PROPOSAL FOR A DIRECTIVE OF THE EUROPEAN PARLIAMENT AND THE COUNCIL

ON

THE CIVIL LIABILITY AND FINANCIAL SECURITIES OF SHIPOWNERS

COMMENTS OF THE INTERNATIONAL GROUP OF P&I CLUBS

1. Introduction and general statement of position

1.1 The International Group of P&I Clubs (the Group Clubs) is the umbrella organization of its thirteen constituent Group Clubs, which are mutual not-for-profit insurance organizations that between them cover the liabilities (which include pollution, loss of life and personal injury, cargo loss and damage and collision risks) of over 90% of the world's ocean-going tonnage. The Group clubs are true mutuals in that the insured shipowner members own and control their individual clubs, the day to day activities and operations of which are delegated to managers. Each club is responsible for claims up to a limit of US $6 million per claim above which level claims are pooled between the 13 Group Clubs.

1.2 The Group has a close interest in the Commission's proposals on Civil Liability and Financial Securities of Shipowners and supports the underlying policy objectives of (i) preventing damage and (ii) ensuring an effective compensation regime. Several of the Commission's proposals are supported by the Group, for instance, the early entry into force of the liability Conventions developed by the IMO regarding Bunkers, Hazardous and Noxious Substances (HNS) and passenger liabilities (Athens)

1.3 However, other of the Commission's proposals require careful consideration since they are based on questionable assumptions with regard to the intended purpose and operation of the current maritime liability insurance system. The comments below are intended to explain in more detail how the current international system of maritime liability insurance works so as to provide further background for the discussions on these issues.

2. Ship safety and civil liability

A comprehensive set of international conventions

2.1 Over the years the IMO has drafted a number of international maritime conventions providing for compensation to third parties. These Conventions are either in force or are likely to come into force within a reasonable timeframe. The conventions include CLC, Bunkers, HNS and Athens and all provide for compulsory insurance and direct action for almost all types of damage affecting private citizens.

A main weakness, however, is that several of these conventions have not been ratified and implemented by a number of states, including several EU Member States. The Commission therefore quite rightly points out that the efficient and speedy implementation of these conventions is an important next step towards establishing a fully satisfactory maritime liability regime also for European waters.

Further, it should be noted that once these Conventions have been ratified and implemented, the Commission's proposals will be limited in practice to cargo claims, dock damage and collisions and similar types of claim, all of which only involve commercial parties and their insurers and have no impact on the ordinary citizen.

Aim of the international regime

2.2 In the Explanatory Memorandum, the Commission notes that *"it is mainly in substance that the rules established by these conventions are unsatisfactory, because they make no real contribution either to preventing damage or to ensuring it is repaired".*

2.3 It is essential to realise, however, that the international conventions which have been established through international cooperation over decades are not aimed at *preventing* damage as far as marine accidents are concerned. This goal is primarily addressed through flag state implementation, port state control and the classification societies, the main functions of which are to ensure that ships are of appropriate quality and meet internationally agreed standards. The aim of the conventions is to provide third parties who have suffered loss and damage with sure, speedy and satisfactory compensation. In this very important objective, the current international system has worked and continues to work most efficiently. The Group Clubs do not therefore agree with the statement that the conventions do not contribute to ensuring that damage "is repaired."

2.4 The proposition underlying the Commission's approach is that changes made with regard to the liability regime, and particularly limitation, will necessarily produce an improvement in ship safety.

"The possibility of removing these ceilings on civil liability is a real incentive to take account of the risks inherent in owning ships and therefore contribute towards making operators act more responsibly."

There is no evidence to support this proposition and it is unlikely that an increase in a liability which is already substantial will produce any effect on behaviour, particularly if that liability is insured. This is particularly so in the context of mutual insurance where the shipowner's individual losses are shared between the entire membership of his club (up to the individual club limit of US $6 million) and between all the Group clubs if the claim exceeds this limit. Ironically, it is the operators of sub-standard shipping whose behaviour is most likely to remain unaffected by measures of this kind.

2.5 The Commission is of course correct in recognising that sub-standard shipping is a problem that needs to be addressed. However this objective could be better achieved by targeting efforts on areas which specifically deal with ship safety (such as port state control, flag state compliance and classification) and encouraging Member States to take an active part in the Working Group on quality shipping which has recently been established by the IOPC Fund Assembly.

