INTERNATIONAL OIL POLLUTION COMPENSATION FUNDS	**Agenda item: 5**	**IOPC/APR10/5/4**	
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	1992 Fund Executive Committee	**92EC48**	
	1992 Fund Working Group	**92WG6/1**	●

1992 FUND SIXTH INTERSESSIONAL WORKING GROUP:

PROBLEMS ASSOCIATED WITH INTERIM PAYMENTS

Submitted by the International Group of P&I Clubs

Objective of document:	To provide the 6th intersessional Working Group with an overview of the common practices of P&I Clubs in relation to the handling and funding of claims under the 1992 Civil Liability Convention (1992 CLC).
Summary:	This document outlines issues which arise when P&I Clubs make interim payments to claimants as an alternative to establishing a limitation fund for distribution by the Court and identifies the practical measures commonly taken by Clubs to facilitate the prompt and fair settlement of claims.
Action to be taken:	1992 Fund sixth intersessional Working Group: Information to be noted.

1 The Clubs and the International Group of P&I Clubs (International Group)

1.1 The thirteen Clubs in the International Group insure the third party liabilities of approximately 95% of the world oceangoing tanker fleet. The Clubs are the principal providers of the insurance which is required under the 1992 Civil Liability Convention (1992 CLC). The Clubs have been involved in most major tanker spills and have worked very closely with the IOPC Funds ever since the first Fund Convention came into force over thirty years ago.

1.2 All Clubs pool claims above a certain level so that if there is an incident subject to the 1992 CLC which results in claims exceeding that level (currently US$ 8 million), all thirteen will be collectively sharing the cost of compensation payments.

1.3 The Clubs also collectively buy reinsurance for claims which exceed US$ 50 million. The underlying contract is the largest reinsurance contract in the marine sector with a huge number of insurers (approximately 80) who will contribute to the cost of cases giving rise to claims above this level.

1.4 The following five different scenarios may occur:

1. Claims falling within the 1992 CLC limit.
2. Claims exceed the 1992 CLC limit and the 1992 Fund Convention is not in force.
3. Both the 1992 CLC & the 1992 Fund Convention are in force. Claims exceed the 1992 CLC limit but not the 1992 Fund Convention limit.
4. Both the 1992 CLC and the 1992 Fund Convention are in force. Claims exceed the 1992 CLC and the 1992 Fund Convention limits.
5. The 1992 CLC, 1992 Fund Convention and 2003 Supplementary Fund Protocol are in force.

2 Scenario 1 - Claims falling within 1992 CLC limit

2.1 The great majority of pollution incidents involving tankers give rise to claims which do not reach a level at which the IOPC Funds become involved. Data collected in 2004 on all pollution incidents outside the United States involving tankers during the 25 year period from 1978 to 2002 showed that 98% of cases were fully compensated by shipowners and their P&I Clubs (cf document 92FUND/WGR.3/22).

2.2 This trend has been reinforced by the steady adjustments of the 1992 CLC limits. The latest increase, which took effect in November 2003, raised the maximum limit from a maximum of 59.7 million SDR to 89.77 million SDR (US$ 140 million[<1>]). In the case of larger tankers (in excess of 140 000 GT), the IOPC Funds will only be involved in incidents which give rise to claims for pollution damage exceeding 89.77 million SDR. Fortunately cases on this scale are rare.

2.3 At the outset of a case, the Club which insures a vessel involved in a claim which is subject to the 1992 CLC will make an estimate of the total claims' amount. There is inevitably an element of uncertainty and if there is a reasonable risk that claims will exceed the 1992 CLC limit, the IOPC Funds will always be notified if the spill occurs in a State Party to the 1992 Fund Convention in accordance with the International Group of P&I Clubs (International Group)/IOPC Funds Memorandum of Understanding (MoU). However in a great many cases, the Club will often be able to proceed on the basis that the 1992 CLC limit will not be exceeded. An example could be an operational accident involving a large tanker in the confines of a port which requires a limited clean-up response. The existence of a limit will not affect the handling of the claim and there is no pro-rating. There is no need to establish a limitation fund in order to ensure that the shipowner and Club can protect themselves against the risk of being required to pay more than the 1992 CLC amount.

