ENVIRONMENTAL LIABILITY AND THE INTERNATIONAL CONVENTION SYSTEM – RECENT DEVELOPMENTS

Introduction

This paper looks from a P&I perspective at recent developments relating to international laws concerning environmental liability, especially as prompted by proposals of the European Commission (EC). The paper deals mainly with pollution by oil.

The function of the P&I Clubs in relation to environmental damage is fundamentally no different from their role in any other type of liability incident. They indemnify the shipowner in respect of claims for which he is legally liable.[1] In getting to the point where a Club can approve a claim for payment, it will provide many other distinctive services. There is the normal process of investigating facts, analysing relevant law, and negotiating settlements, but the Club will also help the owner deal with many related problems after the incident, reflecting the close relationship between insurer and insured which has existed since the 19th Century founding of the "Club" concept.

The Clubs have a legitimate interest in helping owners to prevent environmental damage. The Clubs also have a legitimate interest in opposing unfair or unsustainable liability regimes insofar as they impact on maritime carriers and on their insurances. The Clubs therefore closely monitor prospective developments in the law and make their insurance expertise available to IMO, CMI, and other relevant bodies.

Oil pollution damage from tankers – the CLC and IOPC Funds

The compensation system embodied in the international Conventions has proved to be a very effective mechanism, and a valuable model for subsequent international legislation at IMO. In order to understand recent developments, and criticisms of the EC, it is worth reminding ourselves of the background and key features of the system.

Modern international oil pollution law began with the "Torrey Canyon" incident in 1967. Although not the first pollution incident, its scope of damage and the accompanying publicity made prompt action unavoidable. Governments gathered together at IMO and adopted two Conventions: the 1969 Civil Liability Convention (CLC) and the 1971 Fund Convention. The CLC, which entered into force in 1975, established liability for shipowners, while the Fund Convention, which entered into

[1] The cover provided by the Clubs for oil pollution liabilities is currently limited to $1,000 million per ship per accident. The general limit on Club cover is determined by the limit of what can be collected in 'overspill calls' which are capped at a figure equal to 2.5 per cent of the property fund calculated under the 1976 Limitation Convention for each ship entered in the Clubs which are parties to the International Group Pooling Agreement – this formula might accommodate a claim of about $4.5 billion.

force in 1978, provided a resource paid for by oil companies to supplement the compensation under CLC.

Soon after the entry into force of the Conventions, two incidents, "Amoco Cadiz" in 1978 and "Tanio" in 1980, called into question the fairness of the system and revealed that the limits of compensation provided by the two Conventions might be insufficient to satisfy damage claims in a major spill. This set in chain a process of revision leading to the 1992 CLC and 1992 Fund Convention, both of which entered into force in 1996 (almost twenty years after the question was first considered).

Strict liability

Under the 1969 and 1992 CLC, the shipowner is liable for pollution damage caused by an escape of oil from his ship unless he can bring himself within one of three limited defences set out in those Conventions. Liability does not depend on proof of negligence. Under the 1969 CLC, if the tanker is carrying oil in bulk as cargo, then the owner's liability to pay compensation is triggered as soon as oil (whether cargo or bunkers) escapes from the ship.

The 1992 Convention extends this liability to tankers in ballast when there is an escape of bunker oil and also to the so-called "pure threat" situation. Where there is a "grave and imminent threat" of causing pollution damage, preventive measures will fall within the scope of the 1992 Convention, but not within the 1969 CLC.

There are three defences to liability for: (a) damage resulting from act of war, or from a “natural phenomenon of an exceptional, inevitable and irresistible character”, (b) damage wholly and intentionally caused by act or omission of a third party, and (c) damage wholly caused by negligence of a government or authority in the maintenance of lights or other navigational aids.

Absent one of these causes, the shipowner will be liable for the "pollution damage" from an incident.

Channelling of liability

Under CLC, liability is "channelled" to a single party - the registered owner. Only the registered owner is liable even if the ship is bareboat chartered. The registered owner's rights of recourse against any other party who might be liable are preserved, so other parties are indirectly at risk, but only the registered owner is directly liable under the 1969 and 1992 CLC.