3. Limitation and civil liability

The fundamental principles of limitation of civil liability

3.1 In its Explanatory Memorandum the Commission also points out that

"these conventions establish a traditional principle of maritime law: the almost complete limitation of operator liability."

It is very important to recognise that shipowners' limitation rights have not been introduced in these conventions in order to protect the shipowner (conversely, the conventions expose the shipowner to a liability in "no-fault" cases), but rather to serve as the cornerstone of a system which is designed to and does in practice provide sure, speedy and adequate compensation to victims of marine accidents, regardless of fault and geographic location.

Under the conventions the shipowners' entitlement to limit liability comes in exchange for an imposed strict liability, which in effect means that a shipowner will always be liable up to a limited amount regardless of negligence, fault or geographic location.

In practice, under the existing system most claims are settled without any reference to limitation (because the limit is set higher than the average claim). Furthermore, in the few cases where limitation does apply this will very often only have an impact on how different insurers and/or contributors (such as the IOPC Funds) apportion the risk or claim among each other and it is therefore not something, which has an impact on the claimant or the victim.

3.2 *The test of limitation – historical background*

The Commission's proposals seem to express some surprise that the current test of conduct for which the shipowner would forfeit the right to

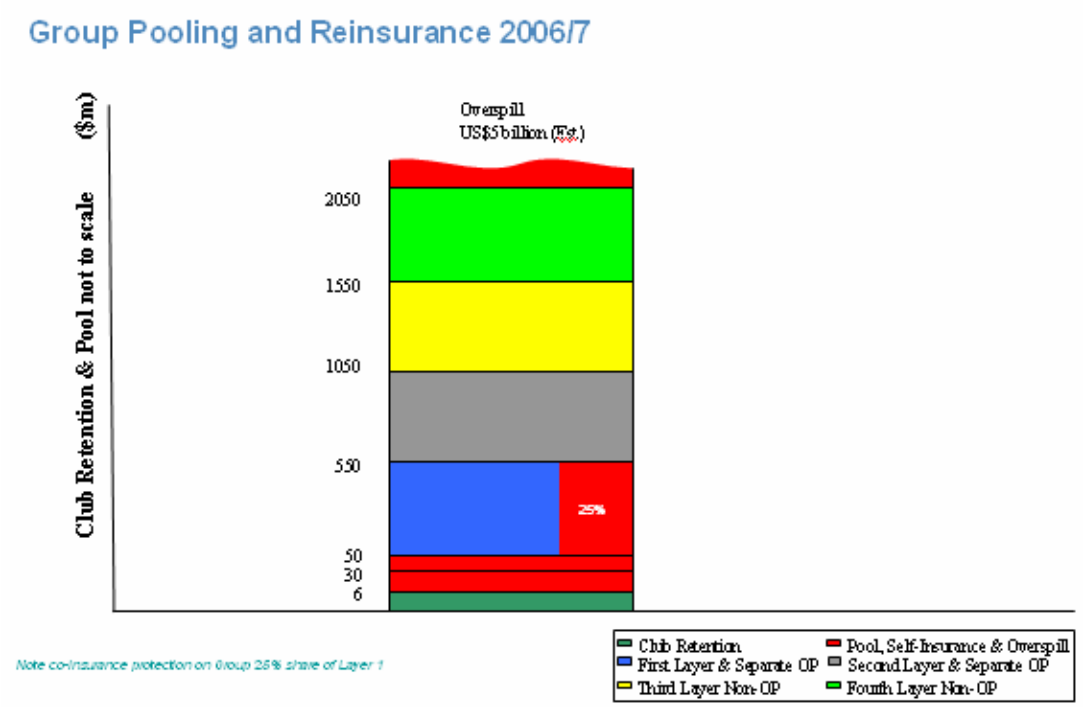
limitation means that the limit is unbreakable in most circumstances. This was the intention of States when the 1976 LLMC was drafted. Previously, under the 1957 Convention the owner would lose the right to limit if the claim resulted from the 'actual fault or privity of the owner'. Over time this test was eroded in practice so as to be equated with simple negligence with the result that limitation could not be relied upon in individual cases. In practice, this worked to the detriment of victims of maritime incidents (uncertainty of compensation, delay in payment etc). States acted to correct this tendency by establishing a clearer test when the 1976 LLMC was agreed in return for a substantial increase in the limitation amounts. The alternative language ("gross negligence") proposed by the Commission would have the same effect in practice as the 1957 language and would be a serious step in the wrong direction and undermine the fundamental principles of certainty and prompt payment of compensation to victims provided by the conventions. Even those who might support abolition of limitation would recognise that merely changing the test would result in far more cases going to Court with the increased legal costs, uncertainty of outcome and delays inherent in litigation.

