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## LESSONS LEARNED FROM THE NAKHODKA INCIDENT

### A REVIEW OF THE CLAIMS HANDLING, ASSESSMENT AND SETTLEMENT PROCESS

#### Note by the Director

**Summary:** The Director has undertaken a review of the claims handling process in respect of the *Nakhodka* incident and the lessons learned. Some of the lessons learned were taken into account in organising the claims handling process in respect of the *Erika* and *Prestige* incidents, the benefits of which are highlighted in this document.

**Action to be taken:** Take note of the information contained in this document.

## 1 Introduction

- 1.1 At its October 2002 session the 1992 Fund Executive Committee considered a proposal by the Japanese delegation to review the lessons learned in respect of the *Nakhodka* claims handling and settlement process so that these could be taken into account in the organisation of the handling of claims arising from future incidents with a view to improving the speed and efficiency of the process in order to reduce the burden on claimants as quickly as possible. The Committee endorsed a proposal by the Director that he should submit a report to the governing bodies at their October 2003 sessions on the points raised by the Japanese delegation and other related issues after a further examination of what lessons could be learned from the *Nakhodka* incident (documents 92FUND/EXC.18/14, paragraph 3.3.33 and 71FUND/AC.9/20, paragraph 15.6.33).
- 1.2 This document describes the process that was put in place in Japan to deal with claims arising from the incident. The document focuses on the ways in which the different types of claims were assessed and the particular problems faced by the experts appointed by the shipowner's insurer, the United Kingdom Mutual Steam Ship Assurance Association (Bermuda) Ltd (UK Club) and the IOPC Funds. Finally, general conclusions are made regarding the future handling of claims arising from major incidents as well as specific conclusions regarding the

future handling of claims in Japan. In reaching these conclusions it is recognised that the claims handling procedures adopted by the Funds in different countries will sometimes be dictated by factors outside the Funds' control and that some flexibility will therefore be necessary according to the particular circumstances.

- 1.3 The Director wishes to acknowledge the excellent work of all of the experts and claims office staff engaged by the UK Club and the Funds to deal with the claims arising from the *Nakhodka* incident. No criticism of their objectivity and professionalism should be inferred from the statements in this document or lessons learned and the conclusions drawn.

## **2 The organisation of the handling of claims arising from the *Nakhodka* incident**

### *Historical background*

- 2.1 Prior to the *Nakhodka* incident the 1971 Fund had been involved in 43 incidents in Japan. All the vessels involved in those incidents had been entered with the Japan Ship Owners' Mutual Protection and Indemnity Association (Japan Club) and the claims for compensation had been dealt with by a small network of Japanese marine surveyors established by the Japan Club to act on its behalf, not only in Japan, but also in other countries where a vessel belonging to a member of the Club was involved in an incident. The claims handling process had worked well in these earlier incidents involving the Funds, although none had been on the same scale as the *Nakhodka* incident, nor had any of them necessitated the setting up of a Claims Handling Office.
- 2.2 Besides being the first major pollution incident in Japan involving the IOPC Funds, the *Nakhodka* was also the first such incident in Japan dealt with by the Funds involving a P&I Club other than the Japan Club. Nevertheless, it seemed natural and logical for the UK Club and the Funds to continue to rely on the network of surveyors that had been involved in previous pollution incidents in Japan.