This channelling of strict liability to the registered owner is accompanied by the protection of other potential defendants who (save in relation to a recourse action asserted by the registered owner) are not liable under the Convention even if proved to be negligent. Under the 1969 CLC, this immunity is given to servants and agents of the owner, but it is extended under the 1992 CLC to include charterers, managers and operators, as well as pilots and salvors.

One result of the liability provisions of the CLC is that 99 per cent of the time you don't need a lawyer to advise whether or not there is liability for a given incident and on whom such liability falls. Perhaps the MLA is not the audience most likely to enjoy the pojnt, but from the position of the claimant and from the position of the insurance provider a system that delivers compensation with the minimum of legal disputation is highly desirable!

Limitation of liability

In return for the strict liability imposed under the Convention, the registered owner is given the right to limit his liability. In the 1969 CLC, the limitation provisions were modelled on the 1957 Limitation Convention and provided for a limit at 133 Special Drawing Rights (SDRs) per "limitation" ton up to a maximum of 14 million SDRs. Limitation rights could be denied in the event of actual fault or privity on the part of the owner.

The 1992 Convention greatly increased the limit, imposing for the first time a minimum limitation figure of 3 million SDRs for ships up to 5,000 gross tons and an additional 420 SDR for each ton in excess of 5,000 up to the new maximum of 59.7 million SDRs. In addition, the 1992 Convention changed the test for depriving the owner of limitation rights to the test embodied in the 1976 Limitation Convention – requiring the claimant to prove that the damage resulted from the owner's personal act or omission, committed with intent to cause such damage, or recklessly and with knowledge that such damage would probably result.

This is a test that makes the owner's right to limit more certain. However, in the event that the owner loses the right to limit under the 1992 CLC, it is likely that he will also have prejudiced his insurance cover. Club rules exclude cover for liability arising from ‘wilful misconduct’ (as does the International Group Pooling Agreement, and as does the UK Marine Insurance Act 1908).

Compulsory insurance

In order to ensure the availability of money to meet the owner's liability, the CLC provides for compulsory insurance. The ship (if carrying more than 2,000 tons of persistent oil in bulk as cargo) must carry a certificate from the competent authority of the flag state (or another state signatory to the Convention) certifying that there is in force a policy of insurance (or other financial means) covering the owner's liability under CLC. This provision has not changed in the 1992 CLC, although the amount has increased to the new limit.

The flag state will only issue the CLC certificate if it has received a so-called ‘blue card’ from the insurer, representing that the required insurance is in place. By making this representation, the Clubs, contrary to their normal philosophy of acting as indemnity insurers, have agreed to accept the direct liability referred to in the Convention, but they can always limit their liability to the owner's limit irrespective of whether the owner can do so. In addition, the insurer has a further defence to direct liability based on wilful misconduct of the owner.

However, in relation to direct third party claims the Clubs cannot use any of the other policy defences or exclusions found in the 'small print' of Club Rules, so they may be at risk of having to pay, to third parties, claims which they could have declined to pay if brought by the assured shipowner.

Terrorism

A topical example of how this could arise is that of pollution damage caused by an act of terrorism, where the owner could be deprived of the liability defence of 'act or omission of third party' if his negligence (in security precautions) were a contributory factor. In such a case, the Club's war risk exclusions, which extend to loss caused or contributed to by acts of terrorism, would deprive the owner of cover, but could not be used to deny a direct third party claim under the CLC certificate.

This slight mismatch between the exclusions of cover in P&I Rules and the liability defences available to shipowners under the Conventions is itself nothing new. However, the risk of adverse consequence for a Club has become greater with the increased risk of maritime terrorism and the heavier duty of care imposed on owners by the International Ship and Port Facility Security (ISPS) Code. Steps are accordingly being taken to clarify the International Group pooling arrangements for such exposure, to the extent that a Club's payments cannot be recovered from the shipowner's P&I war risk underwriters.

Cargo contribution

A unique feature of the development of the international regime was the recognition at the time of the 1969 CLC that there would be cases where the owner's limit of liability was inadequate to allow full compensation to be paid to victims. Therefore a source of additional compensation would be required, which it was agreed should be the owners of the cargo. This resulted in the 1971 Fund Convention, which established the International Oil Pollution Compensation Fund (IOPC Fund) as a separate legal entity, administered by a Director and secretariat in London.

