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ALTERNATIVE DISPUTE SETTLEMENT PROCEDURES

Note by the Director

1 Introduction

1.1 At the 1st Intersessional Working Group of the 1992 Fund on alternative dispute settlement procedures, the Director undertook the following task (document 92FUND/A.2/18, paragraph 6.9):

(a) to carry out a preliminary study of the possibilities of the 1992 Fund using arbitration, mediation or conciliation to promote the out-of-court settlement of disputes; and

(b) to study the claims settlement procedures of commercial insurers, such as the P & I Clubs, and to establish whether the experience gained from commercial insurers could be used to improve the claims settlement procedures applied by the 1992 Fund.

1.2 This document sets out the results of the Director's study.

2 Arbitration, mediation and conciliation

2.1 It was suggested at the Working Group that other methods to facilitate claims settlement, such as arbitration, mediation and conciliation, could be considered. It was noted that, under Internal Regulation 7.3, the Director was authorised to agree with any claimant to submit a claim to binding arbitration, but that arbitration procedures had not been used by the 1971 Fund or by the 1992 Fund. It was pointed out that arbitration was widely used in commercial disputes, *inter alia* because it was normally faster than court proceedings.

2.2 It was noted by the Working Group that the Assembly and Executive Committee of the 1971 Fund had taken the view that a claim was admissible only if it fell within the definitions of "pollution damage" or "preventive measures" laid down in the Conventions as interpreted by the 1971 Fund bodies, and that the claimant was required to substantiate the amount of his loss by documentation or other evidence. It was also noted that

the 1992 Fund Assembly had decided that the 1992 Fund should follow the policy as regards admissibility of claims for compensation which had been laid down by the 1971 Fund.

2.3 In this context, the question was raised of whether an arbitrator, mediator or conciliator should be permitted to assess a claim on the basis of equity. Most delegations opposed the idea that assessment might be made on the basis of equity, and emphasised that the criteria for admissibility referred to in paragraph 2.2 above should be respected.

2.4 The Director has pursued these matters with an arbitrator and a firm of London solicitors with considerable experience in this field. Their views are summarised below.

Arbitration

Experience has shown that the incidents which are most likely to result in protracted litigation are major incidents involving many claims. Legal proceedings naturally take longer if their function is not merely to resolve individual claims against the Fund, but also to ensure fair treatment as between claimants. This latter function is particularly important in cases where a risk is perceived that the aggregate of established claims will exceed the maximum amount of compensation available.

In cases where the total amount of the claims does not exceed the 1992 Fund's limit, the submission of some claims to arbitration could speed up the settlement of claims slightly, although delays are more often caused by the claimant not providing supporting documentation than by the type of settlement procedures adopted.

Arbitration would be binding only on the parties to the arbitration agreement, leaving open the risk of the results of the arbitration being challenged by other claimants competing for the total amount of compensation available from the 1992 Fund. The risk of such a challenge is greater when a claim is decided by arbitration, since this pre-supposes disagreement between the Fund and the claimant.

If arbitration is chosen, *ad hoc* agreements to resort to arbitration have to be reached in the period immediately following the incident. A number of factors might cause this process to be difficult and time-consuming. When entering into such an agreement, it would be necessary for the Fund and the claimant to agree on certain matters which would not have to be addressed in the course of court proceedings, for example the appointment of one or more suitable arbitrators, the terms of reference of the arbitrators and the applicable law.

The only area in which a significant role for arbitration procedures could be envisaged would be that involving disputes between the 1992 Fund and parties such as P&I Clubs or Governments. Private arbitration in London between the 1992 Fund and a London-based P&I Club may be more attractive and convenient to both parties than lengthy court proceedings abroad.

Some agreements to arbitrate allow arbitrators to decide a dispute not in accordance with any system of law but, for example, in accordance with equity *(ex aequo et bono)*. There may be some jurisdictions where arbitrators are, as a matter of domestic law, empowered to determine the issues other than in accordance with the strict letter of the law.

It may seem obvious that the arbitrators should apply the law of the State where the pollution damage was suffered. However, the arbitrators would then not necessarily be bound to apply the same criteria for the admissibility of claims as those adopted by the Fund Assembly, and

the arbitrators may not do so if they conclude that a different interpretation of the term "pollution damage" would be adopted by the national courts. The Fund may then consider that it can submit a claim for arbitration only if the terms of reference bind the arbitrators to apply the criteria adopted by the Fund. This may not be acceptable to claimants.

If the process of reaching an agreement to submit a claim to arbitration were to fail, the result would be more delays for the claimants. The claimant may then have to start court proceedings, which would result in increased costs and delay settlement of legitimate claims.

Since arbitration proceedings are normally held in private, it would be necessary to consider whether the privacy of arbitrations could in practice be observed by the 1992 Fund as a public body. Any reports of the arbitration in the 1992 Fund's documents would be open to public scrutiny.

