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Agenda item 25

92FUND/A.3/23/1
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ASSESSMENT OF CONTRIBUTIONS

APPLICATION OF THE CAPPING SYSTEM

Note by the Director

Summary:	The Director decided not to use the authority given to him by the Assembly at its 2nd session to issue invoices for a deferred levy to the <i>Nakhodka</i> Major Claims Fund of up to £30 million for payment during the second half of 1998. The Japanese delegation has requested that the capping system should apply to further contributions to that Major Claims Fund up to the amount of the deferred levy.
Action requested:	Decide whether the capping system should continue to apply to further contributions to the <i>Nakhodka</i> Major Claims Fund up to an amount of £30 million.

1 Introduction

1.1 Article 36 ter of the 1992 Fund Convention introduced a system of capping contributions during the first years after the entry into force of the Convention, in order to ensure that the oil industry in the major contributing Member State would not be exposed to an excessive financial burden during that early stage of the 1992 Fund's existence.

1.2 At its 1st session, the Assembly took a decision concerning when the capping system should cease to apply. The Assembly also introduced a system of deferred invoicing at that session.

1.3 The Japanese Government has requested that the Secretariat should apply the capping system to future invoices up to an amount of £30 million, ie the maximum 1997 deferred levy to the *Nakhodka* Major

Claims Fund which was decided by the Assembly at its 2nd session for which the Director decided not to issue invoices.

1.4 The Director considers that the request of the Japanese Government is one on which the Assembly should decide. This document therefore sets out background information with regard to this question and deals with the application of the capping system to future levies to the *Nakhodka* Major Claims Fund.

2 Consideration of when capping should cease to apply

2.1 Text of the 1992 Fund Convention

The capping provisions in the 1992 Fund Convention are contained in Article 36 ter which reads as follows:

1 Subject to paragraph 4 of this Article, the aggregate amount of the annual contributions payable in respect of contributing oil received in a single Contracting State during a calendar year shall not exceed 27.5% of the total amount of annual contributions pursuant to the 1992 Protocol to amend the 1971 Fund Convention, in respect of that calendar year.

2 If the application of the provisions in paragraphs 2 and 3 of Article 12 would result in the aggregate amount of the contributions payable by contributors in a single Contracting State in respect of a given calendar year exceeding 27.5% of the total annual contributions, the contributions payable by all contributors in that State shall be reduced *pro rata* so that their aggregate contributions equal 27.5% of the total annual contributions to the Fund in respect of that year.

3 If the contributions payable by persons in a given Contracting State shall be reduced pursuant to paragraph 2 of this Article, the contributions payable by persons in all other Contracting States shall be increased *pro rata* so as to ensure that the total amount of contributions payable by all persons liable to contribute to the Fund in respect of the calendar year in question will reach the total amount of contributions decided by the Assembly.

4 The provisions in paragraphs 1 to 3 of this Article shall operate until the total quantity of contributing oil received in all Contracting States in a calendar year has reached 750 million tons or until a period of 5 years after the date of entry into force of the said 1992 Protocol has elapsed, whichever occurs earlier.

2.2 Consideration by the 1971 Fund Assembly

2.2.1 In the context of its preparations for the entry into force of the 1992 Fund Convention, the 1971 Fund Assembly considered at its 18th session the question of the application of paragraph 4 of Article 36 ter, ie when the capping system should cease to apply. The discussions of the 1971 Fund Assembly were based on a document prepared by the Director (document FUND/A.18/13/5), the relevant parts of which read as follows:

6.1 Under paragraph 4 of Article 36 ter, the capping provisions shall operate "until the total quantity of contributing oil received in all Contracting States in a calendar year has reached 750 million tons" or until five years after the entry into force of the Fund Protocol,

whichever is the earlier. From the information available to the Secretariat, it is likely that the quantity of 750 million tonnes will be reached well within the five-year period, probably within 12-18 months of the entry into force of the 1992 Fund Convention.

6.2 One approach would be to consider separately for each fund whether the quantity of 750 million tonnes had been reached for that fund. For the general fund, the applicable tonnage would be the total of (a) the full tonnage of States which are Members for the whole year in question and (b) the tonnage of States which become Members during the year reduced pro rata to reflect the portion of the year during which the Convention applied (cf Internal Regulation 3.6 of the 1971 Fund and proposed Internal Regulation 3.4 of the 1992 Fund). For a major claims fund the applicable tonnage would be the full tonnage of States which were Members on the date of the incident in question. It is suggested, however, that the system would become too complex if this approach were adopted. It is therefore proposed that the capping procedure should no longer apply in respect of decisions to levy contributions taken by the Assembly after the date on which the reported total quantity of contributing oil received in all Member States exceeds 750 million tonnes. This latter approach is, in the Director's view, in conformity with the wording of Article 36 ter, paragraph 4.

