INTERNATIONAL
OIL POLLUTION
COMPENSATION
FUND

EXECUTIVE COMMITTEE
42nd session
Agenda item 3

FUND/EXC.42/2
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INCIDENTS INVOLVING THE IOPC FUND

RIO ORINOCO

Note by the Director

1 The incident

1.1 The asphalt carrier *Rio Orinoco* (5 999 GRT), registered in the Cayman Islands, experienced problems with the main engine while en route from Curaçao to Montreal with about 9 000 tonnes of heated asphalt cargo and about 300 tonnes of intermediate fuel oil and heavy diesel oil on board. During repairs in the Gulf of St Lawrence, the ship dragged anchor in bad weather and grounded on the south coast of Anticosti Island (Canada) on 16 October 1990. An estimated 185 tonnes of the intermediate fuel oil was spilled and came ashore east of the grounding position. About ten kilometres of the coastline were heavily polluted, and small patches of oil were spread over a further 30 kilometres. No asphalt cargo was spilled. Over subsequent weeks the cargo cooled and a significant part became solid.

1.2 The weather deteriorated and the grounded ship moved, finally coming to rest wedged between rocks. The Canadian Coast Guard attempted to refloat the vessel in December 1990, but these attempts failed. After extensive preparations, the ship was refloated on 7 August 1991 and removed to a safe haven.

1.3 The *Rio Orinoco* was entered with Sveriges Ångfartygs Assurans Förening (the "Swedish Club") for both hull and P & I insurance.

1.4 The limitation amount applicable to the *Rio Orinoco* was fixed by the Canadian Court at Can$1 182 617 (£543 000). The limitation fund was constituted by the Swedish Club by means of letter of guarantee.

1.5 The present document deals mainly with two issues, ie whether the IOPC Fund should take legal action against the Swedish Club in Sweden to recover any amounts paid by the IOPC Fund in compensation and whether the Fund is exonerated from its obligation to indemnify the shipowner and his insurer for a portion of the limitation amount prescribed in Article V.1 of the Civil Liability Convention.

2 Claims settlements

2.1 The Canadian Government submitted claims totalling Can$12 382 224 (£6 million) relating to the clean-up operations carried out by or on behalf of the Canadian authorities. The IOPC Fund approved and paid these claims for a total amount of Can$11 791 848 (£5 645 200).

2.2 The Swedish Club submitted subrogated claims for the cost of clean-up operations and waste disposal. These claims were settled at Can$2 222 661 (£979 150). After making a reduction to take account of the limitation amount (Can$1 182 617), the IOPC Fund paid a total amount of Can$1 040 044 (£458 635) towards these claims.

2.3 Indemnification of the shipowner in the amount of Can$295 654 (£134 400) has not yet been paid, as the limitation proceedings have not been completed.

3 Investigation into the cause of the incident

3.1 The Transport Safety Board of Canada carried out an investigation into the cause of the incident.

3.2 The Board's Report stated that the *Rio Orinoco* had grounded after dragging her anchors following a main engine failure. From the findings in the Report, it appeared that the underlying cause of the incident was the unseaworthiness of the ship at the beginning of the voyage both as regards the equipment and its maintenance/state of repair, and as regards the crew manning the vessel. In a communiqué from the Transport Safety Board the *Rio Orinoco* was referred to as a "substandard ship".

3.3 The Report stated that the vessel's machinery was continually undergoing repairs. It was also mentioned that, due to frequent varied and serious malfunctions and breakdowns, planned maintenance could not be undertaken. It was noted that the *Rio Orinoco* had proceeded to the anchorage near Anticosti Island to repair the main engine, which had failed several times as a result of the use of heavily contaminated fuel. It was pointed out that the ship had experienced serious and continuing fuel contamination and machinery breakdowns during the two previous voyages. According to the Report, only one of the three generators was fully operational upon departure from Curaçao, and the fuel oil was not always treated before use. The Report also stated that the condition of the engine room machinery was not brought to the attention of the classification society (Det Norske Veritas), and that the cumulative effect of the deficiencies would have called into question the seaworthiness of the ship.

3.4 The Report criticised the qualifications of the crew. It was stated that the master, the chief officer and the chief engineer did not hold the required Cayman Islands' certification, that the ship did not carry the appropriate number of qualified engineers and that there was no certified radio officer on board. It was also mentioned that the engine room crew were subjected to long hours of physically demanding work in uncomfortable conditions. According to the Report, the constant need for repair of the machinery increased the stress on the crew. The Report expressed the view that these factors together degraded the performance of the crew and compromised safety.

