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Preface

Director's preface

The year 2007 was characterised by several candidates' successful delivery and defence of their doctoral theses. Henrik Inadomi, Camilla Dalbak, Alla Pozdnakova, Odd-Harald Wasenden, Sondre Dyrland, Henrik Ringbom and Anne Karin Nesdam have all now obtained the degree of doctor of law or PhD. The institute would like to congratulate all of them on the successful completion of their projects. Needless to say, we are very proud of this result. Furthermore, Mikaela Bjørkholm, delivered her PhD theses in October 2007, and Morten Kjelland, Trond Solvang and Beate Sjåfjell handed in their doctoral theses before 1 November 2007, which was the final deadline for obtaining the degree of doctor of law.

As all the fellows mentioned above have completed their projects and thus their stay at the Institute, we are in need of new candidates. Two new PhD research fellows started at the Institute during 2007: Kaja de Vibe, who is writing about the new market for retirement insurance, and Eve de Coning, who is writing about corporate liability for ship safety and environmental damage.

During 20007 we have also strengthened our Nordic profile. Professor Hannu Honka from Åbo Akademi stayed with us as guest professor during the spring of 2007. Further, professor Vibe Ulfbeck from the University of Copenhagen and professor Svante Johansson from the University of Gøteborg, was employed as professor II at the institute.

The research focus this year has been on the project Safety, Security and Discharge Control at Sea, which was awarded a research grant amounting to NOK 4.000.000 over 4 years from the Norwegian Research Council at the end of 2006. The project is

being led by Professor Erik Røsæg, who also wrote the project outline on which the award of the grant was based. At this stage, Eve de Coning's research fellowship is being funded through this grant. The institute is also offering postdoctoral fellowships to two doctors of law: Kristina Maria Siig, currently employed at Syd Danske University, and Alla Pozdnakova, who is working as a researcher at the institute. The institute is working with the Ministry of Fisheries and Coastal Affairs to define relevant research topics under this project in relation to the transport of oil from Russia along the Norwegian coast. The project will also co-operate with the Research Group in Natural Resources Law which is administered by the institute. The project will hold a conference in January 2008.

Since Mikaela Björkholm has now delivered her PhD thesis, research fellow Henrik Bjørnebye at the Department of Petroleum Law has taken over as editor of Simply.

As in previous years, the Institute in 2007 received 25% of its funding from the Scandinavian Council of Ministers, for which we are, of course, extremely grateful. Our main sponsors besides the Scandinavian Council of Ministers are:

- the Norwegian Oil Industry Association (OLF)
- the Ministry of Petroleum and Energy/ The Research Council of Norway
- the Eckbo Foundation

We are very grateful to all our sponsors.

Furthermore, the P&I club Skuld has agreed to fund an annual research scholarship to be awarded to a research assistant to write a masters dissertation within the field of P&I insurance, as well as a smaller award to be made available to students on the Master of Laws in Maritime Law programme who choose to write their papers on a P&I topic. We are very grateful to Skuld for their generosity.

We would also like to express our gratitude to the numerous practitioners who help us with lectures, student advice, information and exams year after year, in most cases without any fee. Their contribution is important in making the Institute what it is: a meeting place for young and established researchers, practitioners and students, all of whom combine open-minded enthusiasm for new knowledge with penetrating analysis. In particular, we are delighted with the way in which practitioners and researchers from other institutions have contributed to our specialised masters programme.

More than two dozen evening seminars were held during the year, as well as several seminars extending over two or more days. I would particularly like to mention the energy law seminar held in Noordwijk aan Zee, Netherlands (in co-operation with Nederlandse Vereniging voor Energierecht and University of Groningen). We hope to be able to hold further joint seminars in the future.

Trine-Lise Wilhelmsen

Editor's preface

We hereby present SIMPLY 2007, published one year after the 2006 edition. This edition is slightly more comprehensive than has been the case over the last few years, and I would like to offer my warm thanks to all the authors for their valuable contribution to the completion of this project.

The wide range of topics presented in this yearbook serves to emphasise the variety of research that is currently being carried out at the Scandinavian Institute of Maritime Law. With one exception, all the authors are in some way connected to the Institute. Together they represent all levels of research activity and include professors, researchers, doctoral candidates and masters students.

As in earlier editions, the articles published in this yearbook focus primarily on topics related to maritime law. In the first article, Professor Trine-Lise Wilhelmsen provides an extensive overview of developments in Norwegian and Scandinavian maritime law. This is followed by Byoungil Kang's comprehensive article, based on his masters paper delivered at the Institute, on the subject of subcontracting under shipbuilding contracts between Norwegian buyers and Korean builders.

A distinctive feature of this year's edition of SIMPLY is the strong focus on EU law, both within the field of maritime law and in relation to other topics. In her article based on her trial lecture for the dr. juris degree, researcher dr. juris Alla Pozdnakova discusses the maritime security problems entailed in allowing beneficial shipowners to remain anonymous and explores the implications of EU law for Member States' measures that require disclosure of identity. Researcher dr. juris Ellen Eftestøl-Wilhelmsson then presents an overview of the content and context

of the ongoing work to establish an EU intermodal transport and carrier liability regime.

We are also pleased to be able to present an article by Professor Rosa Greaves on EC external competences and their implications for maritime agreements, based on her presentation at the Institute's maritime law Post Seminar last spring. Turning back to the internal aspects of EC law, Maria Hempel discusses the legality of shipping pools under EC competition law.

The last three articles in this year's edition relate to topics other than maritime law, emphasising the broad range of research carried out at the Institute. Dr. juris Camilla Dalbak discusses oil companies' obligations to respect human rights in an article that is based on one of her trial lectures for the dr. juris degree. The editor's preface to last year's edition of SIMPLY called for the inclusion of some major articles on petroleum law in this year's edition. This request has been answered by dr. juris Anne-Karin Nesdam's extensive article on the organisation of Norwegian gas sales and EC competition law. Finally, research fellow Catherine Banet presents an important development of current interest in her article on the legal agenda for the review of the EU emissions trading scheme.

As the articles presented in this yearbook are independent of each other, there is no common bibliography. Materials referred to are instead cited in footnotes or in appendices to the individual articles.

Henrik Bjørnebye

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EARLIER EDITIONS OF SIMPLY I

EARLIER EDITIONS OF MARIUS VIII

BOOKS PUBLISHED BY SJØRETTSFONDET FROM 1990 XLIV

Part I
Developments in Norwegian and Scandinavian maritime law

Professor Dr. Juris Trine-Lise Wilhelmsen,
Scandinavian Institute of Maritime Law,
University of Oslo

1 Introduction

The purpose of this article is to provide an overview of developments in Scandinavian maritime law during recent years.[1] The article focuses on recent amendments to the Norwegian and Scandinavian Maritime Codes (MC)[2], the new Ship Safety Act,[3] amendments to the Norwegian Marine Insurance Plan (NMIP)[4] and developments in court practice, as reflected in the *Nordiske Domme i Sjøfartsanliggende* (ND).

The current Maritime Code (MC) in Scandinavia is a result of cooperation between Norway, Denmark, Sweden and Finland, and was enacted during 1994. The rules in the codes are substantially the same, but not identical. Further, the sections are numbered differently: in the Norwegian (NMC) and Danish (DMC) codes, the sections have continuous numbers, whereas the Swedish (SMC) and Finnish (FMC) codes have a system of double numbers, i.e., first a figure

1 A somewhat shorter version of this article was published in February 2007 in Il Dirittio Maritimo 2007, pp. 288-318. The previous equivalent overview in this periodical was written by Erik Røsæg, Maritime Cases from Scandinavia, Il Dirittio Maritimo 2004 pp. 302-317. His article concentrated on judgments from Nordiske Domme i Sjøfartsanliggende ("Scandinavian Maritime Cases", abbreviated "ND") and described court cases from 2001 to mid-2003. This article therefore discusses some of the more interesting cases in ND from no. 7 of 2003 to no. 9 of 2004. In addition, recent amendments to maritime legislation are discussed, but amendments after February 2007 are not covered.

2 The Norwegian Maritime Code 24 June 1994 no. 39 (NMC), The Danish Maritime Code 16 March 1994 (DMC), the Swedish Maritime Code 9 June 1994 (SMC) and the Finnish Maritime Code 15 July 1994 (FMC).

3 Lov om skipssikkerhet 2007 no. 9.

4 Norwegian Marine Insurance Plan of 1996, Version 2007.

indicating the chapter, thereafter the number of the paragraph within the chapter. References will therefore be different for the different countries.[5]

It is interesting to note that much of the new regulation in Norwegian maritime law focuses on safety, security and liability in the maritime sector. This is in line with the research strategy of the Scandinavian Institute of Maritime Law, where we have just started a research project entitled "Safety, Security and Discharge Control at Sea". This is also in line with the international trend in legislation, in particular in the EU.

2 Amendments/proposed amendments to the NMC

2.1 Duties of the Master in cases of distress – post *Tampa*

The duties of the Master in cases of distress are regulated in NMC § 135. The first and second subparagraphs concern the situation where the ship is in distress. According to the third subparagraph, the master also has a duty to assist any person in distress at sea or threatened by danger at sea. This rule has been amended[6] to conform to amendments in the SOLAS Convention[7] chapter V art 33 and 34 and the SAR Convention[8] article 2.1.1, as a consequence

[5] Falkanger/Bull/Brautaset: Scandinavian maritime law, The Norwegian Perspective, 2nd ed, Oslo 2004, see pp. 26-27. In the previous 1893 Code, on the other hand, the numbering was similar for all countries.

[6] Act 7 April 2006 no. 9, in force 1 July 2006.

[7] The International Convention for the Safety of Life at Sea (1974) (SOLAS).

[8] The International Convention on Maritime Search and Rescue, 1979 (SAR). Norway ratified the SAR Convention 9 December 1981, cf.

of the *Tampa* incident in August 2001. After the *MS Tampa* rescued more than 400 refugees from the waters off Christmas Island, Australia refused to allow the refugees to go ashore, and the ship was detained. This caused problems for the refugees, the owner and the ship, and it became clear that the international regulations were insufficient. The new rules in the SAR and SOLAS Conventions are first and foremost addressed to the authorities, i.e., they establish a duty for the authorities to cooperate to find a solution in similar cases.

However, some amendments were included in NMC § 135 concerning the duty of the Master.[9] NMC § 135 third subparagraph acquired a new third sentence conforming to the SAR Convention art. 2.1.1. The provision extends the concept of a person in distress at sea to include any person in need of assistance having found refuge on a coast in a remote location within an ocean area inaccessible to any rescue facility other than as provided for in the SAR Convention. A new fourth sentence conforms to a new clause 6 in art. 33 of the SOLAS Convention Chapter V, and states that persons that are taken on board shall be treated with humanity, which includes respecting their dignity and providing care to the extent that is possible on the particular ship. And a new fourth subparagraph implements the new art. 34-1 in the SOLAS Convention chapter V, which states that no one shall prevent the captain from undertaking efforts etc. that are necessary for the security of human beings at sea, or for the protection of the maritime environment. The provision makes it clear that no one shall be permitted to prevent the captain from performing these duties.

Proposition to Odelstinget (part of the Parliament) (Ot Prp) no. 31 (2005-2006) Om endringer i lov 24. juni 1994 no. 39 om sjøfarten (sjøloven) p. 2.

[9] Ot prp no. 31, p. 1.

2.2 Amendments concerning the global limitation of shipowner's liability

2.2.1 Denunciation of the 1976 LLMC Convention

A characteristic feature of maritime law is the right of shipowners, charterers and managers to limit their liability for maritime claims. Internationally, the right of limitation rests on the Brussels Convention of 1957, which was followed by the 1976 LLMC Convention [10] and the 1996 LLMC Protocol.[11] Norway ratified the 1996 LLMC Protocol in 2000 and implemented its rules in the NMC.[12] However, Norway did not denounce the 1976 LLMC Convention at the same time, but instead included both systems in the NMC.[13] This implied that Norway was bound by the rules of the 1976 LLMC Convention in relation to shipowners from states that had ratified the 1976 LLMC Convention but not the 1996 LLMC Protocol. As the main difference between the 1976 LLMC Convention and the 1996 LLMC Protocol concerns the limitation amounts, the lower amounts in the 1976 LLMC Convention therefore applied with regard to shipowners from countries bound by the 1976 LLMC Convention.[14] The reason for having this double

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[10] The 1976 London Convention on the Limitation of Liability for Maritime Claims (the 1976 LLMC Convention). Today, the rules have been amended by the 1996 LLMC Protocol. The Scandinavian countries have each accepted the 1996 LLMC Protocol, denounced the 1976 LLMC Convention and implemented the 1996 regime in the Nordic Maritime Codes.

[11] Protocol of 2 May 1996 to the 1976 LLMC Convention.

[12] NMC chapter 9, cf. Act 7 January 2000 no. 2 and 19 January 2001 no. 4.

[13] Previous NMC § 170, cf. chapter 9 subchapter III.

[14] Ot prp no. 79 (2004-2005) Om lov om endringar i lov 24.juni 1994 no. 39 om sjøfarten (sjøloven) (ansvar for opprydningstiltak etter sjøulykker m.m.) p. 6, cf. the previous NMC § 170 and chapter 9 subchapter III.

system was to avoid a situation where, due to the termination of the 1976 LLMC Convention before the 1996 LLMC Protocol had been ratified by a sufficient number of countries, the Scandinavian countries would be left without a relationship under the Limitation Conventions with several other countries.[15]

The 1996 LLMC Protocol came into force on 13 May 2004. It had by then been ratified by all the Scandinavian countries. Finland, Denmark and Sweden have denounced the 1976 LLMC Convention.[16] In order to secure the application of similar rules in the Scandinavian countries and to protect injured parties in Norway, Norway denounced the 1976 LLMC Convention in 2005 and amended the NMC so that all liability claims subject to Norwegian law will be treated according to the 1996 LLMC Protocol.[17] The amendment has no consequences for Norwegian shipowners, but will affect shipowners from other countries to the extent their liability is tried according to Scandinavian law.

2.2.2 Exception for clean-up costs

According to the global limitation rules, shipowners etc. may limit their liability subject to an exception in the case of gross negligence.[18] The right applies to most types of maritime claims,[19] and specific limits are applicable to personal injury to passengers, other personal injury and damage to property, graduated according to the size of the vessel.[20] The guiding principle of the system is that statutory limits shall apply to all claims subject to limitation arising

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[15] Ot prp no. 79 p. 7.

[16] Ot prp no. 79 p. 8.

[17] Act 88/2005, in force 1 November 2006.

[18] 1994 NMC and DMC § 174, SMC and FMC 9:4.

[19] 1994 NMC and DMC § 172-173, SMC and FMC 9:2 and 9:3.

[20] 1994 NMC and DMC § 175, SMC and FMC 9:5.

out of one and the same event for which persons entitled to limitation of liability are liable.[21] It has therefore traditionally been viewed as a system of global limitation of shipowner's liability in respect of all types of damage that a ship may cause in the event of an accident.[22]

Both the 1976 LLMC Convention and the 1996 LLMC Protocol art. 18 give Convention States a right, at the time of ratification, to make a reservation excluding the application of the convention in relation to certain claims. This right concerns claims in respect of: 1) the raising, removal, destruction, or rendering harmless of a ship which is sunk, stranded, abandoned or wrecked, and of everything that is or has been on board the ship; and 2) the removal, destruction or rendering harmless of the ship's cargo.[23] Norway did not make such reservation when the 1976 LLMC Convention was implemented in Norwegian law, as the legislator did not see any reason to treat these claims in a special way.[24]

The 1996 LLMC Protocol raises the limitations amounts significantly compared to the 1976 LLMC Convention. Even so, the increase in the amounts is not much higher than what would be necessary to keep up with general inflation. It is not realistic to expect the amounts in the 1976 LLMC Convention to be raised any further in the near future. At the same time, it has been demonstrated that maritime accidents near the coast, or in areas of the high seas not far from the shore, can result in pollution damage and the costs of measures to avoid or limit pollution may

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21 1994 NMC and DMC § 175 no. 4, SMC and FMC 9:5 no. 4.

22 Selvig: The Lugano Convention and Limitation of Shipowners' Liability in Simply 2005.1 on p. 3.

23 The 1996 LLMC Protocol art 2. no. 1 letter (d) and (e) cf. the previous NMC § 172 first subparagraph no. 4 and 5.

24 Ot prp no. 79 p. 13, Ot prp no. 32 (1982-1983) Om lov om endringer i lov 20. juli 1893 om sjøfarten m.m p. 21.

substantially exceed the limitation amounts. The compensation available may also be reduced because several other claims may stem from the same accident. Costs incurred in removing or destroying the ship and cargo etc. that exceed the shipowner's liability will normally be covered by the relevant State. Even if the limitation rules are important in the maritime sector, in particular in relation to the shipowner's insurance cover, it is important for the limitation amounts to be sufficient to cover costs following casualties occurring along the Norwegian coast, especially for dealing with pollution or the risk of pollution. It seems fair that the shipping industry should cover such risks to a greater extent than follows from the legal framework in the LLMC Convention and Protocol.[25]

Norway therefore made such a reservation when ratifying the 1996 Protocol.[26] The other Scandinavian countries have not done so.[27] The reservation has been followed by new legislation in NMC chapter 9 in relation to clean-up costs.[28] The main element in the legislation is that claims relating to clean-up costs after maritime casualties are subject to a special limitation amount if the ship exceeds 300 tons.[29] Thus, if the ship is smaller than 300 tons, the ordinary limitation rules apply.[30] The claims that are subject to special rules are claims relating to: 1) raising, removing, destroying or rendering harmless a ship which is sunk, stranded, abandoned or wrecked; 2) removing, destroying or rendering harmless the ship's

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25 Ot prp no. 79 pp. 13-14.

26 28 June 2002, Ot prp no. 79 p. 15.

27 Ot prp no. 79 p.17-18, Norges Offentlige Utredninger (NOU) (Norwegian Public Report) 2002:15 pp. 30-31.

28 Act 88/2005, in force 1 November 2006.

29 NMC § 172 a first sentence. This implies that the special rules also apply to a substantial part of the fishing fleet, cf. Ot prp no. 79 p. 25.

30 NMC § 172 second subparapgraph.

cargo; and 3) measures taken to avert or minimise losses for which liability would be limited under this section of the NMC, including losses caused by such measures.[31]

It follows that liability for the above-mentioned claims is not unlimited, but instead subject to higher limitation amounts. This is contrary to the general principle in Norwegian law that the polluter shall pay.[32] The reason that this approach was chosen was to ensure that it would still be possible to effect P&I insurance to cover this liability. This consideration was particularly important in relation to freighters and smaller vessels operating along the Norwegian coast, as it would presumably become impossible for them to obtain P&I cover if liability were unlimited.[33] On the other hand, the goal was to establish the limitation amounts at a level where they would cover the costs that, given experience of maritime accidents, could be expected.[34] The result was a provision setting the limit on liability for claims encompassed by the special rules at 2,000,000 SDR. For ships exceeding 1,000 tons, the limit increases by 2,000 SDR for every ton from 1,001 to 10,000 tons and by 500 SDR for every ton in excess of 10,001 tons.[35] The provision reflects experience that has shown that the need for higher limitation amounts is most relevant for ships of 3,000-20,000 tons.[36] Even though the increase in the amounts is substantial as compared to

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31 NMC § 172 a nr 1 and 2 conform to the 1996 Protocol art 2 no. 1 letters d and e. The interpretation of the rules is commented on in Ot prp no. 79 pp. 41-42 and NOU 1980:55 Begrensning av rederansvaret p. 17.

32 Ot prp no. 79 p. 23.

33 NOU 2002:15 chapter 7 and p. 38, Ot prp no. 79 p. 19 and pp. 23 et seq.

34 Ot prp no. 79 pp. 23-26, cf. NOU 2002:15 enclosure 1.

35 NMC § 175 a.

36 Ot prp no. 79 pp. 22 and 25-26.

the 1996 Protocol, it is presumed that this will not directly cause P & I premiums to rise.[37]

The provision contains no rule stating that the limitation amounts shall be adjusted according to inflation etc. Such an approach was ruled unnecessary because the 1996 Protocol art. 8 contains special provisions making the procedure to amend limitation amounts easier than under the 1976 LLMC Convention. The legislators thus considered that the special limitation provisions could be adjusted when the general amounts in the 1996 LLMC Protocol were adjusted.[38]

The 1996 LLMC Protocol and the previous rules in NMC chapter 9 did not contain any rule to the effect that expenses incurred by the owner in order to prevent or reduce damage could be claimed against the limitation amount.[39] This was contrary to the position under the conventions concerning liability for oil pollution, as implemented in NMC chapter 10. The attitude of the legislator was that the 1996 LLMC Protocol does not prohibit such a rule in relation to claims where the ratifying State has reserved against the application of the LLMC Convention, and that a rule saying that the owner's own costs to prevent or reduce damage could be claimed against the limitation fund would provide an incentive for the owner to instigate such measures.[40] Such a provision was therefore included.[41]

The new limitation amounts for clean-up costs etc. are subject to the same rules concerning the parties who have a right to

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[37] Ot prp no. 79 pp. 25-26, pp. 18-19, NOU 2002:15 p. 38 cf. chapter 7.

[38] Ot prp no. 79 p. 26.

[39] Cf Ot prp no. 79 p 26 and NOU 2002:15 pp. 15-16, stating that such a rule would be directly contrary to the LLMC Convention and that the Norwegian rules must be interpreted in the same way.

[40] Ot prp no. 78 pp. 27-29.

[41] 1994 NMC § 179.

limitation, claims excepted from limitation, conduct barring limitation, distribution of limitation amounts, limitation funds and limitation actions, the legal effects of the constitution of a limitation fund etc. However, the relationship between the limitation rules in the other Scandinavian countries and the Norwegian rules on clean-up costs had to be resolved.[42] A limitation fund constituted in another Nordic country would also be open for claims subject to special rules according to the NMC. Without special regulation, the limitation amount for an owner domiciled in another Nordic country, but liable under Norwegian law, would in this situation be the ordinary limitation amount plus the special limitation amount for clean-up costs according to the NMC. This result is avoided by stating that the ordinary rules shall apply provided an additional fund is constituted in Norway amounting to the liability amount according to the NMC less an amount equivalent to the part of the fund constituted in another Nordic country that will cover the same claims.[43]

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[42] According to NMC § 178 no. 2, after a limitation fund has been constituted in our Kingdom or in Denmark, Finland or Sweden, arrest or other enforcement proceedings in respect of ships or other property belonging to a person on whose behalf the fund was constituted and who is entitled to limitation of liability cannot be carried out in connection with any claim for payment that can be demanded from the fund. If an enforcement measure has already has been carried out, it shall be annulled, and security given shall be released. This means that a fund established in any Scandinavian country will be binding on a Norwegian court even if the damage triggering the limitation action occurred in waters under Norwegian jurisdiction. Similar rules applies if the fund has been constituted in the port where the event occurred, the port of disembarkation or the port of discharge, cf. NMC § 178 no. 3 second sentence.

[43] NMC § 178 a, Ot prp no. 79 pp. 34-36, NOU 2002:15 pp. 42-43. The same holds true if a fund is constituted in a port as mentioned in § 178 no. 3 second sentence, cf. note 42 above.

2.3 Carrier's liability for personal injuries

The carrier's liability for personal injuries is regulated in NMC chapter 15. The starting point is that the carrier is liable for personal injuries caused by the carrier or someone acting on his behalf. Liability is limited in a similar way as under other liability regimes in the maritime sector. According to NMC § 422, the limit of the carrier's liability for personal injuries has now increased from 175,000 SDR to 400,000 SDR for each passenger. The reason for the increase is that 175,000 SDR is less than the general level of compensation in recent tort cases, where compensation amounting to NOK 4 million is not uncommon. In cases of lifelong invalidity after road traffic accidents, compensation has exceeded NOK 10 million. In the light of this discrepancy, the limitation amounts should have been adjusted previously. However, the IMO has negotiated a new convention on liability for passengers.[44] Norway played a leading role in the negotiations and it was felt that it would be inappropriate to change national Norwegian legislation before the negotiations were completed. Furthermore, marine insurers have normally paid full compensation for personal injuries sustained during maritime casualties.[45]

The Athens Convention was accepted by the IMO in 2002. The limitation amount for passengers under the Convention is 400,000 SDR. The Convention also contains rules concerning the duty to effect insurance. The Convention has been signed by Norway, but it has not been ratified. In general, Norway does not implement rules in new conventions before they are ratified. One reason for this is

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[44] Athens Convention relating to the Carriage of Passengers and their Luggage by Sea 2002. The original Athens Convention dates from 1974 with protocols dating from 1976 and 1990. Formally, the 2002 Athens Convention is a protocol to the 1974 Athens Convention, but it states that the text is to be entitled the Athens Convention 2002.

[45] Ot prp no. 79 p. 37

to maintain uniformity in maritime legislation internationally and, in particular, in the Scandinavian countries. The other Scandinavian countries are waiting to implement the new limitation amounts until the Convention is ratified. Even so, Norway has decided to implement the new amounts. However, the global limitation amount has not been raised. This implies that the rise in the amount for each individual passenger will not take full effect in the case of a major accident.[46]

As a result of the increased limit on liability in NMC § 422 first subparagraph first sentence, there is no longer a uniform solution under Nordic law on this matter. Because of this, the provision in NMC § 430 first subparagraph, which states that some provisions are of a mandatory nature in domestic trade in the Nordic countries, no longer includes a reference to § 422 first subparagraph first sentence.

However, NMC § 430 second subparagraph is a new provision which states that the limit on the carrier's liability is binding for passenger traffic in, to or from Norway and in all other situations where Norwegian law is applicable. This means that the limitation rules are mandatory when it comes to passenger traffic relating to *Norway,* but not in domestic trade in the other Nordic countries.[47]

2.4 Maritime inquiries

Maritime inquires are regulated in NMC chapter 18 II. The system has up to now been that maritime accidents are investigated through a maritime inquiry or by a commission established to handle the relevant casualty. A maritime inquiry is a special procedure for collecting evidence concerning a maritime accident carried out in a District Court. The purpose is to investigate the cause of the

[46] Ot prp no. 79 p. 37. The 1996 Protocol art 6 gives the States a right to implement higher limitation amounts for damage suffered by passengers, cf. Ot prp. no. 90 (1998-1999) subchapter 4.1.1.

[47] Ot prp no. 79 p. 43.

casualty and establish whether there are circumstances that give rise to criminal liability.[48] While the system seems to function in respect of establishing whether criminal offences have been committed, it is less effective for gathering evidence in relation to questions concerning liability in tort and safety at sea.[49] Further, the maritime inquiry procedure in several respects contravenes fundamental principles in the IMO Code in relation to the investigation of maritime accidents, in particular with regard to the making of a distinction between the investigation to clarify the causes of the accident and that concerning questions related to liability and guilt.[50]

A commission of inquiry can be established if an incident results in heavy loss of life or property or if the investigation, for other reasons, is expected to be particularly complex. Such a commission has the same purpose as a maritime inquiry, but the procedure is different.[51]

The provisions in the NMC about maritime statutory declarations are now replaced with provisions that give responsibility for the investigation of shipping disasters to one permanent authority. It is up to the government to decide which authority is to have this responsibility.[52] The ministry has suggested that a common investigation Commission should be established in respect of aircraft, trains, ships etc.[53]

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48 NMC § 472 to § 474, Ot prp no. 78 (2003-2004) Om lov om endringer i lov 24.juni 1994 no. 39 om sjøfarten (sjøloven) og enkelte andre lover (undersøkelse av sjøulykker) p. 17.

49 Ot prp no. 78 p. 18.

50 Ot prp no. 78 p. 24, NOU 1999:30 chapter 7 pp. 40-49.

51 NMC § 485, Ot prp no. 78 2003-2004 p.32.

52 New NMC § 473, Ot prp no. 78 p. 93 as per Act 7 January 2005 no. 2. The rules are expected to be enforced 1 July 2008.

53 Ot prp no. 78 p. 84, cf. chapter 6 and p. 12.

The purpose of giving responsibility for the investigation of shipping disasters to a particular commission is to improve the investigation of shipping disasters and also improve work on preventing such disasters. Compared with today's maritime statutory declarations, such a commission will consist of people with a higher level of expertise relevant to this kind of work. A commission will be able to investigate individual accidents more thoroughly and comprehensively than is possible today. A commission will also develop competence in this field, thus benefiting preventive work.[54]

The rules concerning the investigation of maritime accidents will apply to accidents involving Norwegian ships and foreign ships where the accident occurs either within Norwegian waters or outside Norwegian waters, provided the flag State consents or Norwegian jurisdiction applies according to international public law.[55] The provision must be seen in conjunction with the UNCLOS[56] rules concerning jurisdiction and the coastal, flag and port States' rights of enforcement. The principle of flag State jurisdiction implies that a ship shall "sail under the flag of one State only and …. shall be subject to its exclusive jurisdiction on the high seas".[57] Every state "shall effectively exercise its jurisdiction and control in administrative, technical and social matters over ships flying its flag".[58] In particular, it is the duty of the flag State to "take such measures for ships flying its flag as are necessary to ensure safety at sea".[59] This implies that the investigation of maritime

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54 Ot prp no. 78 p.7 and chapter 6.

55 New § 472, Ot prp no. 78 p. 93.

56 The United Nations Convention on the Law of the Sea, 1994, ratified by Norway 24 June 1996, cf. NOU 2005:14 p. 60.

57 UNCLOS art. 92 no. 1 first sentence.

58 UNCLOS art. 94 no. 1.

59 UNCLOS art. 94 no. 3

casualties shall be undertaken by the flag State, regardless of whether the casualty occurred in the waters of the flag State. It also follows from UNCLOS that the coastal State has a right to investigate casualties involving foreign ships that occur in the territory of the coastal State, e.g., if the casualty has caused risk to life or the environment in the coastal State.[60]

The concept of a "maritime accident" includes any accident in connection with the operation of a ship where people have died or where substantial damage has been caused to persons, the ship, cargo, property not on board the ship or the environment.[61] To ensure that an investigation takes place, the captain or the owner have a duty to notify the Commission immediately about the accident.[62] The Commission shall upon notification immediately decide whether investigations shall be initiated, and if so, start the process.[63] Any person involved has a duty to disclose information regardless of any right to professional confidentiality, and the ship, the wreck or items from the ship may not be removed.[64] Further, there are rules concerning the taking of measures to secure information, the right to professional confidentiality, documentation, international investigations, expert assistance, the rights of those involved and reports concerning the investigation.[65]

The amendments will bring the Norwegian system closer to the systems in place in the other Scandinavian countries. In 1990, Denmark established a special entity to investigate maritime accidents

60 UNCLOS art. 2 cf. IMO-Code art 1.1, cf. Ot prp no. 78 p. 13 and pp. 15-16.

61 New § 472, Ot prp no. 78 p. 93.

62 New § 475, Ot prp no. 78 p. 94.

63 New § 476, Ot prp no. 78 p. 94.

64 New § 477 and 478, Ot prp no. 78 pp. 94-95.

65 New § 479 to 485, Ot prp no. 78 pp. 95-96.

under the auspices of the Director of Maritime Directorates. Until 2001, this entity functioned side-by-side with a maritime inquiry procedure that was regulated in a similar way to the Norwegian system. In 2001, however, the rules were amended so that this special entity took on the major role in respect of these investigations. A maritime inquiry is no longer mandatory, but may be held at the request of any person having a significant legal interest in the holding of such an inquiry.[66] Sweden and Finland, on the other hand, have rules concerning maritime inquiries that are similar to the current Norwegian system and there are no immediate plans to change the rules. Both countries have, however, also established special investigation commissions that investigate certain types of maritime accident.[67]

2.5 Proposed implementation of the HNS Convention

The HNS Convention[68] was agreed on 3 May 1996. Norway signed the HNS Convention on 25 September 1997, but made a reservation against non-ratification of the Convention.[69] The purpose of the Convention is to secure compensation in tort where damage is caused by the carriage of hazardous and noxious substances. The Convention applies both to pollution damage and to other damage caused by the dangerous nature of the cargo, for

[66] Ot prp no. 78 p. 22.

[67] Ot prp no. 78 p. 23.

[68] International Convention on Liability and Compensation for Damage in Connection with the Carriage of Hazardous and Noxious Substances by sea, 1996.