### *Setting up the Claims Handling Office and the appointment of staff*

- 2.3 Since the marine surveying company that was appointed by the Club and the Funds to monitor the clean-up operations had its main office in Kobe, and since the city was conveniently located in relation to the affected area, the decision was made to set up the Claims Handling Office in the same building by renting additional office space adjacent to the surveying company's office. The decision was also taken to appoint the General Manager of the surveying company as the Manager of the Claims Handling Office.
- 2.4 The relatively small number of marine surveyors in Japan with the specialist knowledge required to assess claims for compensation made it difficult to recruit a sufficient number of experienced staff, particularly since some surveyors were unwilling to commit themselves to working full time on the *Nakhodka* incident for a period estimated to last at least three years. The Funds and the UK Club decided to use the experts from ITOPF to assist in the assessment of claims and to review the assessments made by the Japanese surveyors of claims, particularly in respect of the costs of clean-up measures and fisheries damage, to ensure that the assessments were consistent with the Funds' technical criteria and their policy of uniform application world wide.
- 2.5 The *Nakhodka* was also the first incident in Japan that gave rise to a significant number of claims from the tourism sector and therefore none of the surveyors in Japan had the necessary experience of assessing such claims. The decision was therefore made to engage the Funds' United Kingdom-based tourism experts, who had participated in the assessment of tourism claims arising from the *Sea Empress* incident, to provide training to the Japanese surveyors in the procedures that had been developed to assess such claims arising from that incident.

### 3 Claims assessment

#### *Timing of the assessments*

- 3.1 The claims submitted to the Claims Handling Office and the settlement amounts are summarised in the table below.

Claim category	Number of claims	Claimed amount ¥	Settled amount ¥
Clean-up/preventive measures	102	28 016 023 883	22 994 387 360
Fisheries	9*	4 993 246 571	1 751 348 322
Tourism	347	3 036 165 000	1 344 157 000
Total	458	36 045 435 454 (£191 million)	26 089 892 682 (£138 million)

\* 112 Fisheries Co-operative Associations representing 8 260 individual fishermen

- 3.2 It was clear from the outset, given the large number of claims and their complexity, that it would take a considerable amount of time to complete their assessments. The UK Club and the Funds therefore requested the experts to carry out preliminary assessments to enable provisional payments to be made to those claimants that requested them. During the first year following the incident the UK Club and the IOPC Funds made provisional payments totalling ¥4 608 million (£23 million), most of which was on the basis of preliminary assessments.
- 3.3 By the time of the third anniversary of the *Nakhodka* incident in January 2000 some 307 claims (corresponding to 67% of the total number of claims submitted) totalling ¥28 000 million (£140 million) (corresponding to 80% of the total amount claimed) had been assessed.
- 3.4 By the time of the fourth anniversary in January 2001 some 447 claims (corresponding to 98% of the total number of claims submitted) totalling ¥30 000 million (£150 million) (corresponding to 86% of the total amount claimed) had been assessed. The remaining 11 claims were all in respect of costs incurred by government agencies, the most significant being the claim by the Japan Maritime Disaster Prevention Centre (JMDPC) for ¥3 250 million (£16 million) for the costs of the construction of a temporary causeway to the grounded bow section of the *Nakhodka* to facilitate the removal of the remaining oil onboard. The assessments of these remaining claims were completed during the early part of 2001, although final settlements were not reached until August 2002 as a result of the need for the agencies to obtain authority from the Ministry of Finance to accept amounts lower than those claimed.
- 3.5 A number of delegations, including the Japanese delegation, expressed their concerns about the time taken to complete the assessment of the claims. Although some of the reasons for the delays were due to the particular circumstances of the incident and the shortage of experts, it must be emphasised that it would be unrealistic to expect all claims arising from an incident of this magnitude to be dealt with in less than three years. Nevertheless, a number of lessons were learned regarding the handling of the different categories of claims as discussed below.

#### *Claims in respect of clean-up and preventive measures*

- 3.6 There were nominally only 102 claims in respect of the costs of clean-up and preventive measures, which included claims by commercial contractors, the operators of power stations whose facilities were threatened by oil, government agencies and regional governments (Prefectures). Included with the claims by the Prefectures were claims by 122 municipalities and villages that were involved in organising shoreline clean-up operations, including the

management and welfare of the large number of volunteers that offered their services. It was also common for most claimants to submit several claims corresponding to different phases of the clean-up, with some of the claims being submitted as late as two years after the incident. Once claims had been finally assessed further delays occurred in reaching settlements as a result of some public sector claimants having to wait for the approval of their governing bodies, which only met infrequently.