3.5 The Report noted that the principal members of the management team were part-owners of one or more vessels operated by the management company. It was also stated that the vessel's managers were aware of the condition of the vessel with respect to both machinery and manning.

4 Legal action taken by the IOPC Fund

4.1 In October 1993, as a precautionary measure, the IOPC Fund brought legal action in the competent Federal Court of Canada against the owner of the *Rio Orinoco* (Rio Number One Ltd) and the company which managed the vessel (Horizon Management Corp Inc). In the statement filed with the Court, the IOPC Fund requested that the defendants be ordered to pay, jointly and severally, to the IOPC

Fund the sum of Can$12 831 892 (the total amount paid by the Fund), plus interest. The IOPC Fund also took action against the Swedish Club as guarantor of the shipowner's liability.

4.2 In the light of the findings of the Transport Safety Board, the IOPC Fund took the view that the ship was not seaworthy when it ran aground and that the incident was due to this unseaworthiness. The findings indicated, in the Fund's view, that the shipowner must have been aware of the condition of the ship and the lack of qualifications of the crew. For this reason, the IOPC Fund maintained in its pleadings to the Court that the incident occurred as a result of the actual fault or privity of the shipowner and that the owner was not entitled to limit his liability (Article V.2 of the Civil Liability Convention).

5 Consideration by the Executive Committee at its 38th session

At its 38th session, the Committee discussed what measures should be taken by the IOPC Fund, in the light of the findings set out in the Report of the Transportation Safety Board. The Committee instructed the Director to carry out an in-depth examination of the Report, with the assistance of legal and technical experts. In addition, the Committee instructed the Director to continue his investigations into the financial circumstances of the shipowner and the management company, in order to ascertain whether there would be any financial advantage in pursuing the legal action taken against them by the IOPC Fund. The Director was also instructed to consider whether the IOPC Fund should take any other legal action, including recourse action. Finally, the Director was instructed to examine whether or not, in the light of the findings in the Report, the shipowner's insurer should be entitled to indemnification under Article 5 of the Fund Convention.

6 Director's analysis presented to the Executive Committee's 40th session

6.1 At its 40th session, the Executive Committee considered the results of the Director's study, as set out in paragraphs 8.1.1-8.2.16 of document FUND/EXC.40/3.

6.2 For the reasons set out in the study, the Director considered that the only possible source of recovery would be the insurers of the *Rio Orinoco*, ie the Swedish Club. He presented his views on the legal questions which would arise if the IOPC Fund were to seek recovery from the Swedish Club.

6.3 The Director drew attention to the fact that the Swedish Club Rules, which form part of the contract between the Swedish Club and the shipowner, contain the so-called "pay to be paid" clause, ie the Club is under obligation to indemnify the shipowner only for compensation actually paid to the injured party<1>. The same clause is contained in the Rules of all the major P & I Clubs. For this reason, the Director expected that the Swedish Club would maintain that the IOPC Fund was not entitled to any recovery from the Club, since the shipowner had not made any payment to victims.

6.4 The Director concluded that the Canadian courts would probably uphold the "pay to be paid" rule if a direct action were pursued against the Swedish Club in Canada. He also took the view that it was unlikely that the IOPC Fund would succeed if it brought a so-called "oblique action" against the Swedish Club in Canada (cf paragraphs 8.2.11 and 8.2.12 of document FUND/EXC.40/3).

6.5 The Director had also examined whether the IOPC Fund should take the legal action against the Swedish Club in Sweden.

<1> Rule 2.3 reads: "Unless the Association otherwise decides the member is only covered in respect of such sums as he has paid to discharge liabilities, costs or expenses referred to in Chapter II".

6.6 The relevant Swedish law is contained in the Swedish Insurance Contracts Act, Section 95, first and third paragraphs, which read as follows:

> "The insured is not entitled to collect indemnity under the contract of insurance for more than the amount he has paid to the injured party, or the amount for which the injured party has given his consent.
>
> If an insured who is declared bankrupt has a claim on the insurer for an indemnity which he may not collect without the consent of the injured party, the latter shall be entitled, if the administrator of the bankrupt's estate does not pay him such indemnity, to have the claim of the insured against the insurer assigned to him, and the administrator is bound in such a case to make available to him all documents concerning the insurance in the possession of the bankrupt's estate to the extent required for collecting the amount due."