The governing body is the IOPC Fund Assembly made up of representatives from all states party to the Convention. It is funded by contributions from the importers of persistent oil in contracting states. The purpose of the IOPC Fund is to make supplementary compensation available to victims when the amount of compensation payable by the owner under the CLC is insufficient. The IOPC Fund 1971, which has now ceased to operate, made available a total of 60 million SDRs per incident, from which the shipowner's liability under CLC is deducted. Under the continuing 1992 Fund Convention the maximum amount available in total compensation has risen to 135 million SDR, less what is payable by the shipowner under the 1992 CLC.

The general impact of recent large spills in Europe

Following the Erika spill in 2000, the European Commission issued a 'Communication' that included proposals to change the CLC and Fund Conventions.

The Communication stated in its introduction that "...the EC intends, firstly, to seek to increase the compensation available under collective compensation schemes of the IOPCF type and, secondly, to establish the principle of responsibility of the carrier and owner of the cargo." It was clear from the Communication that these objectives were derived from the second and third of three criteria by which, the EC suggested, the satisfactory nature of any liability and compensation scheme should be judged.

First, it was suggested that there should be a mechanism for prompt compensation without victims having to resort to lengthy judicial procedures. The EC agreed that the CLC and IOPC Funds met this criterion.

Second, it was suggested that the maximum compensation limit should be high enough to cover admissible claims from any potential disaster resulting from a tanker accident. This criterion was not met, hence the need for an increase.

Third, it was suggested that the regime should discourage tanker operators and cargo interests from transporting oil in anything other than tankers of 'impeccable quality'. The EC believed this criterion was not met because under the CLC channeling provisions no individual responsibility would attach to anyone other than the registered owners and the latter enjoyed almost unbreakable limitation rights.

Finally, the EC ‘Communication’ proposed four actions: (a) strengthening the CLC/Funds system, (b) creating a European third tier fund of EUR 1 billion, (c) introducing strict liability for any party causing or contributing to pollution damage, (d) imposing sanctions on any party who was grossly negligent in causing or contributing to pollution damage.

No doubt concerned by the threat of regional action explicit in the EC Communication, the IMO and IOPC Fund made arrangements to review a number of aspects of the CLC and Fund Conventions.

November 2003 increases in limitation of liability.
Under the so-called ‘tacit acceptance’ procedure contained in the 1992 Conventions, it was agreed at the IMO Legal Committee meeting in October 2000 that the limitation of amounts of compensation available would be increased by 50.37 per cent from 1st November 2003, raising the total compensation available from the 1992 Fund to about 203 million SDR (about US $275 million). The Convention provides that any such increase may not exceed an amount equivalent to the original 1992 limits increased by 6 per cent per annum, calculated on a compound basis from January 1993. The 50.37 per cent figure was the maximum permitted under this provision.

2003 Supplementary Fund Protocol
Some States regarded these increases as being adequate, but others, particularly in Europe, regarded them as insufficient, especially in the light of the further huge damage caused by the 'Prestige' spill in 2002.

By way of compromise between these two views, a Protocol was drafted to provide a third tier of compensation which 1992 Fund Members could ratify on an optional basis if they felt higher limits of compensation were needed. The Protocol to the 1992 Fund Convention to establish an International Supplementary Fund was therefore adopted in May 2003 and, when in force, will provide total compensation of SDR 750 million (approximately $1,055 million) - including amounts paid under the 1992 CLC and Fund Conventions - for damage in States parties to the Protocol.

The Supplementary Fund will be financed by receivers of oil in participating States, with each State deemed to have received a minimum of 1 million tons of contributing oil. For a transitional period of 10 years (or until total contributing oil reaches 1000 million tons, if sooner), the aggregate contributions of any single State in a calendar year are capped at 20 per cent of the total annual contributions to the Supplementary Fund. The Protocol will enter into force three months after 8 States with combined contributing oil imports of at least 450 million tons have ratified. It is expected that EU states will work to encourage speedy ratification and that the Protocol could come into force before the end of 2004.