[69] NOU 2004:21 p. 9.

instance fire and explosion.[70] The Convention is drafted along the same lines as the 1969 CLC Convention.[71]

The EU decided in 2002 that its Member States should adopt the necessary national measures to ratify the HNS Convention within a reasonable time or by 30 June 2006 at the latest.[72] The NMC Committee has therefore proposed that Norway should ratify the HNS Convention and has drafted a new chapter 11 of the NMC to implement the rules. The work of the Committee was coordinated with similar work in Denmark that resulted in a similar proposed amendment. Sweden and Finland did not participate. The proposition (Ot prp) was expected at the beginning of 2007, but has not yet been made official. Internationally, ratification of the HNS Convention is at a standstill. Several EU countries have still not ratified the Convention, and discussions are now taking place within the EU as to how to proceed. The fate of the Convention is therefore somewhat unclear.

The Norwegian proposal corresponds to the rules in the HNS Convention. The main elements are as follows. The owner of the ship is liable irrespective of fault for damage caused by the carriage of hazardous or noxious substances.[73] This liability includes liability for loss of life or personal injury, losses due to damage to property not on board the ship, loss or damage to the environment through contamination and the costs of preventive measures.[74] The owner is not liable for damage caused by war, hostilities, civil war,

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[70] NOU 2004:21 p. 15.

[71] NOU 2004:21 pp. 9-10, p 7 and enclosure 1 containing the Convention in English text and Norwegian translation.

[72] Resolution 2002/971/EF, 18 November 2002.

[73] Proposed NMC § 211, cf. NOU 2004:21 p. 44 and p. 28, HNS Convention Art. 7 no. 1, cf. NOU 2004:21 p. 56 cf. p. 17.

[74] Proposed NMC § 211 second subparagraph, cf. NOU 2004:21 p. 44 and p. 28 HNS Convention art. Art. 1 no. 6, cf. NOU 2004:21 p. 52 cf. p. 16.

insurrection or natural phenomena of an exceptional, inevitable and irresistible character, or caused by an act or omission done with the intent to cause damage by a third party, or by the negligence or other wrongful act of any government or the failure of the shipper to furnish information concerning the hazardous or noxious nature of the substances shipped.[75] Liability is channelled to the owner, i.e., a claim for damages cannot be raised against the crew or the servants or agents of the owner, the pilot or others performing services for the ship, any charterer, manager or operator of the ship, or any person performing salvage operations or taking preventive measures.[76] Liability is limited to SDR 10 million for ships less than 2,000 tons, with the limitation amounts rising proportionally in step with the tonnage.[77] The owner has a duty to insure against such liability and injured parties have a right of direct action against the insurer.[78] In addition to claiming against the owner, the injured party may claim compensation from an HNS Fund established for this purpose and financed by a tax to be paid by receivers of HNS goods.[79]

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[75] Proposed NMC § 213, cf. NOU 2004:21 p. 45 cf. p. 30, the HNS Convention Art. 7 no. 2, cf. NOU 2004:21 pp. 56-57 cf. p. 17.

[76] Proposed NMC § 214, cf. NOU 2004:21 p. 45 cf. p. 31, HNS Convention Art. 7 no. 5, cf. NOU 2004:21 p. 57 cf. p. 17.

[77] Proposed NMC § 215, cf. NOU 2004:21 p 45 cf. p. 32, HNS Convention Art. 9, cf. NOU 2004:21 pp. 58-59 cf. p. 17.

[78] Proposed NMC § 219 and § 221,cf. NOU 2004:21 p. 46 cf. pp. 34-35, HNS Convention Art. 12. no. 1 and no. 8, cf. NOU 2004:21 p. 61 and 63 cf. p. 17.

[79] Proposed NMC § 222 and 223, cf. NOU 2004:21 p. 47 cf. p. 36, HNS Convention chapter III, Art. 13 and 14, cf. NOU 2004:21 p. 64 et seq. cf. pp. 17-20.

3 New Ship Safety Act

3.1 The need for amendments

Until November 2006, the safety of the Norwegian fleet was regulated by the Seaworthiness Act of 1903.[80] Several problems in relation to this act made it necessary to pass a new regulation. Firstly, the structure of the regulation was unsatisfactory. Secondly, the practical solutions were outdated compared to the modern handling of safety problems. Thirdly, there were problems relating to supervision and the taking of sanctions, in that the supervision system was outdated and the possible sanctions were perceived as insufficient. Fourthly, the regulation allowed limited flexibility and fifthly, it contained far too many details.[81] Added to these problems, inherent in the Act itself, was the fact that safety issues in relation to ships were also dealt with in several other Acts.[82] Measures to restructure and modernise the legislation were thus necessary.

A Committee to revise the Act was established in October 2003 and its proposals were presented in 2005.[83] The proposition from

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80 Act 9 June 1903 no. 7 relating to public control of the Seaworthiness of ships. Contrary to the SMC, ship safety is not regulated by common Scandinavian rules. In Denmark, the relevant regulation is the Act concerning safety at sea dating from 1998, in force from 1 March 1999. The current version today dates from 26 July 2002, cf. LBK no. 627 of 26/7/2002. Swedish ship safety is regulated by the Ship Safety Act, which came into force on 5 June 2003 (2003:364), whereas the Finnish regulation is the Ship Safety Act 17.3.1995/370.

81 NOU 2005:14 ”På rett kjøl” New Ship Safety Act pp. 33-35.

82 For instance, Act 19 June 1964 no. 20 concerning the measurement of ships, Act 17 June 1966 no. 2 concerning Hovercraft, Act 18 June1971 no. 90 concerning mustering of employees on ships, Act 3 June 1977 no. 50 on working and resting hours on ships, cf. further NOU 2005:14 p. 25 et seq.

83 NOU 2005:14.

the legal department was presented on 9 June 2006[84] and accepted in November 2006. The new Act is no. 9 of 2007 and came into force on 1 June 2007.

The goal of the new Act was to gather all the rules concerning the safety of ships into one piece of legislation, to give the legislation a new and improved structure, and to adjust the manner of regulation to take account of modern systems for risk management within the framework of international law as defined in international conventions and EU legislation. In particular, the need for legislation to take account of internal control methods was emphasised.[85]

3.2 Overview of the Ship Safety Act (SSA)

The SSA is divided into 11 chapters that distinguish clearly between the various issues it covers. Chapter 1 defines the purpose of the Act, the installations that it applies to and the geographical limits of its application. Its purpose is to secure life, health, the environment and material values.[86] As for the installations it applies to, it is important to emphasise that the Act applies to both Norwegian and foreign ships.[87] For Norwegian ships, the law applies regardless of where the ship is situated. In relation to foreign ships, the law only applies to the extent permitted according to international public law in Norwegian territorial waters, within the Economic Zone and on the continental shelf.[88]

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[84] Ot prp no. 87 (2005-2006) New Ship Safey Act.

[85] NOU 2005:14 p. 11 and pp. 15-17.

[86] SSA § 1first subparagraph

[87] SSA § 2 first subparagraph

[88] SSA § 3 first and second subparagraph. The solution conforms to the solution in the Swedish Ship Safety Act § 1 and the Danish Safety at Sea Act § 1 no. 3 cf. regulation 16 August 1999, but here the geographical area is somewhat more limited, cf. NOU 2005:14 pp. 81-82.

The way in which these provisions are drafted is rather similar to those provisions defining the application of the new rules concerning maritime inquiries in the NMC, cf. subchapter 2.3 above and the explanation of these rules' relationship with the rules in UNCLOS. The application of the SSA to ships flying the Norwegian flag follows from the flag State principle. The main principle in relation to coastal State jurisdiction is that the coastal State has wider jurisdiction over the surrounding waters the closer those waters are to land. Thus the coastal State has full jurisdiction and enforcement rights in its internal waters and territorial waters, although in the latter area these rights are limited by the principle of innocent passage.[89] However, the SSA also provides the King with the authority to regulate the extent to which the Act shall apply to foreign ships outside the above-mentioned geographical area to the extent this is permitted by public international law.[90] The relevant areas in this context are foreign territorial waters and the high seas. As a starting point, the coastal State has no jurisdiction in these waters. However, UNCLOS provides for a limited right of enforcement in respect of environmental matters, e.g., Norway may enforce sanctions against breach of the discharge rules if the ship later arrives at a Norwegian port.[91] The EU has also adopted two directives that regulate discharges and emissions from ships and

89 UNCLOS article 2 cf. Art. 17 and Art. 8.

90 SSA § 3 third subparagraph. On this point the application is wider than the Danish and Swedish legislation, cf. NOU 2005:14 p. 82.

91 UNCLOS § 218 no. 1, Ringbom: The EU's Exercise of Port and Coastal State Jurisdiction, Scandinavian Institute of Maritime Law Yearbook (SIMPLY) 2006, p. 206.

these presumably also apply on the high seas.[92] The SSA therefore provides a legal basis for applying this regulation.

The SSA chapter 2 contains rules concerning the duties of the shipowner and safety management. The concept of "shipowner" is tied to the definition of the "company" as the entity that is responsible for carrying out duties imposed by the ISM code.[93] The main duty of the owner is to ensure that life, health, the environment and material values are protected in accordance with the rules in the Act and to ensure that this duty is fulfilled.[94] The owner further has a duty to establish, implement and develop a system of safety management that can be documented and verified to identify and control risk and secure fulfilment of the requirements defined in the Act or any regulation implemented according to the Act. There are no absolute requirements concerning the system employed. Rather, the presumption is that the extent and content of the system and requirements for documentation will be adjusted to the needs of the particular owner and the activities performed.[95] The provisions must be viewed in conjunction with international developments in regulatory style within the IMO, from regulations that were based on the detailed involvement of the authorities to requirements for a safety management system as defined in the ISM code.[96] The

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92 Directive 2005/33 regulating the sulphur content in ship's fuels and Directive 2005/35 providing for sanctions for violations of the Marpol discharge standards , cf. Ringbom p. 221.

93 The International Management Code for the Safe Operation of Ships and Pollution Prevention (ISM Code) adopted by IMO 4 November 1993 by resolution A 741(18), cf. SSA § 4 first subparagraph and Ot prp no. 87 (2005-2006) p. 107.

94 SSA § 6.

95 SSA § 7, cf. NOU 2005:14 pp. 17-18.

96 The ISM Code was amended by The International Convention for the Safety of Life at Sea (1974) (SOLAS) Chapter IX, cf. further NOU 2005:14

requirement for a safety management system first and foremost relates to safety management in the traditional sense, but it is wide enough to encompass security and anti-terrorism measures if such requirements should follow from international obligations.[97] The focus on a safety management system is followed up with definitions of the duties of the owner that are specified by means of functional requirements, rather than through specific and detailed requirements. One result of this approach is that the concept of seaworthiness is not included in the new Act.[98]

The more detailed functional requirements are defined in chapters 3 to 6 of the Act.[99] Chapter 3 concerns technical and operative safety, and regulates questions concerned with the safety of the ship as such. The starting point is that the ship shall be designed, built and equipped in a manner that ensures the safety of life, health, the environment and material values in relation to the purpose and trading area of the ship. Further detailed regulations are to be provided by the Ministry.[100] The chapter also contains regulations concerning the operation of the ship[101] and the quality of the crew.[102] Chapter 4 regulates personal safety and addresses questions relating to the safety of persons working on board. These provisions overlap with the Act on maritime crews, which is the main Act governing matters concerning the working environment at sea. The regulation

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pp. 83-84. The ISM Code is implemented in the EU by Regulation (EC) no. 336/2006 15 February 2006.

97 NOU 2004:14 p. 86.

98 NOU 2004: 14 pp. 86-88.

99 This approach is very different from the other Scandinavian legislation, making a comparison difficult. An overview of this legislation is found in NOU 2005:14 chapter 5.

100 SSA § 9 second subparagraph.

101 SSA § 11 to § 14.

102 SSA § 15 to § 20.

of personal safety relates, i.a., to safety measures, the planning and performing of work, working and rest hours, living accommodation and free time.[103]

Chapter 5 regulates environmental safety. The provisions here are a continuation of the rules in the previous seaworthiness act and are founded on MARPOL 73/78[104], OSPAR[105] and UNCLOS. The starting point in chapter 5 is that contamination of the environment by the ship through discharge, dumping or disposal of dangerous goods or in other ways is prohibited unless it is permitted by legal rules. Further, the ship shall be designed, constructed and equipped, and also operated, in such a manner as to avoid contamination. The same considerations apply to the scrapping of the ship.[106] Chapter 6 regulates states of readiness in relation to security measures and terrorism. The owner has a duty to implement measures to prevent, and protect the ship against, terrorism, piracy, stowaways and other illegal acts.[107] In order to fulfil this obligation the master has authority if necessary to initiate enforcement measures.[108]

Chapter 7 regulates supervision. Supervision of the safety of ships has previously been delegated to classifications societies.[109] Under the SSA, a supervisory authority is to supervise the safety management system.[110] Norwegian ships shall be controlled, whereas foreign ships

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[103] SSA § 21 to § 30.

[104] The International Convention for the Prevention of Pollution from Ships (MARPOL) 73/78.

[105] Convention for the protection of the Marine Environment of the North-East Atlantic, ratified by Norway 23 June 1995 and in force from 25 March 1998.

[106] SSA § 31, § 32, § 33 and § 36.

[107] SSA § 39 first subparagraph.

[108] SSA § 40.

[109] SSA § 41 second subparagraph.

[110] SSA § 42.

may be controlled.[111] Chapter 8 defines the measures available to the supervisory authorities if the requirements of the act are not fulfilled. If the owner fails to fulfil the requirements of the act, the supervisory authority can require the owner to implement the necessary measures within a given time limit.[112] If the measures are not implemented, further enforcement measures may be instigated. These include:[113] the application of a new time limit in respect of fines; the withdrawal of certificates if the measures are not implemented or the fines not paid; the imposition of restraints on the ship from leaving port or demands that the ship goes to port; or other necessary measures, if necessary including the use of force, but within limits as defined by international public law, such as stopping and boarding the ship at sea and refusing a foreign ship permission to enter Norwegian territorial waters (within limits as defined in public international law). In chapter 9, the supervisory authorities are provided with a legal basis for imposing administrative sanctions in the form of infringement fees for the breach of several of the provisions in the act, whereas chapter 10 contains rules concerning criminal liability, i.e., penal fines or prison sentences of up to two years. The supervisory authorities must choose between the two types of sanctions. If infringement of the provisions is referred to the police, infringement fees shall not be imposed.[114] Infringement fees may be imposed on a person acting on behalf of the owner, the master or any other person working onboard, but the infringements that trigger the fee are different for the three groups.

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[111] SSA § 43 and § 44.

[112] SSA § 49 first suparagraph

[113] SSA § 49 first subparagraph cf. § 50 -§ 54.

[114] Ot prp no. 87 p. 131.

The condition for imposing such a fee is that the breach must have been negligent or deliberate.[115]

4 Amendments to the Norwegian Marine Insurance Plan

4.1 Introduction

Marine insurance in Norway is regulated by the Norwegian Marine Insurance Plan 1996 (NMIP). The NMIP is an agreed document drafted by a committee consisting of a wide range of members from all parties interested in the use of the plan, with the Scandinavian Institute of Maritime Law acting as secretariat. When the 1996 amendment was completed, a smaller committee consisting of representatives from the same groups was established continually to adjust the NMIP according to developments in the shipping and insurance sector. The basis of the plan is still the 1996 NMIP, but the amendments are distinguished by the designation of different versions.[116]

The version in force until 1 January 2007 was Version 2003. In the period 2003-2006, however, several amendments were agreed upon, resulting in an amended Version 2007. A full overview is

[115] § 55 first and second subparagraph.

[116] The different versions are published on http://www.norwegianplan.no/, allowing an opportunity to examine both the English and the Norwegian versions. The NMIP is supplemented with Commentaries that are also published on the same website. The NMIP is presented in Bull: Marine Insurance Symposium: Opening. Aim of the Symposium. The Norwegian Marine Insurance Plan 1996. Experience from UNCTAD concerning harmonization of marine insurance, MarIus no. 242, pp. 1-12, and Bull: Norwegian Marine Insurance Plan of 1996. In: Huybrechts (ed): Marine Insurance at the turn of the Millennium. Antwerpen 1999/Simply 1997 pp. -123-138.

provided in the preface to the 2007 Version. The presentation here will be limited to four of the more important amendments: the exclusion of risks under the Institute Extended Radioactive Contamination Exclusion Clause (RACE II) from the general cover; the introduction of part cover for RACE II perils and requisition by the ship's own state in the war risk conditions; amendments to the rules concerning seaworthiness and safety regulation to conform to the new SSA; and new rules concerning cash settlements in relation to hull insurance.

4.2 Exclusion of RACE II perils

Cover under the NMIP is divided into insurance against marine perils and insurance against war perils.[117] Previously, both types of insurance contained a general exclusion in relation to "nuclear" perils.[118] As the concept of "nuclear peril" is very wide, it was assumed that any kind of peril connected to a nuclear risk was excluded. However, in the aftermath of the terrorist attack in New York on 11 September 2001, the English insurance market introduced the RACE II clause to be incorporated in all reinsurance and insurance contracts. The clause reads as follows:

1. In no case shall this insurance cover loss damage liability or expense directly or indirectly caused by or contributed to by or arising from

    1.1 ionising radiations from or contamination by radio-activity from any nuclear fuel or from any nuclear waste or from the combustion of nuclear fuel.
    1.2 the radioactive, toxic, explosive or other hazardous or contaminating properties of any nuclear installation,

[117] NMIP § 2-8 (marine perils) and § 2-9 (war perils).

[118] NMIP 1996 Version 2003 § 2-8 letter d and § 2-9 second subparagraph letter b.

reactor or other nuclear assembly or nuclear component thereof

1.3 any weapon or device employing atomic or nuclear fission and/or fusion or other like reaction or radioactive force or matter

1.4 the radioactive, toxic, explosive or other hazardous or contaminating properties of any radioactive matter. The exclusion in this sub-clause does not extend to radioactive isotopes, other than nuclear fuel, when such isotopes are being prepared, carried, stored, or used for commercial, agricultural, medical, scientific or other similar peaceful purposes.

1.5 Any chemical, biological, bio-chemical or electromagnetic weapon

The clause was immediately incorporated verbatim into all marine insurance and reinsurance policies, but it was not incorporated into the Plan. The main reason for this was that it was hoped that the exclusion was an exaggerated reaction to the terrorist attack that would be deleted or modified in time. As this did not happen, it was decided to incorporate the clause into the Plan. In order to ensure that the exclusion in reinsurance contracts is identical with the exclusion in the direct insurance contract, the clause is included verbatim in the NMIP Version 2007.[119] However, it is assumed that the exclusions as defined in subparagraphs 1.2 to 1.4 first sentence in the RACE II clause, as a general rule, conform to the previous exclusion in relation to nuclear perils. On the other hand, the exclusion in relation to biological and chemical etc. weapons is new. The exclusion is identical in marine insurance and war risk insurance,

[119] NMIP1996 Version 2007 § 2-8 letter d and § 2-9 second subparagraph letter b. These clauses only define the perils excluded. Rules concerning causation and burden of proof as required in the introduction to the RACE II clause are found in the NMIP 1996 Version 2007 § 2-12 third subparagraph (burden of proof) and § 2-13 second subparagraph (causation). The regulation is discussed in more detail in the Commentary to § 2-8 and § 2-9, published on the above-mentioned website.

except for the provision in subparagraph 1.4 second sentence, which is only included in respect of insurance against marine perils.

4.3 Limited cover for RACE II perils and requisition by the ship's own state

In the previous versions of the NMIP, limited cover for nuclear risks was provided for ships insured with the Norwegian War Risks Association. This Association also covered requisition for ownership or use by a foreign State.[120] Requisition by the ship's own flag state has not previously been covered under the NMIP.

Cover for nuclear risks was deleted when the Association included the RACE II clause in its policies. The Association has, however, worked continually to reinsure parts of the RACE II risks, and has provided some cover in respect of these risks in its policies. In addition, limited cover has been provided in relation to requisition by the ship's own state. In 2007, this cover was extended and included in the NMIP. This new cover is divided into two main parts: limited cover for RACE II perils/requisition by the ship's own state and limited cover for certain costs.[121]

Cover for requisition by the ship's own state and perils covered by the RACE II clause is limited to total loss and damage.[122] Further, cover is limited to the limitation amount specified in the policy in respect of any one ship per year and to a total per year for the

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[120] NMIP1996 Version 2003 § 2-9 third subparagraph letters a and b.

[121] In the previous versions of the NMIP, the special rules for cover by the Norwegian War Risk Association appeared in different provisions through the plan. In the 2007 Version, all these special rules are gathered in chapter 15 section 9. Section 9 no. 1 contains general rules, most of which are a continuation of previous provisions. Limited cover for requisition by the ship's own state and perils covered by the RACE II clause are contained in section 9.2, whereas limited cover for certain costs is contained in section 9.3.

[122] NMIP Version 2007 § 15-27 cf. § 15-28.

Association.[123] The reason the amount is kept open is that the exposure is tied to the protection the Association can obtain in the reinsurance market.[124]

The limited cover for certain costs is more limited in that only costs directly relating to the RACE II clause 1.5, i.e., biological and chemical etc. weapons are covered. Further, only contingency costs as defined are included, i.e., clean-up costs, costs in connection with quarantine, costs relating to the crew, cost of discharge etc.[125] Similarly to the general RACE II cover, this cover is set at a limited amount. However, the limitation is drafted somewhat differently from the general RACE II cover, in that one limitation amount applies to each ship per casualty and there is one aggregate limitation amount for the Association's total liability per year. Both limitation amounts are defined in the policy, cf. what was said above with regard to reinsurance.[126]

4.4 New rules on seaworthiness and safety regulation

The NMIP chapter 3 contains rules concerning the duties of disclosure and due care. Contrary to the rules discussed above, which concern insurance against objective perils, these rules concern the acts and omissions of the assured. In the previous versions of the Plan, two major aspects of how this was regulated were that the insurer was not liable for loss caused by: 1) the ship not being seaworthy; and 2) breach of a safety regulation as defined

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[123] NMIP Version 2007 § 15-31 first subparagraph.

[124] Commentary Version 2007 to § 15-31.

[125] NMIP Verson 2007 § 15-32 and § 15-33.

[126] NMIP Verson 2007 § 15-34 first and third subparagraph, cf. Commentary to § 15-34.

in the Plan.[127] Thus, the concept of seaworthiness, which was linked to the previous Seaworthiness act, was a cornerstone of this regulation.[128]

As mentioned above in chapter 3, however, the new SSA does not employ the concept of unseaworthiness. Instead, the owner's duties with regard to the safety of the ship are defined through functional requirements connected to the technical and operative standard of the ship. The presumption is therefore that the (previous) concept of unseaworthiness equates to the ship's failure to fulfil these standards, which in turn presumes that a (functional) safety regulation has been breached. To conform to this change, the rule concerning unseaworthiness was deleted from the Plan, and the rules concerning safety regulation were adjusted in line with the SSA.[129] The concept of unseaworthiness has been changed to non-compliance with a technical and operational safety regulation.[130]

4.5 Compensation for unrepaired damage

Hull insurance is regulated in the NMIP part II. The rules for compensation for damage are contained in chapter 12. The starting point in relation to hull insurance for damage to the ship is that the insurer is liable for the costs of repairing the damage.[131] The previous versions of the NMIP contained a limited exception from the duty to repair in cases where the ownership of the ship had passed from the assured by sale, enforced auction, seizure or

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127 NMIP Version 2003 § 3-22 and § 3-25.

128 Commentary to NMIP 2003 § 3-22 cf. also Falkanger/Bull/Brataset pp. 493-495.

129 The provision concerning safety regulation is moved to § 3-22 and § 3-24 is left open.

130 Cf for instance NMIP Version 2007 § 3-23 and § 3-27 letter (a).

131 NMIP § 12-1 first subparagraph.

requisition. This right is now extended to a general right to obtain compensation for unrepaired damage.[132] The provision conforms to the English conditions.[133]

5 Maritime law cases

5.1 International public law – jurisdiction

Questions concerning jurisdiction, in particular the relationship between flag State jurisdiction and coastal State jurisdiction, have gained importance during recent years. The issue is closely related to international efforts to avoid pollution and contamination damage, cf. comments on the HNS Convention in subchapter 2.5 above. The question of coastal State jurisdiction was discussed in ND 2004.1 SSC concerning the right to impose a water pollution charge after an alleged spillage of oil from a foreign ship in the Swedish Exclusive Economic Zone (EEZ):

> The owner claimed that Sweden did not have jurisdiction to impose the charge and that jurisdiction in the EEZ primarily rested with the flag State. Coastal State jurisdiction presumed that the flag State had lost its jurisdiction and this could only occur pursuant to the provisions in UNCLOS art. 220, i.e., if the coastal State intervened when the ship was situated in the EEZ. Further, the charge represented a legal proceeding that could only be imposed according to the conditions in art. 220.6, which presumed that the spillage had been substantial. The court pointed out that the water pollution charge was an administrative charge that could be imposed whether or not the spillage was substantial and regardless of fault. Furthermore, the charge could be imposed on both Swedish and foreign ships. The charge had been introduced on the basis of MARPOL 1973/78 and in consideration of

[132] NMIP § 12-2 first subparagraph.

[133] Institute Time Clauses Hulls 01/10/83 and 1/11/95 clause 18.1, International Hull Clauses (01/11/03) clause 20.1.

the provisions in UNCLOS. The Swedish EEZ was established according to UNCLOS art. 55. According to UNCLOS art. 56, the coastal State has right and duty to implement measures to protect the marine environment in the EEZ. The court concluded that the claimant's allegations as to limitations on Swedish jurisdiction had no legal basis in the Act concerning measures against pollution from ships. The question was therefore whether the charge complied with international public law. Both the principles of interpretation and the water pollution Act implied that the Act should be interpreted according to international public law. Both UNCLOS art. 56 and art. 211.5, and the rules in MARPOL concerning spillage, implied that the coastal State had a right to prohibit pollution in its legislation. This did not necessarily mean, however, that the Swedish courts had jurisdictional competence in the matter. The court, however, did not agree with the claimant that a water pollution charge constituted "proceedings, including detention of the vessel" according to art. 220.6 ref art. 217.4. Neither could art. 228 giving the flag State priority prevent the coastal State from reacting to a spillage after the vessel had left the EEZ if such a reaction was possible. Thus the charge was upheld.

5.2 The carrier's liability for damage to cargo

5.2.1 The legal basis for liability

There have been several court decisions concerning claims for damage to cargo. The starting point in the MC is that the carrier is liable for any loss suffered because goods are lost, damaged or delayed while in his custody, whether on board or ashore, unless he proves that the loss did not arise out of his own actual fault or neglect or that of someone else for whom he is liable.[134] The traditional view that both the evaluation of negligence and the burden of proof is very strict has been confirmed by cases during this period:

[134] 1994 NMC and DMC § 275, SMC and FMC 1994 13:25, previous MC § 118.

In ND 2003.489 Nord Troms District Court, cargo was damaged by oil and anti-frost fluid during transportation to Svalbard. The owner claimed that the damage was caused by bad weather, whereas the cargo owner claimed that the cause of the damage was unsatisfactory stowage. The court held that the weather had been stormy with high seas, and had become worse than had been predicted in the weather forecast. On the other hand, the weather had not been any worse than could have been expected at that time of year. The carrier therefore had a duty to load and stow the goods in a secure manner to withstand the bad weather and secure the seaworthiness of the ship. The court held that the stowage had been faulty in several ways and that the carrier was liable. This result was in line with previous decisions concerning bad weather that was, however, no worse than what could be expected.[135] The main point is that the risk of damage was foreseeable for the carrier and thus the damage could have been avoided.

ND.2004.70 Åbo Court of Appeal, the *Linda,* concerned a cargo of steel being transported from a Finnish port to Bremen. The cargo was damaged by corrosion and the c.i.f. buyer claimed, i.a., that the sub-carrier, E, was liable under the previous MC. E claimed that the goods were damaged before delivery in the port and that E thus was not liable. The court held that the corrosion damage had occurred while the cargo was in E's custody, stating that the carrier, in order to free himself from liability, had to document how the damage had occurred and show that he was not to blame. Where the direct cause of the loss was known, the carrier could only be free of liability if he could prove that due diligence had been shown in relation to all possible underlying causes. E had neither been able to prove that the hatches had been tight enough to prevent leakage of saltwater when water flowed over

[135] ND 1994.94 Sø Ha *Dana Maxima*, unpublished decisions from the Danish Maritime Commercial Court 24 July 2002 *Maersk* and 3 March 2005 *Arroyofrio Dos*. Cf., on the other hand, ND 1993.268 *Kronprins Harald* (worse weather than could have been expected). Cf also ND 2004.95, referred to below in sub-chapter 5.3.1, where a train that had been shipped from Italy to Finland was damaged by "extremely hard weather" in the Bay of Biscay.

the deck nor demonstrated the use of air dryers to prevent corrosion damage. E was thus held liable.[136]

ND 2004.33 Gøteborg District Court concerned transport of a bulk-unloader from Sweden to the US. The loading of the unloader failed and the unloader was damaged. The carrier was unable to demonstrate that he was not at fault during the loading, cf. further below.

ND 2004.187 Danish Court of Appeal concerned temperature damage to frozen shrimps during storage in the (sub)-carrier's premises in the loading port in Greenland before carriage by vessel to Denmark. As the transport agreement contained no provisions concerning storage, the carrier's liability had to be evaluated according to the MC. The transport documents contained no requirements concerning the temperature, but it was accepted that the sender could expect the temperature to be maintained at minus 25 degrees. The temperature in the storage room was, according to the records, minus 22.3 degrees during the first three days of storage. The carrier was unable to document that he was not at fault in relation to the insufficiently low temperature and was therefore held liable. The decision was in line with another Danish case, but here it was agreed before the transport started that the temperature should be maintained at minus 25 degrees.[137]

One possible defence against liability for the carrier is that the shipper has failed in his duty either to deliver the cargo in such a condition that it can conveniently and safely be brought onboard[138] or to provide information about the cargo. This defence was adduced in ND 2004.33 Gøteborg District Court, as referred to above:

Carrier A claimed that the lifting measures were wrongly placed. The court, however, held that the lifting measures were described in the booking note and that the captain knew how to place them. A also

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[136] This case is similar to ND 1996.361 Sunnfjord District Court, the *Gelo,* in relation to liability for sea-water damage.

[137] Unpublished judgment from the Danish Maritime Commercial Court 11 June 2003, the *Kiliutaq*.

[138] 1994 SMC and FMC 13:5, NMC and DMC § 255.

> claimed that the shipper, B, had given erroneous information about the unloader's centre of gravity and weight, but the court held that the information provided had not been proved to be incorrect.

5.2.2 The use of FIO clauses

The starting point in the MC is that the carrier is also liable for fault on the part of people handling the cargo on behalf of the carrier.[139] In contracts concerning general cargo, a stowage company normally acts on behalf of the carrier, i.e., the carrier will be liable for faults in loading, discharging etc. However, in the case of charterparties, it is often agreed, through an FIO (free in and out) clause, that the charterer is to perform the loading and stowing of the cargo. Even if it is accepted that the carrier may use such a clause as a disclaimer of liability,[140] the carrier will still be liable for failures of supervision and care during loading.[141] This question was addressed in ND 2004.279 Oslo District Court:

> The case concerned a cargo of phosphate performed by a sub-carrier under a charterparty containing an FIOST (free in, out, stowed and trimmed) clause, i.e., these tasks were performed by a stowage company on behalf of the charterer, but under the supervision of the captain. During loading, the stowage company's loading grab touched and punctured one of the topside tanks of the ship. During ballasting some days later, water leaked through the hole and into the tank, damaging the cargo. It was agreed that this was the cause of the damage. The question thus was whether the captain had failed in his supervision of the loading or whether he should have detected the problem before the damage occurred. The court stated that, as a general rule, the captain's duty of supervision could not amount to

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[139] 1994 NMC and DMC § 275, SMC and FMC 1994 13:25.

[140] On the validity of such clauses in relation to the mandatory rules in the MC chapter 13 and the Hague-Visby rules, see Solvang: The doctrine of scope of service and mandatory legislation, Simply 2005 p. 71 et seq, Falkanger/Bull/Brautaset pp. 305-307.