6.7 The Director drew attention to the fact that the third paragraph of Section 95 of the Swedish Insurance Contracts Act thus sets aside the "pay to be paid" rule in bankruptcy situations<2>. It was noted, however, that if a stipulation in an insurance contract was at variance with a provision in the Act, this did not prevent the application of the stipulation, except where the Act prohibited such application (Section 3 of that Act). In the Director's view, the "pay to be paid" rule was such a stipulation. In one authoritative commentary to the Act it was stated that the third paragraph of Section 95 is permissive (ie not mandatory). A committee which recently presented a proposal for a new Swedish Insurance Act also took the view that this provision was permissive. On the other hand, in a case decided in 1954 the Norwegian Supreme Court took the position that the corresponding provision in the Norwegian Insurance Act was mandatory in a bankruptcy situation. In the light of the tendency in Swedish jurisprudence and legislation in recent years to place increased emphasis on the need to protect the injured party, the Director thought that it was possible that the Swedish Courts would take the same position as the Norwegian Supreme Court, but that this was by no means certain.

6.8 In view of the analysis set out above, the Director expressed the view that it was uncertain whether in the case of the *Rio Orinoco* the Swedish Courts would consider the relevant provision of the Swedish Insurance Contracts Act as mandatory, thereby setting aside the "pay to be paid" rule in the Swedish Club Rules. For this reason, the Director was not in favour of taking action against the Swedish Club in Sweden.

7 Consideration by the Executive Committee at its 40th session

7.1 At its 40th session, the Executive Committee took the view that it would not be meaningful to pursue legal action against the shipowner or the management company, since it was unlikely that these companies would have any assets against which a judgement could be enforced. For the same reason, the Committee considered that it would not be worthwhile pursuing action against the individual directors of the management company (document FUND/EXC.40/10, paragraphs 3.2.2 and 3.2.3).

7.2 The Executive Committee noted that the Director had been advised that the "pay to be paid" rule in the Swedish Club's Rules would probably be upheld by the Canadian courts if a direct action were pursued against the Swedish Club in Canada under Canadian maritime law. The Committee also took note of the Director's view that it was uncertain whether in the case of the *Rio Orinoco* the Swedish courts would consider the relevant provision of the Swedish Insurance Contracts Act as mandatory, thereby setting aside the "pay to be paid" rule in the Swedish Club's Rules. The Committee noted that, for that reason, the Director was not in favour of pursuing an "oblique action" in Canada against the Swedish Club, nor of taking action against the Swedish Club in Sweden.

<2> Although Rio Number One Ltd would not be technically bankrupt, since under Cayman Islands law corporate bodies can be placed in liquidation only, it was assumed that the Swedish Court would consider the company as bankrupt for the purpose of this question.

7.3 It was recalled that the Executive Committee had previously taken the position that, except in collision cases, the IOPC Fund should only take recourse action in cases where there were very strong reasons for taking such actions and a considerable likelihood of success. A number of delegations made the point, however, that as a matter of policy the IOPC Fund should try to recover any amount paid by it in compensation if an incident were caused by the unseaworthiness of the ship involved. For this reason, it was generally felt that further consideration should be given to the possibility of the IOPC Fund taking legal action against the Swedish Club in Sweden.

7.4 The Director was instructed to seek further legal advice from an independent Swedish legal expert in the relevant field as to the possibility of taking successful legal action in Sweden against the Swedish Club to recover the amount paid by the Fund, and in particular as to whether a Swedish court would consider the relevant provisions of the Swedish Insurance Contracts Act as mandatory, thereby setting aside the "pay to be paid" rule in the Swedish Club's Rules. It was decided that the IOPC Fund should not pursue its legal action against the company managing the *Rio Orinoco*, nor against the individual directors of this company and that the action against the shipowner should be pursued only to the extent required to preserve the possibility of the Fund taking action against the Swedish Club in Sweden. The Director was instructed to refer the matter back to the Committee when further legal advice had been received.

8 Further legal analysis

8.1 As instructed by the Executive Committee, the Director has obtained an Opinion from an independent Swedish legal expert in the field[<3>].

8.2 In his Opinion, the expert concludes that, for several reasons, it is doubtful whether the Swedish provisions concerning liability insurance could be invoked as grounds for setting aside the "pay to be paid" rule. It is pointed out that the text of Section 95, third paragraph of the Swedish Insurance Contracts Act does not state that it is mandatory. He mentions that the paragraph is referred to as permissive in the semi-official commentary to the Act. A literal application of that paragraph would not, in his view, result in an improvement of the victim's position, since it only gives the victim a right of an assignation of the claim of the insured party. He points out that by acquiring a claim based on contract, the assignee is not placed in a better position than the assignor; the "pay to be paid" rule could therefore be invoked both against the insured party and against the IOPC Fund. The expert expresses the view that Norwegian case law could not be invoked as a decisive argument, due to the differences between the relevant sections of the Swedish and Norwegian Acts. He mentions that a new Swedish Insurance Act is being prepared within the Swedish Ministry of Justice and that according to a draft published in 1993 the right of direct action against a liability insurer would be extended in several situations. He points out that the draft has on this point been severely criticised in particular by the insurance industry and that it is uncertain whether the extension will be included in the Bill. He also states that the Swedish Supreme Court (and even more the lower courts) have usually been reluctant to anticipate political decisions by introducing new legal principles, even if the law seems ripe for a change. He states that it cannot be totally ruled out that an action by the IOPC Fund against the Swedish Club in Sweden would be successful. In his view, it is not very likely, however, that the tendency shown by some judges to modernise insurance law would prevail in this case.

