



INTERNATIONAL  
OIL POLLUTION  
COMPENSATION  
FUND 1992

THIRD INTERSESSIONAL  
WORKING GROUP  
Agenda item 2

92FUND/WGR.3/14/7  
20 January 2003  
Original: ENGLISH

## REVIEW OF THE INTERNATIONAL COMPENSATION REGIME

**Submitted by the International Group of P&I Clubs**

<b><i>Summary:</i></b>	The International Group of P&I Clubs submits that substantive change to the liability and compensation system of the current Conventions will not work to the benefit of claimants. Moreover it is argued that it would not be justified to re-open the Conventions in order to provide a different system of sharing between shipping and oil cargo interests, given that the burden of claims is already shared in practice.
<b><i>Action to be taken:</i></b>	The Working Group is invited to consider the views expressed in the following submission.

### **Introduction**

- 1 The thirteen P&I Clubs that are members of the International Group of P&I Clubs are mutual liability insurers which cover the third party liabilities of shipowners, including liability in respect of oil pollution. The Clubs cover well over 90% of the world's tanker tonnage and are the principal providers of the certificates of financial responsibility which are required under the 1969 and 1992 Civil Liability Conventions (CLC). The Clubs have therefore been involved in most of the major spills in the last thirty years, including those that have taken place outside the CLC/Fund regime.
- 2 The comprehensive report of the Director to the 7<sup>th</sup> session of the Assembly (92FUND/A.7/4) summarises the work undertaken by the Third Intersessional Working Group. Having previously discussed the issues put forward for consideration the Working Group now has to decide whether any of those issues are sufficiently important to merit the disruption which will be inevitable if a new treaty system were to be put in place. CLC 1992 has been ratified by 91 States and the Fund Convention by 84 States. The widespread adoption of the Conventions, which is a tribute to their efficiency and effectiveness, is unlikely to be achieved in the short term by new instruments and the transition period is likely to be prolonged. This would bring about a repeat of the confusion and problems of the transition from the 1969/1971 to the 1992 regime. In our view none of the issues identified by the Working Group would justify disruption on this scale. It was for this reason that the last session of the Working Group determined that any proposals should be

accompanied by treaty language so that an assessment could be made of the consequences of treaty amendment.

- 3 Three subjects have previously been identified that might be considered of sufficient importance to justify amending the Conventions:
  - the overall amount of compensation
  - the test for determining a shipowner's right to limit
  - channelling liability to one party and exonerating others
- 4 The first issue will be addressed at the Diplomatic Conference in May. Presuming that this is successful and an enhanced level of compensation is subsequently available to those States that opt to ratify the Supplementary Fund Protocol the Working Group may decide that the other two issues do not merit re-opening the Conventions. If this were to be the case it is respectfully submitted that it would not be justifiable to re-open the Conventions merely in order to provide a different system of sharing the burden between the shipping and cargo interests, as suggested in the submission made by OCIMF (92FUND/WGR.3/14/2), particularly since it can be readily demonstrated that sharing is already achieved in practice at present and will in all likelihood be maintained in future. This and a number of other issues raised by OCIMF are considered in more detail in Annex I. In the remainder of this submission we address the related issues of the right to limit and channelling, as well as the notion of sharing. In order to consider these issues properly it is however necessary to look into the historical background.

### **Historical Background**

#### ***Sharing the Burden***

- 5 When the *Torrey Canyon* went aground in the English Channel in 1967 claimants (principally the UK Government) faced not only jurisdictional problems but also questions concerning title to sue. These problems were squarely faced by the Conferences which broke new ground in agreeing the 1969 International Convention on Civil Liability for Oil Pollution Damage (CLC) and the 1971 International Convention on the Establishment of an International Fund for Compensation for Oil Pollution Damage (Fund Convention). The touchstone adopted at these Conferences was that victims should not have to shoulder the financial burden of pollution arising from oil spills at sea but instead would receive rapid and adequate compensation in accordance with the Polluter Pays Principle. Then, as now, there were sterile arguments about the identity of the 'Polluter' – on the one hand it was argued that it was the nature of the cargo that caused the damage and that oil receivers were massive international corporations that made enormous profits from the production and transport of oil who were free to select the vessels they chose to carry their cargoes, and should therefore be characterised as the 'Polluter' and made solely liable. On the other hand it was argued that although freight constituted only 8% of the price of petrol at the pump the shipowner should be regarded as the 'Polluter' because he had taken charge of the cargo and that he therefore should be solely liable. In the event the Conferences pursued the goal of providing an efficient compensation system and determined that the tanker industry and the oil industry should broadly share the cost. A study of the cost of tanker spills in the 1990s which was circulated at the last session of the Working Group demonstrated that this objective had largely been achieved.

