

# THE SHARING OF THE FINANCIAL BURDEN BETWEEN THE SHIPPING AND OIL INDUSTRIES UNDER THE INTERNATIONAL COMPENSATION REGIMES

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## ABSTRACT

*The international regime on liability and compensation for oil pollution damage is based on international Conventions adopted under the auspices of the International Maritime Organization (IMO). When the international compensation Conventions were first elaborated over thirty years ago in the aftermath of the Torrey Canyon incident, it was decided to establish a two-tier system whereby the economic consequences of marine oil spills from tankers should be shared between the shipping industry and those industries who either owned or received the cargoes transported by sea. Although the limits of liability and compensation under the Conventions have been revised from time to time, the concept of sharing has been maintained.*

*In 2004 the Secretariat of the International Oil Pollution Compensation Funds undertook a study of the costs of oil spills from tankers worldwide, except the United States, over the past 25 years. The purpose of the study was to examine the extent to which the economic consequences of oil spills had been shared by the shipping and oil sectors under the Conventions as envisaged when they were elaborated and under the voluntary industry schemes which coexisted and interacted with the Conventions for much of that time. The results of the study and their impact on any future revisions of the international Conventions, particularly as regards the sharing of the financial burden, are the subject of this paper.*

## INTRODUCTION

### The main features of the international compensation regime

The present international regime of compensation for damage caused by oil pollution is based on two international Conventions adopted in 1992 under the auspices of the International Maritime Organization (IMO), a specialised agency of the United Nations. These Conventions are the 1992 Civil Liability Convention and the 1992 Fund Convention. As at 15 October 2004 103 Nations were Parties to the 1992 Civil Liability Convention and 91 Nations were Parties to both the 1992 Civil Liability Convention and the 1992 Fund Convention. The current Conventions follow two earlier Conventions known as the 1969 Civil Liability Convention and the 1971 Fund Convention. Although the 1969 Civil Liability Convention is still in force in a few States the 1971 Fund Convention is no longer in force.

Under the 1992 Civil Liability Convention, the owner of a ship carrying a cargo of oil has strict liability, ie he is liable even in the absence of any fault, for any damage by pollution caused by the oil. However, the ship owner can normally limit his liability up to an amount established according to the size (tonnage) of the ship. The maximum amount payable in the case of a ship not exceeding 5,000 units of gross tonnage is United States (US) \$6.6 million. For ships exceeding 5,000 units of gross tonnage the amount increases up to a maximum of US \$131 million in the case of ships of 140,000 units of gross tonnage or over. The ship owner's liability insurer guarantees these amounts.

Under the 1992 Fund Convention, supplementary compensation becomes available when the amount payable by the ship owner and his insurer is insufficient to cover all of the damage. The maximum amount payable under the 1992 Fund Convention is US \$300 million, including the sum actually paid by the ship owner (or his insurer) under the 1992 Civil Liability Convention. The 1992 Fund is financed by contributions levied on any person who has received in a calendar year more than 150,000 tonnes of crude oil and heavy fuel oil in a port or terminal in a Member Nation after sea transport.

The IOPC Fund 1992, which administers the 1992 Fund Convention from its headquarters in London, is governed by an Assembly composed of representatives of the Governments of all Member States. The Assembly elects an Executive Committee made up of 15 Member States, the main function of which is to approve claims for compensation. Organisations connected with the maritime transport of oil, such as those representing ship owners, marine insurers and the oil industry are represented as observers at the IOPC Fund 1992's meetings.

### Review of the adequacy of the regime

The magnitude of claims arising from the *Nakhodka* (Japan, 1997) and the *Erika* (France, 1999) incidents led a number of Nations to question whether the existing Conventions were sufficient to meet the needs of society in the new millennium. In 2000 the 1992 Fund Assembly therefore established a Working Group to examine the adequacy of the international compensation regime (Jacobsson, 2005).

One of the first issues to be addressed was the maximum amount of compensation available under the 1992 Conventions. This led to a proposal by the Working Group to establish a third tier of compensation which would provide compensation over and

above the compensation available under the 1992 Conventions. In May 2003 IMO adopted a Protocol creating a Supplementary Fund. The Protocol is expected to enter into force in early 2005. The total amount of compensation available for compensation in the States that become Parties to the Protocol will be US \$1,100 million, including the amounts available under the 1992 Conventions. The Supplementary Fund, like the 1992 Fund, will be financed by contributions payable by oil receivers in the States that ratify the Protocol.

The Working Group next considered the question of whether amendments should be made to the provisions in the 1992 Civil Liability Convention, in particular regarding the ship owner's liability. It was generally considered important to ensure an equitable sharing of the economic burden of oil spills between the industries involved, i.e. the shipping and oil industries. However, there was disagreement between the two industries on the extent to which the financial burden of oil spills had been shared in the past and would be shared in the future. The IOPC Fund Secretariat was therefore asked to undertake an independent study of the costs of past spills in relation to the past, current and future limitation amounts of the 1992 Conventions. This paper describes the methodology used by the Fund and the main findings.