2.4 There may be other reasons to establish a limitation fund (for example to secure the release of the ship if it has been arrested) but there are many incidents when no limitation proceedings are brought, not least because many spills are minor. There is no benefit to claimants for a fund to be constituted, in fact quite the contrary as the establishment of a limitation fund may mean that they are required to have their claims adjudicated by the court rather than through settlement with the Club with the delay and cost which this entails.

3 Scenario 2 - Claims exceed the 1992 CLC limit and the 1992 Fund Convention is not in force

3.1 The issues involved in such cases and described below to a large extent replicate those faced by a Club when the 1992 CLC and the 1992 Fund Convention are in force and the limit of the 1992 Fund Convention is exceeded. The following information will therefore be particularly instructive for the Working Group in considering the funding of interim payments.

3.2 Most spills occur in States where both the 1992 CLC and 1992 Fund Convention are in force. However, if an incident occurs in a State where only the 1992 CLC is in force and it appears that claims may exceed the 1992 CLC limit, it is highly likely that limitation proceedings will need to be commenced at some stage. This is necessary in order to meet the requirements of the 1992 CLC and to ensure that the right to limit is formally determined by the court. The 1992 CLC does not require the shipowner or Club to make any interim payments. A Club therefore can comply fully with the 1992 CLC by establishing a limitation fund which will be distributed by the court. However Clubs generally try to resolve claims by making advance or interim payments and agreeing settlements rather than forcing claimants to submit their claims to court. The Club will need from the outset to take account of the fact that claimants will receive less than the full amount of their claims.

3.3 Guiding principles:

- Interim payments should be made to alleviate financial hardship if reasonably possible,
- All claimants should be treated equally and receive the same proportion of their claims, and

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[<1>] Conversion of SDR into US$ in this document has been made on the basis of the exchange rate of 1 SDR = US$1.557.

- The Club and shipowner must be certain that they will not be held liable to pay more than the 1992 CLC limit.

3.4 The second and third objectives can be easily met by establishing a limitation fund as provided for in the 1992 CLC. This does not however satisfy the first objective.

3.5 If interim payments are to be made, the Club will have to protect itself by:

- satisfying itself that the claim is admissible,
- making an assessment of the amount of the claim,
- estimating the overall level of claims in order to establish the proportion of each claim which should be paid, and
- satisfying itself that credit against the limitation is provided for.

3.6 This inevitably involves a degree of speculation, particularly in the immediate aftermath of a spill when limited information is available, and assessments are of necessity made on a conservative basis. There is nonetheless an inevitable risk that, for example, high value claims are submitted late in the day which, when brought into the equation, mean that the pro-rating amount which has been applied has been too high.

3.7 This process may be eased if governments or other claimants agree to stand last in the queue or make additional funds available to meet claims.

3.8 As noted above, the Clubs collectively pool and reinsure claims. One consequence of increased 1992 CLC limits is that the reinsurance market bears a large proportion of the payments in major cases. As noted above, reinsurance comes into play once claims exceed US$ 50 million. In a case such as the *Hebei Spirit* where claims reach the maximum 1992 CLC limit of 89.77 million SDR (US$ 140 million), reinsurers will be contributing approximately US$ 90 million. If the 1992 CLC limit had to be paid twice (ie interim payments up to the 1992 CLC limit and a requirement to pay the funds into court to establish a limitation fund), the reinsurers would be called upon to pay US$ 230 million rather than US$ 90 million. This would have a profound effect and call into question the continued availability of insurance cover for liabilities under the 1992 CLC.

Subrogation

3.9 The 1992 CLC recognises that the shipowner or Club may make interim payments and provides that if they have paid compensation for pollution damage they acquire subrogation rights up to the amount paid. The Club which makes an advance payment can therefore take over the rights against the limitation fund which the claimant had before he received the interim payment (Article V, paragraph 5 of the 1992 CLC).