2.2.2 During its consideration of the issue, the Assembly of the 1971 Fund noted the Director's view that the capping procedure should not apply in respect of decisions to levy contributions taken by the Assembly of the 1992 Fund after the date on which the reported total quantity of contributing oil received in all Member States exceeded 750 million tonnes, and that this approach was in conformity with the wording of Article 36 ter, paragraph 4 of the 1992 Fund Convention. Most delegations shared this view. One delegation stated, however, that the question of when the application of the capping provisions should cease ought to be considered separately for each fund. The Director was instructed to study this issue further, bearing in mind that the majority of delegations favoured the former approach (document 71FUND/A.18/26, paragraph 16.11).

2.3 1992 Fund Assembly

2.3.1 When the matter was considered by the 1992 Fund Assembly at its 1st session, held in June 1996, the Director expressed the view that the system would become too complex if levies to each fund were to be considered separately (document 92FUND/1.1/17, paragraph 4.4). The 1992 Fund Assembly decided that the capping procedure should not apply in respect of decisions to levy contributions taken by the Assembly after the date on which the Director received from Member States reports on contributing oil where the reported quantity received in all Member States (ie those States for which the 1992 Fund Convention had entered into force) together exceeded 750 million tonnes. It was noted in this context that the timing of a decision by the Assembly to levy contributions could affect whether or not the capping procedure would be applied (document 92FUND/A.1/34, paragraph 17.4).

2.3.2 It should be noted that when the issue was discussed at the Assembly's 1st session, it was pointed out that the application of the capping system was a very delicate issue, especially in respect of Major Claims Funds. It was also mentioned that the Assembly could reconsider various issues relating to the termination of the capping system if and when any problems were foreseen.

3 Introduction of deferred invoicing

It had been emphasised both by a number of delegations of Member States and by representatives of the oil industry, that the IOPC Funds should not collect monies that are not necessary for the operation

of the Funds. In June 1996, therefore, the Assemblies of the 1971 Fund and the 1992 Fund introduced a deferred invoicing system to alleviate the burden on the oil industry by reducing the monies held by the Organisations for a prolonged period. Under this system the respective Assembly fixes the total amount to be levied in contributions for a given calendar year, but may decide that only a specific lower amount should be invoiced for payment by 1 February in the following year, the remaining amount, or a part thereof, to be invoiced later in the year, if necessary (documents 71FUND/A/ES.2/22, paragraphs 11.1 - 11.6 and 92FUND/A.1/34, paragraphs 16.1 - 16.3).

4 Assembly decisions in respect of the levy of 1997 contributions

4.1 At its 2nd session, held in October 1997, the Assembly fixed a levy to the General Fund (£6 million) and a levy to the *Osung N°3* Interim Major Claims Fund (£3.5 million) for payment by 1 February 1998 (document 92FUND/A.2/29, paragraphs 27.4 and 27.6).

4.2 In addition, the Assembly decided to make a second levy of £30 million to the *Nakhodka* Major Claims Fund, as 1997 contributions. The Assembly decided, however, that the whole of this levy should be deferred. The Director was authorised to decide whether to invoice all or part of the deferred levy for payment during the second half of 1998 (document 92FUND/A.2/29, paragraph 27.5).

4.3 It should be noted that levies to the 1992 Fund's *Nakhodka* Major Claims Fund are based on the total quantity of contributing oil received during 1996 in States which were Members of the 1992 Fund on the date of the incident, ie some 657 million tonnes.

4.4 It should be noted that the 1971 Fund Assembly, at its 20th session held in October 1997, decided to make a second levy of annual contributions of £35 million to the *Nakhodka* Major Claims Fund, out of which £30 million was payable by 1 February 1998. The 1971 Fund Assembly authorised the Director to decide whether to invoice all or part of the amount of the deferred levy for payment during the second half of 1998 (document 71FUND/A.20/30, paragraph 26.7).

5 Director's decision in respect of the *Nakhodka* Major Claims Fund deferred levy

5.1 The system of deferred invoicing was introduced by the Assemblies of the 1971 Fund and the 1992 Fund in the light of the concerns expressed by some delegations (and by the oil industry) that the 1971 Fund had in recent years levied considerable sums of money to Major Claims Funds well in advance of compensation being paid. The Assemblies have considered that the deferred levy (or part thereof) should be invoiced only to the extent necessary. The Assemblies have taken the view that any amounts due in respect of deferred invoices should be considered as an integral part of the levy of the year in which the Assembly determined the total amount of compensation of the annual contributions (documents 71FUND/A/ES.2/22, paragraphs 11.1 - 11.6 and 92FUND/A.1/34, paragraphs 16.1 - 16.3).

5.2 When the Director assessed the situation in early June 1998, he found that the 1971 Fund held a balance of some £165 million. At that time, the 1971 Fund had paid some £23 million to victims of the *Nakhodka* incident. The Director took the view that it would be possible to pay claims arising out of the *Nakhodka* incident up to the 1971 Fund limit (60 million SDR or £48.5 million) by loans from other Major Claims Funds, and that it would therefore not be necessary to invoice the deferred levy of £5 million decided by the 1971 Fund Assembly, or a part thereof.

