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APPORTIONMENT OF COMPENSATION PAYMENTS BETWEEN P & I CLUBS AND THE IOPC FUNDS

Note by the International Group of P & I Clubs

1 Introduction

1.1 Recent cases and developments have led the Clubs to review their practice in funding compensation payments in incidents governed by the Civil Liability and Fund Conventions. Concerns have arisen in the context of incidents where claims are presented for amounts which exceed the compensation limit under the applicable Fund Convention.

1.2 To date such cases have been few, but as experience of them has increased it has become clear that they involve extra factors which can be complex and problematic. The purpose of this Note is to draw attention to the potential difficulties and to explain why, in some cases, Clubs may feel constrained to take a different approach to the payment of compensation from that normally taken when the claims fall within the Fund Convention limit. In particular, they might find it necessary to maintain a reasonable proportion of the CLC limitation fund in reserve until the final total of established claims has become clearer.

2 Legal framework

2.1 So far as the Clubs are concerned, the successful operation of the international system of compensation has, over the years, required a balance to be struck between an approach which is technically correct and one which contributes in a practical manner to the prompt payment of claims. Exactly how that balance should be struck has often depended on a number of factors and varied considerably with the circumstances of the particular case. Whilst purely legal considerations have by no means been the sole guide, the underlying legal framework must naturally be kept in mind.

2.2 For the Clubs the liability limit set by the Civil Liability Conventions is an important element in the legal framework. It is seen as a vital ingredient in a system which imposes strict liability on the shipowner – despite the fact, as recent cases have highlighted, that primary blame may lie elsewhere – and in which the insurer agrees to act as a guarantor amenable to direct action. Insurers need the certainty associated with clear and fixed limits in order to contribute actively, as they have sought to do, to the smooth operation of a system such as that established by the Civil Liability and Fund Conventions.

2.3 Although the precise amount of the CLC limit may not be known until some time after the incident, in practice it has seldom differed significantly from initial estimates. For the insurer the real concern lies in the risk of over-payment resulting from voluntary efforts to streamline the compensation system by means of advance or interim payments.

2.4 In all but a very few cases the shipowner has been entitled to the benefit of limitation, and of course limitation always applies to an insurer's liability under CLC. Where the established claims exceed the CLC limit, the legal obligation of the owner and his insurer is to pay to each claimant a pro rata share of the limitation fund. If the Club makes advance payments in such a case, and continues making them until the CLC limit is reached, it is virtually inevitable that some claimants will be overpaid at the expense of others. An obligation will remain to make good the shortfall suffered by those in the latter category. This could lead to the insurer ultimately bearing a burden of claims substantially higher than the CLC limit. The prospect of such an outcome is naturally a matter of concern for the Clubs and their reinsurers. In principle this is probably no different from the concern with which the Funds would doubtless view the prospect of being held liable for amounts exceeding the limit under the relevant Fund Convention.

2.5 There is no obligation on the shipowner or insurer to make advance payments, or to run the risks of over-payments and their consequences. They are entitled to avoid these by simply establishing a limitation fund and leaving the court to distribute it among claimants in the appropriate proportions. In practice however it has been commonplace, particularly in cases involving the IOPC Funds, for the Clubs to make advance or interim payments.

3 Practical considerations

3.1 Distribution of the available compensation by the competent court is likely to be more time-consuming than voluntary payments by the compensation bodies providing the funds. The proportions of a limitation fund to which each claimant is entitled cannot be known with certainty until the admissible amount of every claim has been established. This may not be possible until after the three-year time limit for proceedings has expired, and possibly until a substantial time later if legal proceedings are involved, especially if these result in appeals. Accordingly, if a P & I Club decides simply to follow the procedure provided for in the Civil Liability Conventions, it is likely that compensation from the Club will not reach the claimants for a number of years.

3.2 The Clubs have recognised that many typical claimants could suffer undue hardship if compensation were to be distributed rigidly in accordance with the procedure which the Conventions envisage. They have therefore been willing on many occasions to make immediate payments to victims who have established their claims, and also to fund various types of interim payments. This has of course been facilitated considerably in cases where the Fund Conventions apply, and particularly by the readiness of the Funds to treat the Clubs as subrogated to the rights of claimants whom they have compensated.

3.3 Whilst it is a matter for the individual Club to decide what approach it will take to these issues in the circumstances of the individual case, in general the difficulties addressed in this Note should not arise in relation to incidents where the Funds are involved, and where the aggregate of claims is anticipated to fall and actually falls within the limit of compensation set by the applicable Fund Convention.

3.4 The position is however materially different in cases where the claims are presented, before expiry of the three-year time limit, for amounts exceeding the Fund Convention limit. In such cases there are important reasons for a more cautious approach on the part of the Clubs. Such cases by definition involve claims which are substantial, and prospectively many times the amount of the CLC limit. In the example set out in the Director's Note (document 71FUND/EXC.60/12 or 92FUND/EXC.2/6), where payment of established claims is restricted to 25%, a possible total is predicated of four times the Fund Convention limit. Such a total could typically amount to approximately forty times the CLC limit. Even when restricted to 25%, the compensation payments would still amount to ten times the claimant's entitlement from the CLC fund. In such a situation the payments cannot be funded by the Club alone without an abnormally significant departure from the legal process. This naturally calls for extra certainty that the necessary financial adjustments will be made to restrict the Club's ultimate liability for claims to the CLC limit.

3.5 Unfortunately in such cases there is less certainty rather than more. Where claims have fallen within the limit prescribed by the applicable Fund Convention, financial adjustments agreed between the Clubs and the Funds have been uncontroversial in the absence of any incentive for these to be challenged by claimants receiving full compensation. Where this limit is exceeded, however, there are concerns that claimants will not be bound by private arrangements between the Club and the Funds. Rights of subrogation may depend on uncertain considerations of national law and be open to challenge.