3.10 On the face of it, this means that a Club which constitutes a limitation fund will receive a credit against that fund for the amount of the interim payments. This should ensure that the Club will not be required to pay more than the 1992 CLC amount. However, it is not always possible to count on this outcome. For example, the shipowner has paid a proportion of the claim in line with the amount by which claims are being pro-rated but his own subrogated claim for the same amount may be reduced by the same proportion as all other claims with the result that his claim is in effect pro-rated twice. The Club therefore pays more and the claimant receives more than would have been the case if the Club had established a limitation fund for distribution by the Court and makes a better recovery than other claimants who have not received interim payments (cf example in the Annex to this document and the explanation in the following section).

Procedural difficulties

3.11 The concepts of limitation proceedings and subrogation are well established in the maritime and commercial law in some jurisdictions. There is therefore a body of background law and procedure which facilitate the workings of the 1992 CLC. This is not the case in all jurisdictions where the

1992 CLC is in force. Tanker pollution incidents which give rise to significant claims and which require determination by courts are relatively rare. National courts in States Party to the 1992 CLC are inevitably unfamiliar with the 1992 CLC and there are generally no previous cases which can provide guidance. The rules on subrogation as enshrined in domestic law can also differ from jurisdiction to jurisdiction. In some jurisdictions subrogation rights may be exercised only in the name of the party acquiring them (and not in the name of the original claimant) with the result that difficulties arise in the transfer to that party of the claimant's full original claim when only a partial payment has been made, whereas in other jurisdictions subrogation rights may be exercised in the name of the original claimant (cf the illustrative example as contained in the Annex).

3.12 While it has been usual for interim payments to be made against receipts and releases in order to minimise these uncertainties and to clarify the extent of the subrogation rights acquired, it has not been possible in some jurisdictions to develop receipt and release wording that has been regarded both as effective by local legal advisers and compatible with the wording of the 1992 CLC.

3.13 If there is doubt about whether the Club will be able to obtain a credit against its limitation fund for interim payments which it has made, whether by subrogation or otherwise, there is a clear danger that the Club will end up paying more than – perhaps double – the 1992 CLC amount. This has always been a concern but has become more critical with the introduction of higher limits. This is illustrated by the 1992 CLC limit in the *Hebei Spirit* case of 89.77 million SDR (US$ 140 million).

Financing payments

3.14 A Club which makes interim payments in a case where claims exceed the 1992 CLC limit will almost certainly have no alternative but to constitute a limitation fund in order to establish the right to limit and to determine the amount of that limit in the applicable currency. This fund will often be established by way of a cash deposit although sometimes a bank or other guarantee is acceptable. If interim payments are also made, this can give rise to additional financing costs since funds must be found to cover both the limitation fund and the interim payments.

3.15 If the limitation fund is constituted by a guarantee, bank charges will be incurred unless the Court accepts a letter of undertaking by the Club as adequate security. These costs can be considerable, particularly as the guarantee must usually be kept in place until the case is concluded and all claims have been resolved. This can take many years. For example, in the *Nissos Amorgos* case (Venezuela, 1997) the bank guarantee has been in force, and generating costs, for 13 years so far.

3.16 If the limitation fund is constituted by cash deposit, there is the clear problem of payment, at least for a period, of double the 1992 CLC amount. For example, following the *Braer* incident (United Kingdom, 1993), the Club paid claims up to the 1992 CLC limit but was still required to make a cash deposit of the 1992 CLC amount which was only released after ten years when the last claim was withdrawn. The increased 1992 CLC amounts make this an even more serious concern than previously. If a case involves interim payments equivalent to the maximum 1992 CLC limit of 89.77 million SDR (US$ 140 million) and a payment into Court also has to be made for the same amount which is not returned for many years, the financial costs and currency risks are significant.

3.17 The predicament for the Club will be even greater if there is doubt about the entitlement to a full credit for the amount of interim payments. The risk of double payment is a crucial factor which Clubs need to evaluate before deciding on the possibility of making interim payments. If the risk is real, the only safe option is to establish a limitation fund in accordance with the Convention and let claimants submit their claims to the Court. However, the International Group fully appreciates that this may result in the funds they provide being unavailable to claimants until a considerable time after the incident.