Ship contribution v. cargo contribution
When the shipowner relies on a right to limit liability, in a large spill, to a relatively low amount, the result can seem unfair. However, an analysis, drawn up by the International Tanker Owners' Pollution Federation (ITOPF) in respect of 360 spill incidents occurring over the 10 year period 1990 to 1999, showed that the application of the 1992 CLC and Fund regimes to all 360 spills would have resulted in an approximate 50/50 sharing of the total costs, with most incidents being paid for within the shipowner's limit, balanced by occasional more expensive claims involving the Fund.

In addition to considerations of financial balance, a case is sometimes made that it is morally objectionable that a ship at fault should be able to benefit from a limitation of liability. However, this kind of criticism conveniently overlooks the other side of the equation, whereby the shipowner accepts responsibility for paying compensation for pollution damage even if there is no fault at all on the part of his vessel. It is thus not a defect in the Convention system that it separates the concept of compensation from that of blame, but rather a positive merit.

STOPIA
In order to preserve the balanced nature of the current system, the International Group of P&I Clubs proposed, during the development of the Supplementary Fund

Protocol, a means by which extra money could be contributed from the shipowners' side too, in those States that choose to ratify the Protocol.

The proposed method involves a voluntary increase in the minimum limit under 1992 CLC for small ships, from about SDR 4.5 million (November 2003 figure) to SDR 20 million, in States which implement the Supplementary Fund, under a proposed 'Small Tanker Oil Pollution Indemnification Agreement' (STOPIA).

It may be helpful to consider an example. Suppose that in 2005 a tanker of 4500 gt runs aground and spills her entire cargo of highly persistent oil. There are extensive impacts on tourism and fisheries, as well as high clean-up costs. The damage happens in a State party to the Supplementary Fund Protocol, but the quantum of admissible claims under the Conventions is just SDR 70 million. The shipowner is legally liable to pay SDR 4.5 million, being the minimum limit then applicable under the 1992 CLC. The 1992 Fund pays the balance of SDR65.5 million. Under the voluntary scheme, the shipowner would indemnify the 1992 Fund for the difference between his 1992 CLC limit and the limit under the voluntary scheme, i.e. SDR15.5 million. Therefore in total the shipowner would pay SDR 20 million and the 1992 Fund would pay SDR 50 million.

Under the 1992 CLC the minimum limit for small ships affects tankers only up to 5000 gt. However, under the STOPIA proposal, a limit of SDR 20 million would affect ships up to about 30,000 gt, potentially bringing into the scheme about 75 per cent of the world fleet of tankers falling within the 1992 CLC definition of a 'ship', numbering some 6,000 or so vessels.

Discussions towards finalizing the STOPIA scheme are being held between a working group of Club Managers and the IOPC Fund Secretariat. At the same time, new claims funding statistics covering a longer period are being prepared, with ITOPF's help, at the request of the IOPC Fund Directorate, to help assess on a wider basis how well the principle of sharing has worked out during the life of the Conventions.

'Polluter pays'…?

With these new arrangements in place to ensure the adequacy of the amount of compensation available, one might have hoped that the CLC/Fund system would be seen once more as the safe and effective mechanism that in truth for most claimants it has been.

However, that would be to underestimate the dogged determination of the EC to examine other aspects of the system – in particular to address the extent to which it should contain incentives to good corporate behaviour and should be responsive to public expectation that the 'polluter pays'.

Despite its power as a political slogan, the expression "polluter pays" provides no guidance either in relation to current laws or in relation to prospective changes to

them, on what an effective compensation system for maritime pollution should look like. Who, for example, is the polluter?

Is the 'polluter' the person who is to blame for the pollution? If so, one might expect a compensation system in which payment would only follow the determination of blame (inconvenient though that might be for the victims of pollution). In fact, we have the reverse - a system in which a perfect tanker owner, with a perfectly managed and operated ship, meeting every requirement society can dream up, and entirely free from blame, will pay compensation for pollution damage when, for example, a port tug is driven negligently into the side of the tanker.

There are, of course, some very obvious reasons for not linking compensation with blame from the claimants' point of view. Most claimants are concerned to be made whole by compensation, (and a few may seek to profit), and are not remotely concerned about whether the system accords with a political catchphrase.