- 3.7 Although the claims in respect of response measures were relatively straightforward to assess, they were accompanied by substantial documentation in the form of invoices and receipts, all of which had to be sorted, verified and translated into English before the data was transposed into a standard electronic spreadsheet format. This phase was by far the most time consuming part of the claims assessment process.
- 3.8 Most public sector claimants had not had any previous experience of managing a major clean-up response or in presenting claims for compensation in respect of the costs. Although the Japanese surveyors gave the claimants advice on claims submission and provided standard claims forms, many claimants required further assistance and the claims raised many queries that had to be resolved before a final assessment could be completed.
- 3.9 The Japanese surveyors were very meticulous in their final assessments and their reports were produced to a very high standard. Claims were assessed on the basis of eight main response tasks and eight main cost categories. These tasks were response management, surveillance, collection of oil at sea, collection of oil from shorelines, transport, disposal, health and safety and environmental measures. The cost categories were manpower, vehicles, vessels, materials, provisions, contractors, communications and miscellaneous items. Claims in respect of each of these tasks and cost categories were assessed on the basis of reasonableness from technical and cost points of view. For the most part standard rates for manpower, equipment and material resources in Japan were applied in the assessment of all claims.
- 3.10 Assessment reports were prepared in a spreadsheet format showing the claimed and assessed amount for each item followed by a brief explanation of the basis of the assessment. Draft reports were submitted by the surveyors to ITOPF, the UK Club and the Funds for review. In order to avoid lengthy exchanges of correspondence meetings were held in either London or Kobe to finalise assessment reports, which were then approved by the Club and the Funds. The manager of the Claims Handling Office usually met several times with claimants to explain the basis of the assessments thereby facilitating amicable settlements, which were then concluded by the lawyers representing the claimants, the UK Club and the Funds.
- 3.11 A different approach was adopted in the case of the claim by JMDPC in respect of the costs of the construction and dismantling of the causeway. In view of the complexity and sensitivity of this particular claim it was decided that the Funds' staff should first address the fundamental issues regarding the admissibility of the claim before a detailed assessment of the quantum was carried. Once the Funds and the Club had taken the view that not all of the construction costs were admissible, Japanese civil engineering experts were engaged to estimate the admissible costs. The Director and representatives of the UK Club participated in the settlement negotiations with representatives of the Japan Coast Guard and JMDPC.

*Claims in the fisheries sector*

- 3.12 The marine surveyors engaged by the Funds and the UK Club already had considerable experience of assessing fishery claims as a result of their involvement in many previous, albeit smaller pollution incidents in Japan. However, as with the claims in respect of clean-up costs, draft reports were sent to the Funds, the UK Club and ITOPF for review before they were finalised. Once claims had been approved by the Funds and the UK Club the Japanese

surveyors met with the claimants' representatives to conclude settlement agreements as authorised by the Funds and the Club.