## METHODOLOGY

### Sources of cost data

Data on compensation costs incurred by the shipping industry in respect of pollution damage from oil spills was obtained from the thirteen Protection and Indemnity Clubs (P & I Clubs) that are members of the International Group of P & I Clubs. The P & I Clubs are mutual liability insurers that cover third party liabilities of ship owners, including liability in respect of oil pollution. The Clubs provided data in respect of 5,802 incidents that occurred worldwide, excluding the United States, between 1978 and 2002. The reason for excluding the United States was that under its legislation the ship owner's liability was much higher than under the 1992 Civil Liability Convention. In view of the confidential nature of some of the data, it was decided that the results of the analyses should be presented in graphical and tabular form without reference to ship names.

Data on compensation costs incurred by the oil industry in respect of pollution damage from oil spills involving shipping was based on the financial records of the 1971 Fund and the 1992 Fund.

### The voluntary compensation regime

Data was also included in respect of compensation costs incurred by both the shipping and oil industries under the voluntary regime, which coexisted and for a period interacted with the international Conventions. These regime consisted of two schemes, namely the Tanker Owners Voluntary Agreement concerning Liability for Oil Pollution (TOVALOP), which came into force in 1969, and the Contract Regarding a Supplement to Tanker Liability for Oil Pollution (CRISTAL), which came into force in 1971, were introduced by the shipping and oil industries prior to the entry into force of the 1969 Civil Liability and 1971 Fund Conventions respectively. The voluntary schemes were broadly similar in scope to these Conventions and had application worldwide. When the 1971 Fund Convention entered into force in 1978 the voluntary schemes continued to exist so as to provide compensation for pollution damage in those Nations that had not become parties to the Conventions. In 1987, TOVALOP was amended, as a result of which a Supplement was added to the existing Agreement. The CRISTAL Contract was also amended in 1987. The purpose of the amendments was to introduce levels of compensation similar

to those available under the 1984 (subsequently 1992) Protocols to the 1969 Civil Liability Convention and the 1971 Fund Convention. One significant difference between the amended CRISTAL Contract and the 1992 Fund Protocol was that whereas the latter provided a fixed amount of compensation irrespective of the size of the ship, compensation under the CRISTAL Contract was related to ship size, with a maximum of US \$125 million being available for ships greater than 140,000 gross tonnes. However, a key feature of the amendments to the voluntary schemes was that the higher levels of compensation were available worldwide, including in those States that were parties to the 1969/1971 Conventions. This had the effect of ensuring that the financial benefits of what were to become the 1992 Conventions were available worldwide some nine years before the 1992 Fund Convention entered into force. At the time of the amendments, the owners and bareboat charterers of some 97% of the world's tanker tonnage were parties to TOVALOP and most contributors to the 1971 Fund were also parties to the CRISTAL Contract.

Another key feature of the 1987 amendments to the voluntary schemes was that in the case of an incident in a State party to the 1969 Civil Liability Convention and the 1971 Fund Convention, the ship owner was required to reimburse the parties to CRISTAL that had contributed to the 1971 Fund's payment of claims, up to the applicable TOVALOP Supplement limit. Such reimbursement was subject to the ship owner first having paid any amounts required to fulfil his legal obligations under the 1969 Civil Liability Convention and was also subject to the tanker having at the time of the incident been carrying a cargo owned by a party to CRISTAL. This reimbursement mechanism applied to ten pollution incidents involving the 1971 Fund and the total amount reimbursed to parties to CRISTAL in 1971 Fund Member Nations was some US \$92 million.

## METHODOLOGY

All cost data in the study were converted into US dollars, which is the currency used by the P&I Clubs. Payments by the IOPC Funds were converted from pounds sterling, the currency used by the IOPC Funds, into US dollars at a fixed rate of £1=US\$1.6, which corresponded to the average exchange rate over the period covered by the study. With the exception of the *Erika* and *Prestige* incidents the amounts paid by the shipping industry and the oil cargo interests represent the actual or expected payments by the P&I Clubs, CRISTAL and the IOPC Funds as at 31 December 2003. For the purpose of determining the overall sharing of the financial burden of pollution incidents between the shipping industry and oil cargo interests the maximum amounts payable under the 1992 Conventions in respect of the *Erika* and *Prestige* incidents were used. However, in view of the fact that the total costs of these incidents were in excess of the maximum amount available under the Conventions, when examining the costs against the financial limits of the 1992 Conventions and the Supplementary Fund Protocol, the anticipated full admissible pollution costs of these incidents were taken into account.