The Conventions respond to this need by choosing as sources of compensation two classes of persons who have particular relationships with the pollutant, i.e. the registered owner of the ship from which the polluting oil escapes, and the importers of persistent oils generally in their capacity as contributors to the Fund. It is the advanced identification of a closed class of persons that facilitates the compensation mechanism, not the moral position of those persons. Indeed, if morality were the guiding factor, the politicians and environmentalists would join the rest of us as a class of persons - users of cheap oil - who are the primary creators of the risk inherent in transporting the stuff.

Limitation test

In its second paper relating to the Erika (the Erika II Communication), the EC put forward two proposals directly in conflict with the CLC, designed to influence conduct and ensure greater care in the maintenance and choice of ships used to transport oil.

The first was that the liability of the shipowner should be unlimited if it were proved that the pollution damage resulted from gross negligence on his part. The second was that the prohibition of compensation claims for pollution damage against the charterer, manager and operator of the ship should be removed from CLC.

These proposals were discouraged partly on the general grounds that a compensation Convention is the wrong place in which to address issues of punishment and incentivisation of behaviour. Even if the Convention were not the wrong place, it seems doubtful that the EC logic stands up to close scrutiny.

First, where the total amount of pollution damage exceeds the shipowner's limit, it will always be much easier for the claimants to simply seek compensation from the IOPC Fund than it will be for them to recover extra monies from the shipowner by demonstrating gross negligence. Who (other than EC officials, or Friends of the MLA) would want to spend years in court, with an uncertain outcome, in preference

to prompt receipt of compensation from an international Fund designed for that purpose? If damage exceeds the IOPC Fund limits, then the same point will arise in relation to the Supplementary Fund where implemented.

Second, although one can identify circumstances in which a challenge to the owner's limitation rights might be appropriate, such as where (i) the total damage exceeds the total compensation available from Fund or Supplementary Fund, or (ii) the IOPC Fund or Supplementary Fund themselves seek to recover from the shipowner what they have paid to claimants, in either case there is no guarantee that any money would be forthcoming. The insurers direct liability is in all cases limited to the owner's limit. 'Pay-to-be-paid' and other policy defences would be potentially relevant. The kind of one-ship company that the EC seeks to target would have no assets to make the exercise worthwhile.

EC Directive on ship source pollution and criminal liability

To be fair to the EC, there have been recent signs of their heeding the views of those who say that issues of punishment should not be forced into a Convention whose primary purpose is to provide compensation. Rather than proceeding with the Erika II proposals on CLC, the EC has produced a draft "Directive on ship-source pollution and on the introduction of sanctions, including criminal sanctions, for pollution offences". This Directive, instead of changing the limitation test for civil compensation, would criminalise deliberate pollution and would also criminalise accidental spills where due to 'gross negligence', requiring Member States to have criminal sanctions available, including the deprivation of liberty for serious cases and the use of uninsurable fines.

Once again, however, there are some difficulties in what is proposed. First, the meaning of 'gross negligence' is obscure other than in the context of manslaughter, where derived from the opinion of a jury that the defendant's conduct is sufficiently bad to be regarded as criminal. Second, there is already a provision within MARPOL to criminalise accidental spills only where there is a failure to act reasonably to minimise damage after the accident or where the accident results from the owner or Master acting recklessly with knowledge as to the probable outcome. If the EC proposal is to be treated as distinguishable from the existing MARPOL test, then it would seem that 'gross negligence' would be regarded not as akin to informed recklessness, but rather as ordinary negligence flavoured with a large dose of condemnation.

These difficulties seem to have been appreciated by the EC's Council of Ministers, which earlier this month (October 2003) rejected the draft Directive. It remains to be seen, however, whether this will result in the EC renewing its campaign to revise the CLC as suggested in the Erika II Communication, or whether it will turn its attention to other matters.

EC Directive on environmental liability

One such additional matter that potentially threatens the Convention system can be found in the EC's draft 'Directive on environmental liability with regard to the prevention and restoration of environmental damage'.

This document has echoes of US legislation on natural resource damage assessment (NRDA), introducing concepts of 'valuation techniques', 'interim losses', 'compensatory restoration' and 'comparable value' in relation to the valuation of the natural environment and the valuation of any losses caused to it by pollution. Such valuations require the use of theoretical models, which are neither readily accepted under the general CLC and Fund regimes, (although there are guidelines for assessing restorative measures), nor regarded as realistic indicators of actual damage.