#### ***Compensation not Punishment***

- 6 In order to facilitate ready recovery, liability under CLC was not imposed on the party at fault but on the party most easily identified, that is the registered owner of the tanker. Equally, the cargo contribution was levied not against the individual oil company concerned but against the IOPC Fund to which all oil receivers contributed. However, it was recognised that the corollary of this simplicity was that the individual ship operator who may have been negligent in the operation of the ship or the individual oil company charterer who had chartered a sub-standard vessel would not be punished and would not have to bear any individual liability under the Conventions. The

system has worked well in practice since claimants do not have the burden of establishing the liability of the 'guilty' party and payments can be quickly made. However, the consequence of this enviably efficient system is that in several recent cases, notably the *Erika* and the *Prestige*, allegations have been made that sub-standard shipowning and chartering practices have not been sufficiently punished by the imposition of liability.

- 7 The criticism of the existing system and the allegations outlined in the previous paragraph rest on two misunderstandings:

***Does good behaviour follow the imposition of liability?***

- 8 An owner who incurs claims will have to pay a higher premium and this will obviously affect his behaviour. However, because of the pooling arrangement explained in the following paragraph, the effect is only really felt at relatively low levels of liability. In the experience of the Clubs, there is no evidence that there is a necessary link between the imposition of civil liability at high levels and the quality of ships and their operators. A shipowner whose liability in respect of any risk is substantial will already have taken all available steps to minimize that liability and the imposition of further liability is unlikely to produce any further improvement. Furthermore, it is the function of mutual insurance to absorb high level liability by spreading the cost across the whole shipping industry. A shipowner, like other commercial parties, is always able to insure his potential liability (and under CLC is compelled to do so) with the consequence that the direct link between liability and conduct is lost, particularly at the higher level of liability. Insurers in their turn try to ensure that the ships and ship operators they cover are of an appropriate standard but, even though the Clubs run extensive survey programmes in order to supplement the work of Classification Societies and Port State authorities it is not possible for insurers alone to compel the proper performance of the shipowner's obligation to ensure that all ships are maintained and operated to an appropriate standard. This obligation must be encouraged in practice by other methods: Port State Control, the vetting procedures of oil company charterers and the introduction of the ISM Code are all having a beneficial effect in this connection. The Clubs welcome all initiatives to improve standards and are currently considering ways in which they may be able to assist further in this endeavour.

***Can the individual be punished by the imposition of liability?***

- 9 As explained in the Introduction, the Clubs share the liability risks of over 90% of the world's tonnage. This cover is structured in such a way that the individual owner will bear the first layer of any claim, typically \$10,000, and the excess of that amount up to \$5million will be covered by the Club in which his vessel is entered. If an owner incurs claims his premium will obviously reflect that and provide an incentive towards better performance. However, claims in excess of \$5 million are shared under the Pooling Agreement by all Clubs and the incremental cost of such large claims is of necessity spread across the industry and not focussed on the individual assured. Therefore, just as all oil receivers share in the funding of pollution claims falling on the Fund, so major claims under CLC are in practice borne by all shipowners. The drafters of the original Conventions were well aware of this structure and the benefits it provided which is why the burden of compensation has been shared across the totality of the industries concerned; the tanker industry and the oil industry.
- 10 The background which has been sketched in the paragraphs above will serve to illuminate why many of the suggestions made in the aftermath of the *Erika* and *Prestige* are not well-founded. The following paragraphs will examine particular issues and seek to explain why it is not possible to maintain the present efficient compensation system at the same time as introducing elements which would be more responsive to the 'moral' point of view. We then go on to consider some of the implications of the proposed Supplementary Fund.