4 Scenario 3 - Both 1992 CLC the 1992 Fund Convention are in force. Claims exceed the 1992 CLC limit but not the 1992 Fund Convention limit

4.1 Most States where the 1992 CLC is in force have also ratified the 1992 Fund Convention in addition to the 1992 CLC. This will usually resolve the problems which a Club will face in making interim payment provided that the claims do not exceed the 1992 Fund limit.

4.2 The structure of the 1992 CLC and Fund Conventions is that all claimants receive a proportion of their claims from the shipowner or Club and the remainder from the IOPC Funds. If a tanker with a limit of 60 million SDR is involved in an incident which gives rise to claims of 100 million SDR and the provisions of the Conventions are followed faithfully each claimant would receive 60% of its claim from the Club and the remaining 40% from the IOPC Funds.

4.3 That would often not be the most practical solution. It is therefore usual for the Club and the IOPC Funds to agree an alternative way of funding payments. Both the Clubs and the Funds prefer to settle claims rather than to litigate.

4.4 The MOU between the International Group and the 1992 and Supplementary Funds records the shared policy of the Clubs and the Funds to co-operate with the aim of ensuring that, within the legal framework of the conventions, compensation is paid as promptly as possible. (MoU, 19 April 2006 Clause 6: 'Prompt payment of compensation: The Clubs and the Funds shall co-operate throughout with the aim of ensuring that, within the framework of the 1992 Civil Liability Convention, the 1992 Fund Convention and the Supplementary Fund Protocol, compensation is paid as promptly as possible.')

4.5 The common arrangement is for the Club to pay the agreed proportion for all claims up to an amount approximating to the 1992 CLC limit, at which point the IOPC Funds will start to pay claims. Claimants who receive early payments will therefore be paid by the Club and later payments will be made by the Fund. This makes no difference to claimants who will often be unaware who is funding the payment.

4.6 The Clubs are usually in a position to commence making payments sooner than the IOPC Funds. The Clubs are able to raise funds relatively quickly from their reserves and under the International Group's pooling and reinsurance arrangements. However, that does not necessarily mean that the Funds are never able to make payments until the Club has paid up to the 1992 CLC limit. With the higher limits now in force (50% increase in the limits which entered into force on 1 November 2003), this may mean that the IOPC Funds may make no payments for a number of years, as is the case in the *Hebei Spirit* incident.

4.7 The way in which the Club and the IOPC Funds respectively fund compensation payments has in the past been of no interest or relevance to claimants. The final adjustment between the Club and the Funds is carried out at a fairly advanced stage in a case and has not presented significant problems.

4.8 It has been the practice of the IOPC Funds that, even though there is no dispute by claimants or the Funds about the entitlement to limit, the shipowner and Club should obtain a ruling from the competent court. As long as claims do not exceed the limit under the 1992 Fund Convention, claimants have no financial incentive to contest the right to limit.

5 Scenario 4 - Both the 1992 CLC and 1992 Fund Convention are in force. Claims exceed the 1992 CLC and 1992 Fund Convention limits

5.1 As noted, the issues involved in such cases to a large extent replicate those faced by a Club when the 1992 CLC limit is exceeded and the 1992 Fund Convention is not in force. However now the risks of overpayment are shared by the Club and the IOPC Funds. Clubs again have the option of making interim payments. If they do so, they will work in close consultation with the IOPC Funds and with the Funds' approval. However, it will be the Club that makes the payments in view of the Funds' policy of not making payments until the 1992 CLC amount has been paid.

5.2 As payments are normally funded by the Club at the early stages of a claim, it is primarily the Club which has to address the problems associated with interim payments (albeit that this will generally involve close discussion with the Funds).

5.3 While the 1992 CLC provides the mechanism of distribution of the limitation fund by the Court, the 1992 Fund Convention does not contain the equivalent provision since the contribution of payments is dealt with by the 1992 Fund Executive Committee (Article 4, paragraph 5 and Article 18, paragraph 7 of the 1992 Fund Convention).