One element which can make arbitration quicker than court proceedings is that it is to some extent possible to eliminate the right to appeal against an arbitration award.

Mediation and conciliation

Many of the techniques used in mediation and conciliation are already employed by the 1971 and 1992 Funds in their efforts to reach out-of-court settlements, for example the establishment of claims offices, the publication of Claims Manuals and the adoption of a non-adversarial approach. It is therefore unlikely that mediation or conciliation would succeed where the Fund's approach has failed. It should also be recalled that if either party is dissatisfied with the outcome of mediation and conciliation, rights of litigation remain.

Conclusions for the 1992 Fund

2.5 The Director recognises that arbitration may in many cases be a quicker and more convenient procedure for the settlement of disputes than court proceedings. However, the analysis in paragraph 2.4 above shows that it would in many cases be difficult to use arbitration to settle disputes between the 1971 Fund/1992 Fund and claimants. In the Director's view, this could in particular be the case where the need for speedy procedures is the greatest, namely in respect of incidents which give rise to a large number of claims and where the total amount of the claims exceeds the maximum amount of compensation available.

2.6 The Director considers that the benefits of submitting claims to arbitration would be limited to certain particular cases. It could for example be appropriate, in respect of an incident where it is clear that the total amount of the claims will not exceed the maximum amount of compensation available, to submit to binding arbitration an individual large claim or a number of claims giving rise to a particular question of principle.

2.7 It is possible that claimants would be reluctant to submit their claims to arbitration and would insist on having claims decided by the national courts in their own country.

2.8 In view of the position taken by the Assembly and the Executive Committee of the 1971 Fund (and endorsed by the 1992 Fund Assembly) that a claim is admissible only if it falls within the definitions of "pollution damage" or "preventive measures" laid down in the Conventions as interpreted by the 1971 Fund bodies, the Director takes the view that the scope for the 1992 Fund to submit claims to arbitration may be limited.

2.9 For the reasons set out in the last paragraph of section 2.4 above, the Director considers that the use by the 1992 Fund of mediation or conciliation procedures would be of limited value.

2.10 It is possible that increased information to claimants would in some cases contribute to some claims being settled out of court. This issue is dealt with in a submission by the Australian delegation (document 92FUND/A.2/19/1). However, any significant increase in the 1992 Fund's activities in this field would require additional staff resources.

3 Claim settlement procedures

3.1 During the discussions in the Working Group, a number of delegations stated that it might be useful to study how claims were handled by commercial insurers, such as the P & I Clubs. It was also suggested that claims settlement in, for example, P & I Clubs was delegated to junior staff, and that further delegation of the authority to make decisions within the 1992 Fund should be considered.

3.2 Many delegations at the Working Group made the point that commercial insurers could exercise a great degree of freedom in deciding whether to accept or reject a claim, and could take into account commercial considerations or questions of public image.

3.3 The Director has pursued these matters with some P & I Clubs (including a Club with which the Fund has not had cases in common), as well as with Cristal Ltd and an insurer outside the marine field. The information provided is summarised below.

P&I Clubs

The P & I Clubs generally use their local correspondents around the world to provide factual information on a case. Club correspondents and lawyers will be instructed to obtain evidence, to advise upon the legal regime and the shipowner's potential exposure, and to settle claims in accordance with the shipowner's and the Club's joint instructions. Many correspondents have, over the years, developed expertise in the resolution of problems and the handling of liability claims on behalf of the P&I Clubs.

Club correspondents, lawyers or surveyors may be authorised to negotiate settlements with claimants. Neither the Club nor the shipowner is likely to give any standing authority under which correspondents (or others) are authorised in advance to settle claims. Such authorisation may be given on a case by case basis, possibly with a maximum specified settlement amount, and the Club's claims handlers would maintain an overview of the negotiations and agreements reached. Although Clubs may now be relying more on the advice of correspondents and other experts, the authority given to the latter has probably decreased in recent years. It is customary to require the authorisation of the shipowner for the settlement of a claim, although the shipowner may often delegate his authorisation to his own local agent. Funds for settlement of claims are normally supplied by the shipowner with a request for reimbursement from the Club, unless in a particular case funds are advanced by the Club on behalf of the shipowner.

The P & I Club's claims handlers monitor the performance of correspondents and other experts, and records of persons suitable as correspondents or experts are maintained.

P&I Club staff have general authority to make claim settlements subject to certain financial limits which depend on the status of the individual claims handler. In cases where claims involve complex or important issues, or where the amounts involved are substantial, a claims handler may be required to consult with senior colleagues before settlements are made. The

claims handling processes of the Clubs are continuing to develop, particularly as some P&I Clubs establish regional offices.