In addition to establishing the overall sharing of the financial burden between the shipping and oil industries over the period 1978 to 2002, it was decided to consider what the apportionment of costs would have been on the basis of monetary values in 2002 after taking inflation into account. The pollution cost of each incident was inflated from the year of the incident to 2002 monetary values using the International Monetary Fund (IMF) World Consumer Price Index (CPI). Although this index gives inflation values that are considerably higher than the indices of many Nations affected by spills, it was considered most appropriate to use it in view of the worldwide occurrence of tanker spills.

**RESULTS OF THE STUDY**

**Overall sharing of the financial burden**

Around 98% by number of all reported oil pollution incidents involving tankers during the period 1978-2002 worldwide outside the United States of America were fully compensated by the shipping industry under the 1969 and 1992 Civil Liability Conventions or TOVALOP. As regards the sharing of the financial burden between the shipping industry and oil cargo interests (including parties to CRISTAL) the data is summarised in Table 1.

| Basis of payments   | Total paid by shipping industry US\$ | Total paid by oil cargo interests US\$ |
|---|--------------------------------------|--|
| Gross payments within the financial limits under the relevant Conventions or voluntary agreements   | 668,892,249                          | 1,059,856,835                          |
| Net payments after taking into account reimbursements by the shipping industry to parties to CRISTAL that made contributions to 1971 Fund incidents   | 784,568,261                          | 944,180,823                            |
| Net payments after taking into account reimbursements by the shipping industry to parties to CRISTAL that made contributions to 1971 Fund incidents and payments to the 1971 Fund and third parties (governments and private claimants) as a result of recourse actions | 944,335,469                          | 844,344,354                            |

**TABLE 1: Contributions by the shipping industry and oil cargo interests to payments of compensation for pollution damage in respect of 5,802 incidents in the period 1978-2002**

**Sharing the financial burden according to ship size**

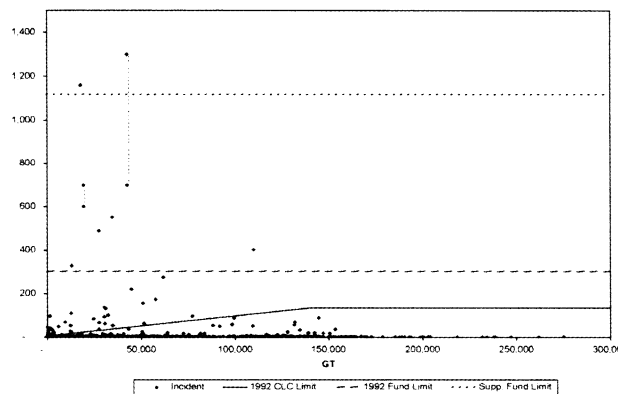
The 1992 Fund also examined the effect of ship size on the sharing of the financial burden between the shipping industry and oil cargo interests. A comparison of the costs was made in respect of incidents involving ships in the following size categories: 5,000 gross tonnes and below, 5,001 to 20,000 gross tonnes, 20,001 to 80,000 gross tonnes, 80,001 to 140,000 gross tonnes and greater than 140,000 gross tonnes.

As with the analysis of the overall sharing of the financial burden, three scenarios were considered: gross payments made by the two industry sectors within the financial limits under the relevant Conventions or voluntary schemes; net payments after taking into account reimbursements by the shipping industry to parties to CRISTAL that made contributions to 1971 Fund incidents; and net payments after taking into account reimbursements to parties to CRISTAL and payments to the 1971 Fund and third parties as a result of recourse actions. Tables 2A, 2B and 2C show the total costs of incidents and the sharing of those costs between the two industry sectors for ships in the above size ranges for the three scenarios. It should be noted that the data for three incidents had to be excluded from this analysis since the gross tonnages of the vessels involved were not known. For the same reason compensation paid

by the 1992 Fund in respect of an incident in the United Kingdom in 2002 from an unknown tanker has been excluded.

**Comparison of the inflated costs of oil spills against the financial limits under the existing Conventions and the Supplementary Fund Protocol**

Graph 1 shows the inflated costs of past spills in relation to the financial limits under the 1992 Conventions and the Supplementary Fund Protocol.



**GRAPH 1: COSTS OF PAST OIL SPILLS INFLATED TO 2002 MONETARY VALUES AND COMPARED WITH THE FINANCIAL LIMITS UNDER THE 1992 CONVENTIONS AND THE SUPPLEMENTARY FUND PROTOCOL**

**CONCLUSIONS**

The data showed that on the basis of compensation payments made within the financial limits of the relevant Conventions (1969 Civil Liability and 1971 Fund Conventions and 1992 Civil Liability and Fund Conventions) and/or the voluntary schemes (TOVALOP and CRISTAL), including reimbursements made by ship owners to parties to CRISTAL that made contributions to 1971 Fund incidents, the shipping industry and oil cargo interests contributed 45% and 55% respectively of the total costs. When payments by the shipping industry to the 1971 and 1992 Funds and to third parties (governments and private claimants) as a result of successful recourse actions by the Funds<sup>1</sup> are taken into account, the sharing of the financial burden between the shipping industry and oil cargo interests was found to be 53% and 47% respectively.