[141] ND 1992.386 NSC *Garden,* Falkanger/Bull/Brautaset p. 306.

> more than a duty to maintain a general overview as to whether the loading was being performed in a diligent manner. The court held that the puncturing of the tank had not caused any sound or movement on board, that it could not have been observed from the deck, and that it had not been noticed by the stowage company. Thus the captain could not be blamed. The crew had performed their inspections in a manner that would normally be sufficient. There had been no indication that anything was wrong and they could not be blamed for not making the investigations that would have been necessary to detect the damage.

5.2.3 The calculation of damages – limitation of liability

According to the MC, damages for the loss of, or damage to, goods shall be calculated on the basis of the value of goods of the same kind at the place and time where the goods were, or should have been, delivered according to the contract of carriage.[142] The carrier's liability shall not exceed 667 SDR for each package or other unit of the goods or 2 SDR for each kilogram of the gross weight of the damaged goods.[143] When the damage concerns trailers connected to a truck, this raises the question whether only the weight of the damaged trailers should be taken into account, or if the weight of the truck should also be included. According to ND 2004.373 NSC, the *Lygra,* only the weight of the trailer is relevant:

> During a passage from Egersund in Norway to Denmark on the MS *Lygra*, one semitrailer hit another semitrailer. Both the trailers were condemned, but the two trucks were undamaged. The owner of the ship accepted liability, but claimed that only the weight of the trailers was relevant for the calculation of the limitation amount. The Supreme Court stated that the amount of liability was tied to the goods "damaged". In this case, only the trailers were damaged, not the trucks. The question was whether the trailers were an integral or an

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[142] 1994 NMC and DMC § 279 first subparagraph, SMC and FMC 13:29.

[143] 1994 NMC and DMC § 280 first subparagraph, SMC and FMC 13:30.

> independent part of the vehicle. The Court held that, because the truck could also be used in combination with other trailers and had its own economic value, it could not be seen as an integral part of the trailer. Consequently, the limitation amount should be calculated based solely on the weight of the two trailers.

5.2.4 Bills of lading

The carrier acknowledges through the bill of lading that certain goods have been received for carriage to a specified destination.[144] Among the information to be included in the bill of lading is the weight of the goods as stated by the shipper.[145] The carrier, on the other hand, has a duty to confirm the accuracy of the information in the bill of lading. The starting point is that the carrier has "a duty to inspect the goods to a reasonable extent". If the carrier has reasonable grounds for doubting the accuracy of the information, the carrier shall make a reservation to that effect in the bill of lading.[146] However, when goods are packed in containers by the shipper, the carrier has no duty, and normally no right, to inspect the contents. The carrier may therefore make a reservation by stating that the container "is said to contain". In relation to weight, it has been claimed that the carrier has no duty to weigh the container if he has no opportunity to check the weight.[147] This view was accepted by the Danish Supreme Court in ND 2004.166 DSC:

> A Danish buyer (D) bought 1.8 million floppy disks from a Philippino seller (F). The disks were packed in a 40-foot container by F, who also provided information in relation to the content and the weight of the

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[144] 1994 NMC and DMC § 292 first subparagraph no. 1, SMC and FMC 13:42 first subparagraph no. 1. Falkanger/Bull/Brautaset p. 309 cf p. 259.

[145] 1994 NMC and DMC § 296 first subparagraph no. 1, SMC and FMC 13:46 first subparagraph no. 1.

[146] 1994 NMC and DMC § 298, SMC and FMC 13:48.

[147] Falkanger/Bull/Brautaset p. 315, Auren: Containertransport, kontroll og ansvar, MarIus 1995 no. 212 p. 49.

> container. The container was transported from the Philippines to Hamburg by ship and by truck from Hamburg to Denmark. In the bill of lading, the container was stated to weigh 36,720 kg. The highest permitted weight for cargo carried in 40-foot containers is about 26,500 kg, implying a total weight of about 30,500 kg. When the vessel arrived in Denmark, the container only contained 431,900 floppy disks and the container weighed much less than was stated in the bill of lading. D argued that, even though the carrier had no general duty to weigh the container, he should have done so in this case, because the weight stated in the bill of lading was 10 tons higher than the permitted weight. If the carrier had checked the weight, he would have discovered the discrepancy and presumably the bill of lading would not have been clean and the letter of credit not effected. The carrier, on the other hand, argued that the reservation was valid, as there had been no possibility or permission to check the contents of the container and no reason to check the weight, as the excessive weight had had no significance as regards seaworthiness or the loading equipment. The Supreme Court held that it was common ground that the carrier had no duty to check the weight of a sealed container, and that it was up to the carrier to decide if the container should be weighed in connection with the transport. The purpose of any such control was not to detect fraud on the part of the seller.

On the other hand, if the carrier knew, or ought to have known, that the statement concerning the goods was incorrect, the carrier could not invoke the reservation unless the reservation expressly stated that the information was incorrect.[148] The question thus becomes what the carrier ought to discover. The argument that the carrier should have checked the weight because he had the opportunity or possibility to do so was not discussed in the Danish case. It has been argued in Norwegian legal theory that if the carrier has the equipment to check the weight, he has a duty to do so, and thus he is not allowed to take a general reservation that the container "is said to" weigh a number of kilos.[149] However, a

[148] 1994 NMC and DMC § 299 third subparagraph, SMC and FMC 13:49.

[149] Auren p. 50.

distinction should be made between the situation where the container is stowed and sealed by the seller, as in the Danish case, and that where the container is stowed by the carrier. In the latter case, it may be argued that the carrier should verify the weight before loading the container.[150]

The duty to investigate is stricter in relation to cargo that is not packed in containers. The main issue is whether the discrepancy between the information in the bill of lading and the actual condition of the goods should have been discovered by the carrier by means of such investigation as he could be expected to carry out.[151] Court practice demonstrates a very strict attitude in relation to this duty of investigation in order to protect the commercial value of the bill of lading.[152] The same is true with regard to the interpretation of an expressed reservation. The reservation must be formulated in such a way that the third party must understand that the bill of lading is not "clean".[153] These traditional and general starting points were referred to in ND.2004.70 Åbo Court of Appeal, the *Linda,* as referred to above in subchapter 2.1:

> According to the bill of lading, the cargo was "Loaded FM open storage, partly rusty, covered by snow. (Shipper's tally)". The question here was whether this represented a reservation in the bill of lading that would render the carrier free of liability for damage caused by rust that was due to the goods being covered by ice that melted. As the carrier had not made an express reservation that the goods were covered by ice that would melt and cause corrosion, even though he

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150 Cf. Berisford Metals v. S/S Salvador 1986 AMC 874 (2CCA) and Continental Distributing v. M/V Sea-Land Commitment 1992 AMC 1743 (SDNY 1992) in relation to US law, Auren p. 50.

151 Kungl. Maj:ts proposition no. 137 år 1973 p. 127 and p. 128, Selvig: Fra kjøps- og transportrettens grenseland, 1975, p. 148.

152 Selvig: Fra kjøps- og transportrettens grenseland p. 149.

153 Selvig: Fra kjøps- og transportrettens grenseland p. 147.

was aware of this, he could not be freed from liability by virtue of the reservation.

5.2.5 The content of a direct action claim against the sub-carrier

ND 2004.70 Åbo Court of Appeal, the *Linda*, also raised the question of the content of a direct action claim against the sub-carrier. This part of the case must be seen in conjunction with two previous Finnish cases about the identity of the party liable for damage to steel cargoes:[154]

> The bill of lading as defined above was issued by the master of the vessel the *Linda*. The *Linda* was on a time charter for "2 vessels of the SMARAGDEN TYPE". In the charterparty, both the owners of the *Linda*, L, and the shipowning company, E, were named as owners. The c.i.f. buyer argued that this also implied that both companies were liable under the bill of lading. The Court of Appeal held that E could not be sued under the bill of lading as E was neither the performing carrier nor the contractual carrier. The master on the *Linda* did not issue the bill of lading on behalf of E. The fact that the *Linda* was managed by E was irrelevant. The Supreme Court, on the other hand, while agreeing that the bill of lading was not issued on behalf of E, held E liable as performing carrier. The Supreme Court referred to the starting point in the MC that the performing carrier shall be responsible for his part of the carriage under the same rules that apply to the carrier.[155] The concept of "performing carrier" included both the sub-carrier, who actually performed the carriage, and an intermediate sub-carrier, who sub-contracted the carriage on to another sub-carrier who was the actual sub-carrier. The question thus was whether E's status was that of intermediate sub-carrier. This was answered in the affirmative because E had signed the charterparty. The court held that

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[154] ND 2000.169, the *Linda*, Åbo Court of Appeal reversed by the Finnish Supreme Court in ND 2003.83. The case is discussed in Selvig: Kommentarer 2002-2003, ND 2003 pp. x-xii and Røsæg: Maritime Cases from Scandinavia, pp. 307-308.

[155] 1994 NMC and DMC § 286, FMC and SMC 13:36, previous MC § 123 second subparagraph.

> the parties' respective roles as liable carriers according to the MC should not be divided. Nor was it decisive that L was the owner of the *Linda* and that the carriage was performed by L.

In ND 2004.70 Åbo Court of Appeal, the *Linda,* concerning E's liability for the steel damage, one of the issues was whether the c.i.f. buyer could claim against E pursuant to a guaranty clause in the charterparty stating: "The owners to be responsible for all damage to the cargo caused by leakage of seawater through the hatches":

> The charterparty was incorporated in the bill of lading by reference. The question was whether the c.i.f. buyer taking direct action against the performing carrier, E, was limited to claiming pursuant to the MC, or whether he could also claim under the guaranty clause. The court held that, in line with Scandinavian legal theory, the claim must be assessed from the performing carrier's point of view. This was because the receiver of the goods was sufficiently protected by his right to claim according to the liability system of the performing carrier. Furthermore, the better known and more generally used the contract conditions of the performing carrier are, the clearer it will be that these conditions, and not the conditions of the contracting carrier, shall be applied. It is not expressly stated, but the presumption here seems to be that the c.i.f. buyer could make a claim according to the guaranty clause as the owners of the *Linda*, L, were the actual performing carriers, and E was liable as performing carrier through the time charter containing the guaranty clause. However, the court found that it had not been established that the corrosion damage had in fact been caused by leakage of seawater through the hatches. The guaranty clause was therefore not applicable.

In relation to the conclusion that the c.i.f. buyer could invoke the guaranty clause, the court referred to previous Scandinavian legal theory.[156] The result is not problematic if the sub-carrier uses his contract as a defence against a claim based on a more favourable clause in the contract between the sender and the contracting

[156] Grönfors: Avtalsinnehållet vid talan direct mot undertransportör, i JT 1979 pp. 269 et seq.

carrier.[157] In such a case, the same solution follows from the provisions of the MC.[158] In the case at hand, the clause in the charterparty provided for strict liability for certain types of water damage, and was thus more favourable for the sender than the position under the MC. It might be argued that the sender (the c.i.f. buyer) should not be put in a better position by taking direct action against the sub-carrier than the position he would have been in when claiming against the carrier.[159] As the contract between the sender and the contracting carrier was not referred to in this case, it is not possible to know if the content of this contract was less favourable. On the other hand, the sub-carrier has no legitimate reason to refuse to cover damage under his contract with the contracting carrier. As E was held liable as sub-carrier because he had signed the charterparty, he was bound by the guaranty clause in relation to the contracting carrier.

5.3 Limitation of liability

5.3.1 The LLMC Convention – jurisdiction for establishing a limitation fund

As mentioned above in subchapter 2.2, the Scandinavian countries have incorporated the LLMC Convention into the MC chapter 9. In order to distribute the limitation amount between all claims arising out of the same maritime accident that are subject to the same limit

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[157] This was the case in Grönfors pp. 274-275, from where part of the argument was referred.

[158] Previous MC § 123 second subparagraph, 1994 NMC and DMC § 286 first and second subparagraph, FMC and SMC 13:36, first and second subparagraph.

[159] Vestergaard Pedersen: Direkte krav ved kontraktkæder. Unpublished manuscript.

on liability, the codes contain rules concerning limitation funds and limitation actions.[160] From the shipowner's point of view, the establishment of the limitation fund amounts almost to a kind of negative declaratory procedure that establishes the shipowner's right of limitation and the extent of any liability incurred.[161] However, there is no need for the shipowner to constitute such a fund before one or more of the injured parties have made a claim for damages. It is therefore only once an injured party has filed a claim, or applied for an arrest, or taken other enforcement measures in respect of a claim subject to limitation, that the shipowner is able to constitute a limitation fund.[162] Nor can the shipowner choose where to constitute the fund, as constituting the fund is a countermeasure by the shipowner that can only take place at a court where a claim has been brought against the shipowner.[163] One question here is how these rules conform to the international rules concerning international jurisdiction, *lis pendens* and the reciprocal recognition of judgments as regulated between the EU Member States in the Brussels Convention[164] and between the EU and EEA Member States in the Lugano Convention.[165] This question was raised in ND 2004.95 Åbo District Court, the *Triaden*:

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160 1994 NMC and DMC § 175 to § 180, SMC and FMC 9:5 to 9:10, Selvig pp. 4-5.

161 Selvig: The Lugano Convention and Limitation of Shipowners' Liability, Simply 2005 p. 5.

162 Selvig: The Lugano Convention and Limitation of Shipowners' Liability, pp. 5-6.

163 NMC § 177 first subparagraph cf. § 234, Selvig: The Lugano Convention and Limitation of Shipowners' Liability p. 6.

164 Brussels Convention 1968 as amended in EU Council Regulation (EC) No. 44/2001.

165 Lugano Convention 10. September 1988.

The case concerned the transportation of four train wagons and two locomotives from Italy to Finland performed by E as sub-sub-contractor on the *Triaden*. During the carriage, the *Triaden* was exposed to rough weather in the Bay of Biscay. Some containers became loose and crashed into the trains, which also became loose so that further damage was sustained. The *Triaden* had to go to Le Havre as port of refuge. The Italian sender of the trains arrested the ship as security for the cargo damage for an amount of EUR 14 million. To release the *Triaden*, the vessel's P&I insurers set up a limitation fund in France on 8 November 2001 pursuant to the 1976 LLMC Convention. The sender started proceedings in a French court on November 30 2001 claiming full compensation for the damage that had allegedly occurred due to gross negligence with the knowledge that damage might occur.

On 7 November 2001, E took legal action to obtain a declaratory judgment of his right to limit his potential liability for the damage to the cargo pursuant to the FMC and the 1976 LLMC Convention. The sender claimed that the plaintiff's petitions should be dismissed. The starting point in the Brussels Convention, articles 21 and 22, is that, where proceedings involving the same cause of action and between the same parties are brought in the courts of different Contracting States, any court other than the court first seized shall decline jurisdiction in favour of the latter court. However, these rules do not necessarily mean that the court where the claim is first brought will be the court that will decide the matter.

The court referred to the Brussels Convention art. 6 a, according to which a State that has jurisdiction in actions in relation to liability arising from the use or operation of a ship will also have jurisdiction over claims for the limitation of such liability. This implied that the court had jurisdiction over the limitation claim. However, the court thereafter referred to art. 57 of the Convention, stating that the convention is without effect in the case of other conventions "which in relation to particular matters, govern jurisdiction or the recognition or enforcement of judgments". As the LLMC Convention of 1976 contains rules on where and when a limitation fund may be constituted or proceedings concerning a right to limit liability started, the rules of the LLMC take precedence over the Brussels Convention. According to the LLMC Convention, a limitation fund may only be constituted if suit has been brought or arrest or other legal proceedings have been

> instituted.[166] The same holds if a claim for limitation is invoked without a fund being constituted.[167] As proceedings in relation to the cargo damage were not instituted in the District Court, the action to constitute a limitation fund was dismissed.

The court presumed that the Brussels Convention implied that the rules in the LLMC Convention 1976 would take precedence over its own rules. The relationship between the Brussels Convention § 57 and the LLMC Convention has been an issue in several Danish cases with varying results.[168] The matter has now, however, been resolved by the Danish Supreme Court,[169] which decided that art. 57 of the Brussels Convention did not apply to the LLMC Convention. This does not, however, mean that the result in the Finnish case is wrong. As mentioned above, the constitution of a limitation fund presumes that suit has been brought or arrest or other legal proceedings have been instituted in the same court. Thus, the LLMC 1976 and the MC bar constitution of such a fund at a Scandinavian court without suit have been brought previously claiming liability or to arrest of the ship.

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[166] 1994 NMC and DMC § 177, SMC and FMC 9:7, The LLMC Convention art 11.

[167] FMC 9:9. The court apparently held that this is the case also pursuant to the LLMC 1976. However, the LLMC art 11 only regulates this issue in relation to the limitation fund. According to art 10, limitation of liability may be invoked notwithstanding that a limitation fund has not been constituted without saying anything about the possibility of doing this as a negative declaratory judicial decision.

[168] Danish Maritime Commercial Court 5 April 2004, *Uno*, Western High Court 23 February 2005, Maritime Commercial Court 11 May 2005, cf. Selvig: The Lugano Convention, pp. 21-22.

[169] Danish Supreme court 17 October 2005, *Mærsk*, cf. Selvig: The Lugano Convention pp. 27-28 and p. 20, see also Fisknes: Lugano-konvensjonen og dens betydning i sjørettstvister, MarIus no. 182 (1991) pp. 102 et seq., in particular pp. 106-107.

5.3.2 Limitation of liability by a shipyard

Contrary to the position regarding the regulation of carriage of goods etc., there is no general rule in international conventions or the MC providing shipyards with a right to limit their liability. However, shipbuilding and repair contracts will often contain clauses limiting the liability of the yard.[170] The question is thus how far such a general limitation clause operates in relation to the degree of fault that may be limited and whose acts may be included within the limitation. This issue was discussed in ND 2003.500 Lofoten District Court, the *Lofottrål II*:

> *Lofottrål II* was damaged by fire while the ship was at a repair yard. The yard had limited its liability to NOK 5 million, whereas the damage was estimated at ca. NOK 9 million. The court referred to legal theory and court practice stating that limitation of liability would not be accepted if the damage had been caused by gross negligence, irrespective of whether it was the employer or employee who was guilty of such gross negligence. The court held that the fire resulted from the use of heat during welding, that the yard had neither adhered to statutory safety regulations nor their own safety procedures, because they had given other work priority, and that this was known both to the welder concerned and the welding foreman. Both were thus guilty of gross negligence and the yard was liable according to the rules on vicarious liability. The right to limit liability was set aside.

The court's reference to legal theory and court practice to presume the rule that liability may not be limited if the employee or his employer is guilty of gross negligence is somewhat problematic. There seems to be general agreement both in Norway and in the other Scandinavian countries that this is correct if it is the employer that is guilty of gross negligence.[171] If the gross negligence

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170 Falkanger/Bull/Brautaset pp. 97-99 and pp. 103-104.

171 Hagstrøm: Om grensene for ansvarsfraskrivelse, særlig i næringsforhold, TfR 4/96 421 flg, pp. 424 et seq. for Norwegian law and pp. 430 et seq. for the other Scandinavian countries, Krüger: Norsk Kontraktsrett, Bergen

is on the part of an employee, the legal position is not so clear.[172] Several court decisions have accepted that liability can be limited regardless of gross negligence by an employee that could not be identified by the employer,[173] and this view is also held in legal literature.[174] The difficult question is thus how to treat senior employees. This implies that the gross negligence of the welder is of no significance as far as the question of limitation is concerned. As for the welding foreman, it might be argued that his level of seniority is not high enough to have any bearing on limitation. On the other hand, as the yard had failed to fulfil both statutory safety requirements and its own safety procedures in a situation where there was a clear and obvious risk of fire resulting in substantial damage, it might be argued that the yard was guilty of gross negligence. If so, the result was correct.

5.4 Salvage

Salvage is regulated in the MC chapter 16. According to the MC,[175] the concept of "salvage" is defined as "any act the purpose of which is to render assistance to a ship or other object which has been

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1989, p. 784 with further references; Bull: Tredjemannsdekninger i forsikringsforhold, Oslo 1988 s. 394 and note 151 with further references.

172 Røsæg: Lastehåndterings- og forvaringstjenester, MarIus 2001 no. 271 p. 41.

173 Rt. 1994.626 Speditørdommen (gross negligence by a port inspector under a freight forwarding contract), ND 1989.225 Norwegian Arbitration, the *Giant 14*, ND 1991.180 Eidsivating Court of Appeal (gross negligence by a captain under a towing contract).

174 Kaasen: Petroleumskontrakter, Oslo 2006, p. 750, Bull op. cit.

175 1994 NMC and DMC § 441 letter (a), SMC and FMC 16:1. The rules are based on the Salvage Convention 1989, which came into force in 1996 and was incorporated in the MC the same year, cf. Falkanger/Bull/Brautaset p. 447.

wrecked or is in danger in any waters". A controversial issue in relation to this provision is the concept of "in danger". The concept raises two questions: 1) is the concept of "in danger" objective, i.e., should the danger to the ship be assessed according to an objective evaluation of the circumstances at the time the salvage was provided, or is the assessment subjective, meaning that the decisive issue is how the parties involved perceived the situation; and 2) if the assessment is subjective, is it is the assessment of the salved, or of the salvor, or both, that is decisive? This issue has been discussed in two previous cases that appeared to lead to somewhat different results, but the results have now been brought together in a new decision by the Norwegian Supreme Court:

> The first case[176] concerned the fishing vessel *Loran*, which, while returning to Norway after fishing in the Shetland Islands, suffered engine problems. There were strong winds at the time. The *Loran* requested assistance from another fishing vessel, the *V*. After a few hours, the *V* took the *Loran* under tow, with the towage later being taken over by a tug, the *M*. Subsequently, it was established that the *Loran* would have had sufficient engine capacity to make it to port without assistance. The *Loran* argued that the vessel had not been in danger and this was accepted by the Supreme Court (4-1). The majority found that the statutory language and the legislative history of the relevant provision in the MC supported a requirement for "actual danger" to be present. This solution was also supported by commentaries in the legal literature, although the particular facts of the case were not commented upon in Scandinavian texts. The question had, however, been touched upon in a foreign legal text. The minority, on the other hand, found no similar support in the statutory language or the preparatory documents. Despite the statements in the legislative

[176] ND 1996.238 NSC *Loran*, discussed in Røsæg: Misaprehension of peril in salvage, SIMPLY 2004, pp. 35-36, Falkanger/Bull/Brautaset: p. 451, Selvig: Kommentarer 1996-97, ND 1997 pp. v-vi. This case is based on the previous 1893 MC § 224, which for the purpose of this issue, is identical to the 1994 NMC § 441. The 1893 MC § 224 was based on the Brussels Convention on Salvage from 1910.

history, the minority considered that the danger should be evaluated as it appeared at the time assistance was requested. Policy considerations suggested that one should give weight to the information available at the time to the masters of the vessels involved. They had no alternative but to take decisions based on their knowledge at the time, and it would cause uncertainty if either of the masters should subsequently be allowed to clarify or correct the assessment of the circumstances prevailing at the start of the salvage operation.

The second case[177] concerned the pilot boat *Los 102*, which, while bringing the pilot out to sea, lost some power with the rudder becoming locked in a starboard position. Shortly afterwards, the *Los 102* lost all power, but the power was partly restored after half an hour. The rudder was still locked. A passing vessel, *A*, connected a towline, which broke after a further half hour. The rescue vessel *AW* had by then arrived and took over on the basis of an express agreement. It was later established that it would have been possible to manoeuvre the *Los 102* at fairly good speed, even with the rudder locked. A unanimous Supreme Court held that the *Los 102* had been in danger. The court referred to the *Loran*, and agreed that the question of whether there was danger should be determined objectively. However, this objective evaluation should be based on the situation as it appeared at the time of salvage. This implied firstly that there could be a salvage situation even though a risk existing at the time when assistance was requested did not materialise subsequently. Secondly, the question of whether the criterion of objective danger was fulfilled should be evaluated based on the competence and skill of the crew on board. The evaluation of the evidence must take into account how the crew on board and the crew on the salving vessel actually evaluated the situation. Decisive to the evaluation of the danger was therefore how the involved parties on both vessels perceived the situation on the spot. On this basis, the Supreme Court assumed that the crew on board *Los 102* did not manage to get sufficient control over the vessel when the power was only partially restored, while the vessel at the same time was located in an exposed area. It was most probable that, under the prevailing

[177] ND 1999.269 NSC LOS 102, cf. Falkanger/Bull/Brautaset pp. 451- 452, Selvig: Kommentarer 1998-99, ND 1999 p xxvi-xxvii, Røsæg: Misaprehension of peril, pp. 36-38. This case also is based on the 1894 MC.

> circumstances, the pilot boat was exposed to a risk of damage that was sufficiently high to be covered by the MC's criterion of danger.

It has been discussed in legal literature to what extent the *Los 102* departs from the *Loran*.[178] It may also be argued that, in the *Los 102,* a salvage contract was actually entered into, and that the assisted vessel therefore could not afterwards claim that the ship was not in danger anyway.[179] However, in the third case, the two earlier judgments seem to be brought together:

> The *Norsk Viking*[180] suffered engine problems near the Norwegian coast and called for assistance from the passing tanker *Senja* (the *S*). The *Norsk Viking* was towed by the *S* for two hours and 45 minutes while engine problems were repaired on board the *Norsk Viking*. A salvage agreement was not made. The Supreme Court referred to the *Loran* and *Los 102* cases and agreed that the presence of danger should be evaluated objectively, further stating that the *Los 102* presented an extension of the legal starting point as defined in the *Loran* with regard to the evaluation of whether or not the danger was proved. The *Loran* was thus not contrary to this starting point. In the particular case, the Supreme Court held that the crew on the *Norsk Viking* did not consider that they were in actual danger. The *Norsk Viking* discovered a leakage when sailing in narrow waters. There was a strong wind and the *Norsk Viking* was situated approx. 2.5 nm from the coast with an expected sailing time of 15 minutes to the coast. However, the source of the leakage was found before the *S* arrived at the scene. Even if the *Norsk Viking* had been close to land at the time,

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[178] Falkanger/Bull/ Brautaset p. 452 considers the *Los 102* judgment as a rejection of the majority view in the *Loran* judgment. Selvig: Kommentarer 1998-99, ND 1999 pp. xxvi-xviii states that the *Los 102* judgment takes a more nuanced approach than the *Loran* judgment. Røsæg: Misaprehension of peril, p. 38 argues that the *Los 102* reaffirms the majority view in the *Loran* that a belief that danger exists does not suffice and that only real danger as evidenced by the evaluations and actions taken by the crew on the assisted vessel is relevant.

[179] Røsæg: Misapprehension of peril p. 37 cf. pp. 12-16.

[180] ND 2001.556 Haugesund District Court, reversed on appeal ND 2004.378 Gulating, cf. the Supreme Court cited in Rt 2004.1909/ND 2004.383.

> the Supreme Court found it was obvious that the *Norsk Viking* could, if necessary, have started the main engine and reduced the leakage with the use of a filter. In this respect, the case departed from the *Los 102* and could be compared to the *Loran*. Even if the crew on the *S* considered the situation to be dramatic, the criterion of objective danger was not fulfilled.

The *Norsk Viking* seems to establish that the concept of danger must be interpreted objectively, but that the assessment of the crew is relevant as evidence of whether there was an objective danger. If the crew on the salvaged vessel and the crew on the salving vessel disagree, the opinion of the crew of the salvaged vessel is decisive. This result has been criticised in the literature. In particular, it has been claimed that policy considerations suggest that a salvor who believes the vessel to be in peril should be protected,[181] as a master who requests salvage has the possibility and a cause to clarify the situation, whereas the salvor will often have no such possibility,[182] that the requirement for the existence of an objective peril could open the door for abuse by the owner of the assisted peril,[183] that such a requirement is difficult to reconcile with the principle of the duty to assist[184] and may lead to the making of difficult borderline evaluations.[185] However, the result seems to conform to the position in English law.[186]

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181 Falkanger/Bull/Brautaset p. 452, Røsæg: Misapprehension of peril, p. 24 and pp. 17-18.

182 Røsæg: Misapprehension of peril, pp. 24-25.

183 Røsæg: Misapprehension of peril, pp. 25-26.

184 Røsæg: Misapprehension of peril, pp. 26-27.

185 Falkanger/Bull/Brautaset p. 452

186 The *Hamtun* and the *St John* [1999] 1 Lloyds Rep 1883, [1999] QB, Røsæg: Misapprehension of peril, pp. 34-35. The US and German courts have chosen a subjective approach, cf. Røsæg pp. 30-31 and p. 40.

5.5 Maritime liens

The regulation of maritime liens has three important characteristics: 1) protection against third parties without the need for registration; 2) priority ahead of all other encumbrances; and 3) a short limitation period.[187] The limitation period is, as a starting point, “one year from the day when the claim in question arose”.[188] Two decisions from the Appeal Committee of the Supreme Court in Norway concern this rule:

> In ND 2004.275, a captain had been fired and was claiming compensation and satisfaction for wrongful dismissal. Shortly afterwards, his employer was declared bankrupt. The captain tried to obtain a maritime lien in a ship regarding payment of his claim. The question was at what point in time the captain’s claim was established. The Court stated that time ran from the time of the dismissal, and that there could not be a requirement that there had to be a legally binding judgment in favour of the claim before the period started to run.
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> Rt 2004.1423 concerned the time-barring of a maritime lien for a tax claim according to the Tax Payment Law (TPL). The 1994 NMC § 51 does not mention tax claims according to the TPL as a claim that can be secured by a maritime lien but, according to case law, a maritime lien for wages and other sums due to the crew include the part of the

[187] Falkanger/Bull/Brautaset p. 119. The rules are contained in the 1994 NMC and DMC § 51 et seq and the SMC and FMC 3:36 et seq. The rules are based on the Brussel Convention 1967 on maritime liens and mortgages. In 1993 a new International Convention on Maritime Liens and Mortgages was approved, but this is not yet ratified by Norway.

[188] 1994 NMC and DMC § 55 first subparagraph and SMC and FMC 3:40.

amount that shall be deducted to pay tax according to the TPL. The court remarked that the maritime lien for the tax deductions is deducted from the seamen's claim for wages and other compensation for services on board the ship, and that such a claim is made when compensation is due and the employer has a duty to deduct the tax.

Part II
Shipbuilding contracts between Norwegian buyers and Korean builders

Subcontracting

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1 Introduction

1.1 Main purpose of this article

This article is intended to serve as a nautical chart for Norwegian buyers and Korean builders when they set sail on the unclear and risky waters (in the form of a shipbuilding contract) between Norway and Korea. The chart will not cover all dangerous areas and give all the necessary warnings, as I do not have sufficient pages to display the whole ocean that is a shipbuilding contract. I will therefore restrict myself to comparing and analysing the most significant 'Subcontracting' clauses in different standard forms under English law. The word-by-word comparative analysis will enable readers to understand the underlying commercial intention and technical meaning of these clauses, to enable them better to predict the legal consequences of these clauses when they are drafting contracts under English law.

1.2 The shipbuilding market

Korea is the world's largest shipbuilding nation and Korean shipbuilders are expected to lead the global market for the next decade. There are just under 80 shipbuilders in Korea, but nine major shipbuilders, who are members of the Korea Shipbuilders' Association (KOSHIPA), account for most of the shipbuilding orders. Seven of these are among the world's top 10 shipbuilders.[1] These giants have threatened the shipbuilding industries of other shipbuilding nations, especially in Europe. The EU has accused

[1] The main players are Hyundai Heavy Industries (HHI), Samsung Heavy Industries (SHI), Daewoo Shipbuilding & Marine Engineering (DSME) and Hanjin Heavy Industries & Construction (HHIC).

Korea of threatening the future of Europe's shipbuilding industry by giving unfair subsidies to Korean shipbuilders and has consequently taken action against Korea as described below.

In 1999, the European Commission reported to the Council on the situation in world shipbuilding. The report showed that European yards were in crisis, trapped in a downward price spiral, due in large part to excess capacity in Korea.[2] This report provoked the European Commission to issue a proposal for a Council Decision on the signing and conclusion of an International Agreement between the European Communities and Korea.[3] Eventually, the European Communities took Korea to the WTO in 2002, claiming that Korean shipbuilders had received subsidies in the wake of the Asian financial crisis of 1997.[4] Moreover, the EU introduced the Temporary Defensive Mechanism for Shipbuilding (the "TDM Regulation"),[5] which prevented Korean builders from selling vessels in the European market.