5.3 With regard to the 1992 Fund, in early June 1998 a balance of £13 million was held in the General Fund and £7 million in the *Nakhodka* Major Claims Fund. Under the 1992 Fund Convention, payments are made from the General Fund up to 4 million SDR (£3.6 million) in respect of any one incident. There was

therefore available at that time some £35 million (ie the balance of some £25 million payable from the 1971 Fund, £3.6 million payable from the 1992 General Fund and £7 million held on the 1992 *Nakhodka* Major Claims Fund) before there would be any need for the 1992 Fund to make a further levy to the *Nakhodka* Major Claims Fund. The Director discussed the likely timetable for the settlement and payment of claims with the IOPC Funds' Japanese lawyer and the head of the Claims Handling Office in Kobe. On the basis of those discussions, he concluded that it was, unfortunately, highly unlikely that, during the period up to 1 February 1999, the two Organisations would make payments reaching £35 million. In the light of this situation, the Director considered that no further monies were required by the 1992 Fund and that, in accordance with the 1992 Fund Assembly's decision, no deferred levy should be made to the *Nakhodka* Major Claims Fund.

5.4 Contributors were notified in June 1998 of the Director's decision not to make a deferred levy in 1998 to either the 1992 Fund's *Nakhodka* Major Claims Fund or the 1971 Fund's *Nakhodka* Major Claims Fund.

5.5 In the Director's view, as a result of his decision not to make a deferred levy in 1998, he is not allowed to issue any further invoices in respect of the *Nakhodka* Major Claims Funds without a new decision by the respective Assembly to levy further contributions.

6 Position of the Japanese Government

6.1 The Japanese Government has stated that it agreed at the Assemblies' October 1997 sessions with the proposals to levy contributions of £65 million to the *Nakhodka* Major Claims Funds, including a deferred levy of up to £30 million to the 1992 Fund's *Nakhodka* Major Claims Fund, on the premise that the capping system would apply to a deferred levy. The Japanese Government has expressed the view that it is therefore possible and most appropriate that the Secretariat should apply the capping system to the next £30 million invoiced in respect of the 1992 Fund's *Nakhodka* Major Claims Fund, on the basis of the Assembly's decision in October 1997, although the deferred levy of £30 million has not been invoiced by the Director so far.

6.2 The Japanese Government has pointed out that the capping system was introduced in the 1992 Protocol to the 1971 Fund Convention for the purpose of avoiding an excessively heavy burden which some contributors receiving large quantities of contributing oil might face during the initial period after the entry into force of the 1992 Protocol. The Government has stressed the fact that it is estimated that the *Nakhodka* incident will result in extensive damage and that it is a typical case which the capping system was supposed to address. The Government has stated that, if the capping system were not applied to this case, the purpose of this system would be totally lost.

6.3 The Japanese Government has stated that it must be considered that Member States agreed to the levy of £65 million (including the deferred levy of £30 million) on the premise that the capping system would apply. It would therefore, in the Government's view, be entirely inappropriate to make the agreement of the 1992 Fund Assembly in October 1997 void simply because the Director did not invoice the deferred levy, due to the fact that the estimated payments during 1998 did not require additional contributions, as this was unrelated to the conditions for the termination of the capping system.

7 Director's analysis

7.1 The decision by the 1992 Fund Assembly to authorise the Director to make a deferred levy of £30 million for the *Nakhodka* Major Claims Fund was taken in October 1997, ie before the date when the total quantity of contributing oil in States for which the 1992 Fund Convention was in force reached 750 million tonnes. For this reason, that levy - if invoiced - would have been subject to capping. However,

as indicated above, the Director takes the view that, unless the Assembly decides otherwise, he is no longer authorised to invoice the deferred levy or a part thereof.

7.2 The total quantity of contributing oil received in Member States (ie those States for which the 1992 Fund Convention was in force) reached 750 million tonnes on 16 May 1998. Consequently, pursuant to the Assembly's decision at its 1st session, the capping would not apply to any levy to the *Nakhodka* Major Claims Fund decided by the Assembly in October 1998 (or later).

7.3 The Director acknowledges that such an application of the capping provisions in the 1992 Fund Convention gives a result contrary to the intentions behind these provisions, ie to ensure that the oil industry in the major contributing Member State would not be exposed to an excessive financial burden during the early stage of the 1992 Fund's existence. It could be considered that, since the Assembly fixed the total levy for the 1997 annual contributions to the *Nakhodka* Major Claims Fund at £30 million and that decision was taken by the Assembly before the cut-off date for the capping system, future levies to that Major Claims Fund up to £30 million should be capped. This approach would give a result which for the contributors would be independent of whether or not the Director used his authority to make a deferred levy.

7.4 In the light of what is set out above, the Assembly may wish to reconsider the question of the application of the capping system to the next £30 million levied by the Assembly.

8 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 consider whether the capping system should continue to apply to further levies to the *Nakhodka* Major Claims Fund up to an amount of £30 million.
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