3.3 *Limitation Amounts*.

Although it is not clearly expressed, the Commission's proposals appear to imply that the level of limitation should be increased. The 1996 Protocol itself introduced a tacit procedure whereby the limits can be amended by the IMO Legal Committee without the need to convene a Diplomatic Conference. However no revision has yet taken place since the revised limits only entered into force in 2004. The Group Clubs submit that if any adjustment is to be made to the amounts of shipowners limits this should be left to the IMO Legal Committee to determine in due course and following a proper review of the sufficiency or otherwise of the revised limits.

4. Limitation and insurance capacity.

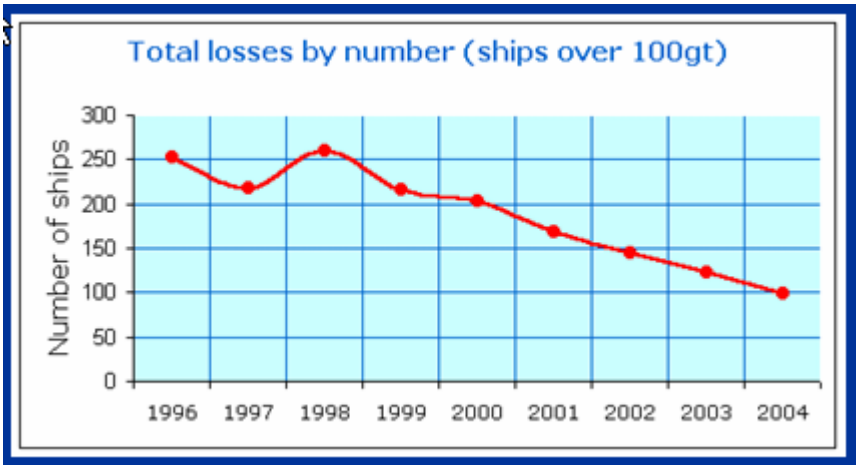
4.1 The assumption seems to be prevalent throughout the Commission's paper that insurance will always be available regardless of the liabilities imposed and other market conditions. The Group Clubs exist in order to cover their members' liabilities and to this end arrange the most extensive cover that is reasonably possible. Cover for oil pollution is limited to $1billion while the cover for non-oil pollution is considerably more (currently in excess of US $5billion). To provide the very high levels of cover which they do, the Group Clubs are dependent on their pooling arrangement whereby claims in excess of each club's retained risk (currently fixed at US$ 6 million) are pooled and shared between the clubs in their respective pooling proportions up to the limits stated above. This pooling arrangement is underpinned by a reinsurance programme which is the largest marine insurance placement in the world. This layered programme, which is renewed annually, protects the Group Clubs for claims exposures from US$ 50 million up to US$ 2.05 billion (for pollution US$1 billion).



For the insurers who participate in this programme, the existence of rights of limitation is an important factor for reinsuring underwriters in assessing the risk and the level of cover which can be offered. Any reduction or removal of limitation rights would have a negative impact on the assessment of risk by the underwriters and companies participating in the reinsurance programme. Indeed, it was acknowledged at the 1976 Diplomatic Conference that if limitation were abolished overnight the capacity of the market would shrink dramatically. Even in today's more robust market a similar consequence is possible. Thereafter capacity might well recover but would be unlikely to reach current levels with the consequence that less insurance cover would be available to meet the liabilities of shipowners and protect their victims. Great care should therefore be taken in considering any weakening in the current test for breaking limitation.