The Norwegian shipbuilding industry has also declined dramatically, having been in crisis since 1998 because of increased competition from Asia. However, it has survived by shifting production towards the national offshore oil and gas industry and ship equipment manufacturing. Norway has now become one of the leading manufacturers of ship's gear in the world. As Korea is a major market for Norwegian suppliers of ship's gear and related services, good prospects for Korean shipyards are good news for

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2 See Com/1999/474, 13 October 1999.

3 See Com/2000/263, 3 May 2000 and Com/2000/0130, 26 May 2000.

4 See WTO dispute DS273, Panel Report WT/DS273/R (Ruling against European Communities).

5 Set forth in Council Regulation (EC) No 1177/2002, and modified in product coverage and duration by Notice 2003/C 148/10 published on 25 June 2003 and Council Regulation (EC) No 502/2004 of March 2004, respectively.

the Norwegian supply industry. Trade and investments between Norway and Korea have grown significantly over the past 10 years in the maritime sector and today Korea is one of Norway's major trade partners in Asia.

Norway has one of the world's largest commercial shipping fleets,[6] so Norwegian shipowners are a major target for Korean shipbuilders. In fact, Norwegian shipowners have many of their ships built at Korean shipyards, including large oil tankers, container ships, combination carriers and ro-ro ships. Korean builders eager to take more shipbuilding orders have focused on building high-tech and high-added-value vessels, e.g., liquefied natural gas (LNG) carriers, liquefied petroleum/chemical gas (LPG) carriers and passenger ships. Since the Norwegian petroleum sector is a major national industry and the cruise business is well established and developed, the number of shipbuilding contracts between Korea and Norway is likely to rise steadily. Moreover, soaring demand for LNG, driven by rising gas consumption and higher crude oil prices, will boost the number of shipbuilding contracts between Korea and Norway.

In short, the shipbuilding market itself clearly indicates why it is worth looking closely at shipbuilding contracts between Norwegian buyers and Korean builders.

1.3 Shipbuilding projects

A shipbuilding project may be a risky joint venture that takes place over a lengthy period.[7] Apart from the builder and the buyer, many

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6 23% of the world's cruise vessels, 19% of the world's gas carriers, 19% of the world's chemical tankers, 10.5% of the world's crude oil tankers <www.randburg.com/no/norship.html>.

7 Cf. Simon Curtis, The Law of Shipbuilding Contracts, Third edition, 2002, p 7.

other parties[8] will be involved in the project. The success of the project in the long run will depend on the buyer's and the builder's endeavours, professionalism and trust, as well as the efforts and expertise of other interested parties.

There are three stages to a shipbuilding project. The first is the 'pre-contract stage', during which the parties negotiate in advance of drafting a final contract. Next, during the 'contracting stage', the parties draft a final contract and sign it. Finally, the 'post-contract stage' is the period during which the contract is performed.

In the first stage, the buyer and builder must carry out lengthy and detailed negotiations before drafting a final contract to establish the commercial, legal and technical basis of the project. They will usually take into account various factors[9] to reach agreement on the substance of the contract, including the ship's specifications. During these negotiations, several agreements or statements[10] will be exchanged between the parties. In most international shipbuilding projects, these primary agreements will not be binding. Both parties are therefore likely to believe that they will not be bound until the final contract is signed. However, this presumption does not always hold true and can leave the parties seriously exposed. There are many legal mechanisms and techniques that may make preliminary agreements binding. Whether or not the agreements are binding will depend on the governing law, because the interpretation and legal effect of terms in the agreements may be different in different jurisdictions. It is therefore important for

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8 E.g. public authorities, class, insurance company, financial institutions, perhaps charterers and brokers.

9 E.g. the parties' previous relationship, expertise, financial strength and market situation.

10 E.g. Invitation to tender, letter of intent, bridge contract, cf. op cit, Curtis, fn 7, pp 7~13.

both parties to be aware of the law governing the legal effect of any agreements entered into during negotiations.

Once the negotiations have essentially been completed, the parties will move on to the second stage, meeting to finalise all the necessary details and to draft the final binding contract and specification. When drafting the contract, the parties will usually choose a standard contract form as their starting point. If they have concluded shipbuilding deals in the past, the previous contract is likely to serve as a template. If not, the builder will usually insist on using his own standard form, while the buyer will want to use his. The choice of form is likely to be influenced by the builder's identity and domicile[11] and a variety of other factors.[12] After choosing a form, both parties will start to amend it and incorporate terms and conditions. The builder will use a blue pen, which is a builder-friendly colour, and buyer will use a red pen, which is a buyer-friendly colour, to amend the contract. As a result, the document becomes very colourful and complex. When the colours of blue and red are mixed, metaphorically speaking, this creates a violet colour, which the parties may never have intended or expected. If the 'violet-coloured' matter becomes the subject of litigation, the judge or arbitrator(s) will look at it through their own coloured lenses (which will generally take the form of English law[13]) and small changes and additions to the wordings may have strikingly unexpected results. Therefore, it is necessary to compare and analyse the terms and conditions of the different standard contract forms (e.g., the Norwegian standard form 2000, and the

[11] Cf. op cit, Curtis, fn 7, p 13.

[12] E.g. demand and competition in the market, parties' powers of persuasion, parties' expertise in the market.

[13] Most Norwegian buyers and Korean builders choose English law as the governing law.

HHI, SHI, DSME and HHIC forms[14]) under English law, in order to increase the predictability of the legal effect of the contract, to which both parties will have added their own favourite colours (i.e., their own standard forms).

The third and final stage is the performance of the contract, i.e., the construction and delivery of the ship. Construction usually takes at least a year and the parties will need to deal with post-contractual changes due to new requirements from the authorities and class and fluctuations in the market. If the signed contract regulates these changes in a 'modification clause' and a 'contract price adjustment clause', there will be no need to make a new agreement. However, if the contract is silent, the parties will have to make a new agreement or amend the contract to cope with the changes. Both parties should carefully contemplate the validity of any such new agreement and the legal effect of it under English law.

2 An introduction to subcontracting in Korea

Subcontracts are of particular importance today in international business, especially in the shipbuilding sector. A shipbuilding project is a construction project that involves the building of a vessel over a lengthy period. The builder will not be able to carry out all of his contractual obligations himself and will usually have to rely on the specialised technological skills of other undertakings. A combination of economies of scale and specialised technological knowledge will often mean that certain parts of the construction process can be performed more cost-effectively by specialised undertakings. The builder will therefore usually enter into subcontracts, assigning his obligations to several (usually, but not necessarily, small)

[14] See fn 1.

subcontractors. In fact, most of the supplies and work will be undertaken by many other parties (subcontractors).

In practice, the builder may want to subcontract freely without the buyer's intervention, while the buyer may want to intervene to ensure that the subcontractor's level of workmanship is satisfactory. If the builder has to obtain the buyer's prior approval before subcontracting every single component, part and piece of contractual work, delays may be incurred. On the other hand, if the builder is able to subcontract any part of the construction work on the vessel without the buyer's consent, it will be very difficult for the buyer to ensure that the quality of the work is satisfactory. Sometimes the buyer may want to use a particular, specialised subcontractor, while the builder may be unwilling to employ such a subcontractor. It is also common for the buyer to be more concerned about the quality or standard of the subcontractors' work, while the builder is normally more concerned about the cost. In short, when it comes to subcontracting, the parties' interests may conflict. This makes the issue of subcontracting very sensitive and it is the potential cause of a lot of disputes between the buyer and the builder, as well as with the subcontractors.

The main shipbuilding contract ought, therefore, to have a clear and detailed subcontracting clause, covering a variety of potential problems with due regard to the underlying commercial, technical and legal context, as well subcontracting practice in shipbuilding projects.

In particular, when a Norwegian buyer drafts the subcontracting clause in a contract with a Korean builder, he must be careful to consider the unique subcontracting system in Korea.[15] The Korean

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[15] "99.7% of Korean enterprises are of small and medium sizes and 72.8% of these small and medium size enterprises depend on subcontracts for business. It means that the industry structure of Korea is rooted in

shipbuilding industry is sustained by subcontractors who undertake most of the actual shipbuilding work. Furthermore, a number of Korean shipbuilders carry out major parts of the construction work in their wholly owned subsidiary shipyards in China. This makes it necessary for a Norwegian buyer to understand (i) the subcontracting system in Korea and (ii) the relationship between the Korean builders and their subsidiary companies in China.

2.1 The subcontracting system in Korea

The major Korean export industries, of which shipbuilding is one, are based on assembly-line production. Parts and components produced by subcontractors are crucial for their competitiveness. Subcontractors are therefore likely to play a vital role in determining Korea's industrial competitiveness and this led the Korean government to enact the SMEs[16] Subcontracting Promotion Act in 1975 to promote the subcontracting business. In this Act, the government designated certain types of subcontracting and encouraged the major builders to subcontract out the itemised types of production to SMEs. But the major builders were able easily to abuse their dominant market position, since the subcontractors were in a weak bargaining position. The government consequently enacted the Fair Subcontracting Transactions Act in 1985 to restrict the unfair trade practices of the major builders, thereby facilitating the development of subcontracting. In this Act, Article 3.2 provides that the Fair Trade Commission can recommend the use of the 'shipbuilding-related standard subcontracting form'[17]

subcontract businesses." See the annual report in OECD "Korea: Competition Law and Policy in 2001-2002" p 24.

16 Small- and Medium-scale Enterprises.

17 Shipbuilding-related standard subcontracting form <Amended on 18th of November, 2002>.

when the builder enters into a contract with a subcontractor. According to Article 1.2 of this form, the Fair Subcontracting Act and the Monopoly Regulation and Fair Trade Act will govern the subcontracting and both parties shall observe the Acts. The Fair Subcontracting Act states in Article 25 that the subcontractors can complain directly about unfair trade practices to the Fair Trade Commission, which will then request the Subcontracting Arbitration Council within the Korean Federation of Small Businesses to arbitrate. Apart from these Acts, there have been many government measures and policies designed to protect subcontractors from the major builders.[18] Some take the form of overriding mandatory rules that will always apply to the relationship between the builder and the subcontractor regardless of the governing law of the subcontract and the main shipbuilding contract. If the subcontracting involves unfair trading practices, Korean subcontractors may be protected by the above-mentioned safeguards irrespective of the claimant. Norwegian buyers are therefore recommended to ensure that the builder remains liable in full for work undertaken by Korean subcontractors.

Norwegian buyers may ignore the above-mentioned recommendation, relying instead on the general principle that, if the builder employs a subcontractor, the builder will normally remain liable in full for the performance of work he has delegated. However, if the buyer wishes to employ a particular supplier, the builder will no doubt wish to make it clear that his own warranty does not extend to such items. If the builder does not wish to take

[18] This paragraph is summarised and extracted from “Development of Industrial Subcontracting in Korea” written by Chuk-Kyo, Kim and Jong-Wook, Won, 1995.

on full responsibility or give a full warranty for such an item,[19] the buyer will be obliged either to negotiate with the subcontractor, in order to obtain a direct contractual warranty in respect of the item in question, or to require the builder to agree to assign to him the benefit of any subcontractor's warranty issued in the builder's favour.

In such a case, under the UK's Contracts (Rights of Third Parties) Act 1999, the buyer may, in certain circumstances, be entitled to enforce the subcontractual warranty provisions directly against the subcontractor. "Such rights arise (in the absence of agreement to the contrary) where either (i) the subcontract expressly provides that the buyer may exercise such rights or (ii) the builder and his subcontractor have intended by their subcontract to confer an entitlement upon the buyer to do so."[20]

However, even though a Norwegian buyer may have obtained a direct contractual warranty from the subcontractor, or ensured that this can effectively be assigned to him by the Korean builder under English law, it is still very risky for him to allow the Korean builder to step out of his own warranty or responsibility toward the subcontracted items in question. For example, if the buyer claims against the engine manufacturer (subcontractor) because there are severe engine vibrations on board a passenger ship, and if the subcontractor argues that the cause of the vibrations is not a defective engine but the builder's poor workmanship in installing it, it will be very difficult for the buyer to prove the actual cause of the vibrations. In such circumstances, the buyer may have to bring claims against both the subcontractor and the builder. Two parallel

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19 This practice is very common in the context of major subcontracted items (e.g., the main or auxiliary engine) or where the completion of the vessel gives rise to technical risks which the builder is not prepared to accept.

20 S. 1(5) of the Contracts (Rights of Third Parties) Act 1999.

disputes concerning the same defect may thus arise if each contract contains a different 'choice of forum' clause or, if the contracts are silent on this, due to forum shopping.

It is possible that one arbitral tribunal may conclude that the engine is not defective and find in favour of the subcontractor, while another arbitral tribunal, in the dispute between the buyer and the builder, may find that the builder installed the engine with due care and find in favour of the builder. As a result, the buyer will not get any compensation for the severe engine vibrations.

Consequently, for a Norwegian buyer, the best way to manage the risk of sub-/non-performance by Korean subcontractors is to insist that the builder remains liable in full.

2.2 The Korean builders' wholly owned subsidiary companies in China

The major Korean shipbuilders, such as HHI, SHI, HHIC and DSME, have wholly owned subsidiary shipyards in China. Korean builders still hesitate to use subcontractors in China other than their wholly owned subsidiaries because of difficulties in controlling work carried out by non-subsidiary companies. Korean builders have wholly owned subsidiary shipyards in China mainly in order to use cheap Chinese labour for the steel work, e.g., construction of the hull and the superstructure. Korean builders will therefore want to transfer, as far as possible, the construction of the hull and superstructure to their shipyard in China. It will be very important for a Norwegian buyer to ensure that any additional costs (such as, but not limited to, travelling expenses or accommodation costs) in respect of supervising the construction of the hull and superstructure of the vessel in China will be borne by the Korean builder.

2.3 Main issues for discussion

Bearing in mind the unique features of Korean builders, as mentioned above, the following chapters will explore various issues in greater depth to answer the following questions: 'What is subcontracting?' (Chapter 3); 'To what extent is subcontracting permitted?' (Chapter 4); 'To what extent is the builder responsible for the performance of the subcontractor?' (Chapter 5); and 'To what extent is the builder protected in particular by the *force majeure* clause against delay or non-performance by the subcontractors?' (Chapter 6). The answers to these questions will vary greatly depending on the different terms and conditions in different shipbuilding contracts.

3 What is subcontracting?

It is important to define subcontracting because, if the builder does not subcontract, i.e., all the contractual works are undertaken by the builder himself, only the ordinary rules (i.e., all the clauses in the shipbuilding contract other than the 'subcontracting clause') will apply. If, however, the contractual works are carried out pursuant to a subcontract between the builder and the subcontractor, the special rules contained in the 'subcontracting clause' will apply. In short, there are two regimes: (i) governing "ordinary" builder's performance; and (ii) a special regime that applies to subcontracting.

Unfortunately, there is no precise definition of subcontracting. However, it will suffice for the purpose of this study to define a subcontractor as a person/entity entrusted by the builder with the performance of his contractual obligations under his contract with the buyer. The term 'subcontractor' has to be defined from the contractual relationships existing between the subcontractor, the builder and the buyer.

3.1 Definition of subcontracting in different standard forms

As the definition of subcontracting varies between different standard forms, we need to understand it in the context of each form. For example, the Norwegian standard form contains a definition of a subcontractor[21] and the subcontracting clause applies as far as works are performed by a subcontractor as defined in Article I. The builder should therefore notify the buyer in writing in ample time before ordering such work, while such prior approval is not required for work performed by non-subcontractors.

The Korean builders' standard forms do not contain a specific definition of a subcontractor, unlike the Norwegian form. This means that we have to infer the definition from the terms in the subcontracting clause.

The SHI form states: "The builder may subcontract any portion of the construction work of the vessel to a subcontractor…". This implies that the work provided by the subcontractor must come within the scope of the construction work if it is to constitute subcontracting for the purpose of this clause. We find the same sentence in the subcontracting clause in the Norwegian standard form, yet the scope of the work is not confined to construction work if we interpret the sentence together with the definition of subcontractor in Article I. This includes a reference to a 'contract for the design, manufacture and supply', which the SHI form does not contain.

[21] Article I 'Definitions' in the Norwegian standard form shipbuilding contract 2000: any person (not being a servant or employee of the Builder) or company, with whom the Builder has entered into a contract for the design, construction, manufacture or supply of any item, equipment, work or service for the Vessel.

The SHI form specifies that "an 'external subcontractor' shall for the purpose of this Article I.4 be any subcontractor who carries out any substantial part of the subcontracted work outside the Shipyard." This implies that an internal subcontractor will be any subcontractor who carries out the subcontracted work inside the shipyard. For example, if a subcontractor carries out the subcontracted work inside the shipyard, he will be an internal subcontractor, even though the same subcontractor will be an external subcontractor when he carries out subcontracted work outside the shipyard. The SHI form thus refines the definition of subcontracting by distinguishing between 'external' and 'internal' subcontractors according to geographical location. Different conditions apply to these two types of subcontractor. An external subcontractor must be approved in advance by the buyer in writing, while subcontracting work may be carried out by an internal subcontractor without the buyer's approval.

The DSME form establishes a straightforward criterion to clarify the relationship between the builder and his subsidiary in Korea by stating: "The performance of works by subsidiaries of the builder in Korea does not constitute subcontracting…". According to the DSME form, subsidiaries in Korea do not need to be wholly owned in order to lose their subcontracting status and be considered totally integrated with the builder. In contrast, the relationship between DSME and its wholly owned subsidiary 'DSME WEIHAI Co. Ltd.' in China is one of subcontracting.

The HHIC form does not contain a subcontracting clause, so it is impossible to infer a definition of subcontracting. In this case, the definition stated in Article 2.1 of the Korean Fair Subcontracting

Transactions Act 1984[22] may apply, since there is no statutory definition of subcontracting in English or Norwegian law.

4 To what extent is subcontracting permitted?

The extent to which subcontracting is permitted will be the subject of individual agreement. Such agreement may be reached on formation of the contract or later by amendments to the contract, either expressly or by implication. In theory, the parties can agree on anything from complete prohibition (the builder may not engage any subcontractors at all) to full permission (the builder can engage any subcontractors for any task or portion of the construction at his discretion). In normal shipbuilding practice, the buyer will not usually be concerned about minor items of contractual work and, as it will be impossible for the builder to carry out the entire project himself, the parties, as a rule, will not agree on a complete prohibition of subcontracting. Neither will they agree on complete freedom to subcontract, as the buyer will want to ensure full compliance with the quality standards stipulated in the contract, at least in relation to substantial elements of the construction work, by requiring the builder to obtain the buyer's prior approval when delegating the contractual work. In short, the extent to which subcontracting is permitted will vary somewhere between complete prohibition and full permission, depending on the terms of the

[22] Subcontracting is when a principal entrusts work involving manufacture (including process), repair, construction or service to a subcontractor, and is when a principal delegates to a subcontractor work involving manufacture, repair, construction or service delegated to the principal by another principal. The subcontractor manufactures, repairs, constructs or services the contractual work and delivers, supplies or provides such work to the principal and receives the contractual price from the principal.

particular subcontracting clauses in the different standard forms. However, what is the situation if the shipbuilding contract does not contain a subcontracting clause, as in the case of the HHIC form? Does silence mean that the builder has complete freedom to subcontract or that he is not allowed to subcontract at all? Alternatively, to what extent is subcontracting permitted? Does the builder need the buyer's permission? Are there any laws or commercial/customary practices that can be applied to fill the gap?

We will attempt to find the answer to these questions in relation to the HHIC form in section 4.1 below. While answering these questions, we will discuss the law and principles that apply in the absence of a subcontracting clause under English law. These general laws and principles will guide us when we try to find answers concerning the scope of permissibility of subcontracting under different standard forms, i.e., the HHI, SHI, and DSME forms and the Norwegian standard form, in section 4.2 below.

4.1 The HHIC form – silent on subcontracting

First of all, we have to find out what legislation and legal principles may apply with respect to subcontracting when a contract is silent on the subject. Together with the other terms and clauses of the HHIC form, such legislation and principles should enable us to establish the extent to which subcontracting is permitted.

As already mentioned, this study is based on English law and this seems an appropriate point to discuss why English law is important in this context. Disputes concerning shipbuilding projects are often very complex and their settlement requires a deep knowledge of shipbuilding techniques. The parties will therefore prefer the dispute to be heard by an arbitrator who is familiar with the technical, financial and legal problems encountered in such shipbuilding projects, rather than by a judge who has less expertise. As a result, almost every standard shipbuilding contract contains an

arbitration clause.[23] Many arbitration clauses stipulate London as the arbitral forum[24] and English law as the governing law.[25] When a Norwegian buyer and a Korean builder have to choose a governing law, usually neither of the parties will want to choose the other party's national law because of fears that the other party will gain an advantage through superior knowledge of his own legal system. Both parties will therefore normally choose English law, which is both neutral and the pre-eminent law for resolving disputes concerning international shipbuilding contracts.

Article XIV of the HHIC form, 'Disputes and Arbitration', in clause two clearly states that disputes "…shall be resolved by arbitration in London…", while Article XX, 'Laws Applicable', states in paragraph one that the contract "…shall be governed by the laws of England." We must first therefore try to identify the applicable legislation and principles in English law.

4.1.1 Applicable legislation and principles in English law

Historically, in England, shipbuilding contracts could safely be regarded as sales contracts with the builder as seller.[26] Diplock J, in MCDOUGALL V AEROMARINE, followed this view stating: "…it seems well settled by authority that, although a shipbuilding contract is, in form, a contract for the construction of the vessel, it is in law a

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[23] See the Norwegian standard form and the HHI, HHIC, SHI, DSME, SAJ and AWES forms.

[24] Arbitration law is in accordance with the rules then in force of the London Maritime Arbitrators' Association (the "LMAA") and subject to the Arbitration Act 1996, as amended, except as otherwise specifically provided.

[25] See the HHI, HHIC, SHI, DSME forms.

[26] See LEE V GRIFFIN (1861) B&S 272, MCDOUGALL V AEROMARINE (1958) 2 Lloyd's Rep p 345.

contract for the sale of goods." Thus the provisions of the Sale of Goods Act (SOGA) 1979, as amended by the Sale and Supply of Goods Act (SSGA) 1994, apply to the contractual relationship between the builder and the buyer. The SOGA 1979 classifies types of contracts for a number of purposes, so it is important to know in which category shipbuilding contracts belong. In short, a shipbuilding contract is classified as an agreement of sale by which the builder agrees to sell to the buyer future goods.[27]

Unfortunately, the SOGA 1979, together with the SSGA 1994, do not contain specific rules regarding subcontracting. In fact, how the seller (the builder) manufactures the goods, e.g., whether he does this himself or by subcontracting, is not an issue in contracts for the sale of goods, assuming that the goods were manufactured according to the agreed description and are reasonably fit for their purpose. The SOGA 1979 and the SSGA 1994 are not therefore of any help in finding answers to the question posed in this chapter.

Since we cannot find rules relevant to subcontracting in the SOGA 1979, this raises the question whether we can apply the English principles of construction law. Two recent House of Lords decisions, HYUNDAI HEAVY INDUSTRIES CO. V. PAPADOPOULOS AND OTHERS (1980)[28] and STOCZNIA GDANSKA S.A. V. LATVIAN SHIPPING CO., LATREEFER INC. AND OTHERS (1998),[29] have cast some doubt on the traditional view of the shipbuilding contract as a pure sales contract. In the HYUNDAI case, Viscount Dilhorne stated: "…the contract was not just for the sale of goods… It was a contract to build, launch, equip and complete a vessel and to sell her… It was a contract which was not simply one of sale but which so far as the construction of the vessel was concerned, resembled a building

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27 See, op cit, Curtis, fn 7, p 4.

28 [1980] 2 Lloyd's Rep. 1.

29 [1998] 1 Lloyd's Rep. 609.

contract." This decision implies that an arbitrator may also apply the principles of construction law to subcontracting by considering the shipbuilding contract as a contract that resembles a construction contract, since subcontracting relates to how the builder constructs the vessel, rather than how the builder delivers the vessel.

However, a leading English legal textbook (Benjamin's *Sale of Goods*) states, with regard to the HYUNDAI and STOCZNIA cases, "…a contract to build a ship, though a contract of sale of goods, has also some characteristics of a building contract." This means that the characteristics of a shipbuilding project may mitigate a strict interpretation of the shipbuilding contract as a pure sales contract, but they do not alter the fundamental nature of the contract itself. Although a shipbuilding project is a substantial and complex construction enterprise, the nature and extent of the commitments assumed by both parties are not exactly the same as in a non-marine construction project. To quote another textbook: "It also should be noted that the impact of construction law principles in the historical development of English shipbuilding contract law has been very limited."[30]

Even though an arbitrator will be allowed to refer to the principles of construction law, he may not be able to find a clear answer to the question posed in this chapter. Referring to John L Powell's article[31], the position under UK construction law is apparently that, in the absence of express terms in the contract, a building contractor may not subcontract works to subcontractors if the contractor was chosen for qualities specific to him, e.g., his particular skill or knowledge, while the contractor may subcontract at least part of the works where the identity of the person actually

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30 See, op cit, Curtis, fn 7, p 2.

31 See John L Powell, *Subcontracting in the United Kingdom*, [1991] ICLR p 334.

doing the particular work is immaterial[32].For example, the hull and superstructures, or major sections of the vessel, may not be subcontracted, while subcontracting may clearly be permissible in respect of minor items. However, the dividing line between substantial elements and minor items will differ depending on the specific type of construction. In shipbuilding projects, there are many substantial elements that the builder cannot perform himself, but he will not always be free to choose subcontractors without interference from the buyer.

The extent to which subcontracting is permissible also depends on the capacity of the yard. For example, the HHI yard is capable of manufacturing main engines, propellers, shafting etc., while the Sam-Wha yard is not. If a Norwegian buyer were to make a contract with the HHI yard and omitted to incorporate a subcontracting clause into the main contract, the arbitrators might agree that the buyer expected the HHI yard to manufacture those items in its shipyard, instead of subcontracting to external manufacturers. In contrast, if a Norwegian buyer were to make a contract with the Sam-Wha yard, no arbitrator would accept the buyer's allegation that the builder was intended to build the vessel himself.

Therefore, the principles of construction law should not be adopted blindly into the interpretation of a shipbuilding contract. An arbitrator will have to consider to what extent these principles are applicable in the particular context and whether or not other principles or rules should be taken into consideration.

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[32] BRITISH WAGGON CO. V. LEA (1880) 5 QBD 149 (DC).

4.1.2 Can a subcontracting clause be implied into a shipbuilding contract?

Where, in the absence of a subcontracting clause, an arbitrator implies such a term, he should do so only where it is necessary to give business efficacy to the shipbuilding contract. In general, a term will only be applied to reflect an intention imputed to the parties given their actual circumstances in relation to the shipbuilding project. An arbitrator can also imply a term into the shipbuilding contract on the basis of custom or usage if there is a general rule that some provision is to be implied into all shipbuilding contracts. Before going any further, we will categorise some typical items that may be subcontracted and discuss the situation in relation to each of them in turn. These items are:

i) the hull
ii) the superstructure
iii) items listed on the Maker's List
iv) items not listed on the Maker's List.

The Hull

In the absence of a subcontracting clause and any statutory provision allowing the builder to contract out the construction of the hull to subcontractors, the cases in which arbitrators will imply into the contract a term to the effect that the builder has a right to subcontract the construction of the hull are strictly limited. It is not the arbitrators' task to make contracts for the parties concerned, their role is only to interpret contracts that are already made. Furthermore, the 'Witnesseth' clause in the HHIC form clearly states: "In consideration of the mutual covenants herein contained, the Seller agrees to build, launch, equip and complete at the Seller's shipyard at Pusan and sell and deliver to the Buyer…" The hull must therefore be built by the builder at the yard unless the buyer consents otherwise.

As mentioned earlier, a shipbuilding contract is a contract for the construction and sale of a ship and the contract contains a description of the ship. If the vessel does not comply with the description when it is eventually delivered, the buyer is entitled to reject the ship for non-compliance. A lawyer specialising in contract law would say that, historically, English law has treated the terms of the description strictly. The HHIC form, in Article I.1. 'Description' states "The vessel shall be a ….. Carrier having Seller's Hull No.…. The vessel, its machinery, equipment and materials shall be of good quality, suitable for the purpose intended and shall be constructed, equipped and completed in strict accordance with the provision of this Contract…" The hull number is one of the substantial aspects of the description. Both in the contract itself, and in correspondence between the parties during the construction period, the newbuilding will be identified by reference to the hull number. This number is allocated to the vessel by the builder on the basis that the project will be carried out at the yard specified in the contract. This means that if the builder subcontracts the construction of the hull to another shipyard, the hull number will change. Consequently, if the hull number changes because construction of the hull has been subcontracted to another shipyard without the buyer's consent, the hull as delivered will be regarded as failing to conform with the contractual description.

As a matter of English law, the description must also be viewed in the context of the particular contract. The House of Lords, in the DIANE PROSPERITY,[33] did not regard the hull number of the vessel delivered under a long-term charterparty as an essential element of the description. However, they would surely have taken a different position if the parties to a shipbuilding contract, rather than a

[33] [1976] 1 WLR 989 (HL), extracted from Mandaraka-Sheppard 'Modern Admiralty Law' p 423.

charterparty, had intended to construct the hull in a particular yard. In normal shipbuilding practice, the contract states a specific shipyard and the intention of both parties is that the hull will be built in that yard. If the builder subcontracts the hull to another shipyard without the buyer's consent, this may not automatically give the buyer a right to rescind the contract, but the buyer may be entitled to reduce the contractual price. In the above case, the cost of building the hull in Osaka and in Oshima might have been different. If the builder moved the building of the hull to a different shipyard in order to save money, the buyer need not pay the full original contact price.

Superstructure

The superstructure and the hull form the major part of the vessel. The superstructure includes a living area, which must be constructed to high standards according to international and national regulations, with the latter varying from country to country. Thus the buyer must ensure that the living area conforms with standards set by the intended register state.

As mentioned earlier, in the absence of a subcontracting clause, arbitrators will not imply terms allowing the builder to subcontract construction of the hull, insofar as the contract clearly states a particular shipyard and hull number in the 'description' clause. With regard to the superstructure, it is not entirely clear whether arbitrators would imply corresponding terms. Arbitrators may only imply such terms as are necessary to give 'business efficacy' to the contract. In other words, the answer depends on the capacity of HHIC to build the superstructure. If HHIC subcontracts the building of the superstructure to another shipyard, even though it has capacity to construct the superstructure in its own facility, the arbitrators will not imply terms allowing it to do so. Arbitrators will not imply terms simply because it would be reasonable to do so but

only where the contract will not be workable without the implied term.

Although, as one English commentator notes, "in certain types of contract, however, terms have become standardised, and they will be implied in all contracts of that type in the absence of any contrary intention. A similar process takes place where a term is implied by a trade custom",[34] in the case of shipbuilding contracts, subcontracting clauses have not become standardised, nor have the English courts laid down a general rule that a subcontracting clause is to be implied into all shipbuilding contracts. For example, the SAJ form, in Article I. 4., states: "The builder may, at its sole discretion and responsibility, subcontract any portion of the construction work of the vessel", while the Norwegian standard form, in Article II. 4., states: "The hull and major sections thereof are to be built by the Builder at the Yard set out in Article II. 1…"

Items on the Maker's List

The Maker's List is an agreed list of makers (subcontractors and suppliers) pre-approved by the buyer to deliver items (equipment or services) in relation to the shipbuilding project. Subcontractors listed on the Maker's List are similar to 'Nominated Subcontractors' in UK construction law, which distinguishes 'Nominated Subcontractors' from 'Domestic Subcontractors'. Nominated subcontractors are nominated by the buyer, while domestic subcontractors are selected by the builder. In the case of nominated subcontractors, the builder will usually have a right of objection to a particular nomination and so is not fully bound by the buyer's nomination, which instead acts more as a prior approval by the buyer. However, the intention of such a nomination differs from the purpose of the Maker's List. The nomination system is intended to enable the buyer to choose his

[34] J. Beatson, Anson's law of contract, p 146.

own subcontractors, while the Maker's List is intended to minimise the potential delays in obtaining the buyer's consent. Furthermore, the builder may be better off in the case of default by a nominated subcontractor than in the case of default by a subcontractor listed on the Maker's List.[35] The builder is usually responsible for the performance of a subcontractor listed on the Maker's List in the same way as for his own subcontractors.