An example of an abstract formula from a South American State, for instance, provided for a fixed quantum of environmental damage per litre, with a multiplier factor for the aggravated damage caused by previous pollution incidents. A bunkering spill last year of 70 litres was calculated thereby to have produced theoretical environmental damage valued at more than $900 million, whereas the reality had been that the spill was cleaned up without causing damage.

A recent university study of reef damages and recoveries, commissioned by the International Group, found that in many cases attempting to measure damage by reference to variation from calculated baseline conditions is an artificial and misleading exercise because of enormous natural variability consequent on changing weather patterns, seasons, etc.

The draft EC Directive recognizes the international regime and contains an exception from the scope of the Directive for damage where liability or compensation is regulated by the CLC, HNS, or Bunkers Conventions. However, while this can usefully encourage quicker ratification of the HNS and Bunkers Conventions, it still leaves scope for considerable mischief. In particular, there are draft provisions to give precedence to the Directive over the Conventions in respect of damage that is more effectively remedied under the Directive than under the Conventions.

Looking to the future ?

Other challenges for the existing conventions

The burden of environmental liability will continue to increase, in the following ways.

First, although not exactly pollution damage, oil pollution clean-up costs have been the most expensive items in tanker accidents to date. They also tend to inflate as (a) more sophisticated equipment is deployed; (b) personnel on site are more and more

numerous; (c) new businesses appear, offering spill management services, consultancy services to spill managers, data services to consultants, and so on. All require money. Even though clean-up and response measures may sometimes have a more negative than positive effect on the environment, the option of leaving it to recover naturally is hardly acceptable from a political point of view, or from the point of view of the newly-born environmental businesses. Moreover, the fact that there are not enough spills to support these businesses in their natural birthplace – the USA – will make them more than eager to extend their services to any other place that follows the US example.

Second, because the environment itself does not belong to anyone or belongs to everyone, many people may claim that they have suffered some economic loss following a spill. Hotel owners, travel agents, railway companies, ice cream sellers - they all may claim for loss of earning due to loss of tourists. Third party claimants tend to become more organized and sophisticated, assisted by pollution claim consultants who, in turn, join the queue of claimants for their fees. Drawing the line to determine who can or can't recover will provide some decent revenue to the lawyers who specialize in this field.

Third, as noted above environmental damage as such is not recoverable under the Conventions, except for the costs of reinstating the damaged environment. By contrast, we see in the United States the development of Natural Resource Damage Assessment (NRDA).

The theory that the responsible party should pay compensation not only for economic loss suffered by individuals, but also for damage caused to the environment itself – including all the organisms which suffer as a result of a spill, irrespective of whether they have economic or commercial value to human beings - is worthy of a lecture in itself and is fraught with difficulties. The problem from an insurer's point of view is that the multiplication factors involved can potentially produce huge monetary values of compensation.

Both CLC and the HNS Convention provide that compensation is only payable in respect of the "costs of reasonable measures of reinstatement actually undertaken or to be undertaken". This is a crucial safeguard from the possibilities of wildly excessive claims for damage to the environment.

However, some countries, unhappy with this, particularly where the damage is too serious to permit reinstatement, may consider adopting domestic laws to allow recovery in respect of polluted natural resources - to make clear that the environment itself is precious and not to be polluted (irrespective of whether consequential loss arises from such pollution).

If this happens, should the Conventions be widened to embrace such claims within current limits, so as thereby to encourage a proper sense of proportion in comparing natural resource damage with loss suffered by individuals for purposes of sharing

finite compensation? Or should the Conventions remain as they are, with other methods being used to discourage unreasonable NRDA legislation? (Following examination of the issue by a working group of the IOPC Fund, the interpretation of the existing IOPC Fund practical guidelines for dealing with such claims has been widened, while leaving the legal definitions of 'pollution damage' in the conventions unchanged.)

Other environmental liabilities

The political nature of environmental issues has slowly brought into focus other environmental liabilities arising from shipping, in particular those relating to air pollution from ships' exhaust, water pollution by coatings, biological pollution caused by ballast water transfers, reef damage from groundings, and even environmental threats to underwater heritage. These are not small problems – and no doubt will be the subject of many future papers and presentations.

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