5 <u>The role of the Group Clubs in addressing substandard shipping</u>

5.1 Whilst the unfortunate incidents involving the "ERIKA" and the "PRESTIGE" remain fresh in mind there has been a sustained downward trend in the incidence of maritime casualties worldwide over the past decade. Furthermore of the decreasing number of casualties that have occurred during this period, an increasing proportion have involved well found rather than sub-standard vessels. (Notably incidents involving the vessels SEA EMPRESS, HANJIN PENNSYLVANIA, ATHOS1, SELENDANG AYU and HYUNDAI FORTUNE to name but a few of the larger ones) The significant improvement in ship standards over recent years has been due in large part to internationally developed and adopted measures such as the ISM code and the increased efficacy of Flag States, Port State control and the Classification Societies in identifying and dealing with sub-standard vessels.



Source LR/Fairplay

Although they are not the front-line policemen of ship standards and safety issues (as was recognised in the OECD Maritime Transport Committee report on the removal of insurance from substandard shipping published in June 2004), the Group Clubs nevertheless play an important and active role in addressing these issues. The Group Clubs have common rules on compliance with flag state and classification society requirements, underwriting quality, survey and audit programmes and invest considerable time and manpower in loss prevention training and materials. The Group Clubs also participate in ship standards and quality issues within the IMO and the IOPC Funds and it was on their initiative that the IOPC Funds working group on quality shipping was set up in April 2006. It is through these and similar means that states and the Group Clubs can effectively and positively contribute towards improving ship standards and safety. Actions such as those envisaged by the Commission which potentially destabilise the underlying operation of the Group Clubs will have a negative impact on this contribution.

6.0 Financial security

Distinction between Certificates of Entry and Certificates of Financial Responsibility

6.1 When addressing the need for "financial guarantees", the Commission's proposal does not distinguish between what are known as "Certificates of Entry" and "Certificates of Financial Responsibility".

6.2 A clear distinction should be made, however, between a Certificate of Entry, which confirms that the vessel is entered in a Group Club (which issues the Certificate) and therefore has P&I cover, and a Certificate of Financial Responsibility (COFR) which provides the third party claimant with a right of direct action against the insurer. The latter is regarded by insurers as an anticipatory guarantee (issued in anticipation of a possible liability which may in fact never arise rather than in response to a liability which has arisen) and as such not only has a bearing on available insurance capacity but is also the subject of recent interest shown by regulatory authorities in the amounts for which insurers are issuing guarantees because of the increased financial exposure.

6.3 In particular, it is difficult to gauge what advantage a COFR would give when the three Conventions awaiting implementation (HNS, Bunkers and Athens) would already give consumers the right of direct action in connection with likely heads of damage. In this connection it should also be pointed out that the 'obligatory insurance systems - set up by a number of third countries' require the production of Certificates of Entry and not COFRs.

6.4 It should also be noted that the requirement of a financial guarantee will have the opposite of the desired effect by reducing the financial exposure of the shipowner. The proposal that an insurer acts as a guarantor means that the insurer is no longer able to rely on the policy defences (for example, breach of flag state or class requirements) many of which concern ship safety. At present a shipowner who lacks ISM certification or has failed to comply with requirements of the Classification Society will know that his cover may be prejudiced. This incentive to comply with the insurance requirements will be lost if the Commission's proposals are adopted.

6.5 It may assist to provide an illustration. A Club notices that deficiencies are found in an entered vessel during a port state control inspection. The Club carries out its own inspection and ascertains that there are ISM deficiencies and outstanding Class requirements. These defects are not remedied and the Club gives notice terminating cover. The vessel owner continues to operate the vessel for charterers and there are substantial claims for cargo damage brought by cargo underwriters. The Club remains on risk for the cargo damage and similar claims for the minimum period of three months specified in the COFR. While the insurers' liability is thus significantly increased, the financial exposure of the owners and charterers and cargo owners from the consequences of operating an unseaworthy ship is correspondingly reduced.