The Maker's List normally includes a number of different makers for the same item. If this is so, the selection of makers will usually be at the builder's option, provided the item fulfils the contractual requirements. So even where the shipbuilding contract is silent on subcontracting, the builder is entitled to subcontract those items on the Maker's List to the makers listed. The builder can also propose other makers than those on the Maker's List for the buyer's acceptance.

The buyer may select a preferred maker among those listed, subject to bearing any additional cost incurred by the builder as a result of such a selection, otherwise the builder can choose freely. The builder will normally inform the buyer of the selected maker before making the order and the buyer must confirm his agreement to the builder's selection or inform the builder of his preferred maker within a certain agreed period (normally one week) of receipt of information regarding the selected maker. When the builder does not receive the buyer's agreement within the agreed period, the builder's selection is deemed to have been confirmed by the buyer and the builder may proceed with the selected maker.

Where the place of production is indicated in the Maker's List, any change must be notified to the buyer for his approval. Otherwise, place of production will be at the discretion of the maker.

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[35] See, op cit, John L Powell, fn 31, p 332.

Norwegian buyers will usually require the makers to comply with the EU Directive on Marine Equipment (with annexes)[36] for equipment delivered and installed on board the vessel. If a maker fails to document compliance with the EU Directives referred to in the contract, he will automatically be excluded from the Maker's List.

Items not listed on the Maker's List

There are many hundreds of items that will need to be installed or with which the vessel will need to be equipped in order to complete the shipbuilding project. If the builder had to manufacture all the items himself without delegating to subcontractors, the shipbuilding contract would not be commercially viable. No one involved in shipbuilding would intend or believe that the builder should have to obtain the buyer's prior approval for the subcontracting of every single item. In the absence of a subcontracting clause allowing the builder to subcontract such items, the arbitration panel may imply such terms (the builder's right to subcontract) into the contract. The implying of such a term is normally said to depend upon an intention imputed to the parties from the actual circumstances. The arbitrator will need to be satisfied that both parties would, as reasonable businessmen, have agreed to a subcontracting clause allowing the builder to subcontract such minor items if it had been suggested to them.

Consequently, when there is no subcontracting clause in the shipbuilding contract, as is the case with the HHIC form, the builder may freely choose subcontractors for such minor items, but a prudent builder may also inform the buyer of the identity of the

[36] This includes both CE marking and the Wheel Mark (Commission Directive 98/85/EC of 11 November 1998 amending Council Directive 96/98/EC, including later amendments).

subcontractor before ordering more important items so that he can avoid taking the whole blame if there is a problem with the subcontracted items.

4.2 The HHI, SHI, DSME and Norwegian standard forms

4.2.1 Hull

The Norwegian standard form, Article II, 4, 'Subcontracting' states: "The hull and major sections thereof are to be built by the Builder at the Yard set out in Article II, clause 1, unless the Buyer consents otherwise." This clearly prohibits the builder from subcontracting construction work on the hull to other yards without the buyer's consent.

The SHI form states: "Save that the constituent elements of the hull and superstructure of the Vessel shall (unless otherwise agreed in writing by the Buyer) be fabricated in Korea the builder may… subcontract other portion…". SHI is therefore not allowed to subcontract construction of the hull to its wholly owned subsidiary yard in China without the buyer's consent. SHI must also submit a list of its proposed "external subcontractors" (i.e., any subcontractor who carries out any substantial part of the subcontracted work outside the shipyard) to the buyer for approval if it subcontracts construction work on the hull to yards within Korea other than the yard specified in the Preamble. However, it may be possible for SHI to employ 'internal subcontractors' to carry out construction work on the hull (e.g., fabricating the blocks, welding) inside its shipyard in Korea without the buyer's consent. The SHI form also allows the builder a certain amount of freedom to subcontract the work of fabricating the blocks that make up the hull to its yard in China, stating : "The Builder shall be entitled, provided the Builder and the Buyer mutually agree, to fabricate up to thirty (30%) percent of the

blocks comprising the hull and superstructure of the Vessel at the facilities of the Builder's wholly owned subsidiary at Ningbo, People's Republic of China but shall assemble the same at the Shipyard."

The HHI form states that "the BUILDER shall not subcontract the main hull thereof outside South Korea without the BUYER's prior written approval which shall not be unreasonably withheld." Thus HHI cannot subcontract construction work on the hull to its wholly owned subsidiary yard in China without the buyer's prior approval, but HHI may be allowed to subcontract construction of the hull to subcontractors in Korea without the buyer's consent. HHI can therefore subcontract the work of fabricating the blocks to its sister company's shipyard in Samho, Korea (or other factories in Korea) or employ subcontractors to carry out construction work on the hull at its shipyard in Ulsan, Korea without the buyer's prior approval. Considering the wording of the Preamble, which states: "The BUILDER agrees to design, build, launch, equip and complete ….at the BUILDER's shipyard in Ulsan, Korea," the HHI shall at least bring the finished blocks to its shipyard in Ulsan, Korea to be assembled (to complete the construction of the hull as a whole), even though it may be allowed to fabricate the blocks in other places.

The DSME form states "The BUILDER may subcontract, at its own responsibility, any portion of the construction work of the VESSEL to subcontractors in Korea, including hull and superstructure of the VESSEL." DSME is therefore free to subcontract construction work on the hull to subcontractors in Korea. However, DSME must submit a list of its intended subcontractors to the buyer in advance and the buyer may request the builder to replace or delete any subcontractor whose level of workmanship, in the sole opinion of the buyer, does not comply with the contract's requirements and specifications, such request not to be unreasonably rejected. The

performance of works by subsidiaries of the builder in Korea does not constitute subcontracting, so the builder is free to employ such subsidiaries without submitting a list to the buyer and, consequently, the buyer cannot request their replacement.

4.2.2 Superstructure

Under the Norwegian standard form, the superstructure is a "major section", so the builder is not allowed to subcontract construction work on the superstructure to other yards without the buyer's consent.

Under the SHI form, the superstructure is in the same category as the hull.

Under the DSME form, insofar as subcontracting to subcontractors in Korea is concerned, the superstructure is in the same category as the hull. However, the builder may also subcontract, at its own risk, the superstructure to DSME WEIHAI Co., Ltd. in China.

Under the HHI form, the builder may, at its sole discretion and risk, subcontract the construction work of the superstructure to subcontractors anywhere without the buyer's consent.

4.2.3 Items listed on the Maker's List

Subcontracting of the items listed on the Maker's List will already have been approved by the buyer, so the selection of the subcontractors from the Maker's List is at the builder's option so long as the equipment performs in accordance with the contract. The SHI form clearly states: "The builder may, at its sole discretion and responsibility, subcontract any portion of the construction work of the Vessel to the subcontractors and manufacturers in the Manufacturer's list that is part of the Specifications."

4.2.4 Items not listed on the Maker's List

Under the Norwegian standard form, the builder may, without interference from the buyer, freely choose its subcontractors in respect of these items, but it must notify the buyer in ample time in writing before placing major orders with subcontractors for equipment or services.

Under the SHI form, the builder may, at its sole discretion and on its sole responsibility, subcontract these items to any properly qualified and equipped subcontractors, provided that the builder has submitted a list of its proposed 'external subcontractors' to the buyer for approval.

Under the DSME form, the builder is allowed to subcontract, on its own responsibility, these items to subcontractors in Korea provided that the builder has submitted a list of the intended subcontractors to the buyer in advance. Compared to the SHI form, the scope of subcontracting permitted under the DSME form is much narrower. For example, DSME is allowed to subcontract these items to 'subcontractors in Korea', while SHI is allowed to use 'any subcontractors'. DSME also has to submit a list of all its intended subcontractors to the buyer, while SHI only needs to submit a list of its proposed 'external subcontractors'.

Under the HHI form, the builder can, at its sole discretion and on its sole responsibility, freely choose subcontractors for these items without giving any notification to the buyer or requiring his approval.

5 To what extent is the builder responsible for the performance of the subcontractors?

Before answering this question, we need to distinguish subcontracting from assignment and novation. Under English law,

the benefit of a contract can be assigned provided that there is no express term forbidding this. In a shipbuilding context, the builder will effect an assignment in favour of the bank that is providing pre-delivery finance for building the vessel. As a result, it is the bank (the assignee) and not the builder (the assignor) that is entitled to the benefit of the contract (i.e., payment by the buyer). However, the burden of a shipbuilding contract (i.e., the builder's obligation to do the work) cannot be assigned so as to relieve the builder (assignor) from the burden of the contract. If the builder wishes to be released absolutely from his obligations under the contract and for a third party to take his place, it is normal for all parties to enter into a novation agreement (the process whereby C takes over B's benefit and burden under a contract with A is called novation and requires the agreement of all three parties). The process terminates the contract between A and B, substituting a new contract between A and C. Novation is thus a tripartite arrangement under which the original contract is discharged by agreement and is replaced by a new contract between the builder and the third party.

The right to assign the contract as a whole should be carefully distinguished from the right to subcontract performance of particular obligations arising under it. In subcontracting, the builder subcontracts performance of work that he is required to perform under the shipbuilding contract with the buyer in whole or in part to one or more subcontractors. The builder nevertheless remains personally liable in respect of his subcontractors' performance in the absence of express provision to the contrary in the shipbuilding contract. In other words, where the builder employs a subcontractor, this will not alter the nature and scope of the

builder's obligations and rights,[37] unless the contract states otherwise.

5.1 Based on the HHI, SHI, DSME and Norwegian standard forms

Under English law, in principle, the parties are free to contract on whatever terms they wish. The answer to the question posed in this section will therefore depend on the terms and conditions of the various standard forms. The builder can exclude his contractual liability towards the buyer for the performance of certain subcontractors (e.g., the buyer's suppliers) or can take responsibility for subcontractors' work in general provided that he is free to subcontract (see, e.g., the HHI form, Art I.4: "The builder may, at its sole discretion and responsibility, subcontract any portion of the construction work of the vessel.").

Certain conditions and warranties are implied into a shipbuilding contract pursuant to the SOGA unless the parties agree otherwise. There are implied conditions that the vessel will correspond with its contractual description (section 13), that it will be of satisfactory quality (section 14(2)), and that it will be reasonably fit for its purpose (section 14(3)). The builder is thus responsible for meeting the above-mentioned conditions irrespective of whether the vessel was constructed by subcontractors. In other words, the builder is liable towards the buyer if the vessel does not satisfy the above implied conditions due to the subcontractors' poor workmanship.

In principle, these implied conditions may be waived or varied by express agreement between the parties. However, as far as the condition that the vessel must correspond with the contractual description is concerned, most standard shipbuilding contract

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[37] See BAY HOTEL & RESORT LTD. v. CAVALIER CONSTRUCTION CO. LIMITED, Privy Council, 16 July 2001.

forms clearly incorporate this condition into the Preamble as in, e.g., the HHI form: "The builder agrees to design, build, launch, equip, and complete the vessel as described in Article I and to deliver and sell the vessel." The builder is thus liable vis-à-vis the buyer for defective items which do not correspond with the description as a result of the subcontractors' poor performance.

Most standard shipbuilding contract forms specify the nature of the builder's responsibility for the performance of subcontractors in their subcontracting clauses. The Norwegian standard form, in Article I.4, states: "…the Builder may, at its sole discretion and responsibility, subcontract any portion of the construction of the Vessel. The Builder shall remain fully liable for the due performance of such work as if done by the Builder at the Builder's yard." We find similar wording in the SHI form, Article I.4, fourth paragraph, and in the DSME form, Article I.4.

The above-mentioned liability of the builder for the performance of the subcontractors has to be read together with the 'Warranty' or 'Guaranty' clause, which will contain a number of crucial exclusions and limitations in respect of the builder's liability for defects in the vessel, including those defects arising from the subcontractors' defective performance. Following delivery and acceptance, the builder will limit the extent of his continuing responsibility for the vessel and, in particular, for any deficiencies in the contractual works, including works performed by subcontractors. The HHI form, Article IX, 1, second paragraph, states: "The BUILDER will be responsible for all machinery or parts of machinery and all constructions which are supplied by subcontractors and will guarantee the above mentioned for a period of twelve (12) months on the basis as laid down in this paragraph." In other words, the builder only takes on responsibility for the subcontractors' performance for a period of 12 months from the date the vessel is delivered to the buyer. This gives rise to the

question of what happens if the subcontractor has given the builder a guarantee in respect of work or equipment for a longer period. Does the builder remain liable for the subcontractors' defective performance until the expiry of the subcontractors' guarantee? The HHI form does not contain a "Subcontractor's guarantees" clause,[38] so the answer here will be negative. Moreover, the HHI form does not contain express terms allowing the buyer to extend the guarantee period for items that are repaired and rectified within the guarantee period.[39]

However, other shipbuilding contracts, e.g., the Norwegian standard form and the SHI and HHIC forms state in their "Subcontractor's Guarantees" clauses that the builder shall assign to the buyer any guarantees given to him by the subcontractors. By virtue of this assignment, the buyer may be able to claim directly against the subcontractors for the defective items or work even after the expiry of the builder's guarantee period (12 months).[40]

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[38] See Norwegian Standard Shipbuilding Contract 2000, Article X, 4.

[39] "Revolving Warranty" clause in the DSME form, Article IX, 3, the Norwegian standard form, Article X, 2., fifth para, the SHI form, Article IX, 3(e), and the HHIC form, Article IX, 1(a) (e.g., "Any repair or replacement, made by the BUILDER hereunder, is subject to a new warranty of quality according to the terms of this Article").

[40] The SHI form Article IX, 6, second para states "The builder agrees upon the expiry of the guarantee period to assign (to the extent to which it may validly do so) to the Buyer, or as the Buyer may direct, all the right, title and interest of the Builder, if applicable, in and to all guarantees or warranties given to the Builder by the supplier of any of the materials used in the construction of the Vessel." The HHIC form, in Article IX, 1, (a) states: "… provided that in the event that the normal guarantee period stipulated by manufacturers or suppliers… exceeds the aforesaid guarantee period, such extended guarantee rights shall be assigned and made available to the buyer by the seller."

5.2 To what extent is the builder responsible for the performance of the subcontractors in tort?

Where the buyer is unable to establish a claim against the builder on the basis of the contract for defects caused by the subcontractors (e.g., because the defects became apparent after the expiry of the warranty period or the contract excludes the builder's liability for the relevant defects), the buyer may try to establish his claim in tort or on the basis of the breach of some statutory duty. The Unfair Contract Terms Act 1977 (UCTA) and the Consumer Protection Act 1987 affect the contractual relationship between the parties, and terms in the contract that exclude the builder's liability may be ineffective if they breach the above Acts.

The UCTA does not apply, however, to so-called "international supply contracts" (s. 26) or to contracts that are governed by English law solely by reason of the parties' choice and which would, but for that choice, have been governed by the law of a country outside the United Kingdom (s. 27(1)). As such, it is unlikely that the UCTA will affect the majority of shipbuilding contracts undertaken outside the United Kingdom, particularly where the Norwegian buyer and the Korean builder have no connection with the United Kingdom.[41]

There are strongly held views that the Consumer Protection Act 1987 gives a right of action to a consumer (the buyer) not only when "consuming" on land but also when "consuming" at sea.[42]

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[41] Cf. op cit, Curtis, fn 7, p 168.

[42] See Tettenborn, "Maritime consumers? – The Consumer Protection Act and shipping law", [1988] L.M.C.L.Q. 211. On product liability in the law of the United Kingdom, see (1991) 20 Anglo. Am.L.Rev. No.3. For a general perspective, see Whitehead and Scott, "A comparison of Product Liability Law in the United States and the European Community", (1991) 2 Euro. Bus. LR 171.

The producer of a defective product is liable, regardless of whether or not there was any negligence, for any damage to persons or property resulting from[43] the defect. Moreover, the builder is also liable, together with the supplier, if the product incorporates a defective component made by the supplier.[44] Therefore, the builder is liable vis-à-vis the buyer for defective components, even if these are made by subcontractors. However, in my opinion, a professional shipowner (buyer) is not a "consumer" of the type the Consumer Protection Act is intended to protect. It is therefore unlikely that the Consumer Protection Act will affect the majority of shipbuilding contracts.

Since the buyer may not be able to establish his claim on the basis of the breach of the aforementioned UTCA and Consumer Protection Act, he may try to find remedies in tort. It is therefore worth discussing the builder's liability vis-à-vis third parties (buyers)[45] for errors made by subcontractors.

English law is well settled with regard to the liability of a builder in tort for a buyer's economic loss incurred as a result of a subcontractors' defective performance. Based on the judgment in THE REBECCA ELAINE (1999),[46] we may conclude that the common law does not impose on the builder any liability in tort to the buyer to whom he owes no duty in contract but who suffered economic loss due to the subcontractors' defective work. It is a general rule that the builder owes no duty of care to avoid the buyer's economic loss in tort, unless the buyer was successfully able to show a special

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43 The maker or builder is not liable for defects which should have been discovered by intermediate examination by the customer: LAMBERT v. LEWIS [1982] A.C. 225.

44 See, Malcolm A. Clarke, 'Shipbuilding Contracts' p171.

45 In tort, the buyer is no longer a contractual party, but becomes a third party.

46 [1999] 2 Lloyd's Rep 1.

degree of proximity that involved both an assumption of responsibility by the builder and the buyer's reliance on information from the builder.

Regarding the builder's duty to warn the buyer of a known damager in equipment supplied by a subcontractor, Tuckey LJ said, "Under English law I do not think that there is any basis for putting failure to warn of a known damager into a category of its own...he *(the builder)* may be under such a duty if he assumes responsibility to his customers *(the buyer)* in a situation, which is akin to contract. That duty may include a duty to warn, but it would be much more difficult to infer in the case of mere silence than in the case of misrepresentation. Reliance by the customer is relevant to whether there has been an assumption of responsibility and essential as to causation."

However, the builder will be liable in tort to the buyer for a reasonably foreseeable physical injury to a person or property caused by dangerously defective equipment supplied by a subcontractor, based on the well known principles established by *Donoghue v Stevenson* [1932] AC 569. For example, if the main engine supplied by a subcontractor causes an explosion that results in death, this may expose the builder to tortious liability.

6 To what extent is the builder protected, in particular by the Force Majeure clause, against delay or non-performance by the subcontractors?

In the previous chapter we discussed the builder's responsibility for the subcontractor's performance and saw that the builder can limit or exclude his liability for the subcontractors' performance by incorporating exclusions in respect of his liability for defects in the vessel in the Warranty clause. In a similar way, the builder may be

able to except himself from liability for delay that may be suffered as a consequence of failure on the part of a subcontractor by relying on the Force Majeure clause. This clause lists a broad range of events that entitle the builder to postpone the Delivery Date. If the builder attempts to rely on the Force Majeure clause in the case of failures in respect of quality or performance on the part of the subcontractors, this raises the question to what extent the builder is protected by the Force Majeure clause. The answer to this question will vary greatly from contract to contract. In the following, I will first state the general principles of Force Majeure before trying to find answers in different standard forms.

6.1 Force Majeure : General principle

Force Majeure clauses are common in contracts and essentially free one or both parties of liability when an extraordinary event beyond the control of the parties, such as a flood, war, riots, acts of God, etc. prevents one or both parties from fulfilling their obligations under the contract.

The concept of Force Majeure is well known in the general law of Korea and sanctioned by the relevant Civil Code.[47] In Norway, there is also a well-developed legal position on unexpected events that interfere with performance of a contract: "It should be noted that under Norwegian law Force Majeure does not permit an extension of the contractual delivery date. Force Majeure only relieves the builder from an obligation to pay damages to the customer for late delivery. Even if the delay is caused by Force Majeure, a substantial delay will still entitle the contractor to terminate the contract".[48] Under English law, similar situations would be regulated by the doctrine of frustration. However, the English

[47] See Korean Civil Code Article 314.

[48] See, Malcolm A. Clarke, 'Shipbuilding Contracts' p 79.

courts have developed certain generally applicable rules as to interpretation and effect of Force Majeure clauses.

Firstly, it is clearly established that, in the context of shipbuilding, the burden of proof is on the builder to prove both the occurrence of the event on which he is relying and that his performance has been adversely affected within the meaning of the Force Majeure clause. Secondly, when interpreting Force Majeure clauses, English courts and arbitration tribunals will, depending upon the precise language used, often apply the *ejusdem generis* rule of construction (see below, Section 6.2.1).[49]

6.2 Force Majeure clause in different standard forms

The HHI form lists more than 35 Force Majeure events that cover a wide range of circumstances, including political, technical and natural (meteorological) risks. However, we only need to consider certain terms to answer the question posed in this chapter. The HHI and DSME forms' Force Majeure clauses state: "… or other causes beyond the control of the BUILDER, or its subcontractors…". In other words, the builder is entitled to postpone the Delivery Date if failure by the subcontractors resulted from circumstance beyond his control. It appears, on the basis of JOHN MOWLEM V. EAGLE STAR AND ORS (1995)[50], that this language must be construed conjunctively, rather than disjunctively, i.e., the builder must show that the events giving rise to his claim for an extension of time were outside both his own control ***and*** that of his subcontractors. In other words, an event that is the consequence of the subcontractor's inexcusable default in the proper performance of his obligations does not constitute a Force Majeure event. In

[49] Cf. op cit, Curtis, fn 7, p 135.

[50] [1995] 44 Con.L.R. 134.

short, under the HHI and DSME forms, the Force Majeure clause only protects the builder against delay or non-performance by the subcontractors to the extent that such an event actually occurred as a result of causes beyond the control of the builder and the subcontractors.

The Norwegian standard form further narrows down the scope of such Force Majeure events by stating: "…by Subcontractor(s) where the cause of delay would have been recognized as Force Majeure Delay under this Article IX if it had affected the Builder, provided that the Builder has shown due diligence in its choice of Subcontractor and ensured a reasonable margin for delays." If the builder cannot prove that he has exercised due diligence in choosing the subcontractor and ensuring a reasonable margin for delays, the Force Majeure clause will not protect him against delay caused by the subcontractor, even thought such delay occurred because of causes beyond the control of the subcontractor.

6.2.1 "Other causes beyond the control of the builder" – the *ejusdem generis* rule

This wording is intended to operate as a sweeping-up provision. *Prima facie*, wording of this type will be construed according to the *ejusdem generis* rule. This has the effect that the meaning of general words may be narrowed and restricted by the specific context in which they are intended to apply. Thus, in HERMAN V. MORRIS (1919),[51] the Court of Appeal held that where the clause read "strikes, lockouts *et cetera*, or any causes beyond the vendor's control", the words "or any causes beyond the vendor's control" were to be construed *ejusdem generis* with "strikes and lockout" and did not, as such, encompass non-performance by the vendors'

[51] [1919] T.L.R. 574.

subcontractor. The use of the words "*et cetera*" made no difference to such an interpretation.[52]

However, the *ejusdem generis* rule is merely a canon of construction and will not apply if terms of the contract indicate that this is the parties' intention. McCardie J[53] held that: "…the rule of *ejusdem generis* cannot be applied at all unless there is some broad test for the ascertainment of genus. So far as I can see the only test seems to be whether the specified things which precede the general words can be placed under some common category. By this I understand that the specified things must possess some common and dominant feature."[54] The Force Majeure clauses in most shipbuilding contracts list a wide range of circumstances, e.g. the HHI form lists more than 35, including political, technical and natural risks, so it is very difficult to establish a "common or dominant feature" sufficient to constitute a genus. Therefore, the *ejusdem generis* rule will be unlikely to apply to the Force Majeure clauses in modern shipbuilding contracts. Relying on this, in the builder's favour, the HHI and DSME forms clearly incorporate the wording "Other causes beyond the control of the builder" in their Force Majeure clauses. The effect of this wording is that the builder does not need to show that events "beyond his control" are similar in nature to one of the specific events listed in the Force Majeure clause.

The Norwegian standard form also incorporates slightly different wording: "any other extraordinary events beyond the control of the Builder." In my opinion, circumstances beyond the builder's control

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52 Cf. op cit, Curtis, fn 7, p 145.

53 At page 330 in S.S. MAGNHILD V. MCINTYRE BROTHERS & CO. [1920] 3 K.B. 321.

54 See also SONAT OFFSHORE S.A. V. AMERADA HESS DEVELOPMENT LTD, supra, per Saville J. at page 149; BOVIS INTERNATIONAL V. CIRCLE LTD. [1996] 49 Con. L.R. 12.

will normally constitute extraordinary events. If the events were ordinary, the builder should be able to control them. The word "extraordinary" is thus redundant and there is no differentiation of the event from "any other cause beyond the control of the builder" in the HHI and DSME forms.

However, the SHI and HHIC forms do not incorporate the wording "other causes beyond the control of the builder" in their Force Majeure clauses. As a result, under the SHI form, the Force Majeure clause protects the builder against the subcontractors' delay or non-performance to the extent that such events are actually incurred as a result of the causes or circumstances listed in the Force Majeure clause

6.2.2 The HHIC form – no reference to subcontractors in the Force Majeure clause

The HHIC form, in Article VIII, 1 (a), "Force Majeure", merely refers to "all such events being beyond the Seller's control…" without adding "or its subcontractors."[55] However, on the basis of the judgment in SCOTT LITHGOW LTD. V. SECRETARY OF STATE FOR DEFENCE (1989), the terms in the HHIC form may protect the builder against defective performance by the subcontractor if the subcontractors' default is "beyond the Seller's control".[56] In this case, the House of Lords held that the shipbuilder was entitled to rely upon the subcontractor's default as being "a cause of delay beyond [his] control".[57]

However, we shall now examine the wording in the HHIC form more closely, in the light of the entire Force Majeure clause, in order to understand the nature and scope of events that can entitle

[55] See the HHI form, Article VIII, 1 and the DSME form, Article VIII, 1.

[56] [1989] 45 Build. L.R. 1, H.L.

[57] Cf. Op cit, Curtis, fn 7, p 147.

the builder to an extension of time. The clause in the SCOTT LITHGOW case stated "delay arising…due to…any…cause beyond…", while that in the HHIC form states "all such events beyond…", which limits the events to those within the scope of the events already referred to in the clause. Moreover, the HHIC form lists very few Force Majeure events compared to other forms. It does not refer to events such as 'labour shortage', 'explosions', 'shortage of materials, machinery or equipment…delays in delivery etc', 'defects in materials, machinery or equipment which could not have been detected by the builder using reasonable care', or 'delays in the builder's other commitments…which in turn delay construction of the vessel'.

Thus the builder is not well protected by the Force Majeure clause in the HHIC form against delay or non-performance as a result of an event beyond the subcontractors' control. In my opinion, for the builder to be well protected, the clause would have to clearly state 'events beyond the subcontractor's control' and also list the aforementioned Force Majeure events.

7 Conclusion

As we have discussed, the answers to the questions we have posed concerning subcontracting (i.e., definition, permissibility, builder's liability, Force Majeure) vary greatly between the different standard forms. The parties to shipbuilding contracts should therefore endeavour to incorporate reasonable and adequate terms and conditions, bearing in mind the peculiar characteristics of subcontracting in the shipbuilding context, after carefully considering the issues discussed in this study. Both parties should also endeavour to harmonise procedural provisions in the main shipbuilding contract and the subcontracts to avoid parallel disputes arising in different fora with the ensuing risk of discrepancies in the outcomes of different, but related, disputes.

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Part III
Anonymity of shipowners as a maritime security problem – EU law implications

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1 Introduction

1.1 Beneficial shipowner: an old problem in a new light

This article discusses the anonymity of beneficial shipowners in the light of the maritime security problems it brings about. The article focuses on the implications of European Union (EU) law for national measures requiring the disclosure of the beneficial shipowner's identity in the Member States' ship registers. More specifically, it analyses whether such measures can amount to a restriction on the freedom of establishment and whether Member States are entitled to impose such restrictions in order to prevent, or contribute to the prevention of, terrorist activities in shipping.[1]

We will first consider the general background to the discussion of the legal issues.

The beneficial owner of a vessel is the natural person or organisation that has the ultimate financial benefit of the vessel's operations and has the ultimate right to take decisions on the way the vessel will be used and the appointment of managers and operators of the vessel or that assigns this function to other companies or persons. It is frequently the case that the identity of the beneficial shipowner is hidden behind a chain of shell companies and is not immediately apparent from the ship register of the flag State. Such corporate arrangements, combined with relaxed ship register requirements, make it possible for shipowners completely to avoid liability arising from tax claims, unsafe

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1 This article is based on the trial lecture for the dr. juris degree delivered by the author on the 6th September 2007 at the Faculty of Law, University of Oslo.

incidents and damage caused to persons or property by ship operations.[2]

Although complex corporate schemes can ensure virtually full anonymity for the shipowner, it is actually ship registers, by allowing registration of a ship legally owned by a company, that provide cover for the actual owners. Ship registration conditions and procedures – including standards of transparency – are not harmonised at an international level. Flags of convenience, or open ship registers, allow anonymity – some of them even advertise anonymity as an advantage of their flag. However, registration rules and routines at traditional ship registers may also contain loopholes that allow strategies by which the identity of beneficial shipowners can remain unknown.

Modern political reality makes the traditional veil of secrecy protecting shipowners look even more alarming. Since the September 11 attacks, and even prior to that, the problem of maritime terrorism has been on the agenda.

It is now common knowledge that terrorist groups have long sought to develop maritime capability. For example, al-Qaeda and the persons behind it may actually own dozens of ships. The Tamil Tigers is a terrorist group with proven maritime capability that owns a substantial number of ships that sail across the oceans under the flags of different countries.[3] Engagement in shipping

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[2] See OECD, *Ownership and Control of Ships*, March 2003, for a description of schemes for concealing the identity of shipowners. Available at <www.oecd.org>, last visited 19 November 2007.

[3] OECD (2003), *op. cit.*; Whitlow, Jon (International Transport Workers' Federation), *Transparency of Ownership and the Impact of Security on Seafarers* (OECD Workshop on Maritime Transport), Paris, 8-9 January 2003. See also references by Fox Jr. (n. 8 *infra*), at p. 98 *et seq.* to discussion of the matter in the United States.

activities by terrorist organisations will only grow in the future unless it is prevented by appropriate measures.

Ships whose owners or operators are affiliated to terrorist organisations can be used to further those organisations' objectives in a number of ways. For example, such ships can be used to transport persons, weapons and equipment for the purposes of conducting an inland terror attack. They can also be used as floating bombs to attack other ships, ports and other maritime targets. To reduce the risk of ships being used in this way, the International Maritime Organisation (IMO) in 2002 adopted amendments to the International Convention for the Safety of Life at Sea (SOLAS 1974) and the International Code for the Security of Ships and of Port Facilities (the ISPS Code) which increase transparency in relation to ship operators. These rules entered into force in 2004. The IMO decided that the central and fundamental question in matters relating to the ownership and control of vessels for maritime security purposes was the identity of the party with effective operational control of the ship. The new maritime security rules therefore oblige the shipping company to have certain information on board. This information is limited to the identity of those persons responsible for appointing the members of the crew and other employees on board the ship, for deciding on the employment of the ship and, in cases where the ship is employed under the terms of a charterparty, the parties to such charterparty.[4]

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[4] For more information and discussion on maritime security regulation generally see Kaare André Kopperud and Moritz Askildt, *Security at Sea. The International Ship and Port Facility Code (ISPS Code) with comments*, Norwegian Shipping Security ANS, 2003; Balkin, Rosalie, "The International Maritime Organization and Maritime Security", 30 (2006) *Tul.Mar.L.J.* 1-34; Hartmut Hesse and Nicolaos L. Charalambous, "New Security Measures for the International Shipping Community", *WMU Journal of Maritime Affairs*, 2004, Vol. 3, No. 2, 123-138; Forrest Booth and Larry Altenbrun, "Maritime and Port Security, Piracy and Stowaways:

Regulatory measures aimed at preparedness and the prevention of terrorism in general and at the enhancing of maritime security have also been adopted at an EU level.[5]

However, while the identity of ship operators and registered owners is being made sufficiently transparent, the matter of the beneficial ownership of ships remains outside IMO and EU regulation.