3.6 Reference has been made in the Director's Note to some of the reasons for these concerns. It is appreciated that in some situations similar considerations may affect the Funds (though generally it is believed that the right of the Funds to be credited with payments they have made involves fewer potential difficulties than the right of other parties to bring claims against them by way of subrogation). In these circumstances it has not been thought helpful to elaborate on the legal issues in any detail in this document, but it may be noted that the case referred to by the Director is by no means the first in which these issues have had to be considered by the Clubs.

3.7 In addition to risks associated with subrogation there is the risk of under-estimating the final total of established claims – ie of interim payments being made for too high a percentage of the established amounts. Although this percentage is normally fixed on a conservative basis, the risk of an under-estimate cannot be excluded until after the three-year time limit has passed.

4 Significance of TOVALOP and CRISTAL

4.1 In the limited number of cases of this kind which have occurred to date, the position of the Clubs has been influenced by the role of the industry schemes TOVALOP and CRISTAL. These have now expired. However in respect of incidents occurring prior to 20 February 1997 the TOVALOP Supplement includes a procedure enabling Cristal Limited to bring a so-called reimbursement claim against the owner (or in reality his Club). The object of such a claim is to reimburse CRISTAL members in 1971 Fund Member States for all or part of their contributions to compensation paid by the Fund in respect of the incident. Reimbursement claims are subject to the financial limit set by the Supplement, against which credit is given for the claims and expenses which the owner has paid.

4.2 In general terms the TOVALOP Supplement limit is broadly equivalent to the CLC 92 limit, and approximately 3½ times the amount of the CLC 69 limit. The industry schemes have therefore operated in such a way that where a CRISTAL cargo was involved (as was usually the case), the real exposure faced by the Clubs was considerably larger behind the scenes than the legal liability limit under CLC 69. (In return, the schemes provided protection to shipowners and Clubs against the risk of liabilities exceeding the Supplement limit, normally as a result of incidents in the United States).

4.3 In practice the effect of the schemes was to provide a considerable margin of safety available to absorb any risk a Club might incur of paying more than the CLC 69 limit in legal proceedings as a result of over payments to individual claimants. In the past this has been taken into account by Clubs

when making interim payments in cases where established claims were expected to exceed 60 million SDR, or where there has been a risk that this may occur.

4.4 It is believed that the particular incident referred to in the Director's Note is the first case in which these issues have arisen after the termination of the schemes in February 1997. It appears likely that they may readily arise again in future.

5 Practical solutions

5.1 The Clubs fully agree on the importance of finding practical solutions which can facilitate prompt payments to victims. Their primary concern is not one of cash flow, but one of managing the risks of over-payment. It is recognised that few solutions, if any, can eliminate these entirely. Clearly, the more they can be reduced, the greater is the scope for practical measures to ensure that the compensation system operates as smoothly as possible.

5.2 Logically it would appear that this is most readily achieved by apportioning payments in such cases so that neither the Club nor the Fund bears a risk which is disproportionate to that borne by the other, or to its expected ultimate liability. The proposal made in the particular case which has been referred to would seem to achieve this.

5.3 It is agreed that if the percentage for payments were set at too high a level then the Clubs would still face at least some adverse consequences as a result of over-payment, even if the Fund has participated in the payments. However a question of degree is involved. The Clubs could more readily accept a degree of risk if this is reduced in monetary terms as a result of being shared between the Club and the Fund in proportion to their respective limits. Without the Fund's participation from the outset, the Club would have to accept a degree of risk which is out of proportion to its liability limit.

5.4 It is also agreed that if possible a payment mechanism would be desirable to avoid any need for claimants to receive two separate cheques.

6 Conclusions

6.1 As advance payments are voluntary it is of course entirely for the Funds and the Clubs each to decide whether they are prepared to contribute towards them, and if so in what proportions. The Clubs see no reason why they should not continue to fund compensation payments in the great majority of cases as they have in the past, but they may not always feel able to do this in the relatively few cases where it is envisaged that established claims may exceed the Fund Convention limit. Depending on the circumstances of the case, Clubs may feel bound to maintain a reasonable proportion of the CLC limitation fund in reserve until the final total has become clearer.

6.2 The Clubs recognise that legal liability on the part of the Funds arises only if claimants are unable to obtain full compensation from the owner of the ship because (in this context) the damage exceeds his liability as limited by the relevant version of CLC. However it is understood that the relevant pre-condition of the Fund's liability is the insufficiency of the compensation available under CLC, not prior payment by the owner. In the types of case under discussion, where a prospect is foreseen of established claims exceeding the Fund Convention limit, the likelihood of them failing to reach the CLC limit is usually small, if not remote. If the Funds were to decide that they are nevertheless unable to contribute to compensation until the owner has first made payments up to his CLC limit, this may limit their freedom of action in any cases where the Club decides to keep a proportion of the CLC limitation fund in reserve.

6.3 If, on the other hand, the Funds decide to contribute to the compensation payments, and the estimated amount of established claims is later revised, there should be ample scope for appropriate re-adjustments to be made in the apportionment of later payments. In the unexpected event of

established claims failing in such a case to reach the CLC limit, there is scope for reimbursement of the Fund either by set-off against a claim for indemnification under the 1971 Convention, or by repayment from the Club concerned. The Funds will hopefully have no problem in agreeing such arrangements with International Group Clubs.

6.4 Given the complexity of some of the issues and importance of close co-operation in this area between the Clubs and the Funds, the Group would be happy to nominate representatives to discuss these matters with the Funds in further detail.