6.7 The issuance of COFRs under CLC operates smoothly due largely to the relatively small number of ships involved and the fact that almost all tankers are entered with Group Clubs in the International Group. The issuance of COFRs envisaged by the Commission would be a very different proposition, involving a far greater number of ships (all vessels over 300gt trading in European waters) and a wider group of insurers.
There would be a significant administrative burden on states. By way of example, at a recent IOPC Funds workshop on the HNS Convention the Danish delegate pointed out that whereas the Danish Maritime Authority only had to issue around 60 CLC certificates per year, it was envisaged that HNS (the application of which covers virtually all types of vessels and not just tankers) would involve around 1800 certificates. Furthermore, when issuing certificates states will need to make an assessment of or carry out vetting of the financial standing of the underlying insurers which will add to the administrative burden and risks.

Doubling of limits for non-parties to LLMC.

6.8 While the International Group welcomes the widespread adoption of LLMC 96, the proposal that vessels flying the flag of non-signatory states would be subject to reduced limitation rights is not supported. One consequence of such a decision would be that double recovery would be available in the event of an incident caused by a vessel flying the flag of a non-signatory state. This discrepancy with normal recovery may be difficult to explain in terms of domestic law (competition/discrimination) and Treaty law (UNCLOS).

7. Insurance - general

7.1 It is suggested in the Explanatory Memorandum that the eventual aim of the Commission will be to remove the ceiling on liability in relation to the Oil Pollution Conventions. This makes the Group Clubs question whether the Commission can be aware that in making this suggestion, the consequence will be that oil receivers will no longer contribute to the cost of oil pollution? The system of sharing the cost of oil pollution has been carefully constructed over thirty years and has recently been endorsed by the IOPC Fund Assembly. Indeed, in the case of large pollution incidents, it underpins the ability to provide adequate levels of compensation to victims. It would be unfortunate and a serious step if this system was undermined by the the Commission's suggestions on limitation.

8. Abandonment of seafarers

The Group Clubs acknowledge the importance of this issue. In almost all cases repatriation of seafarers (Due to sickness or accident or following a casualty for example) is covered by the Group Clubs. In common with general insurance practice however the Group Clubs do not cover their members for the consequences of bankruptcy or wilful/deliberate breach of contractual obligations and are therefore not involved in the abandonment of seafarers (which most often occurs in the increasingly rare occasions when a shipowner becomes bankrupt/insolvent). Insurance is not currently available for this risk and the Commission's proposals should make it clear that a special fund would have to be instituted for this purpose. For example, owners of vessels registered in Norway are obliged to contribute to a fund set up to cover this type of eventuality.

It should also be noted that the issue of abandonment is already being considered internationally. The recently finalised ILO Maritime Labour Convention includes a provision that requires states to ensure that owners of vessels that fly their flag provide financial security for repatriation of seafarers in cases that include insolvency. Moreover, the issue is also the subject of a joint ILO/IMO Expert Working Group study.

9. Conclusions

9.1 The Group Clubs and the European Commission share a common goal in promoting safe maritime transport. The Group Clubs believe however that many of the proposals put forward by the Commission will detract from rather than assist in the pursuit of quality shipping and ship safety. The policy objectives can more readily be met by other means; through flag and port state intervention, classification societies and international initiatives in the IMO and the recently established IOPC Fund Working Group on the Sub-Standard Transportation of Oil. Equally, Certificates of Entry could be employed as part of Port State Control to achieve the desired objectives without the need to set up the COFR machinery envisaged by the Commission which may not only negatively impact on insurance capacity but will also impose a very heavy administrative burden on States. The Group Clubs believe that the specific proposals in relation to limitation are unlikely to lead to any improvement in ship safety standards and will undermine the present Conventions which provide for sure and prompt compensation to the victims of maritime incidents.

10. Summary.

10.1 For the reasons given above, the Group Clubs would support the following measures:

(i) entry into force of LLMC in all Member States
(ii) the requirement that vessels present a Certificate of Entry as adequate evidence of insurance when arriving at an EU port

However, the following measures are not supported:

(iii) the introduction of direct action COFRs in respect of every type of claim
(iv) the introduction of compulsory insurance at double the LLMC limit
(v) changing the test for losing the right to limit
(vi) dealing with abandonment of seafarers by means of liability insurance

In addition, the Group Clubs would suggest that EU Member States who have not already done so should be encouraged to promptly ratify the IMO Conventions on HNS, Bunkers and the carriage of passengers.