In addition to these measures, steps should also be taken to ensure the disclosure of the beneficial owners of ships because this will contribute to the improvement of maritime security and to the efforts of non-maritime organisations engaged in the prevention of terrorism. A system whereby the owners of a vessel can remain completely concealed poses a considerable security risk not only – and not so much – because ships can be used as, or to carry, weapons. Research conducted by the Organisation for Economic Co-operation and Development (OECD) has established that the ownership of vessels has great money-laundering potential and ships beneficially owned by persons or organisations affiliated with terrorists can operate within lawful trades to generate funds to finance terrorist activities.[6] Furthermore, the OECD has indicated that traditional registers may be particularly interesting for illegal

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Renewed Concerns Over Old Problems”, 15 (2002-2003) *U.S.F. Mar.L.J.* 1-48; Justin S.C. Mellor, “Missing the Boat: The Legal and Practical Problems of the Prevention of Maritime Terrorism”, 18 (2002-2003) *Am. U. Int’l L.Rev.* 341-397. See also the IMO’s website <www.imo.org> under section “Maritime security”.

[5] Regulation 725/2004 on enhancing ship and port facility security, OJ [2004] L 129/6. On general EU security policy since 2001 see, *e.g.*, Konrad Dwojak, “European Union’s Security with Regard to the International Situation After September 2001. How has the EU responded to terrorist threats?”, 2006-2007, <www.analyzingeu.eu/konrad/2007/europeanunion-security-after-september-2001>, last visited 13 September 2007.

[6] OECD (2003), n. 2, *supra*, para. 14.

organisations and persons involved in money-laundering and the financing of terrorist activities due to the good reputation of such registers.[7] The OECD has recommended flag States to adopt measures to increase shipowner transparency and to make ship registers harder for criminals to penetrate. Shipowners' anonymity has also been criticised by the International Transport Workers' Federation, and by national governments, notably the United States.[8]

1.2 Further discussion

Transparency in relation to beneficial shipowners can be achieved by improving the transparency of international corporate vehicles – a problem outside the realms of this article – and by improving the transparency of ship registers. The adoption of international uniform standards for ship registers would be the most adequate response to the problem and would help to avoid problems caused by differences in regulation. However, no such rules exist at an international or European level and their adoption in the near future appears unlikely. In the absence of uniform international standards, it is up to individual flag States to adopt the appropriate rules and procedures for their ship registers.[9] It should also be

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7 See OECD, *Maritime Security – Options to Improve Transparency in the Ownership and Control of Ships: Final Report*, June 2004, para. 4. Available at <www.oecd.org>, last visited 16 September 2007.

8 See Whitlow, n. 3, *supra*. However, for a contrary view on the need for disclosure of the identity of beneficial shipowners see J. Benneth Fox Jr., "Vessel Ownership and Terrorism: Requiring Disclosure of Beneficial Ownership is Not the Answer", 4 (2005) *Loy. Mar. L.J.* 92-110.

9 Case 221/89 *The Queen v. Secretary of State for Transport, ex parte (Factortame II)* [1991] ECR I-3905, para. 13. See also Case "M/V "Saiga"" (no. 2) 38 *I.L.M.* 1323 (1999), para. 83, where the International Tribunal of the Law of the Sea denied that states may rely on the concept of a genuine

pointed out that, in practice, the role of individual states, their national governments and intelligence services in the prevention of terrorism is extremely important and must not be underestimated or viewed as less important than the role of international bodies.

Transparency in relation to beneficial shipowners in ship registers could be achieved in a number of ways. On the one hand, flag States might decide to implement a policy of transparency in their ship registration procedures. For example, they might require the unconditional disclosure of the beneficial shipowner's identity, or they might impose reporting obligations on shipowners, who could be offered confidentiality in exchange. Ship registers could be assigned to undertake their own research to the extent practical and necessary (for example, introducing more stringent scrutiny in relation to foreign ships).

On the other hand, flag States might reject registration of a vessel whose owner's identity is unclear or where the owner is suspected of having unlawful affiliations. It is obvious that neither open nor traditional registers will be willing to register ships that may be owned by persons with terrorist affiliations. Flag States that are Member States of the EU are also free to determine the conditions that must be fulfilled in order for a vessel to be registered in their registers. However, in doing so they must comply with EU law.

Both ship registration rules that require the disclosure of the beneficial shipowner and a refusal to register a ship whose beneficial ownership is obscure or suspicious may come into conflict with the principle of freedom of establishment as laid down in the EU Treaty.

In this connection we will discuss the following legal issues.

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link to challenge the validity of ship registration in a flag State (see also n. 10 *infra*).

Firstly, we will analyse whether measures undertaken by Member States to ensure and improve transparency in relation to the beneficial ownership of the ships registered in their ship registers may restrict the freedom of establishment as laid down in the EU Treaty (see 2 below).

Secondly, we will discuss whether, and under what conditions, such measures – if they do infringe the freedom of establishment – may be justified and lawful because they are an attempt to improve maritime security. In this context we will discuss the exceptions to the freedom of establishment expressly provided for in the Treaty and developed in EU case law (see 3 below).

We will conclude this article by summarising its main findings in the form of recommendations for the EU Member States concerning transparency requirements for beneficial shipowners, which the States may wish to consider introducing in their ship registers (4 below).

The sources of law used in the following analysis are the relevant provisions of the EU Treaty, one piece of secondary legislation (Regulation 789/2004) and the jurisprudence of the European Court of Justice (the Court). The problem of a possible conflict between freedom of establishment and the right of the Member States to adopt their own transparency requirements in relation to shipowners has not been addressed as such by the Court. However, there is general case law on the freedom of establishment and a number of cases addressing restrictions on ship registration. In addition, the Court's practice confirms that it is possible to construe the freedom of establishment in the light of case law on other fundamental freedoms.

2 Ship register transparency rules that hinder the freedom of establishment

2.1 Introduction

The provisions of the international conventions governing ship registration state only that there must be a "genuine link" between the flag State and the ship and that States are obliged to maintain registers of ships containing the names and particulars of ships flying their flags.[10] These provisions have been interpreted and applied in rather different ways and in practice do not ensure transparency in relation to beneficial shipowners in all flag States.

States running traditional ship registers commonly require ships flying their flags to be owned legally and beneficially by their nationals, either directly or through companies. This is believed to ensure that the relevant State exercises sufficient control over ships flying its flag. This also, in practice, ensures that the flag State's ship register contains sufficient information to identify the ship's beneficial owners. However, nationality requirements made by the Member States' ship registers may come into conflict with Art. 43 EC if they concern a vessel from another Member State.

[10] UN Convention on the Law of the Sea, 21 (1982) *Int'l Legal Materials* 1261-1354, Arts. 91(1), 94(1). See also the 1958 Geneva Convention on the High Seas, Art. 5. For a comprehensive discussion of the concept of "genuine link" and the relevant international case law see, *e.g.*, Robert Churchill and Christopher Hedley, "The Meaning of the "Genuine Link" Requirements in Relation to the Nationality of Ships" (a study prepared for the International Transport Workers' Federation), October 2000. Available at <www.oceanlaw.net> under section "Projects", last visited 19 November 2007.

2.2 Prohibition of discrimination on the grounds of nationality

Art. 43 EC states that restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited. By virtue of this provision, EU nationals have the right to carry on business under the conditions laid down by a Member State for its own nationals. That means that direct and indirect discrimination against the nationals of other Member States is not allowed.

The concept of establishment involves the actual pursuit of economic activity through a fixed establishment in another Member State for an indefinite period.[11] Consequently, registration of a vessel does not necessarily involve establishment within the meaning of the Treaty, in particular where the vessel is not used to pursue an economic activity or where the application for registration is made by, or on behalf of, a person who is not established, and has no intention of becoming established, in the Member State concerned.[12] However, where a vessel constitutes an instrument for pursuing an economic activity that involves a fixed establishment in the Member State concerned, the registration of that vessel cannot be dissociated from the exercise of the freedom of establishment.[13] It follows that conditions laid down for the registration of vessels must not form an obstacle to freedom of establishment within the meaning of Art. 43 EC.[14]

Art. 43 EC is understood as prohibiting restrictions on ship registration on the grounds of nationality. A Member State is not allowed to adopt legislation requiring that the legal or beneficial

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[11] Case C-246/89 *Commission v. UK* [1991] ECR I-4585, para. 21.

[12] *Ibid.*, para. 22.

[13] *Ibid.*, para. 23.

[14] *Ibid.*, para. 24.

owners of a vessel are nationals of that Member State or companies incorporated in that state and, in the latter case, that such companies are fully or partly owned by nationals of that State.[15]

Furthermore, a Member State may not prevent registration of a vessel that is owned by a company set up in another Member State. Art. 48 EC provides that

> "Companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Community shall, for the purposes of this Chapter, be treated in the same way as natural persons who are nationals of Member States."

According to *Commission v. Netherlands*, it follows from Art. 48 EC that the right to freedom of establishment is guaranteed not only to Community nationals but also to companies formed in accordance with the legislation of a Member State.[16] It follows that if an EU-registered company is controlled or owned by nationals of third states, this has no bearing on the company's freedom of establishment within the EU and, in particular, its right to register its vessel in the register of another Member State. In effect, this means that a Member State may not prevent the registration of a ship whose beneficial owners are unknown provided the above-mentioned criteria are met, *i.e.*, the ship is formally owned by a company set up in another Member State, even one whose corporate laws permit the registration of shell companies.

Prohibition of discrimination also implies that Member States are not allowed to single out foreign-owned vessels when requiring the disclosure of beneficial ownership or for stricter checking routines. Insofar as the registration of vessels owned by nationals or companies of EU Member States is concerned, the only way for a

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[15] *Factortame II*, n. 9, *supra*, para. 17; Commission v. UK, n. 11, *supra*.

[16] Case C-299/02 *Commission v. Netherlands* [2004] ECR I-9761, para. 16.

Member State to introduce transparency in relation to beneficial shipowners, while complying with Art. 43 EC, is to apply these requirements equally to all EU entities willing to register a vessel in that Member State's register.

However, in certain cases, even rules that are applied *without* any discrimination can restrict freedom of establishment within the meaning of Art. 43 EC.

2.3 Prohibition of other (non-discriminatory) restrictions on the freedom of establishment

A conflict with the freedom of establishment may arise in cases where a national of a Member State where ship registration conditions, and, in particular, transparency standards, are more relaxed, wishes to register his vessel in another Member State that has stricter transparency requirements. In such a situation, the shipowner may be put in a less advantageous position in comparison to his position in his home country. His access to the market of the other Member State may be hindered, even if the disclosure rules are applicable to all shipowners without discrimination. The shipowner may wish to remain anonymous for reasons that may range from reduced liability exposure and other economic considerations to a desire to avoid being traced because the person behind the registered owner, or chain of owners, has connections with illegal organisations. Apparently, from the shipowner's subjective point of view, the extent of the disadvantage that may be suffered may be significant.

The question arises whether the freedom of establishment encompasses a broader range of rights than a right to equal treatment. The jurisprudence suggests, with the support of legal writers, that the freedom of establishment implies the right to resist the application of national measures that are *liable to hinder or*

make less attractive the exercise of the right of establishment guaranteed by the Treaty.[17]

The scope of this right is less clear, but it appears to catch all national measures that affect access to the market by nationals of other Member States (including companies established in other Member States). If a disclosure of identity is a pre-condition for exercising the freedom of establishment, it can be argued that the reporting obligations, or other transparency conditions, imposed on beneficial shipowners by a Member State's ship register amount to a restriction on their access to the market. In addition, if a shipowner risks losing the anonymity he currently enjoys, or may have enjoyed in another Member State, he may lose interest in entering the new market altogether.

Two interests need to be balanced to determine whether a non-discriminatory national measure concerning shipowner transparency infringes Article 43 EC.

On the one hand, it is necessary to decide whether the transparency requirements amount to *conditions for market access* for the persons or companies concerned. If they do, their effect must be sufficiently certain and direct for the measure to be considered as hindering the freedom of establishment.

On the other hand, Member States are still competent to adopt their own conditions for ship registration in the absence of harmonisation. This right cannot be deprived of any significance by an extremely broad construction of Article 43 EC. To consider *any* ship registration rule that differed from other Member States' rules as limiting the freedom of establishment would apparently be going too far.

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[17] See Arnull, Anthony; Dashwood, Alan; Dougan, Michael et al., *Wyatt & Dashwood's European Union Law*, 5th Ed., London: Sweet&Maxwell, 2006, pp. 754 *et seq.*

Taking account of shipowners' arguments justifying their need for anonymity would also help in finding a balanced and comprehensive solution in cases of non-discriminatory restrictions. Such arguments would have to be based on shipowners having lawful interests so vital to them that a requirement for disclosure of identity would amount to a restriction on market access. Why is anonymity so essential for beneficial shipowners? It is common knowledge that, irrespective of the innocent grounds many shipowners might attempt to rely on, anonymity protects them from being traced in the case of incidents giving rise to liability. In addition, more recently, terrorist affiliations have become a feature of the shipping industry. The Treaty does not allow reliance on the freedom of establishment to justify the wrongful avoidance of national rules.[18] Shipowners should not, therefore, be allowed to manipulate a fundamental right guaranteed by the EU Treaty to promote unlawful objectives.

2.4 Transfer of a ship to another Member State's ship register: Regulation 789/2004

Refusal by a Member State to register a vessel, because its beneficial owners are either unidentified or suspicious, may conflict with Regulation 789 of 2004.[19] The Regulation does not harmonise conditions for ship registration in the EU, but was adopted to make it easier to transfer cargo and passenger ships between registers within the Community. The Regulation may be understood as making it unlawful to prevent a vessel from being re-flagged in

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18 *Wyatt & Dashwood's European Union Law*, p. 793 *et seq*.

19 Regulation No 789/2004 of the European Parliament and Council on the transfer of cargo and passenger ships between registers within the Community and repealing Council Regulation No 613/91, OJ [2004] L 138/19.

another EU Member State. This, accordingly, opens up a possibility to demand the transfer of a ship that is already registered in one Member State's ship register (in a register, say, with no transparency obligations as to the beneficial ownership) to another Member State's register without complying with the latter's rules on disclosure.

Regulation 789/2004 prohibits Member States from rejecting the transfer to their registers of vessels for technical reasons arising from differences in the interpretation of the IMO conventions, provided such vessels comply with the requirements of those conventions and have the appropriate certificates.[20] It appears from the wording of the Regulation that a refusal to accept transfer will be prohibited if it amounts to such a "technical reason" and, in line with the wording of the Regulation, such a technical reason can be defined by reference to an international convention governing shipping safety – and security.

As mentioned earlier, international regulations concerning maritime security do not address the question of the beneficial shipowner's identity. At the same time, the Regulation expressly allows a Member State accepting a ship to apply rules that *differ* in scope and nature from those referred to in the Conventions concerning shipping safety.[21] It can, therefore, be concluded that national rules preventing the transfer of vessels owned by anonymous shipowners between EU Member States' ship registers are not addressed by the Regulation.

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[20] *Ibid*., Art. 4.

[21] *Ibid*., Rec. 6.

3 Impact on maritime security of the anonymity of beneficial shipowners

3.1 Introduction

Member States may even be allowed to adopt discriminatory measures restricting the freedom of establishment in respect of shipowners whose true identity is unclear, provided these measures serve to fulfil certain legitimate objectives.

Firstly, Member States can justify non-discriminatory transparency rules by the need to take into account imperative requirements of general interest. Secondly, Member States can apply transparency requirements in a discriminatory manner if this is necessary in the interests of public policy or public security.

The Court has confirmed on a number of occasions that it is for the Member States to decide the level of protection they will provide in relation to the objectives set out in Art. 46(1) EC and the general interest and also the way in which that level of protection is to be attained. However, Member States can only act within the limits set by the Treaty and, in particular, must observe the principle of proportionality, which requires the measures adopted to be appropriate for ensuring attainment of the relevant objective, but not to go beyond what is necessary for that purpose.[22]

We will firstly consider whether maritime security and measures to combat terrorism fall within the scope of the objectives that the exceptions to the freedom of establishment are designed to protect. The wording of the Treaty does not give any details concerning how the objectives of "general interest" and "public policy and

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[22] Case C-55/94 *Reinhard Gebhard* (Reference for a preliminary ruling) [1995] ECR I-4165, para. 37; Case C-19/92 *Dieter Kraus v Land Baden-Württemberg* [1993] ECR I-1663, para. 32; *Commission v. Netherlands*, n. 16, *supra*, paras. 15-18.

security" must be interpreted. It appears that these three objectives are, in principle, rather similar, although it is also clear that public policy and public security arguments are subject to a more restrictive interpretation than a general interest argument because they protect Member States' rights to discriminate on the grounds of nationality.

Secondly, we will examine whether (and how) the Member States observe the principle of proportionality when imposing transparency measures in relation to beneficial shipowners, *i.e.*, whether the measures are appropriate for ensuring attainment of the objectives they pursue and do not go beyond what is necessary for that purpose.

3.2 Justifications for transparency measures or for refusal to register anonymous ships

3.2.1 Imperative requirements of general interest

A Member State can rely on certain imperative requirements of "general interest" to justify imposing conditions on ship registration that require disclosure of the beneficial ownership. The wording of Art. 43 EC, or of other provisions on the freedom of establishment, does not expressly provide for such an exception, which has been developed in the jurisprudence of the Court. However, imperative requirements of general interest cannot be acted on by the taking of measures that amount to discrimination on the grounds of nationality. Therefore, transparency requirements applicable only to vessels owned by nationals of other Member States or by companies owned by nationals of other Member States or third countries cannot be justified by such "general interest". Only measures that make market access less attractive for shipowners from other Member States, because they will be subject to stricter disclosure rules, can be allowed on general interest grounds.

If a Member State adopts a transparency rule that is restrictive within the meaning of Art. 43 EC, it should first of all examine the aims and interests that this rule is designed to protect. The Court has, in principle, accepted a broad range of aims protecting imperative requirements of "general interest", although it has not always been possible for the party claiming that the restriction was justified to show that the proportionality requirement has been met. In particular, maintenance of the social order has been accepted as a justification.[23] The need to protect the interests of creditors and the effectiveness of fiscal supervision have also been taken into account.[24] One Advocate General has suggested that the "objectives of ensuring safety at sea and preventing, reducing and controlling marine pollution", pursued through the provisions of the international conventions, to which the Community has acceded, may be thought to constitute imperative reasons of general interest or even grounds of public policy within the meaning of Art. 46(1).[25]

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[23] See, e.g., Case C-275/92 *Schindler* [1994] ECR I-1039, para. 58.

[24] *Wyatt&Dashwood's European Union Law*, pp. 804-805.

[25] Opinion of Advocate General Léger in *Commission v. Netherlands*, n. 16, *supra*, para. 61. On Art. 46, see 3.2.2 *infra*. The Advocate General also lists a number of judgments in the transport sector where the public safety and security exceptions were construed. Thus, in the inland transport sector, it is settled case law that road traffic safety is among the imperative reasons of public interest that may justify a restriction on fundamental freedoms guaranteed by the Treaty. See Case C-55/93 *Van Schaik* [1994] ECR I-4837, para. 19; Case C-314/98 *Snellers* [2000] ECR I-8633, para. 55; Case C-246/00 *Commission v. Netherlands* [2003] ECR I-7485, para. 67. In the maritime transport sector, the Court has held, with regard to mooring or nautical services, that the maintenance of public security in coastal waters, as well as in ports, could be justified by considerations of public security within the meaning of Article 46(1) EC. See Case C-266/96 *Corsica Ferries France* [1998] ECR I-3949, paras. 60 and 61, and Joined Cases C-430/99 and C-431/*99 Sea-Land Service and Nedlloyd Lijnen* [2002] ECR I-5235, paras. 41 and 42.

The general interest protected by non-discriminatory transparency measures is the prevention of the financing of terrorism through shipping activities and – at least indirectly – the protection of society against terrorist attacks. The absence of internationally binding regulations aimed specifically at increasing transparency in ship registers is not sufficient to exclude it from the range of interests that can justify at least a non-discriminatory restriction on the freedom of establishment. In any case, transparency of beneficial shipownership has been recently put on the political agenda by the OECD and other organisations, which consider such transparency necessary in the light of threats to maritime security and anti-terrorism policy.

3.2.2 Public policy and security

These considerations can be developed further in the context of the first paragraph of Article 46, which lays down exceptions on the grounds of “public security” and “public policy”.

Art. 46(1) EC states:

> “The provisions of this Chapter and measures taken in pursuance thereof shall not prejudice the applicability of provisions laid down by law, regulation or administrative action *providing for special treatment for foreign nationals on grounds* of *public policy*, *public security* or public health”. (italics added)

It follows from the very wording of this provision that the objectives of public policy and security are designed to justify discriminatory measures restricting freedom of establishment. The wording of the Treaty and Article 46(1) does not explain in more detail what constitutes grounds of “public policy” or “public security.” However, exceptions justifying discriminatory restrictions on the fundamental freedoms must be narrowly construed. That is why the interests to be protected on the grounds of public policy and security must be rather serious. At the same time, it is not

always possible or, indeed, necessary to draw a very clear distinction between objectives concerning public policy, on the one hand, and objectives concerning public security, on the other.

In case law it has been mentioned that a discriminatory measure can be justified if it prevents a "threat affecting one of the fundamental interests of the society."[26] In addition, such a threat must be "genuine and sufficiently serious".[27] A similar provision is included in the Regulation on the transfer of ships between Community registers. This allows Member States to suspend registration of a vessel for reasons relating to *serious* danger to safety, security or to the environment.[28] The risk must also be current.[29]

In one case, the Court authorised prohibition of an economic activity consisting of the commercial exploitation of games simulating acts of manslaughter on the grounds of protecting public policy due to the fact that that activity was an affront to human dignity and the prohibition was therefore regarded as imposing a justified restriction on a fundamental freedom.[30]

As mentioned at the start of this article, terrorists and their affiliates have two basic purposes for using ships and engaging in shipping activities: first, to conduct terror attacks and, second, to support terrorism by raising funds and money laundering. Terrorist attacks involve an immediate danger of large-scale loss of life and other damage. Terrorism is a broader concept that also involves other conduct to promote terrorist objectives, including the financing and other support of terrorists. Terrorist ideology and

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26 See, *e.g.*, Case C-466/98 *Commission v. UK* [2002] ECR I-9427, para. 57.

27 *Ibid.*

28 Art. 6(2) of the Regulation.

29 *Commission v. UK*, n. 26, *supra*, para. 57.

30 Case C-36/02 *Omega Spielhallen- und Automatenaufstellungs-GmbH v. Oberbürgermeisterin der Bundesstadt Bonn* [2004] ECR I-9609.

support for it are a less immediate but no less significant danger. Both terror attacks and terrorism in general disregard a number of fundamental values: most importantly, the sanctity of human life and the physical integrity of the population. The prohibition of, and sanctions for, terror attacks and certain other activities related to terrorism (notably, financing), as well as the need to prevent such activities, are all set down in several international and European documents. National laws also impose sanctions, both for the carrying out of terror attacks and for the financing of terrorism.

Maintaining the anonymity of shipowners where this may facilitate either terrorist activities or the financing of such activities is clearly not in the interests of security and the general good of society. In addition, the large-scale damage that a successful terrorist attack may bring about makes terrorism a much more significant threat than the other types of unlawful activity in which shipowners may be involved (such as tax evasion or breaches of maritime safety requirements). However, it is apparent that not all (or indeed most) anonymous shipowners whose freedom would be restricted by transparency rules will have any connections with terrorism. This question will be also touched on in the context of proportionality. Instead of targeting a *specific* person or company, transparency standards and refusals to register vessels owned by anonymous persons will be likely to have a general character. Could such *general* preventive measures be allowed under Article 46(1)?

In the context of the freedom of movement of persons, restrictions on the grounds of "public security" have been construed as permissible only in relation to *personal* conduct committed by an individual affected, whereas generally preventive considerations could not serve as justification for the restriction of this freedom.[31]

[31] *Wyatt&Dashwood's European Union Law*, p. 689.

Such personal conduct must also constitute a present threat to security or be contrary to public policy.[32] However, it appears that such a narrow construction would not take into account the differences between, on the one hand, an individual criminal act of a "regular" nature, such as theft, causing personal injury or damage to property, or even murder, and, on the other hand, engaging in terrorist activities. In the latter case, it is the general prevention of the crime, and not the reaction *post factum* that is vitally important. However, for the sake of legal certainty and the more effective practical implementation of preventive measures, Member States are recommended to elaborate more detailed requirements for achieving the desired standard of transparency in their ship registers and to develop criteria for determining what amounts to anonymous or suspicious shipownership, leading to the refusal or suspension of the registration of the vessel in their ship registers. These standards could be based on the OECD recommendations for ship registers mentioned at the start of this article. International and EU laws in the field of terrorism and security should also be consulted.

An in-depth review of such laws and their possible usefulness in formulating transparency standards as regards beneficial shipownership is not possible in this short lecture, but some of them can be mentioned briefly. Thus, the International Convention for the Suppression of the Financing of Terrorism provides for certain measures to combat such financing and imposes obligations on the contracting states in this respect.[33] Council Regulation 881/2002 imposes specific restrictive measures directed against certain persons and entities associated with bin Laden, the al-

[32] *Ibid.*

[33] The full text of the Convention is also available at <www.un.org/law/cod/finterr.htm>, last visited 19 November 2007.

Qaeda network and the Taliban.[34] The Regulation requires that all funds and economic resources – sufficiently broadly defined also to include ships owned or held by the specific persons listed shall be frozen. In my view, these and other relevant documents on the prevention of terrorism can be used by Member States' ship registers as guidance for construing and applying the exceptions to the freedom of establishment laid down in Article 46 EC to anonymous and suspicious shipowners.

3.3 Proportionality of the transparency measures

3.3.1 Overview

From the above we may conclude that terrorism, and the use of ships to further terrorist aims, is clearly a threat to public security and will be covered by the exceptions to the freedom of establishment. But do transparency requirements imposed on shipowners by ship registers *actually* help in the pursuit of maritime security objectives? Proportionality is the second criterion that both non-discriminatory and discriminatory national measures concerning transparency of beneficial shipownership must fulfil, if such measures are to be justified on the grounds of the general interest or public policy or security.

To be proportional, these measures must, on the one hand, be suitable for the attainment of the objective they pursue. On the other hand, they must not go beyond what is necessary in order to attain it.[35]

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[34] OJ [2002] L139/9.

[35] *Reinhard Gebhard*, n. 22, *supra*, para. 37; *Dieter Kraus*, n. 22, *supra*, para. 32; *Commission v. Netherlands*, n. 22, *supra*, para. 15 *et seq*.

3.3.2 Causal link

It is necessary for Member States introducing requirements on shipowner transparency in their ship registers to explain how these measures will contribute to improvements in the field of maritime security or anti-terrorism generally.

The question arises whether the proportionality requirement can only be met if the Member State in question shows that the transparency measure will influence directly the maritime security situation or prevent terrorists from deriving funds from shipping. On a number of occasions, the Court has said that there must be a direct link between the threat and the measures infringing the right of establishment[36] and that a hypothetical threat is not in any event sufficient to justify a discriminatory measure that restricts the freedom of establishment.[37]

It can be (and has been) argued that a requirement to disclose the beneficial ownership of a vessel will not *directly* improve maritime security and will not help prevent terrorist attacks from happening or terrorist organisations from collecting funds and generating revenues. It has also been argued that terrorists will not willingly disclose their identities or political affiliations in any ownership records. Terrorists can, in any case, derive income indirectly from a vessel-owning corporation through the transfer of funds to charity and similar activities. In practice this means that disclosure of the beneficial shipowner will have no impact on the current process of investigation but costs will rise both for shipowners, on whom will be imposed a reporting obligation and who will be deprived of their veil of secrecy, and for ship registers, which will have to conduct more thorough examinations. The argument goes further that shipowners are very often not the actual

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[36] *Commission v. UK*, n. 26, *supra*, para. 57.

[37] *Commission v. UK*, *op. cit.*

operators of the vessel and it is unnecessary to impose a burden of transparency on them as long as operators have an obligation to reveal their identity.

In my view, the requirement for there to be a link between the restrictive national measure and the threat should be seen in the light of the limited competence of ship registers and it should be sufficient to show that there is an indirect link. First of all, the primary objective (and effect) of transparency measures is to prevent the registration of a ship that is beneficially owned by an anonymous person with suspected terrorist affiliations in the ship register of the Member State in question. Given the limited extent of their competence, ship registers can only contribute to some aspects of maritime security and anti-terrorism policy.

It can be argued that it is the beneficial shipowner that, from the outset, decides how its vessels will be used. Owners are also the ultimate beneficiaries of the revenues generated by the vessels they own and can put these revenues to any use they wish, including activities that may be inimical to security interests. The OECD also reports that, in many cases, terrorist-related activities (especially those that are complex and logistically difficult) could only be executed with the knowledge or agreement of the shipowner.[38] The beneficial shipowner can, therefore, be held responsible for the uses to which his vessels are put. In addition, transparency requirements would make it more difficult for terrorists to own ships.

If the ownership of vessels were perfectly transparent, then owners who were known or suspected of being terrorists would find it much more difficult to use their vessels for such purposes without at least raising the suspicions of security agencies. Perfect transparency would force terrorists into complex and convoluted

[38] OECD (2003), n. 2, *supra*, para. 15.

ways of hiding their involvement in such ships, which would increase their risk of being uncovered.

Beneficial owners may seek anonymity for a variety of reasons, legal or otherwise, that have nothing to do with security. However, the reality is that the cloak of anonymity can *assist* those who wish to remain hidden because they engage in illegal or criminal activities, including terrorism.[39]

3.3.3 Only necessary measures

Lastly, transparency measures introduced by Member States' ship registers must not go beyond what is necessary to attain the envisaged objective: *i.e.*, it is always necessary to consider whether a less restrictive measure could resolve the problem. Apparently, the most restrictive measure would be a decision to refuse or suspend registration of a vessel owned by a person or a company who is not a national of the Member State operating the register. Discriminatory disclosure rules obliging only non-resident shipowners to identify themselves would be less restrictive than an outright refusal, whereas generally applicable (non-discriminatory) reporting requirements should, respectively, be considered the least restrictive.[40]

Furthermore, rules requiring such a standard of transparency that the only course of action for anonymous shipowners hiding behind shell companies would be to alter their corporate structure, share capital or their management may entail serious disruption within a company and also require the completion of numerous formalities with financial consequences. Such rules may impose an unnecessarily

[39] *Ibid.*, para. 18.

[40] See *Commission v. Netherlands*, n. 22, *supra*, para. 19, where the Court discusses the burden imposed on shipowners by the nationality requirements of the ship register.

heavy burden on shipowners. Instead, requirements for transparency can be fulfilled by beneficial shipowners without it being necessary for them to re-structure their businesses completely. For example, they could be allowed to preserve their corporate structure, but could reveal their identities by reporting to the ship register. This appears to be a sufficiently inexpensive and the least restrictive way of ensuring that the beneficial shipowners of a vessel are known.

4 Summary and concluding remarks

From the foregoing we can conclude that opportunities for shipowners to remain anonymous make it possible for terrorist organisations to use ships to further their objectives, in particular to raise funds and launder money. International and EU law do not provide for uniform ship registration rules, including rules requiring transparency as to the identity of beneficial shipowners. To minimise the exposure of their ship registers to misuse by terrorists, flag States, including EU Member States, should introduce national transparency standards for beneficial shipowners in their ship registers. In doing so, Member States must ensure that they do not infringe EU law.

Firstly, Member States are recommended to apply requirements as to the disclosure of beneficial shipownership equally to vessels owned by nationals of Member States, including those owned by companies. In cases of corporate ownership, companies established in another Member State and owned by non-EU nationals must also be treated equally.

Secondly, a Member State should assess whether non-discriminatory transparency requirements have the effect of restricting the access of shipowners to the market, so that their freedom of establishment may still be infringed. Non-discriminatory rules that restrict the freedom of establishment can still be justified by imperative requirements of “general interest”. The prevention of

terrorists gaining financing through shipping activities can fulfil such requirements.

Further, if a Member State considers that, because of security concerns, registration of a vessel owned by a registered owner from another Member State is not possible at all, or at least not until the identity of the beneficial shipowner is disclosed, the Member State may take appropriate measures, even if its own nationals are not subject to them. In doing so, the Member State must rely on "public policy" or "public security" considerations, as laid down in Article 46 of the Treaty.