5.4 As noted above, the structure of the 1992 CLC and the 1992 Fund Convention is that all claimants receive a proportion of their claims from the shipowner or Club and the remainder from the IOPC Funds. If the Club pays the interim payments, it does so on the understanding that it is on its own behalf **and** on behalf of the Funds. The Club will therefore need to secure a credit for this against its own limitation fund as described in Scenario 2 by way of subrogation or otherwise, **and** also to claim against the IOPC Funds. Similarly, the IOPC Funds will be entitled to claim against the owners and Club for a proportion of the claims which it has paid.

5.5 This may be a purely accounting matter between the Club and the IOPC Funds in the previous scenario where the 1992 Fund Convention limit is not exceeded. However in the present scenario (unlike in the previous scenario), there are claimants who have not received full settlement of their claims. They may conclude that they have a prospect of increasing their recovery by participating in the court proceedings and increasing funds available to meet outstanding claims by, for example, challenging the owners' subrogated rights. The Court may then be asked to approach the case as if payments had been made in strict compliance with the manner set out in the Conventions. This would be extremely complicated and the outcome uncertain. If the analysis of the Court differs from the practices adopted by the IOPC Funds and the Club there is a risk that the payments may be ordered in excess of limits of the Club and the IOPC Funds.

6 Scenario 5 - 1992 CLC, 1992 Fund Convention and Supplementary Fund Protocol are in force

Where the Supplementary Fund Protocol is in force, 750 million SDR is available to meet claims and it is unlikely that this limit will be exceeded. If the limit is exceeded, the problems referred to above will apply.

7 Action to be taken

1992 Fund sixth intersessional Working Group:

The 1992 Fund sixth intersessional Working Group is invited to take note of the information contained in this document.

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Example:

1992 CLC limit = 60 million SDR and Total claims = 80 million SDR.

Claimant A and Claimant B each have admissible claims for 200 000 SDR. Claims are pro-rated at 75%.

Claimant A receives:

Interim payment from P&I Club (75% of 200 000 SDR)	= 150 000 SDR
From limitation fund 75% of the remainder of 50 000 SDR	= 37 500 SDR
Total recovery	= 187 500 SDR

Claimant B has not requested an interim payment and claims 200 000 SDR from limitation fund.

Claimant B receives 75% of total claim of 200 000 SDR from limitation fund = 150 000 SDR

P&I Club claims from limitation fund the 150 000 SDR it has paid claimant A.

Court awards P&I Club 75% of interim payment of 150 000 SDR = 112 500 SDR

Result:

Claimant A receives 93.75% of his claim (187 500 SDR of 200 000 SDR)

Claimant B receives 75% of his claim (150 000 SDR of 200 000 SDR)

The Club pays 37 500 SDR too much and in excess of 1992 CLC limit

Explanation:

If the total aggregate of claims of 80 million SDR is established against a limitation fund of 60 million SDR, and the Club makes an interim payment of 150 000 SDR to a claimant who has an admissible claim of 200 000 SDR, one scenario is that the Club is subrogated to the claim for 200 000 SDR and recovers his interim payment of 150 000 SDR. In that case the original claimant receives his full pro rata entitlement and the Club's interim payment is fully reimbursed (This analysis applies in jurisdictions where the right of subrogation may be exercised in the name of the original claimant).

However, as explained in the example above, if the 1992 CLC is interpreted in such a manner that the Club's subrogation rights may be exercised only up to 150 000 SDR and the original claimant remains entitled to maintain a claim for the remaining 50 000 SDR, the original claimant receives in total 187 500 SDR at the expense of the Club which recovers only 112 500 SDR in respect of his interim payment of 150 000 SDR (This analysis applies in jurisdictions where the right of subrogation may be exercised only in the name of the paying party acquiring them, ie the Club).

Although Claimants A and B claim identical amounts, they are not treated equally as Claimant A receives a higher proportion of his claim than Claimant B.