**The Right to Limit Liability under CLC**

- 11 In order to maintain the sharing of the burden between the tanker and oil industries it is essential that the shipowner, the responsible party under CLC, should be entitled to limit his liability. Moreover, it is important that the right to limit should be practically unbreakable since it is an integral part of the compensation system that both paying parties should be clearly aware at the outset of their exposure in relation to each incident. Anything that would encourage regular litigation on this point following spills would risk a breakdown in the current close co-operation between the Clubs and the IOPC Fund, resulting in compensation payments being delayed.
- 12 These points were well understood by the delegates to the first revision Conference in 1984: Article V.2 of CLC 1969 provided that the shipowner would lose his right to limit if it could be shown that the incident was caused by his 'actual fault or privity,' however litigation in several jurisdictions had demonstrated that the courts were construing this test as bordering on simple negligence, thus undermining the purpose of the Convention. The consequence was that in 1984 the more stringent test (which had first been introduced in LLMC 1976) was adopted, which required that the shipowner would lose his right to limit if it was proved 'that the pollution damage resulted from his personal act or omission, committed with the intent to cause such damage, or recklessly and with knowledge that such damage would probably result.' In this way the revision Conference of 1984 ensured that the aim of the compensation system established in 1969/71 would be maintained by avoiding needless litigation about degrees of negligence while ensuring the sharing of the burden between the two industries involved. This conclusion was then adopted at the later revision Conference which was held in 1992.

**Channelling of Liability**

- 13 As explained above, the drafters of the 1969/71 system deliberately imposed strict liability under CLC only on the registered owner. Their purpose in doing so was to facilitate the bringing of claims and their swift conclusion, even though it was recognised that the registered owner may not have been involved in the operation of the ship at all. If this were not done and an attempt made instead to impose liability on the negligent charterer or operator then litigation would inevitably ensue in order to determine whose fault had given rise to the spill. The victim would remain uncompensated until the litigation had been concluded. The public may abhor the fact that an operator is not held immediately liable for the consequences of a spill which has been caused by his negligence. Nonetheless it is suggested and has been recognised by successive revising Conferences thus far that this is a price that should be paid in order to ensure prompt compensation to victims – particularly bearing in mind that the liability of the registered owner is covered by compulsory insurance. Moreover, it should always be borne in mind that although the victim will only be able to claim against the registered owner, the recourse action that the owner will undoubtedly bring in domestic law will ensure that any other party at fault will be ultimately held liable – but without impeding the action of the claimant.

**Sharing the Burden – the Proposed Supplementary Fund**

- 14 During the last ten years the consciousness has been growing that the overall amount of compensation available under the Conventions was not sufficient to meet claims arising from major oil spills, particularly those involving heavy fuel oil. This is illustrated by the *Nakhodka*, *Erika* and *Prestige* incidents, demonstrating that the primary problem in these cases is the nature of the cargo and the tankers selected to carry this highly polluting type of oil. In several recent incidents claims settled by the IOPC Fund have had to be pro-rated because it was not known at the outset whether the overall limit would be exceeded. The *Erika* once again brought the issue to a head and as a consequence it was agreed that the limits under the Conventions should be increased according to their own terms. Limits increased by about 50% will be brought into force in November 2003. However certain States felt that a further increase was necessary and have proposed that a third tier of responsibility, a Supplementary Fund, should be put in place in those

jurisdictions which require further protection. The third tier proposal is to be considered at a Diplomatic Conference to be held in May 2003.