9 Director's assessment

In the light of the Opinion referred to in paragraph 8 above, the Director considers it unlikely that the Swedish Courts would set aside the "pay to be paid" rule in the Swedish Club Rules. For this reason, the Director proposes that the IOPC Fund should not take legal action against the Swedish Club in Sweden.

<3> Mr Bertil Bengtsson, Professor of private law at the University of Stockholm and the University of Upsala 1968-1977; Justice of the Swedish Supreme Court 1977-1993; Chairman of the Insurance Law Commission 1980-1989.

10 Indemnification of the shipowner

10.1 Under Article 5.1 of the Fund Convention, the IOPC Fund shall indemnify the shipowner or his insurer for a portion of his liability under the Civil Liability Convention. In the *Rio Orinoco* case that portion would be 25% of the limitation amount, viz Can$295 654 (£134 400).

10.2 The IOPC Fund is not obliged to pay indemnification to the shipowner or his insurer if the pollution damage resulted from the wilful misconduct of the owner himself (Article 5.1). The IOPC Fund may be exonerated, wholly or partially, from its obligation to pay indemnification if the Fund proves that, as a result of the actual fault or privity of the owner, the ship did not comply with the requirements of certain international instruments and that the incident or damage was wholly or partially caused by such non-compliance (Article 5.3). The instruments in question are (cf document FUND/A.17/28, paragraph 6):

(i) the International Convention for the Prevention of Pollution from Ships, 1973, as modified by the Protocol of 1978 relating thereto (MARPOL 73/78);

(ii) the International Convention for the Safety of Life at Sea, 1974, as modified by the Protocol of 1978 relating thereto (SOLAS 74/78);

(iii) the International Convention on Load Lines, 1966; and

(iv) the Convention on the International Regulations for Preventing Collisions at Sea, 1972.

10.3 The Director considers that the IOPC Fund cannot prove that the pollution damage resulted from the wilful misconduct of the shipowner himself. In his view, the Fund would not therefore be able to invoke Article 5.1 as a ground for refusing to pay indemnification.

10.4 The Director has examined, with the assistance of technical experts and on the basis of the Report of the Transport Safety Board, whether at the time of the incident the *Rio Orinoco* did not comply with the requirements of the above-mentioned instruments. He has been advised that there is no evidence to suggest that the ship did not comply with the requirements of MARPOL 73/78, the 1966 Convention on Load Lines or the 1972 Collision Regulations.

10.5 As set out above, the Report of the Transport Safety Board mentions that the condition of the engine room machinery was not brought to the attention of the classification society and that the cumulative effect of the deficiencies were such that it would have called into question the seaworthiness of the ship. The Report also questions whether the crew were qualified (paragraphs 3.2-3.4 above).

10.6 There is no evidence to suggest that the *Rio Orinoco* did not comply with the requirements of SOLAS 74 in respect of its construction or equipment. There are, however, two regulations of SOLAS 74 which may be relevant to the cause of the incident, viz Chapter I, Regulation 11 relating to maintenance conditions after survey and Chapter V, Regulation 13, relating to manning. These provisions are reproduced at the Annex to the present document.

10.7 The Report states that the *Rio Orinoco* was not manned by the required number of qualified seafarers. The question is whether this fact constitutes the ship's non-compliance with the requirements of SOLAS 74, since that Convention does not contain any specific requirement for the crew required for safe manning. There is no evidence that the absence of a radio officer on board was a factor contributing to the incident.

10.8 As stated above, the master and the officers did not hold the appropriate Cayman Island's certificates. This constitutes a non-compliance with the 1978 International Convention on Standards of Training, Certification and Watchkeeping for Seafarers which is not included in the list of instruments set out in Article 5.3 of the Fund Convention. This non-compliance appears, therefore, not to be directly relevant for the purpose of determining whether indemnification should be paid.