The data also showed that the sharing of the financial burden varied considerably with different size ranges of ships. For ships in the size range 5,001–20,000 gross tonnes, the shipping industry contributed only 16% of the total costs of some 1,127 incidents on the basis of payments made within the financial limits of the relevant Conventions and/or voluntary schemes. Even after successful recourse actions against shipowners by the 1971 and 1992 Funds were taken into account the shipping industry only contributed 39% of the total costs for incidents involving ships in this size range. In contrast, there was a 50:50 sharing of the financial burden between the shipping industry and oil cargo interests for incidents involving ships in the size range 20,001 and 80,000 gross tonnes both before and after the effects of recourse actions were taken into account.

When the costs of all 5,800 incidents were inflated to 2002 levels the total cost was some US \$6,592 million. On the basis of the existing financial limits under the 1992 Conventions and the Supplementary Fund Protocol, the 1992 Fund would only have been required to pay compensation in respect of 50 incidents

| Ship gross tonnage | Number of incidents | Total compensation paid US\$ | % paid by shipping industry | % paid by oil cargo interests |
|--------------------|---------------------|------------------------------|-----------------------------|-------------------------------|
| ≤ 5,000            | 1,275               | 194,661,610                  | 37                          | 63                            |
| 5,001–20,000       | 1,127               | 510,344,080                  | 16                          | 84                            |
| 20,001–80,000      | 2,221               | 732,038,755                  | 42                          | 58                            |
| 80,001–140,000     | 860                 | 183,268,260                  | 73                          | 27                            |
| >140,000           | 315                 | 107,905,839                  | 69                          | 31                            |
| TOTAL              | 5,798               | 1,728,218,543                | 39                          | 61                            |

TABLE 2A: Gross payments within the financial limits under the relevant Conventions and voluntary schemes

| Ship gross tonnage | Number of incidents | Total compensation paid US\$ | % paid by shipping industry | % paid by oil cargo interests |
|--------------------|---------------------|------------------------------|-----------------------------|-------------------------------|
| ≤ 5,000            | 1,275               | 194,661,610                  | 46                          | 54                            |
| 5,001–20,000       | 1,127               | 510,344,080                  | 16                          | 84                            |
| 20,001–80,000      | 2,221               | 732,038,755                  | 51                          | 49                            |
| 80,001–140,000     | 860                 | 183,268,260                  | 73                          | 27                            |
| >140,000           | 315                 | 107,905,839                  | 95                          | 5                             |
| TOTAL              | 5,798               | 1,728,218,543                | 44                          | 56                            |

TABLE 2B: Net payments after taking into account reimbursements by the shipping industry to parties to CRISTAL that made contributions to 1971 Fund incidents

| Ship gross tonnage | Number of incidents | Total compensation paid US\$ | % paid by shipping industry | % paid by oil cargo interests |
|--------------------|---------------------|------------------------------|-----------------------------|-------------------------------|
| ≤ 5,000            | 1,275               | 194,661,610                  | 46                          | 54                            |
| 5,001–20,000       | 1,127               | 548,847,246                  | 39                          | 61                            |
| 20,001–80,000      | 2,221               | 699,590,723                  | 50                          | 50                            |
| 80,001–140,000     | 860                 | 237,674,405                  | 79                          | 21                            |
| >140,000           | 315                 | 107,905,839                  | 95                          | 5                             |
| TOTAL              | 5,798               | 1,788,679,822                | 53                          | 47                            |

TABLE 2C: Net payments after taking into account reimbursements by the shipping industry to parties to CRISTAL that made contributions to 1971 Fund incidents and payments to the 1971 Fund and third parties as a result of recourse actions

and the Supplementary Fund would only have been liable to pay compensation in respect of seven incidents. The oil cargo interests and the shipping industry would have contributed 57% and 43% of the total costs respectively. If the anticipated full admissible costs of the *Erika* and *Prestige* incidents were taken into account the total costs would be in the region of US \$7,890 million and the contributions by oil cargo interests and the shipping industry would become 64% and 36% respectively.

## REFERENCES

Jacobsson, M., 2005. Recent developments within the international compensation regime. *Proceedings of the 2005 International Oil Spill Conference, American Petroleum Institute, Washington DC pp xx-yy*

1 The policy of the Funds is to take recourse action wherever appropriate. The Funds have successfully pursued recourse actions against third parties in respect of the *Tanio* (France, 1980), *Sea Empress* (United Kingdom, 1996), *Nakhodka* (Japan, 1997) incidents and several smaller incidents.