- 3.13 The majority of fishery claims were in respect of loss of earnings of individual fishermen caused by the suspension or interruption of fishing due to the presence of oil in the vicinity of their fishing grounds as well as the consequential loss of revenue by the fishery co-operative associations that handle catches. The claims were generally very straightforward to assess and did not give rise to any particular difficulties.
- 3.14 In the case of sea fishing by boat losses of earnings were assessed on the basis of the number of lost fishing days and the average daily catch over the period of the loss in the three years prior to the incident. Losses of profit were then determined according to the method of fishing by reference to published fishery statistics and after deducting any saved costs.
- 3.15 A number of claims were also filed in respect of alleged damage to seabed resources, including various species of seaweed and shellfish. These claims were based on the assumption that the oil spilled from the *Nakhodka* had affected the reproduction of seaweeds and caused mortality of young shellfish that had been laid on the seabed prior to the incident. The claimants further assumed that these adverse effects would have an impact on the resources for between 2 and 6 years. The Funds and the UK Club rejected the allegations regarding mortality and long-term impact on marine products due to the lack of evidence, but accepted that the presence of oil caused disruption to the harvesting of seaweed and shellfish, and that in the case of one species of seaweed this had led to the abandonment of harvesting for the entire season.
- 3.16 Claims for losses in earnings from the harvesting of seabed resources were assessed on the basis of co-operative association records of yields in the three years prior to the incident and losses of profit were determined after deduction of harvesting costs and any other saved costs.
- 3.17 Losses of revenue of the fishery co-operatives were based on the normal commissions charged made by each association.
- 3.18 An onshore fish farm located in Ishikawa Prefecture, which relied on a constant supply of clean seawater, filed claims for losses due to mortality of fish as a result of disruption to the seawater supply caused by the presence of oil in the vicinity of the intake, retardation of growth of fish due to suspension of feeding, early shipment of immature fish to mitigate further losses and the postponement of introduction of juvenile stocks. In view of the financial difficulties faced by the owners of the fish farm the Funds and the UK Club decided to assess as a matter of urgency the most substantive claim item, which was in respect of mortality of fish. The Funds and the UK Club accepted that the disruption to the seawater supply had caused the temperature of the seawater in the tanks to increase and that this had led to the higher than normal levels of mortality of both mature and immature fish. The claim was assessed after taking into account normal mortality rates of fish of different stages of maturity as recorded by the fish farm over the previous three years of operation. In the case of mature fish the losses were determined on the basis of their average weight and by reference to invoices demonstrating the selling price over relevant period. For immature fish the losses were determined on the basis of the purchase price of the juvenile fish and the additional value of the fish as a function of the weight increase expressed in management and feed costs. This element of the claim was assessed within one month of its submission by the claimant and enabled an interim payment to be made pending the assessment of the remaining elements. The claimant subsequently withdrew the elements relating to losses due to retarded growth of fish and delayed re-stocking of juveniles due to them being unable to substantiate and quantify the losses.

- 3.19 The claim resulting from the early sale of immature fish at a reduced price in order to minimise losses was assessed on the basis of the achieved selling prices compared with the normal market price after the deduction of saved costs resulting from the early sale of the fish.

*Claims in the tourism sector*

- 3.20 As indicated above, the *Nakhodka* incident was the first in Japan to give rise to claims in the tourism sector, as a result of which the Funds and the UK Club were unable to find local experts who had the necessary knowledge and experience to interpret and assess such claims. The decision was therefore made to engage a marine surveying company to undertake the assessments after training some of its staff by the Funds' British tourism experts. Because of the lack of experience of the Japanese surveyors in this field it was further decided that the British experts should review all draft assessment reports before they were submitted to the Funds and the UK Club for their consideration. Once assessments had been reviewed and approved by the Funds and the UK Club, the Japanese surveyors met with individual claimants to explain the basis of the assessments prior to concluding settlement agreements.
- 3.21 Claims in the tourism sector were submitted by owners of hot spring resorts, guesthouses and restaurants that catered primarily for tourists visiting the affected area. All claims were in respect of economic losses suffered over a three-month period immediately following the incident. Although the majority of claims had been assessed by the time of the third anniversary of the incident there was some criticism of the time taken to complete the assessments. There were a number of factors that contributed to these delays, not least being the comparatively small number of claims assessors. Delays were also due in part to the fact that all the claims were submitted at the same time, in August 1997. However, another major reason for the length of time taken to complete assessments was the decision to make on-site visits to each claimant's premises. This was considered necessary in order for the assessors to gain a clear understanding of the nature and size of the facilities, the type and quality of the services offered and any other circumstances that may have contributed to the alleged downturn in business activity. All site visits had been completed within two years of the incident.
- 3.22 Most claimants submitted a great deal of documentation with their claims including historical income tax returns, annual statements of profit and loss, monthly statements of sales and costs of sales and ledgers covering the claim period for the four years prior to and the year of the incident. However, the documentation required very careful analysis in order to determine what the turnover of each business would have been had the incident not occurred. A further complicating factor was that many of the claiming businesses had suffered a major downturn in turnover following the Kobe earthquake in 1995 with some continuing to decline and others only having partially recovered following this impact, making it difficult to discern any clear trading pattern prior to the *Nakhodka* incident on the basis of the documentation alone. Only by interviewing claimants could the reason for a particular trading pattern be clearly understood.
- 3.23 Assessments were made in the same way as all previous tourism claims dealt with by the Funds. The reduction in turnover of each business was determined by comparing the actual with the expected turnover - based on the turnover in previous years - for the period of the loss. In order to determine the businesses loss of profit, deductions were then made for reduced costs of sales and any other savings in variable costs, for example as a result of laying off of temporary staff and savings in energy and other consumables.