The Member State must show that the discriminatory transparency requirement or its refusal to register the ship serve to counter a sufficiently serious threat to the fundamental interests of society. It must also show that the measure is proportional to the threat. In principle, prevention of terrorist financing by shipping operations qualifies as an exception to the fundamental freedoms on the grounds of public policy or security.

Finally, Member States can be recommended – in the absence of international or EU harmonisation – to develop more detailed transparency standards and formulate clearly disclosure requirements for beneficial shipowners wishing to register vessels in the Member State's ship register. Member States should take into account international and EU documents on maritime security and the prevention of terrorism when they interpret the relevant Treaty provisions and adopt the appropriate legislation.

Part IV
EU intermodal transport and carrier liability – content and context

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1 Introduction

This article presents an overview of the content and context of the ongoing discussion on *carrier liability* under a *multimodal contract of transport* within the European Union (EU) and the European Economic Area (EEA). It is part of an ongoing research project on these questions.

Multimodal transport is normally characterised by the fact that the *carriage is performed* using two or more modes of transport, in an integrated transport chain, and that the carriage is governed by one contract only. This is opposed to the traditional unimodal system, where separate contracts govern each leg of the transport, which may be undertaken, e.g., by air, sea, road or rail. Both the bases for liability, as well as the limits on liability, vary according to the different legal regimes governing these different modes of transport.

In a situation where the carriage involves more than one mode of transport, but is governed by a single contract of carriage, several problems may arise. The main problem is that a multimodal contract of carriage often does not include any reference to a particular mode of transport. This leads to uncertainty and unpredictability as regards the liability of the contracting carrier.

If the multimodal contract is signed by an entity that is not in fact a carrier, but rather some kind of forwarder, spediteur or agent, it may be difficult to identify and pursue the actual carrier for loss or damage that occurs during transport. Once the carrier has been identified, the problem arises of identifying the time and place when the damage occurred. Only once the time and place of the damage are known is it possible to decide which unimodal liability system is applicable. And even if it is obvious which regime applies,

the legal position under the existing unimodal regimes is not always clear-cut.

The relevant unimodal conventions have been implemented differently in different states and some key questions, such as the period of the carrier's liability and the basis for, and limitations on, liability are not resolved at all homogenously. In addition, some Member States within the EU have their own legal framework governing *internal* multimodal transport.[1]

In other words, the present legal situation with regard to multimodal transport and carrier liability is not at all satisfactory. The problem has therefore been discussed in various international bodies for several years.[2]

Questions concerning the liability of the carrier under a multimodal contract have also been on the EU's agenda for some years, mainly as part of the European Commission's work on creating an effective *intermodal transport chain*. This is part of the European freight transport policy as laid down in several Communications and White Papers.[3]

The Commission has appointed two groups of legal experts that have both presented reports on these questions. The first group published its work on "Intermodal Transportation and Carrier Liability" in 1999. The group started by discussing the problems

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1 An example that could be mentioned is the German HGB § 452 – 452d regulating various questions in relation to Frachtvertrag über eine Beförderung mit verschiedenartigen Beförderungsmitteln (Contract of Carriage by Various Modes of Transport).

2 See below at 4.

3 Most recently in the White Paper: "European Transport Policy for 2010: Time to decide" and its mid-term review: Communication from the Commission: Keep Europe moving – Sustainable mobility for our continent. COM(2006) 314 Final, Brussels, 22.06.2006. The legal questions are, however, not discussed in these two papers.

associated with the lack of a coherent international liability regime and looked at earlier attempts at unification. The most interesting section of the report is, however, the third part, which contains the group's views on a possible future *regional legal instrument*. Without coming to any conclusions on the content of such a regime, it is clear that the group considered that a regional legal instrument would have advantages, particularly in resolving the question of the carrier's liability during a multimodal transport.[4]

The second group of experts started its work where the first group left off and has presented a draft set of uniform liability rules for intermodal transport that has a connection with the EU,[5] the *EU proposal*. The liability provisions of this proposal will be presented in this article.[6]

It must be emphasised that the EU proposal only represents a first draft intended for further discussion and so by no means represents the Commission's final opinion. This is expressly stated in the introduction (summary) to the proposal. The proposal nonetheless potentially forms a part of the programme aiming to reduce problems in the transport sector within the EU and, in my opinion, offers an alternative in the international debate on the regulation of international multimodal transport.

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4 Intermodal Transportation and Carrier Liability. Study co-funded by the European Commission, Director General for Transport, DGVII, June 1999.

5 Integrated Services in the Intermodal Chain (ISIC) Final Report Task B: Intermodal liability and documentation. Research report commissioned by the European Commission – DG TREN provided by an independent panel of legal experts. Published by ECORYS Nederland BV, Rotterdam 2005.

6 In addition to the provisions on carrier liability in Part 3, the EU proposal contains provisions on Documentation (articles 3 – 7), on Dangerous Goods (article 12), on Notice of Loss, Damage or Delay (article 13) and finally on Limitation of Actions (article 14). These articles will not be commented on in the following.

One question is, of course, *why* the legal experts advised the Commission, and thus the EU, to consider a regional solution. Another option would have been to wait until the international discussions led to an *international convention* acceptable to the involved stakeholders. The history of these discussions, however, suggests that the adoption of such a convention might be an onerous task. There has been an earlier attempt to develop a convention on *multimodal transport*: The United Nations Convention on International Multimodal Transport of Goods (Geneva, 24 May 1980), known as the MT Geneva Convention. This Convention has, however, never entered into force. The feasibility of a new *international* legal instrument in this area is therefore still unclear.[7]

At present, the issues are being discussed internationally within the framework of the UN, in the United Nations Conference on Trade and Development, UNCTAD, as well as in the United Nations Commission on International Trade Law, UNCITRAL. The latter has recently produced a Draft Convention on the Carriage of Goods [wholly or partly] [by sea][8], (the UNCITRAL draft).

From the point of view of multimodal transport, the most interesting part of the UNCITRAL draft is that it actually contains provisions on multimodal carrier liability where the transport has a sea leg. The solutions provided in this context do not, from a Nordic point of view, depart much from the Hamburg-adjusted Hague-Visby solution we already apply to maritime transport.

In contrast, the EU proposal appears both modern and radical. This applies both to the proposed basis of liability and to its

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[7] For example, within the UN, see the UNCTAD report UNCTAD/SDTE /TBL/2003/1: Multimodal Transport: The Feasibility of an International Legal Instrument.

[8] As presented to the United Nations Commission on International Trade Law, Working Group III (Transport Law) Nineteenth session. New York, 16-27 April 2007. **A**/CN.9/WG.III/WP.81

limitation. The proposed basis of liability is "strict" in the sense that the multimodal carrier, or Transport Integrator, as described in the proposal,[9] can not prove itself innocent from presumed fault. On the other hand, it is excused if the loss, damage or delay was caused by circumstances beyond its control.[10] As far as limitation is concerned, the liability is limited to 17 SDR per kilogram of gross weight, which is the same as the highest monetary limit found in unimodal regimes. This quite "rough" liability system is softened by the fact that the proposal does not aim at a new regional mandatory legal instrument. On the contrary, it is based on an opt-out solution where the parties may agree otherwise.

The EU proposal seeks at providing the cargo interests with a simple and foreseeable method of indemnification irrespective of issues such as the Transport Integrator's rights of recourse against sub-contractors. This aspect is accordingly left out of the proposal.

As it is the main goal of the proposal to address the need expressed in Europe for a streamlined and relatively straight forward regime, it is the main goal of this article to give a short introduction both to the *content* of the EU proposal as well the *context* in which it appears.

As mentioned, the proposal is part of an important process within the EU concerning the creation of an efficient and sustainable transport policy. The aim is to tackle the major obstacles to a European intermodal transport chain and this means that the uncertain legal position of the the Transport Integrator needs to be clarified. A harmonised legal instrument on carrier liability is accordingly a prerequisite for an effective European intermodal transport chain.

This is the background to the discussions on a regional legal solution within the EU and is the topic of section 2 of the article.

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9 On the terminology see 5.2.

10 The proposed liability regime is presented below at 5.4.

Of course, the question of an international solution to the problem of multimodal carrier liability is also being discussed within the framework of the UN. To put the regional European discussion in context, section 3 looks briefly at the international situation. Section 4 then contains a presentation of the content of the *liability regime* proposed by the EU. The EU proposal also aims to regulate functional and liability issues relating to the use of a transport document, as well as question concerning the transport of dangerous goods. These questions, along with other interesting issues, such as the conflict of conventions, will not, however, be analysed in this connection. Section 5 presents some conclusions and comments on the proposed regulation of liability.

2 The European Transport Policy

2.1 Efficient and sustainable mobility

As mentioned above, the European discussion on intermodality extends further than the mere *legal questions* relating to the multimodal contract governing the carriage involved. In fact, the question of carrier liability is seen as just one of several obstacles to the main goal of increasing intermodal freight transport within the EU, making the European Transport Chain more efficient and sustainable.

The question of a Common European Transport Policy has been on the political agenda for about 15 years, starting with the White Paper on "The future development of the common transport policy – A global approach to the construction of a Community framework for

sustainable mobility”,[11] also published in a Supplement to the European Bulletin.[12] In the Supplement, the Commission started by stating that the end of 1992 “…will mark the beginning of a new departure for the Community’s common transport policy (CTP).”[13] The challenge for the Community’s transport system was defined as how to provide, in the most efficient manner, “…the services that are necessary for the continued success for the single market and the mobility of the individual traveller, while continuing to reduce the inefficiencies and imbalances of the system and safeguarding against the harmful effects that increased transport activity generates.”[14]

An efficient transport system is, in other words, seen as an essential prerequisite for the Inner Market and the EU’s competitiveness.

2.2 Intermodality and intermodal freight

The White Paper and the Bulletin were followed up by a *Communication* from the European Commission on Intermodality and Intermodal Freight Transport in the EU in 1997.[15] The Communication was based on the recognition of the fact that the

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[11] See the White Paper: The future development of the common transport policy – A global approach to the construction of a Community framework for sustainable mobility. COM (92) 494 final.

[12] The Bulletin of the European Communities, Supplement 3/1993, The future development of the common transport policy – A global approach to the construction of a Community framework for sustainable mobility.

[13] Supplement 93 at 1.

[14] Op. cit. at 92.

[15] Commission Communication to the Council, the European Parliament, the Economic and Social Committee and the Committee of the Regions, on Intermodality and Intermodal freight transport in the EU. COM(97)243 finale.

transport sector had proved incapable of appropriate self-regulation. From 1970 to 1997 European freight transport had increased by about 70%. In the same period, road transport had increased its market share from nearly 50% to 72%.[16] Consequently, the transport systems had become a source of environmental and social costs. A "business as usual" approach was accordingly not considered feasible. The EU decided that it needed a *Common european transport policy* and the *concept of intermodality*[17] was presented as a solution to the above-mentioned problems:

> "The objective is to develop a framework for an optimal integration of different modes so as to enable an efficient and cost-effective use of the transport system through seamless, customer-oriented door-to-door services whilst favouring competition between transport operators."[18]

The reason the transport industry itself was incapable of reforming the transport system was, according to economists, that any change of mode in the current modally-oriented transport system involved a *change of system*, rather than a mere technical transshipment. This change of system created, according to the Commission, "*friction costs*"[19]that prevented the formation of a competitive intermodal transport chain. In other words, in order to strengthen the intermodal transport chain, the friction costs would have to be identified and reduced.[20] In its Communication, the Commission

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16 Op. cit. at 3.

17 The concept of "intermodality" is explained below in section 3.2.

18 Op. cit. at 16.

19 Friction costs are defined as a measurement of the inefficiency of a transport operation. They are expressed in the form of higher prices, longer journeys, more delays, less punctuality, lower availability of quality services, limitations on the types of goods available, higher risk of damage to cargo and more complex administrative procedures. COM (97) 243 at 26.

20 Op. cit. at 27.

identified friction costs at three levels and suggested a range of actions to reduce these costs.

The first level of friction costs was linked to *infrastructure*, which was clearly inadequate. In 1997, a comprehensive network of modes, with interconnections between modes, was lacking. This was partly apparent physically – in certain transport corridors, there were no connections between, e.g., ports and the rail network. Another problem was that technical specifications for different modes of transport were regulated differently. Even a variation of loading unit dimensions could cause friction costs.

Even if the infrastructure could be made to work, a second level at which such costs could arise was at the *points of transport between modes*.[21] Road, rail, air and waterborne transport were characterised by dissimilar levels of performance, different working times etc. This problem was considered particular valid in relation to terminals.

The third level of friction costs to be identified was linked to the existing *mode-based information transmission system* and other *administrative bottlenecks*. At this level, *legal friction costs* were also identified. Each mode of international transport in Europe is regulated by different liability conventions. In addition, special liability regimes exist for national transports in several Member States. The problem of determining where in the transport chain the ultimate responsibility lies for cargo damage, loss or delay, is clearly a friction cost in the terminology of the Commission.

The uncertainty in relation to the issue of carrier liability during multimodal transports was, in other words, considered to form an obstacle to an efficient European transport chain.

According to the Commission, the challenge for policymakers would be to provide a framework for an *optimal integration*

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[21] Op cit. at 35-39.

between transport modes. In the Communication, several possible courses of action were mentioned. These were discussed by four action groups: *Group A –Integrated infrastructure and transport means*, *Group B – Interoperable and interconnected operations*, *Group C – Mode-independent services and regulations* and *Group D – Horizontal activities*.[22] The titles of the discussions are not very informative in themselves, but the content is explained in the Communication. Groups A, B and D cover possible actions in relation to issues of logistics and competition:

> As part of the task assigned to *Group A – Integrated infrastructure and transport means*, the Commission pointed out the need for a coherent infrastructure network at a European level. To attain such a goal, a revision of the Guidelines for a trans-European transport network needed to take place.[23] Furthermore, the points of transfer between modes needed to be turned into attractive nodes, providing logistical services.[24] Finally, work on harmonising standards for loading units needed to be initiated by the Commission. In this regard the Commission itself intended to act as a driving force in the relevant standardisation bodies and international organisations.[25]
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> For optimisation of *Interoperable and interconnected operations,* as discussed by *Group B,* management and control of the new door-to-door transport chain was essential. The Commission therefore planned to conduct a survey of the various actors in the market. The PACT (Pilot Actions for Combined Transports)[26] would continue and would, in addition to the existing modes of rail, road, inland waterways and coastal shipping, also include *Short Sea Shipping*. Of

[22] Op. cit. at 45 et seq.

[23] Op. cit. at 49.

[24] Op. cit. at 51-53.

[25] Op. cit. at 55.

[26] Commission Decision concerning financial assistance to pilot actions for combined transport 93/45/EEC of 22.12.92, O.J. No. 16, 25.02.93 and the proposal for a Council Regulation concerning the grant of Community financial assistance for actions to promote combined goods transport, CO;(96) 335 final, 24.07.1996, O.J. No. 343, 15.11.1996.

> great importance was the issue of open access to infrastructure for licensed rail operators.[27] More controversial was the proposal on common charging and pricing principles.[28] On the other hand, a revision of Regulation 1107/70 with regard to aid for combined transport, as well as the rules on state aid, would have to be conducted.[29] Cooperation to secure efficient door-to-door transport, such as the coordination of intermodal timetables was, nevertheless, welcomed by the Commission.[30]
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> In respect of the fourth and last action group, *Group D – Horizontal activities,* the Commission discussed various research projects that would have to take place to carry out the necessary innovations to fulfil the project outlined in the Communication.[31] A European Intermodal Reference Centre for Freight Transport should be established together with National Round Tables where questions on intermodality could be discussed in contrast to the traditional modes.[32]

The question of carrier liability was the subject of *Group C – mode-independent services and regulations* and this group's discussions are therefore the most interesting from the point of view of this article. Here the Commission discusses the idea of introducing a voluntary intermodal liability regime applicable within the EU.[33] Because the Commission is handing over the preparation of such a regime to a group of legal experts, the question is dealt with on less than half a page of the 20-page Communication.[34] In the small

[27] Work on creating trans-European Rail Freight Freeways has been given priority. COM (97) 243 final at 61.

[28] COM (97) 243 final at 62-63.

[29] Op. cit. at 66-68.

[30] Op. cit. at 69.

[31] Op. cit. at 83-87.

[32] Op. cit. at 92.

[33] In addition to the legal questions, the concept of introducing an intermodal real-time electronic and transaction system is discussed as a part of action group C. Op. cit. at 71-78.

[34] Op. cit. at 81-82.

amount of space allotted to the subject, however, the Commission draws up *guidelines* for how the liability regime should function.

The conditions for liability for damaged or lost (and probably also delayed) goods should be *transparent*. They should *not be mode specific* and there should be no distinction between *national and international transport.* Considering the *duration* of the carrier's liability, this should cover any "value added logistics activity…for example warehousing or product customisation at the nodal point".[35]

The Commission has thus spelt out its desire for a legal solution in which the concept *one transport – one document – one liability* is realised. Along with its efforts to create a legal instrument applicable throughout the EU, the Commission, in close cooperation with the Council, wants to keep international discussions on an international legal instrument alive. In this respect, the Communication is addressing the reopening of the MT Geneva Convention.[36] In other words, the Commission is working on a legal instrument for the EU, but it also wants to revitalise the international discussion.

3 The current international situation

3.1 No binding international convention in operation

The idea of an international legal instrument that would harmonise the carriers' liability when the transport is performed under a multimodal contract is not new, but has been discussed for

[35] Op. cit. at 81, third sentence.

[36] Op. cit. at 82.

decades.[37] The so-called container "revolution" is almost 50 years old and there has been a massive increase in containerised transport since it started in the 1960s. In recent years, the world seaborne trade in containerised cargo has more than doubled. In the wake of this development, multimodal carriage has also increased.

Despite these developments, it seems almost impossible to reach an international agreement on a harmonised legal instrument

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37 The first attempt to create an international binding legal framework was made by the International Institute for the Unification of Private Law (UNIDROIT) starting in the 1930s. This work resulted in a "draft convention on the international combined transport of goods" (UDP 1963, ET.XL.II.DOC.29). This was followed by a "draft Convention on Combined Transport – Tokyo Rules" made by the Comité International Maritime (CMI) in 1969. These two drafts were then combined into a single draft convention by the Inland Transport Committee of the UN Economic Commission for Europe (UN/ECE), the so-called "Rome Draft" of 1970. During 1970-71, this draft was modified by UN/ECE in cooperation with the Intergovernmental Consultative Organisation (IMCO). This work resulted in a "Draft Convention on the International Combined Transport of Goods", the TCM draft (a French acronym for "Transport Combiné de Marchandises". The TCM was never developed any further, but the content of the draft is reflected in standard bills of lading such as the Baltic and International Maritime Conference´s (BIMCO) Combiconbill and in the "Uniform Rules for a Combined Transport Document" of the International Chamber of Commerce (ICC), first published in 1973 as publication No. 273 (later slightly revised and published in 1975 as ICC Publication No. 298). As international work had not so far led to any harmonised binding legal instrument, UNCTAD followed up the work and eventually prepared a draft convention that led to the "The United Nations Convention on International Multimodal Transport of Goods" (Geneva, 24 May 1980), see below. A further description of these previous attempts to achieve uniformity is given in the UNCTAD report "Implementation of Multimodal Transport Rules, UNCTAD/SDTE/TBL/2, 25th June 2001 at 16.

covering multimodal transports, even though there is a desire for such an instrument within the business sectors involved.[38]

The present international situation is that there is no binding legal instrument on multimodal transport in operation. The UN's attempt to regulate the area, through the MT Geneva Convention, failed. As mentioned above, this Convention was never accepted and has not been ratified or implemented by any leading transport nation. The main reason seems to be disagreement on the *question of liability*. The carriers are unwilling to accept a liability system that would be more onerous than the existing one. The wish for uniform, predictable rules does not outweigh this risk.

So, regardless of the continuing growth of multimodal transport, the legal background is not homogenous, but fragmented and complex. The present legal framework consists of a complex array of international conventions designed to regulate unimodal carriage, diverse regional/sub-regional agreements, national laws and standard contracts.[39]

3.2 The feasibility of an international legal instrument

An UNCTAD paper, published in 2003, "Multimodal Transport: The feasibility of an international legal instrument",[40] discusses whether there is a demand for an international harmonised legal instrument on multimodal transportation and, if there is, how this instrument should be drafted.

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38 This was revealed in a discussion paper published by UNCTAD in 2003. The discussion and the paper, Multimodal Transport: The feasibility of an International Legal Instrument. UNCTAD/SDTE/TLB/2003, are presented below at 4.2.

39 Report of Expert Group 1 p. 14.

40 UNCTAD/SDTE/TBL/2003/1. 13 January 2003.

To promote an informed discussion of these topics, UNCTAD produced a questionnaire that was distributed to virtually all interested parties, including operators of transport services, freight forwarders, providers of logistics services and terminal operators, liability insurers and cargo insurers, as well as shippers and users of transport services. Responses were received from, *inter alia,* 60 governments of both developing and developed countries and 49 industry representatives.[41]

On the question of the desirability of a new international instrument, the great majority (92%) of respondents considered an international instrument governing liability arising from multimodal transportation desirable.[42]

The legal content of such an instrument was, however, less easy to agree on. One key question concerned the kind of liability system the legal instrument should embody. Here UNCTAD presented *three optional systems*, in general based on existing liability systems: the uniform liability system; the network system; and the modified liability system.[43]

A *uniform liability system* applies the same liability rules irrespective of the unimodal stage of transport during which loss, damage or delay occurs. Under such a system, the result should be the same whether or not the loss can be localised.[44]

In a *network liability system*, different liability rules will apply depending on the unimodal stage of transport during which the loss, delay or damage takes place. The network system implies the existence of a secondary "fall-back" set of rules to apply when the

[41] Op. cit. at 2.

[42] Op. cit. at 27.

[43] Op. cit. at 44.

[44] Op. cit. at 45.

damage cannot be localised. This is, to a large extent, the international legal situation today.[45]

The third optional system discussed by UNCTAD is the *modified liability system*. This system more-or-less represents a compromise between the two liability systems mentioned above. An international legal instrument based on a modified liability system would provide various solutions to questions relating to liability.[46]It would probably be easy to obtain consensus on the instrument as such, but not, of course, in the area of liability. The system would be flexible and allow for many different solutions. On the other hand, such an instrument would lack the benefits of a uniform system, such as the important aspect of predictability. As far as predictability is concerned, a uniform liability system would undoubtedly be better.

The problem with the *uniform liability system* is concerns from business that the carriers' liability would increase compared to the current situation. Two situations in particular have been highlighted.[47] First, if uniform rules applied irrespective of the modal stage of transport during which the damage occurred, a carrier would no longer be able to take advantage of the potentially less burdensome liability rules that might otherwise apply. Second, there is concern about the carriers' right to seek recourse against any responsible sub-contracting actual or performing carrier. If the sub-contracting unimodal carrier is subject to less burdensome liability rules, the multimodal carrier might not get his total loss reimbursed. A uniform liability system would, in other words, meet resistance from the transportation industry.

[45] Op. cit. at 49.

[46] Op. cit. at 53.

[47] Op. cit. at 47.

This industry would probably support the idea of a *network liability system*. This is the alternative that differs least from the present international legal framework and also the system that provides the carrier with the possibility of relying on the less burdensome liability system. The UNCITRAL Draft Convention is based on a network system. The EU proposal, in contrast, is based on a uniform liability system.

4 The EU draft on uniform liability rules for intermodal transport

4.1 Introduction

It was apparent from the very beginning that the EU proposal should be based on a *uniform liability system*. The expert group drafting the EU proposal had clear instructions: they were to draft a set of uniform intermodal liability rules which “concentrate the transit risk on one party and which provide for a strict and full liability of the contracting carrier for all types of losses (damage, loss, delay) irrespective of the modal stage where a loss occurs and of the cause of such a loss”.[48] The proposal might, in consequence, be characterised as *uniform and efficient*.

This “strict” approach is, however, softened by the fact that the parties to the contract may agree to *opt-out* of the regime. In contrast to the present international regimes that are either mandatory (conventions) or based on voluntary opt-in solutions (private rules), the EU proposal aims to become the standard solution, but with a possibility for the parties to opt out.

If the parties do not opt out of the regime, the carrier will face *strict liability* for loss, damage or delay from the time it takes over

[48] The EU proposal p. 6.

the goods until the goods are delivered, except in the case of circumstances *beyond the control* of the carrier. On one point the proposal leaves some freedom of contract to the parties, who may agree to a higher monetary limit on the Transport Integrator's liability than is provided by the EU proposal itself.

4.2 Terminology

4.2.1 Intermodal transport

It is not only the liability system of the EU proposal that differs from the existing legal regimes. The terminology of the EU proposal is also somewhat different from the terminology that has come to be accepted at an international level. The MT Geneva Convention uses the term *multimodal transport* to refer to a situation where the carriage involves more than one means of transport.[49]

The EU proposal does not use the term multimodal transport, instead favouring the term *intermodal transport*. The term intermodal transport was introduced by the Commission in its Communication from 1997 in which the concept of *intermodality* was explained. According to the Commission, intermodality "…can bee understood as the movement of goods whereby at least two different modes are used in a door-to-door transport chain." [50] Here the fact that a single contract covers carriage performed by two or more modes of transport is crucial.

One might ask whether there is any difference between the terms *multimodal* and *intermodal* transport. While the term "multimodal transport" is strictly a legal term, referring to the fact that the transport is performed by two or more different modes governed by

[49] Op. cit. Article 1.

[50] See COM (97) 243 Final on Intermodality and Intermodal Freight Transport in the European Union, p. 1.

a single contract, *intermodality*, in the context of the EU, has an *economic* aspect.

According to the Commission, intermodality is a "...quality indicator of the level of integration between the different modes: more intermodality means more integration and complementarity between modes, which provides scope for a more efficient use of the transport system."[51] The *economic basis* for intermodality is thus that transport modes that are economically and operationally efficient on an individual basis, can be integrated into a door-to-door transport chain in order to improve the overall efficiency of the transport system.

Intermodality accordingly focuses on economic efficiency in integrating the different modes of transport into a single transportation chain. This means that legal tools alone (the regulatory conditions) are not enough. Issues of a purely logistical character, such as practical questions to do with infrastructure, loading units, services etc., also have to be considered.[52]

The Commission's idea is that market mechanisms will encourage the use of multimodal transport chains: "The object is to develop a framework for an optimal integration of different modes so as to enable an efficient and cost effective use of the transport system through seamless, customer oriented door-to-door services whilst favouring competition between transport operators."[53]

As outlined above, this political ambition to create an efficient intermodal freight transport system in Europe extends further than merely resolving the legal obstacles to its success. We might say that the term intermodality reflects this.

[51] L.c.

[52] L.c.

[53] L.c.

Nevertheless, from a *legal point of view* the choice of term is of no relevance. Both *intermodal* and *multimodal* cover the situation where a carriage is performed by more than one mode of transport governed by one single contract. The terms are frequently used interchangeably.

The compatibility of the terms is expressed in the EU proposal's comments on the draft articles. As mentioned above, the EU proposal does not use the terms *intermodal transport* or *intermodality* in its proposed provisions. The terminology is, however, taken for granted and explained indirectly through the definition of a "*Contract of transport*" in Article 1:

> 1. For the pur*pose of this* Regime:
>
> (a) "Contract of transport" means a contract whereby a Transport Integrator undertakes to perform or procure the transport of goods from a place in one country to a place in another country, whether or not through a third country, involving at least two different modes of transport, and to deliver the goods to the consignee.

The regime applies, in other words, to contracts for the carriage of goods "involving" at least two different modes of transport. This means that the Proposal *will not apply* to the extent that a contract of transport is within the scope of unimodal regimes such as CMR, CMI, the Hague/Visby Rules or the Montreal Convention.[54]

4.2.2 Transport Integrator

The Transport Integrator is defined in Article 1, paragraph 1(f).

> …a "Transport Integrator" means any person who concludes a contract of transport and who acts as principal, not as agent or on behalf of the consignor and assumes responsibility for the performance of the contract.

[54] This might lead to a problem of a conflict of conventions, but the likelihood of this is probably reduced by article 2 "Scope of application", see below at 5.3.

According to comment (i) to Article 1, paragraph 1(a) the term "Transport Integrator" is applied to the multimodal transport operator to reflect the overall project of "Integrated Services in the Intermodal Chain", of which the EU proposal forms part,[55] and to distinguish the EU proposal from other transport regimes and the Transport Integrator from other operators in the field.[56]

To understand which entities are subject to the proposed liability regime, Article 1, paragraph 1(f) must be read together with Article 1, paragraph 1 (a), as referred to above. This definition tells us that the proposal encompasses not only the carriage of goods (i.e., the *performance of the transport)*, but also the task of *procuring such a transport*, typically an operation that is taken care of by, for example, freight forwarders.

The latter group is excluded from the existing unimodal transport liability regimes, as well as from the UNCITRAL draft convention, where a carrier is indirectly defined in Article 1 paragraph 1 "Contract of carriage" in which "a carrier …undertakes to carry goods form one place to another." The MT Geneva Convention also relates liability to a "…carriage of goods……..from a place in one country…to a place designated for delivery in a different country" (Article 1, paragraph 1), in other words, freight forwarders, are excluded. Both regimes are emphasising the performance of the transport, and not the procuring of such. This of course does not exclude the multimodal carrier who is not performing the carriage himself. Essential is whether or not it has undertaken to perform the carriage

In contrast to the earlier legal regimes and proposals, the EU proposal recognises that the close connection between the

55 The EU proposal p. 16.

56 The Geneva Convention uses, for example, the expression Multimodal Transport Operator (MTO).

functions provided by a freight forwarder and a multimodal "carrier" has consequences for the scope of application of the liability regime. A freight forwarder is an independent professional who organises and coordinates a carriage from departure to destination. His work includes negotiating contracts of transport that are concluded in his own name, but on behalf of his customer. He has complete freedom to choose the means of transport, but normally does not perform the carriage himself, although he may do so.[57] The task of a freight forwarder is, in many respects, identical to the task of a multimodal "carrier" and, in many jurisdictions, freight forwarders are considered to be carriers if they charge a fixed price for their services.[58]

The EU proposal's inclusion of freight forwarders within the same liability system as the Transport Integrator is a step forward in achieving legal certainty in this area. As Kiantou-Pampouki remarked, the international situation is confused, regarding both the activities of freight forwarders as well as their legal status.[59] If the freight forwarders wish to exclude themselves from the proposed liability system, they may "opt out" pursuant to the rules in Article 2, "Scope of Application".

For the record, it should be mentioned that the term Transport Integrator, unless the context requires otherwise, includes its "…servants or agents, and any other person engaged for the performance of the obligations under the contract of transport," (Article 1, paragraph 2).

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[57] See Aliki Kiantou-Pampouki: Multimodal Transport Carrier Liability and Issues Related to Bills of Lading. The General Report p. 11 et seq. Published in: Aliki Kiantou-Pampouki (ed): Multimodal Transport. Carrier Liability and Issues Related to Bills of Lading, XVth International Congress of Comparative Law Bristol 1998, Brussels, 2000.

[58] The EU proposal p. 18.

[59] L.c.

4.3 Scope of application

4.3.1 Opt out

As mentioned above, the EU proposal is based on an "opt-out" solution. According to Article 2:

> "The provisions of this Regime shall mandatorily apply to all contracts of transport…
>
> Unless the parties to the contract have agreed that it shall not be governed by the regime."

Several other legal regimes also operate within this area, such as, for example, the various unimodal regimes. The proposal is therefore only an option. A mandatory international regime would, of course, provide the greatest certainty through a high level of harmonisation. However, given the international situation, such a regime would be almost impossible to establish. It would probably also be strongly opposed within the EU by important players in the industry and thus generate commercial and political tensions. To avoid this, but also to increase the level of harmonisation compared to a situation where soft law (opt-in) solutions were chosen, the expert panel chose a kind of middle way by proposing a legal regime based on an opt-out solution.

This opting out could be done in several ways or "in any form", as expressed in the comments to the proposal.[60] It is sufficient for the agreement to emerge from a Transport Integrator's general conditions. With the exception of the provisions on the limitation of liability, it is not possible to exclude only parts of the proposal from the contract, as this would prevent the proposal from being simple and transparent. On the other hand, it is not possible to prohibit the parties from including parts of the regime in their contracts.