- 15 The proposed Supplementary Fund will be funded by oil receivers, which has given rise to some dismay among cargo interests who have protested that this will distort the sharing arrangements that are currently in place. It has therefore been suggested that a method be found for tanker interests to share in the funding of the Supplementary Fund. However, it is generally recognised that this proposition, if implemented formally, would run up against insurmountable problems of treaty law. For this reason attempts were made to develop voluntary agreements which would have the same effect, but it proved impossible to obtain a sufficient level of agreement from oil receivers. It was therefore suggested by tanker interests and their insurers that in those countries where the third tier was implemented the minimum limit under CLC would be voluntarily increased from about SDR 4 million to SDR 20 million (as proposed by OCIMF). This proposal has been agreed in principle by Club Boards and discussions on the structure of the proposed agreement with the IOPC Fund are still taking place (see Annex II attached).
- 16 It is hoped that in this way it will be possible to maintain the current balance as between the tanker industry and oil receivers. Given the volatility of claims it is impossible to achieve precision in predicting the sharing of the burden of compensation in future but we are confident that the proposal we have made will go a long way to balancing the exposure of cargo interests when the Supplementary Fund is implemented. It should also be borne in mind that the voluntary minimum increase in the shipowner's limit will apply to all claims arising in countries which have adopted the Supplementary Fund, whereas the third tier exposure will arise only if a sufficiently large claim occurs. While it is certain that there will be a significant increase in the burden on shipowners by virtue of the voluntary increase in the minimum limit for small ships, it is quite possible that over a period of years there may be no claim sufficiently large to reach the third tier (especially after the further operational improvements which are likely to be implemented following the *Prestige*), in which case the balance of exposure will fall more heavily on shipowners than on cargo interests. In any event we have proposed that the arrangement be reviewed from time to time within three or four years after the implementation of the Supplementary Fund in order to ensure that an appropriate balance is maintained in the light of claims figures at that time.

### **Conclusions**

- 17 We remain strongly of the view that the international compensation regime has been remarkably successful. We fear that attempts to amend the Conventions in substance will destroy the system, while failing to produce any dividend in terms of improvements in performance from the perspective of claimants. We would therefore urge that no attempt be made to re-open the Conventions since in our view the only effect of this would be to weaken the position of victims.

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## ANNEX I

### Comments on the submission made by OCIMF (92FUND/WGR.3/14/2).

We offer the following general observations on the OCIMF paper.

- 1 Despite the use of phrases such as “environmental imperative”, the OCIMF proposals do not seek to benefit claimants but are aimed exclusively at reducing the financial exposure of the oil industry. The proposals therefore seem to have little relevance in the context of the discussion going forward in the Working Group. In particular we would note:
  - a No objective justification is given for the proposed new CLC limit of SDR 90 million, save that it is approximately equivalent to the maximum limit that will apply to tankers over about 140,000 GT after 1 November 2003. Adoption of the proposal would not increase the amount of compensation available to claimants and the complex treaty law implications are conveniently ignored.
  - b To suggest that tanker size is not relevant to the calculation of liability limits ignores the fact that the cost of dealing with a 100,000 tonne spill will clearly be far more expensive than dealing with a 1,000 tonne spill of the same oil. The fact that small spills can be disproportionately expensive (as demonstrated by the Clubs’ own statistics) is primarily due to the type of oil involved, as demonstrated by the three most expensive spills dealt with by the Funds in recent years – the *Nakhodka*, *Erika* and *Prestige*, all of which were carrying heavy fuel oil cargo.
  - c If larger claims are paid because shipowners’ liability under the CLC is increased then reinsurance premiums will also increase. To suggest that it could be accommodated within the existing insurance arrangements shows a misunderstanding of the financial dynamics of liability insurance.
  - d If the compulsory insurance requirement were to be extended to all tank vessels carrying cargoes of oil in bulk the number of vessels to which certificates would have to be issued by flag states would be increased dramatically, without any corresponding benefit to claimants.
  - e Given that the *Pontoon 300*, *Al Jaziah 1* and *Zeinab* were all allegedly engaged in the illegal transport of oil from Iraq it is doubtful that the compulsory insurance requirement would have made any difference.
  - f One of the attractions for some States of joining the Fund is that it guarantees that expensive claims for spills from small tank vessels are met in circumstances where the owners of such vessels cannot obtain or afford high levels of insurance, or choose not to insure because of illicit operations. The ability to opt out of CLC and Fund would therefore not serve the interests of claimants.
- 2 The OCIMF argument proceeds on the basis that an increase in the liability of the individual shipowner will produce a corresponding improvement in his behaviour. This is a flawed assumption because:
  - a It ignores the effect of insurance (a cornerstone of the CLC), as well as the consequent fact that the financial burden is not shared between individual shipowners and individual charterer oil companies but between the two industries.
  - b Even without the effect of insurance it is plain that if an individual already has a substantial liability, a further increase in that liability is unlikely to influence his behaviour.
- 3 The allegation that the cost statistics previously provided to the Working Group by the Clubs are inaccurate is strongly rejected. The statistics provided by each Club are confidential and the sort of detail mentioned by OCIMF is not even revealed to the other Clubs in the International Group. However, the accuracy of the analyses can be confirmed. As was made clear at the time of OCIMF’s request, the International Group would be happy to respond to any question of detail on the figures. In connection with the statistics now presented by OCIMF we would note:

- a The OCIMF analyses are necessarily incomplete and misleading since they consider only claims brought against the IOPC Funds. The Clubs' statistics include the hundreds of claims (probably 95% of the total) that were settled within the CLC limit and never reached the Fund.
- b Given that the OCIMF analyses only consider Fund cases, the conclusion that the majority of the compensation was paid by the contributors to those Funds is not surprising.
- c The OCIMF analyses fail to take into account several factors. For instance, in looking at the growth in the number and value of claims against the Funds no account is taken of the equivalent growth in the number of Fund States over the same period, or the move from the 1969/71 Conventions to the 1992 Conventions.

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## ANNEX II

### Small Tanker Oil Pollution Indemnification Agreement (STOPIA)

In our submission to the October 2001 session of the Assembly (92FUND/A.6/4/3) and in our submission to the April 2002 session of the IOPC Fund Third Working Group (92FUND/WGR.3/11/1) we outlined a proposed voluntary scheme whereby shipowners would agree, subject to certain conditions, to a substantial voluntary increase in the minimum limit of liability applicable under 1992 CLC to smaller tankers.

The details of the STOPIA scheme have been considered by Club Boards on several occasions and the main elements of the scheme have been agreed. This scheme would be implemented by two agreements, drafts of which have been under discussion with the Director of the IOPC Fund for some time. Whilst the Director has no current mandate to bind the Fund, he has made a number of helpful suggestions aimed at facilitating the effective operation of STOPIA.

The principal elements of the STOPIA scheme which have been agreed by Club Boards are as follows:

- 1 Under STOPIA the owners of relevant tankers of 29,548 GT or less would contract with the IOPC Fund to reimburse claims paid in excess of the relevant limit of liability under 1992 CLC up to SDR 20 million per incident. All contributors to the 1992 Fund would therefore benefit in circumstances where the scheme applied.
- 2 The scheme would apply to approximately 6,000 tank vessels, representing about 75% of the world fleet of tankers falling within the 1992 CLC definition of “ship”.
- 3 The scheme would only apply in the event of a tanker spill affecting a State party to the Supplementary Fund when liability was imposed under 1992 CLC.
- 4 The scheme would come into effect at the same time as the entry into force of the Supplementary Fund
- 5 The flag of the vessel or the ownership of the cargo would not be relevant.
- 6 The 1992 CLC limit (including the increases which come into effect in November 2003) would have to be exceeded, but the scheme would operate even if claims did not reach the third tier Supplementary Fund.
- 7 The tanker owner’s liability under the scheme would not exceed the 1992 CLC limit plus the voluntary tranche.
- 8 Under an amendment to the Memorandum of Understanding between the IOPC Fund and the International Group of P&I Clubs, the Clubs would guarantee the tanker owner’s contractual liability to the IOPC Fund, subject only to the defences available to shipowners and insurers under 1992 CLC.
- 9 Shipowners and Clubs would reserve the right to withdraw from the voluntary scheme if any essential element of the 1992 Conventions affecting tanker owner liabilities were to be amended.