea, 2007)**

The *Hebei Spirit* incident is believed to be the first case under the international regime since the *Honan Sapphire* incident (17.11.95) in which the maximum CLC limit has applied. In the latter case the applicable amount was 14 million SDR, being the maximum limit in force at the time under the 1969 CLC. The higher limits which were introduced by the 1992 CLC , and raised by 50%[<5>] following the *Erika* incident, have resulted in the *Hebei Spirit* being subject to the current maximum of 89.77 million SDR (approximately US$140 million). This is a substantially higher CLC limit than in any previous case.

It is also believed to be the first case in which the CLC limit has exceeded the retention limit of the International Group Pool under the Group Reinsurance Contract (which at the time of the incident was set at US$50 million), with the result that US$90 million, or nearly two-thirds of the compensation due from the shipowner, will be funded by the Group's market commercial reinsurers.

The owners and the Skuld Club were advised by their Korean lawyers that even if they made interim payments up to US$140 million this would not protect them from the prospective liability to deposit the **same amount** in court at a future date in order to avail themselves of limitation (this is consistent with similar advice received by several Clubs in incidents in various jurisdictions). If it were necessary to require two separate collections of the limitation amount – once for interim payments and a second time deposit in court – commercial reinsurers would be called upon to provide funds amounting in total to US$230 million instead of US$90 million. The implications of this would be very serious. Even if it were clear that the excess would in due course be reimbursed, there would still be substantial implications in terms of the continued willingness of reinsurers to cover liabilities under CLC Certificates. When it is taken into account that there is no legal requirement to make interim payments, no shipowner or P&I insurer could realistically agree to make them without appropriate measures to guard against risks of this kind.

In the absence of any prior formal agreement between the Clubs and the Funds on funding of interim payments, arrangements were concluded between the Club and the Korean Government. The Government undertook to provide the funds required for payment into court if that became necessary, and also to ensure that all claimants received 100% of their assessed claims. This has enabled the Club to make interim payments for the full amount of assessed claims, and to agree to continue making such payments until they have reached the CLC limit.

The *Hebei Spirit* incident has also highlighted the risk of under estimating the final total of established claims, with the consequence that interim payments could be made for too high a percentage of the established amounts. It will be recalled that in March 2008 the 1992 Fund Executive Committee decided that payments should be limited at the time to 60% of the amount of the damage actually suffered by each claimant. In light of new information and the remaining uncertainties as to the total amount of admissible claims, the Executive Committee subsequently agreed in June 2008 that any such payments made by the 1992 Fund should be limited instead to 35%. Clearly, had the Clubs made any interim payments to claimants on the basis of the

[<5>] This was accomplished by way of the tacit amendment procedure under Article 15 of the 1992 CLC.

March 2008 decision of the Executive Committee, they would not have been in a position to seek re-payment from such claimants to adjust the actual pay-out in line with the June 2008 decision of the Executive Committee.

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Annex II

Terms of Reference (draft)

Recognising the policy and legal complications of interim payments made by the P&I Clubs directly to claimants in cases where a limitation fund has also been established in the competent court and the benefits of reaching a common understanding on the intended legal effect of such interim payments, the Working Group shall have the following mandate:

(a) to examine the underlying causes which inhibited the Clubs to make interim payments

(b) to examine the experience of the *Hebei Spirit* incident, including whether the Co-operation Agreement concluded in that incident could assist the Working Group in its consideration of the issue and provide the basis for a model agreement, summary of principles or similar document which could assist member governments in speedily making similar arrangements in response to incidents within their jurisdiction, and

(c) to consider whether alternative solutions would be possible to overcome the identified risk, including:

  (i) what role, if any, the Fund could have in relation to any potential arrangements regarding interim payments made by the shipowners, and
  (ii) whether the Memorandum of Understanding between the Fund and the International Group Clubs should be amended to include provisions designed to overcome the risk of overpayment by the shipowner.