10.9 As for Chapter I, Regulation 11 of SOLAS 74/78, the question is whether a failure to maintain the ship and its equipment was a cause of the incident and, if so, whether and to what extent this should lead to the IOPC Fund being exonerated from its obligation to pay indemnification to the insurer in this case. The following parts of the Report of the Transport Safety Board may be relevant in this regard.

- Observations made by the engineering staff and those made during the investigation indicate that the vessel's machinery was in a constant state of repairs and necessitated watchkeepers to remain in the machinery space. As the main engine and auxiliary machinery, due to frequent varied and serious malfunctions/breakdowns, were maintained operable as each crisis arose, planned maintenance could not be undertaken. (Section 1.13)

- The condition of the engine-room machinery was not brought to the attention of DNV. Thus, the Class records indicated that the vessel met the DNV Class requirements and the vessel was considered to have been in Class at the time of the occurrence, although this condition was prevalent from the previous voyage. Despite this, no known declarations or requests for exemption were made.

  Further, the vessel was operated in that condition without either:

  (a) the repairs being effected; or

  (b) precautionary safety measures being taken to ensure that the vessel had sufficient compressed air capacity to meet the manoeuvring needs.

  The cumulative effect was such that it would have called into question the seaworthiness of the vessel and rendered the "*Rio Orinoco*" unsatisfactory with respect to international, flag state, and classification society rules governing the operational fitness of the vessel. (Section 2.4)

- The "*Rio Orinoco*" grounded after dragging anchor as the result of main engine failure and the inability of the vessel's crew to restart the engine in order to halt the drag of the anchors. (Section 3.2)

10.10 In the Director's view, the sections of the report quoted above may provide grounds for maintaining that the ship was not fit to proceed to sea without danger to the ship and that the ship therefore did not comply with Chapter I, Regulation 11 of SOLAS 74/78.

10.11 The Executive Committee is invited to consider whether, in the light of the facts set out in paragraphs 10.4-10.10 above and in particular in paragraphs 10.7 and 10.9, the IOPC Fund should be considered exonerated, pursuant to Article 5.3, from its obligation to pay indemnification to the shipowner and his insurer.

11 Action to be taken by the Executive Committee

The Executive Committee is invited to:

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

(b) decide whether the IOPC Fund should pursue legal action against the Swedish Club in Sweden to recover the amount of compensation paid by the Fund (paragraph 8); and

(c) decide whether and, if so, to what extent the IOPC Fund is exonerated from its obligation under Article 5.1 of the Fund Convention to indemnify the shipowner and his insurer for a portion of the limitation amount prescribed in Article V.1 of the Civil Liability Convention (paragraph 10).

* * *

ANNEX

EXTRACT FROM THE 1971 SOLAS CONVENTION

Regulation 11 of Chapter I

Maintenance of conditions after survey

(a) The condition of the ship and its equipment shall be maintained to conform with the provisions of the present regulations to ensure that the ship in all respects will remain fit to proceed to sea without danger to the ship or persons on board.

(b) After any survey of the ship under regulations 6, 7, 8, 9 or 10 of this chapter has been completed, no change shall be made in the structural arrangement, machinery, equipment and other items covered by the survey, without the sanction of the Administration.

(c) Whenever an accident occurs to a ship or a defect is discovered, either of which affects the safety of the ship or the efficiency or completeness of its life-saving appliances or other equipment, the master or owner of the ship shall report at the earliest opportunity to the Administration, the nominated surveyor or recognized organization responsible for issuing the relevant certificate, who shall cause investigations to be initiated to determine whether a survey, as required by regulations 6, 7, 8, 9 or 10 of this chapter, is necessary. If the ship is in a port of another Party, the master or owner shall also report immediately to the appropriate authorities of the port State and the nominated surveyor or recognized organization shall ascertain that such a report has been made.

Regulation 13 of Chapter V

Manning

(a) The Contracting Governments undertake, each for its national ships, to maintain, or, if it is necessary, to adopt, measures for the purpose of ensuring that, from the point of view of safety of life at sea, all ships shall be sufficiently and efficiently manned.

(b) Every ship to which chapter I of this Convention applies shall be provided with an appropriate safe manning document or equivalent issued by the Administration as evidence of the minimum safe manning considered necessary to comply with the provisions of paragraph (a)[<1>].

<1> Paragraph (b) was added by the Amendments adopted in 1988 by the Maritime Safety Committee of IMO through Resolution MSC 12(56). These Amendments entered into force on 29 April 1990. The IOPC Fund Assembly decided at its 12th session not to include these amendments in the list of instruments contained in Article 5.3 of the Fund's Convention and therefore the provisions of paragraph (b) are not relevant for the purpose of Article 5 of the Fund Convention.