Since claimants normally reside where their claims arise, it is the Club's policy to seek to deal with claims in the local environment and in the local language. In this connection, the role of the correspondent is crucial, even though in some cases the authority to deal with the claimant will be given to a local lawyer. A procedure will then be approved by the Club for examining the claims and related documents.

A P&I Club insures shipowners against certain types of legal liability which the shipowners incur towards third parties. Where the merits of an individual claim or category of claims are in doubt, or where settlement negotiations fail, a decision is required as to the position to be taken in opposing that claim (or category of claims) in the legal proceedings. During the proceedings, the local lawyer is a key advisor and will be expected to seek instructions from the Club. During the course of the legal proceedings, attempts will still be made to reach an amicable settlement in order to avoid court costs. A club will form a view as to the likely outcome if the claim were to be pursued in court. This evaluation will take into account *inter alia* the law of the relevant jurisdiction, the particular features of the legal system, the impact of any settlement on other pending claims in the same case and the precedent value of the settlement in other current or future cases. Commercial factors may be of some relevance, particularly the amount at which a claim can be settled and the likely cost of opposing a claim. The essential question is always whether, by a compromise, a potentially greater exposure is avoided. Although public relations considerations are not normally an overriding factor in settlement negotiations, the benefits gained by reaching compromise solutions are recognised as important in cases which generate considerable public interest. However, the P&I Clubs have an interest in ensuring that the shipowners' legal liability should, as far as possible, be contained to a legitimate minimum.

CRISTAL Ltd

Experts used by CRISTAL Ltd are not given authority to settle claims. Only the Board of Directors have authority to take decisions on the settlement of claims. However, before the Board will consider and approve any claim, it must have been reviewed in detail by the CRISTAL Working Committee, which is a body made up mainly of in-house lawyers from a number of CRISTAL's members.

CRISTAL is a mutual compensation scheme and when taking decisions on claims, the Board must follow the terms of the CRISTAL contract. Otherwise, any one of its members could question the decision and refuse to make the contributions required to enable CRISTAL Ltd to pay a particular claim. It is understood that CRISTAL Ltd has never made a settlement because it was commercially advantageous to do so or from a public relations viewpoint.

Commercial Insurer

It is expected that the insured must prove his claim and act at all times as a prudent uninsured. With regard to third party claims, the insurer would normally expect to control matters but would very rarely be dealing direct with the claimant.

Claims are investigated by adjusters, who have access to the insurer's surveyors' reports. The adjusters may use consultants for this investigation. An assessment is made as to whether the claim is covered by the insurance policy, the amount of the loss is calculated subject to the policy conditions and consideration is given to any potential for recovery from third parties.

A full report is issued to the insured and this report forms the basis of the claim presentation to the insurer.

In third party liability matters, the appointment of an expert or lawyer would in the first instance be the responsibility of the insured, although the insurer expects regular reporting of progress. The insurer should not admit liability or enter into a settlement or compromise agreement without the prior approval of the insurer, as it does not automatically follow that the insurance policy will cover the claim because the insured has a legal liability.

As a consequence of huge insurance losses in recent years, insurers have generally moved towards a more controlled procedure for claims settlement, not a more flexible one. Rigorous evaluation of claims by the experts appointed by the insurers is common. The use of surveyors appointed by the insured is far from being readily accepted by insurers, and direct reporting to the insurer (ie not via the broker) is becoming more common.

With regard to legal and contractual liability insurances generally, insurers are not obliged to pay claims unless a legal liability is established and quantified. However, the liability may well be established by agreement between the parties rather than by litigation. It is unlikely that an insurer would make a payment from a purely public relations standpoint, as the insurer would generally view public relations as strictly a matter for the insured. Nevertheless, there are occasions where a negotiated settlement is favourable as opposed to expensive and time-consuming litigation. Even in these cases, however, the insurer would usually need to be convinced that the insured has a *prima facie* liability although not yet formally established.

Conclusions for the 1992 Fund

3.4 The Director considers that the prompt settlement of claims would be facilitated if, as is the case within the P & I Clubs, he were able to delegate to other staff members decisions on claims settlements to a greater extent than he is permitted to do at present (cf Internal Regulation 7.13). He takes the view that the 1992 Fund should not delegate such authority to experts or to staff at claims offices.

3.5 On the question of flexibility, the Director notes that P & I Clubs are able to consider commercial factors and public relations aspects of a settlement. He notes also that Clubs may consider it preferable in some circumstances to avoid the risk of an unfavourable court decision, thereby creating a precedent. In view of the need for the 1992 Fund to abide by the definitions laid down in the Conventions, as interpreted by the Fund bodies, the Director considers that it would not be appropriate for the 1992 Fund to take such factors into account for the purpose of claim settlements.

4 Action to be taken by the Assembly

The Assembly is invited:

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

(b) to give the Director such instructions as it considers appropriate in respect of the issues dealt with in the document.