#### 4 Lessons learned and conclusions for the handling of future incidents in Japan and elsewhere

A number of lessons were learned in the handling of claims arising from the *Nakhodka* incident in the light of which different procedures were put in place for dealing with claims arising from the *Erika* and *Prestige* incidents and these procedures may also be applicable in the event of another major incident in Japan. The main lessons learned and conclusions for improvements are set out below.

- (i) There is a shortage of marine surveyors in Japan who have the necessary expertise to assess claims in respect of the costs of clean-up and preventive measures, have a sufficiently good knowledge of the English language and would be willing and able to work for the 1992 Fund and the shipowner's insurer on a full time basis for a minimum of three years. In order to enable the Fund's experts to focus their efforts on the assessment of claims so as to speed up the overall process it is concluded that they should, to the extent possible, not be used to manage and run the Claims Handling Office. The Funds have already adopted this policy in the setting up of such Offices in France and Spain in response to the *Erika* and *Prestige* incidents. The primary role of the managers and staff appointed to run these offices is to facilitate the submission and prompt processing of claims for pollution damage and the payment of compensation. Although the Claims Handling Office in these cases serves as a focal point for claimants, the staff are not authorised to make assessments of claims nor to express any opinions to the claimants regarding the admissibility of their claims or on the amounts claimed.
- (ii) One of the most time consuming parts of the claims handling process was the scrutinising and collation in an electronic format of the voluminous amounts of documents submitted by claimants. It is concluded that claimants should be given greater assistance by the Secretariat in the presentation of their claims and be encouraged to submit them in electronic format. It should be recognised, however, that the processing of claims submitted in a language other than one of the 1992 Fund's official languages would still take considerable time in the case of large incidents involving thousands of claims.
- (iii) The production of assessment reports was also very time-consuming due to the level of detail contained in the reports. It is concluded that the Fund should provide experts with generic report formats for different categories of claims to ensure that the assessments are presented in a uniform way and with only the level of detail required by the Fund and shipowner's insurer to process claims. Such generic reports have already been prepared for recent incidents in respect of some fishery and other economic loss claims and these reports should be extended to include all types of claims.
- (iv) Fishery claims were assessed by the same group of surveyors that dealt with claims for clean-up costs thereby adding to their already heavy workload. Japan and the Republic of Korea are the only Fund Member States where the Fund and the insurer have tended to rely on marine surveyors to undertake the assessment of fishery claims. Although these surveyors have considerable experience in dealing with such claims, the limited pool of qualified people inevitably resulted in delays in completing assessments. It is concluded that if a major incident were to result in a large number of individual fishery claims the Fund and the insurers should consider recruiting Japanese fishery experts to assess claims in the future. The Technical Guidelines, which are being developed by the Funds' experts, should be of assistance in this regard (cf document 92FUND/A.8/24).

- (v) As indicated above, prior to the *Nakhodka* incident the marine surveyors that undertook the assessments of claims in the tourism sector had no previous experience of such claims and this inevitably contributed to delays in completing the assessments. In the event of another incident in Japan involving a large number of claims in the tourism sector, the Fund should consider engaging people with specialised accounting skills recognising that it will still be necessary to provide training and supervision. The 1992 Fund's experience of having had to deal with some 3 500 tourism claims arising from the *Erika* incident showed that people with accounting experience, as well as being in greater supply than marine surveyors, are better equipped to interpret the financial documentation provided in support of tourism claims.

**5 Action to be taken by the governing bodies**

The governing bodies are invited:

- (a) to take note of the information contained in this document; and
- (b) to give the Director such instructions in respect of the issues dealt with in this document as deemed appropriate.
-