[60] The EU proposal p. 18.

4.3.2 International transport

If the parties have not opted out of the regime, it will be applicable to international multimodal transports with a point of contact in the EU. The definition of a contract of transport in Article 1 paragraph 1[61]makes it clear that the regime does not apply to domestic transport within EU Member States. The transport must be from "a place in one country to a place in another country." The more precise meaning of the reference to international transport becomes clear in Article 2, on the scope of application. This states that the proposal will apply to all contracts of transport if:

> a) "the place for the *taking in charge* of the goods by the Transport Integrator … is in a State member of the European Economic Community or
>
> b) the place *for delivery* of the goods... is in a State member of the European Economic Community"

The proposal is not limited to international *internal transport*, but will apply to exports and imports to or from the European Economic Community, or in practical terms, the EU.[62] One point of contact with the EU is sufficient. Either the place of loading or the place of delivery must be within the EU. This broad scope is in line with the transport policy of which the proposal forms a part.

4.4 The proposed liability regime

4.4.1 The liability of the Transport Integrator

The provision on the liability of the Transport integrator is to be found in Article 8, which is here quoted in full:

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61 See above at 5.2.1.

62 The European Economic Community, the EEC is, due to changes in the treaties, nowadays known as the European Community, the EC. The EC area equates to the EU.

> 1. The Transport Integrator shall be liable for total or partial loss of the goods or damage to the goods occurring between the time he takes over the goods and the time of delivery, as well as for any delay in delivery.
>
> 2. Delay in delivery occurs when the goods have not been delivered within the time expressly agreed upon by the parties to the contract of transport or, in the absence of such agreement, within a reasonable time, having regard to the circumstances of the case.
>
> 3. If the goods have not been delivered within 90 consecutive days following the date of delivery determined according to paragraph 2, the claimant may treat the goods as lost.
>
> 4. The Transport Integrator shall not be liable for any total or partial loss of the goods, or damage to the goods, or delay in delivery of the goods to the extent that it was caused by circumstances beyond the control of the Transport Integrator.

Article 8, paragraphs 1 and 4, regulate the *basis for the liability*, which as mentioned above is *strict*. This is apparent from the wording of the introduction: “The transport Integrator *shall be liable…”*. The only exception from liability is provided for in Article 8, paragraph 4, which states: “The Transport Integrator *shall not be liable*…to the extent that …[the loss] was caused by *circumstances beyond the* control of the Transport Integrator”.

This is stricter than the existing unimodal regimes and the proposed multimodal regimes. Liability under both the UNCITRAL Draft[63] and the MT Geneva Convention is based on negligence with a reversed burden of proof.[64]

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[63] See UNCITRAL Draft Convention Article 17, paragraphs 1 and 2. According to Article 17 paragraph 2: “The carrier is relieved of all or part of its liability pursuant to paragraph 1… if it proves that the cause or one of the causes of the loss, damage, or delay is not attributable to its fault of any person referred to in article 18, paragraph 1.” Article 18 contains rules on the carrier’s liability for other persons.

[64] See Geneva Convention Article 16, paragraph 1. The multimodal transport operator is liable unless: “…he, his servants, agents or any other person referred to in Article15 took all measures that could reasonably be required

The basis for liability is in line both with the Commission's instructions to the expert group[65] and the attempt to create a European intermodal freight transport system, where the intention is to reduce the friction costs of changing from one mode of transport to another. In other words, the basis of liability must be considered in this context. Strict liability offers greater certainty to the cargo interests and is therefore presented as the optimal solution in the European context.

Liability cannot, of course, be total. If the failure in performance of the obligation in question is literally *beyond the control of the Transport Integrator*, it will face no liability. This type of liability is also familiar outside the transport sector in international contract law, for example, in the United Nations Convention on Contracts for the International Sale of Goods (CISG).[66] The concept was created in order to reach a compromise between common law liability with a strict liability except for situations characterised as "*force majeure*" and the continental tradition of liability based on neglect.

One might ask what type of liability the EU-proposal is aiming at. As to the wording, the liability system clearly reminds that of the CISG. On the other hand, reading the comments to the proposed Article, it seems like the liability is in line with the common law liability: "The result is a strict liability overall, which is similar to that found for contractual obligations in common law legal systems,…".[67]

Under the proposal, the Transport Integrator will not be liable if it can establish that the loss, damage or delay was "…caused or

to avoid the occurrence and its consequences." Article 15 contains rules on the liability of the multimodal transport operator for his servants, agents and other persons.

65 EU proposal p. 6.

66 In norwegian we are familiar with the consept as "kontrollansvar".

67 EU proposal p. 22.

contributed to by fault on the part of consignor or consignee, to that extent the Transport Integrator will be exonerated."[68] The example is either not very exact or it indicates a wish on the part of the expert group to insert a wider exception for the Transport Integrator than a Nordic reader would expect from an exception for circumstances "beyond the control of" a party.

4.4.2 The period of responsibility

As far as the period of responsibility is concerned, the EU proposal is in line with the usual situation in regimes governing transport. The normal approach is that liability attaches to the period from the time the Transport Integrator *takes over the goods* to *the time of delivery*. The goods are considered as being taken over by the Transport Integrator (or carrier) when they are received into the Transport Integrator's *custody and control*. The time of delivery is when custody and control passes from the Transport Integrator to another person.

As far as the scope of the liability rule is concerned, this is also in line with the usual approach. The Transport Integrator is liable for "total or partial loss of the goods or damage to the goods, … as well as for any delay in delivery".[69] If the time of delivery is not expressly agreed upon, the goods are delayed if they do not reach their destination within a "reasonable time". The goods are considered lost if they have not been delivered within 90 consecutive days, following the date of delivery.

It is uncertain how the industry will view the rules on the basis of liability. A definite subject of debate, however, is the proposed rule on the limitation of liability.

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68 EU proposal p. 22.

69 EU proposal p. 22.

4.4.3 Limitation of Liability

The research carried out by UNCITRAL during discussions on the feasibility of an international legal instrument has shown, as has been the case with all previous attempts at harmonisation, that one of the key areas of disagreement is the issue of limitation of liability. The conclusion of the UNCITRAL project was that 92% of the stakeholders favoured an international solution but, since no one wanted their liability to become more burdensome than it was at present, it was impossible to establish a common position on limitation. Various network liability systems have therefore been proposed as the solution. Both the MT Geneva Convention and the UNCITRAL Draft are based on some kind of network system.

As uncertainty in relation to liability during intermodal transportation was considered one of the major obstacles to achieving a European intermodal transport chain, it was clear that the EU proposal could not be based on a network system. The goal of *one transport – one document – one liability* had to be achieved. It is therefore not surprising that the expert group suggested a uniform liability system, applying a single level of limitation irrespective of the mode where the loss, damage or delay occurred.

The proposed limitation rule reads as follows:

> 1. When the Transport Integrator is liable for loss resulting from loss of or damage to the goods according to article 8, his liability shall be limited to an amount not exceeding 17 units of account per kilogram of gross weight of the goods lost or damaged.
>
> 2. The liability of the Transport Integrator for loss resulting from delay in delivery according to the provisions of article 8 shall not exceed twice the amount of the charge payable under the contract of transport.
>
> 3. The aggregate liability of the Transport Integrator, under paragraphs 1 and 2 of this article, shall not exceed the limit of liability for total loss of the goods as determined by paragraph 1 of this article.

> 4. By declaration of value or otherwise, the Transport Integrator and the consignor may agree on limits of liability exceeding those provided for in the preceding paragraphs of this article.
>
> 5. The unit of account referred to in paragraph 1 is the Special Drawing Right as defined by the International Monetary Fund. The amounts referred to in paragraph 1 shall be converted into the national currency of a State according to the value of such currency on the date of the judgement or award or the date agreed upon by the parties. The value of a national currency, in terms of the Special Drawing Right, shall be calculated in accordance with the method of valuation applied by the International Monetary Fund, in effect on the date in question, for its operations and transactions.

Neither of the groups of legal experts appointed by the Commission has questioned the need for a rule limiting liability. In the light of the legal context of the EU proposal, this would have been remarkable. Legal certainty is a key objective on the path towards an efficient European intermodal transport chain. A fixed cap on liability is therefore necessary in this context.

It is more surprising that the proposal contains no provisions on how to calculate the loss for which the Transport Integrator will be liable. If the Transport Integrator loses his right of limitation (which will be the case, according to article 10, where the damage, loss or delay was caused intentionally by the Transport Integrator), the EU proposal does not regulate how this loss should be calculated.

Concerning the reasons for the choice of 17 Special Drawing Rights, the EU proposal is based on the highest monetary limit found in unimodal regimes, such as those governing rail and air transport.[70] Such a limit avoids the limitation amount being insufficient whenever an intermodal transport includes a leg by rail or air. As far as carriage involving a sea or road leg is concerned, the proposal would lead to an increase in limitation amounts. For

70 EU proposal pp. 10-11.

road carriage, the limit would more than double from 8.33 SDR to 17 SDR and for sea carriage the limitation amount of 2 SDR per kilogram would increase greatly. Because of the alternative unit limitation system employed in sea transport, it is the view of the group of legal experts that the proposal will still sometimes provide the Transport Integrator with a lower limit than the combined unit/per kilo limitation under the Hague/Visby Rules.[71]

This harmonised uniform limit on liability might, of course, lead to a potential *conflict of conventions*. If it is clear that the damage occurred when the goods were being transported by road, the Transport Integrator might want to invoke the liability rules of the CMR with its provision for unit limitation of 8.33 SDR. The group of legal experts behind the EU proposal states that it is the intention that in all such cases it is the proposal and not the CMR that should apply.[72] If the proposal is implemented as an EU Regulation, such a conflict might be avoided. These questions are, however, not at all clear and should be subject to further research.

As far as delay is concerned, a limit equal to twice the amount payable under the contract will apply (Article 9, paragraph 2). However, the combined liability for damage or loss and delay shall not exceed 17 SDR (Article 9, paragraph 3).

If Transport Integrators find that the EU proposal does not satisfy their interests, there is always the possibility of opting out of the system. Otherwise, the proposal is based on a kind of “take-it-or-leave-it” principle. From this, however, there is one exception. The consignors are allowed to make a *declaration of value* and to obtain full compensation up to that value. In such cases the Transport Integrator will normally increase its charges by applying so-called “ad valorem freight”. The EU proposal is here in line with the standard position on this question: there is no reason why the

[71] Op. cit. p. 11.

[72] Op. cit. p 12.

parties should not be entitled to agree on higher limits or, indeed, no limit at all and to do so in some other form than a declaration of value.[73]

On the other hand, if the Transport Integrator *by wrongful intent* or *recklessness* has caused the loss, damage or delay, knowing that this would be the result of its actions or omissions, then the Transport Integrator will lose the right to benefit from the limitation of liability provided in Article 9. This follows from Article 10, Loss of right to limit responsibility:

> The Transport Integrator shall not be entitled to the benefit of the limitation of liability provided for in this Regime if it is proved that the loss, damage or delay in delivery resulted from a personal act or omission of the Transport Integrator done with the intent to cause such loss, damage or delay or recklessly and with knowledge that such loss, damage or delay would probably result.

The loss of the right to limit liability only applies if the intent or recklessness resulted from "a personal act" by the Transport Integrator. Firstly, this means that the group of persons mentioned in Article 1, paragraph 2, "the servants, agents or other persons engaged for the performance for the obligations under the contract of transport", is excluded.[74] Secondly, if the Transport Integrator is a corporation (which it normally will be) the conduct will be categorised as personal if it is an act or omission of a human being concerning an executive matter which that person is authorised to decide without further reference to any other person in the managerial structure of the enterprise.[75]

The EU proposal is here in line with present conventions and draft conventions. Both the MT Geneva Convention, Article 21, as

[73] EU proposal at p. 23.

[74] Op. cit. p. 16.

[75] Op. cit. p. 24

well as the UNCITRAL Draft, Article 64, contain the same exception from the benefit of the limitation rules.

4.4.4 Non-contractual liability

Finally, it should be mentioned that, to prevent cargo interests from seeking to put themselves in a better position than would be the case under the EU proposal, the proposal limits the effect of a tort claim against the Transport Integrator in Article 11:

> The defences and limits of liability provided for in this Regime shall apply in any action against the Transport Integrator in respect of loss resulting from loss of or damage to the goods, as well as from delay in delivery, whether the action be founded in contract, in tort or otherwise.

5 Conclusions

One of the main *legal obstacles* in the process *Towards a European Multimodal Transport Chain* is the friction costs resulting from the uncertain legal position of a multimodal carrier, especially in relation to the question of carrier liability. This issue has been discussed internationally for decades. It is no secret that the main problem has been the industry's response to proposed new legal instruments. Even though there is apparently a demand for a clear and foreseeable legal solution, no one wants their own liability to be more burdensome than under the existing system.

To placate the industry, earlier draft conventions have been, and still are, based on a *network liability system*. Under a network liability system, different liability rules will apply depending on the unimodal stage of transport during which loss, delay or damage takes place. Such a system requires the existence of a secondary "fall-back" set of rules to apply when the damage cannot be localised.

Under such a system, the industry would not face the imposition of any liability more burdensome than the current situation. On the other hand, the goal of a predictable, uniform liability system would not be achieved.

The EU faces a major problem in that its transport industry is unable to meet market demands or the challenge of providing more sustainable transport. The European Commission is therefore attempting to establish a European transport policy in which the European intermodal transport chain plays an essential role. The EU proposal, which advocates a strict *uniform liability system*, must be evaluated in this context.

Part V
EC external competences: recent developments and the implications for maritime agreements

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1 Introduction

One of the difficulties facing the international community when concluding agreements, to which the EC[1] and its Member States are parties, is the uncertainty as to the extent to which the EC has replaced the Member States in terms of competence to conclude such agreements. The judicial authority which has exclusive competence to determine this question is the European Court of Justice (ECJ). In the 1960s[2] the ECJ made it clear that a new legal order had been created by the Treaty of Rome establishing the European Economic Community (renamed European Community by subsequent Treaty amendment). The Court observed that the Member States had transferred their sovereign powers in a number of fields to the European Community, thus depriving the Member States from acting in those fields. In other areas, the Community shares competence with the Member States or has no competence. However, since its establishment in the 1950s, amendments to the EC Treaty have conferred on the EC further internal competences. Thus, the extent of the Community's external competence in these new areas, remain a matter of concern for the international community.

In 2006, the ECJ delivered an Opinion[3] on the nature of the Community's competence to conclude an international agreement

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1 As the European Community (EC) rather than the European Union (EU) has legal personality to enter into international agreements, reference will be made throughout this paper to "EC" or "the Community."

2 Case 26/62 *Van Gend & Loos* [1963] ECR 1.

3 Under Article 300(6) EC Treaty one of the EC institutions or a Member State may request the ECJ to deliver an Opinion as to the compatibility with the provisions of the EC Treaty of a proposed international agreement.

and a judgment on the status, within the Community legal order, of mixed agreements, that is, agreements where the competence is shared between the EC and the Member States.

In Opinion 1/03[4] in respect of the conclusion of the Lugano Convention,[5] the ECJ ruled that in determining whether the Community has exclusive competence account has to be taken not only of the field concerned but also the nature and content of the rules and provisions incorporated in the international agreement to ensure that the agreement is not capable of undermining the uniform and consistent application of the Community rules and the proper functioning of the system which they establish. Three months later, in the *Mox Plant* case,[6] the ECJ ruled that mixed agreements have the same status in the Community legal order as purely Community agreements and that the exercise of Community competence in a mixed agreement is not necessarily confined to the Community's exclusive competence.

This paper is based on a presentation delivered at the Scandinavian Institute of Maritime Law in November 2006 and has two objectives: first, to describe briefly the general external EC competence to conclude international agreements; and, secondly, to evaluate the ECJ's Opinion 1/03 in respect of the Lugano Convention and its ruling in the *Mox Plant* case. These are important developments which should be of interest to those negotiating and concluding International Maritime Organization agreements (IMO Agreements). Given the direction that the ECJ has taken in giving a broad interpretation to the EC's external exclusive competence and interpreting mixed agreements as being

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4 [2006] ECR I-1145.

5 The Convention of Lugano on jurisdiction and the enforcement of judgments in civil and commercial matters, 1988, OJ 1988 L319/9.

6 Case C-459/03 *Commission v Ireland* [2006] ECR I-4635.

equal to pure Community agreements in their internal effect within the Community's legal order, it may well be that certainty as to the effectiveness of international maritime agreements might be better secured by having the EC becoming a party to IMO-Conventions. If the Member States themselves are in effect deprived from independent action under Community law would it not be better for the international maritime community that the EC should be accountable for the obligations and responsibilities imposed by such agreements?

2 EC competences in concluding international agreements

The EC Treaties have conferred on the EC expressed exclusive and shared competences to conclude international agreements. For example, Article 133 EC Treaty confers on the EC exclusive expressed competence to negotiate international agreements within the scope of the common commercial policy. Exclusive implied competence has also been conferred upon the EC by the manner in which the ECJ has interpreted the EC Treaties. Relying on the doctrine of implied powers, the Court has ruled that the Community has power to conclude international agreements arising not only from the expressed powers conferred by the EC treaty, but also from the internal measures adopted by the Community exercising its internal competences. Well known examples of exclusive implied competence are to be found in the Court's *Opinion 1/76*[7] and in its *ERTA* ruling.[8] In *Opinion 1/76* the ECJ concluded that where an international agreement is a prerequisite to enable the Community to discharge an obligation arising under

[7] [1977] ECR 741.

[8] Case 22/70 *Commission v Council* [1971] ECR 263.

the EC Treaty, then it will be implied that the Community has exclusive competence to conclude such an agreement. *Opinion 1/76* concerned an agreement to regulate navigation on the Rhine. Under the EC Treaty, the Community has a duty to establish a common transport policy which includes the regulation of internal waterways. In attempting to reduce over capacity operating on the river Rhine, the Community required the cooperation of non-EC States. Thus, in order to achieve an internal EC Treaty objective, it was necessary to conclude an international agreement. In this type of situation the ECJ ruled that the exclusive competence could be implied. Although such a situation has never arisen again,[9] the ECJ confirmed its ruling in *Opinion 1/76* in *Opinion 1/03*.[10]

A more common example of exclusive implied competence is to be found in the *ERTA* ruling where the ECJ established an important general principle. In simple terms the so-called *ERTA* doctrine states that where common rules have been adopted by the Community, the Member States no longer have the right, acting individually or even collectively, to undertake obligations with non-EC States which affect those rules. Thus where the Community has occupied a field by, for example, adopting secondary measures such as regulations, it has exclusive competence to conclude international agreements in this field.[11]

In all other cases the Community has either shared competences with the Member States or no competence. Confusion however arises since it is very rare that international agreements concern only an area where the Community has exclusive competence. It is

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[9] In fact the existence of exclusive implied powers arising from such situations appeared to have been denied in *Opinion 1/94* [1994] ECR I-5267 (the WTO Opinion), and in the *Open Skies* cases, Cases C-466-69/98, C-471-72/98 and C-475-76/98, [2002] ECR I-9427 et seq.

[10] Paragraphs 114 and 115 of the Opinion.

[11] At para 17 of the *ERTA* judgment.

much more common to have international agreements covering a number of fields. In most cases the Community's exclusive competence will rarely extend to the entire agreement. However as the Community expands its policies and exercises its law-making powers, the more relevant the *ERTA* doctrine becomes. One such area is marine pollution where several EC directives have been adopted as a response to the number of accidents on European waters such as Prestige and Erika.

A further complication arises since the Commission, in practice, negotiates on behalf of the Member States and then leaves the issue as to who signs the final agreement to a later stage.[12] Clear examples of this practice can be seen in the WTO Agreement and in the Lugano Convention. In both cases an Opinion was sought from the ECJ under Article 300(6) EC Treaty[13] since the Member States claimed shared competence whilst the Commission claimed exclusive competence to conclude the agreement on behalf of the EC.[14]

Thus the picture that emerges is rather confusing to non-EC states. The Commission appears to have external and internal roles. It acts externally on behalf of the Community when the latter has exclusive competence or as 'an agent' or 'a representative' of the Community and the Member States where the competence is mixed. It also has an internal role in helping the Member States to reach a common view. In the case where the Community has exclusive competence, the Commission's role is definitely stronger and easier to discharge. However, where the competence is shared, the arrangements to get the Member States to reach a common

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12 The negotiation takes place in accordance with Article 300 EC Treaty.

13 See note 3 above.

14 *Opinion 1/94* and *Opinion 1/03* both cited above at notes 9 and 4 respectively.

position in their individual negotiations with the non-EC State or organisation are informal and sometimes more difficult to achieve.

3 The ECJ Lugano Opinion, the *Mox Plant* judgment and maritime agreements

The *ERTA* doctrine has been further developed by the ECJ in *Opinion 1/03,* the Lugano Opinion. The facts were as follows. The Treaty of Amsterdam conferred new powers on the Community in respect of judicial cooperation in civil matters, so the EC adopted Regulation 44/2001 on the recognition and enforcement of foreign judgments.[15] After the adoption of the Regulation, the Commission was authorised to negotiate with the EFTA countries a convention (Lugano) on similar terms. However, before the Lugano Convention was signed, the ECJ was asked to deliver an Opinion on whether the Community had exclusive competence to conclude this international agreement. The uncertainty as to the type of competence the Community could exercise arose because the ECJ had delivered some judgments post *ERTA* which were, if not contradictory, certainly unclear. In the WTO Opinion (*Opinion 1/94),*[16] the ECJ appeared to restrict the *ERTA* doctrine by suggesting that the Community obtained exclusive implied external competence only after a certain policy field had been completely harmonised by Community measures. However, in the *Open Skies* judgments[17] the Court stated that exclusive implied competence existed where

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[15] Regulation 44/2001, OJ 2001 L12/1. The Regulation does not apply to Denmark. This Regulation replaced the so-called Brussels Convention on Jurisdiction and Recognition of Foreign Judgments which had been concluded between the EC Member States as early as 1968, OJ 1978 L304/34.

[16] See above note 9.

[17] Ibid.

policy fields had been 'largely harmonised'. A similar expression had been used earlier by the ECJ in *Opinion 2/91* delivered in respect of an International Labour Organization Agreement.[18]

In the Lugano Opinion the Court stated that in determining whether the Community has competence and whether that competence is exclusive, account must be taken not only of the field «but also of the nature and content of the Community rules»[19] and the terms of the international agreement concerned. It is not necessary for the fields covered by the international agreement and the Community legislation to coincide completely but it is necessary to take into account not only the current state of EC law but also future developments.[20] The most important factor is not whether the field has been largely harmonised but to safeguard «a uniform and consistent application of the Community rules and the proper functioning of the system which they establish in order to preserve the full effectiveness of Community Law.»[21] There is clearly a change of emphasis placing effectiveness of Community Law at the centre of the formulated test. This is in line with developments in other areas of the Community legal order where effectiveness of Community law has become the primary concern of ECJ judgments.[22]

Thus, in the context of external exclusive competence, it is necessary to carry out a detailed analysis of the provisions of the specific international agreement in order to establish whether any term in the agreement is capable of affecting Community rules and

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18 Convention No.170 concerning the safety in the use of chemicals at work [1993] ECR I-1061.

19 Paragraph 127 of the Opinion.

20 Paragraph 126.

21 Paragraph 128. See also Livranos in (2006) CMLRev 1087-1100.

22 For example, in the context of national remedies for breaches of Community law.

«undermining the uniform and consistent application of the Community rules and the proper functioning of the system which they establish.»[23] In *Opinion 1/03*, the ECJ started with an analysis of the rules on the jurisdiction of courts[24] followed by a similar analysis of the rules on the recognition and enforcement of judgments in civil and commercial matters under both the Lugano Convention and Regulation 440/2001.[25]

In respect of the jurisdiction rules, the Court noted that the Convention's rules on conflict of jurisdiction in international agreements with non-EC States establish criteria for jurisdiction not only in non-EC States but also in the Member States themselves. Regulation 44/2001 provides for a unified system which applies not only between different EC Member States but also to relations between a Member State and a non-EC State.[26] Thus the Court concluded that the Convention covers matters governed by Regulation 44/2001[27] and that the unified system of rules on conflict of jurisdiction established by the Convention is capable of affecting the Community's rules of jurisdiction.[28]

As far as recognition and enforcement of judgments rules are concerned, the Court concluded they could not be disassociated from jurisdiction rules as had been argued by some of the Member States' governments.[29] The Court referred to several articles in the Regulation in support of this conclusion.[30]

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[23] Paragraph 133.

[24] Paragraphs 139 to 161.

[25] Paragraphs 162 to 170.

[26] Paragraph 144.

[27] Paragraph 142.

[28] Paragraphs 151 to 153.

[29] Paragraphs 162 and 172.

[30] Paragraphs 163 to 166.

Furthermore, an examination of provisions of the Lugano Convention revealed that they affect the uniform and consistent application of the Regulation and the proper functioning of the system that it established.[31] Thus the rules in the Lugano Convention are capable of affecting the system the Regulation established for the recognition and enforcement of judgments. It affected the system set out in the Regulation because the Convention rules would permit a judgment delivered in a Contracting State to be recognised in another Contracting State without the requirement of any special procedure. Community rules are therefore affected since the Convention rules enlarge the scope of recognition of judicial decisions and increases the number of cases in which judgments delivered by non-EC courts, whose jurisdiction does not arise from the application of the Regulation, will be recognised.[32]

Opinion 1/03 demonstrates that exclusive competence is still an issue which gives rise to uncertainty and debate, and that the *ERTA* principle is likely to have the effect of creating new Community external competences as the EC acquis grows. It is likely that the importance of the *ERTA* doctrine will increase as the EC widens the scope of the common maritime transport policy to include maritime safety and security legislative measures. Once the field is «largely harmonised», the competence of the EC Member States to conclude international agreements in these fields is vastly reduced, if not extinguished, since it is more likely that the effectiveness of Community law will be endangered by the adoption of rules at international level.

In addition, there are two important constraints on Member States in the exercise of their own competence, irrespective of whether the competence is shared with the Community. The first

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[31] Paragraph 170.

[32] Paragraph 170.

constraint is to be found in the duty of cooperation imposed by Article 10 EC Treaty which is now perceived as a constitutional principle within EU external relations law.[33] The text of the Article is as follows:

> Member States shall take all appropriate measures, whether general or particular, to ensure fulfilment of the obligations arising out of this Treaty or resulting from action taken by the institutions of the Community. They shall facilitate the achievement of the Community's tasks.
>
> They shall abstain from any measure which could jeopardise the attainment of the objectives of this Treaty.

Thus, the Member States have an expressed duty not to exercise sovereign powers they may have retained where such conduct would not be in the best interests of the EC. For example, in the *Mox Plant* judgment the Court confirmed that the Republic of Ireland was in breach of this EC Treaty obligation by omitting to inform and consult the Commission before bringing proceedings against the UK before an international tribunal.[34]

The other constraint arises from the obligation imposed on the Member States by Article 292 EC Treaty. The Article states that

> Member States undertake not to submit a dispute concerning the interpretation or application of this Treaty to any method of settlement other than those provided for therein.

The meaning and scope of this provision was the main issue that the ECJ had to consider in the *Mox Plant* case. The case came before the ECJ because the Republic of Ireland decided to take proceedings against the UK before the International Tribunal for

[33] Koutrakos P "The Elusive Quest for uniformity in EC External Relations" (2001) Vol 4 Yearbook of European Law 243 at p. 258 and confirmed in Opinion 2/91 (re ILO Convention) and Opinion 1/94 (re WTO Agreements).

[34] Paragraph 179 of the judgment.

the Law of the Sea in respect of an alleged breach of the UN Convention on the Law of the Sea (UNCLOS). The Republic of Ireland wished to complain that the UK was violating UNCLOS. It alleged that the Sellafield Mox (mixed oxide) plant, which recycles plutonium from spent nuclear fuel, was increasing the pollution in the Irish Sea and the UK had not acted in accordance with its international obligations.

In its pleadings before the International Tribunal, the Republic of Ireland supported its case by requesting that the provisions of the Convention be construed by reference to EC legislative measures (directives) which were binding on the Republic of Ireland.[35] The meaning and scope of Community directives can only be determined by the ECJ which has exclusive competence to interpret and deal with questions of validity of Community measures.[36] The Commission therefore initiated Article 226 proceedings alleging that the Republic of Ireland acted in breach of Articles 10 and 292 EC Treaty by raising the interpretation of these EC directives before another forum.[37] The Commission based its case not on the initiation of the dispute settlement proceedings *per se* but on the failure not to inform and consult with the Community institutions before initiating the UNCLOS procedure. In the circumstances, it would have been appropriate for the ECJ to have focussed either on the procedural internal irregularities (ie not consulting the relevant

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[35] Council Directive 90/313, OJ 1990 L155/56, on the freedom of access to information on the environment and Council Directive 85/337, OJ 1985 L175/40, on the assessment of the effects of certain public and private projects on the environment.

[36] Articles 220 and 292 EC Treaty.

[37] Article 226 EC Treaty provides a 2-stage procedure enabling the Commission, as the guardian of the EC Treaty, to initiate proceedings before the ECJ against an EC Member State where it alleges that the Member State has failed to fulfil its Treaty obligations.

institutions) or on the likelihood of affecting the uniformity and effectiveness of Community law as determined in *Opinion 1/03*. The Court, however, chose to focus solely on the scope of the Community's competence that was exercised on the conclusion of UNCLOS. Since the Community concluded the Convention on the basis of Article 175(1) EC Treaty (protection of the environment) the external competence exercised on this occasion is shared between the Community and the EC Member States.[38]

The Court starts its reasoning by referring to the principle 'that mixed agreements have the same status in the Community legal order as purely Community agreements, as these are provisions coming within the scope of Community competence.'[39] Thus the Court confirms that mixed agreements are fully assimilated to Community agreements and, therefore, the provisions of the Convention now formed an integral part of the Community legal order given that the Community is a party to UNCLOS.[40]

As already explained above, the EC external competence is not limited to exclusive competences. Thus the ECJ's *Mox Plant* judgment is very significant as it answered the question of whether the Community by participating in UNCLOS had limited itself to exercising only those competences which it held exclusively (ie matters of fisheries conservation) or whether it also exercised competences which it shares with the Member States (ie environmental dimension).[41] The ECJ's approach was to make it clear that the answer to this question varies from case to case and cannot be determined in the abstract. However, the Court

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[38] Paragraph 83 of the judgment.

[39] Paragraph 84.

[40] Paragraph 82.

[41] Paragraph 96.

confirmed that the exercise of Community competence in a mixed agreement is not by definition confined to exclusive competences.

The next step in the analysis is to determine whether the provisions of UNCLOS relied upon by the Republic of Ireland before the International Tribunal come within the scope of Community competence irrespective of whether that competence is exclusive or shared. The Court emphasized that the key issue is one of attribution of competence and not the nature of that competence.[42] Furthermore, an international agreement cannot affect the allocation of responsibilities as defined in the EC Treaty and, consequently, the autonomy of the Community legal system.

Having ruled on the principle, the Court then proceeded to consider to what extent the Community, by becoming a party to the UNCLOS Convention, had indeed exercised its external competence in matters of environmental protection.[43] The Court took into account several factors. First, the legal basis of the Council Decision[44] to conclude UNCLOS included a reference to Article 175(1) EC Treaty. Secondly, the recital in the preamble to the Council Decision states that approval of the Convention by the Community is designed to enable it to become a party to it within the limits of its competence. Thirdly, the Declaration of Community competence, which was made at the time of the conclusion of UNCLOS and which was required by Annex IX to the Convention,[45] specified the extent and nature of the field of competence transferred by the EC Member States to the EC.

The conclusion reached by the Court at the end of its analysis was that the Convention provisions relied on by the Republic of

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42 Paragraph 93.

43 Paragraphs 97 to 120.

44 Council Decision 98/392 OJ 1998 L179/1.

45 Discussed further below.

Ireland fell «within the scope of Community competence which the Community had elected to exercise by being a party to the Convention.»[46] Thus the ECJ ruled it had jurisdiction to deal with disputes relating to the interpretation and application of these provisions and to assess the UK's compliance with them.[47] The Court also concluded on the basis of Articles 220 and 292 EC Treaty, that its jurisdiction was exclusive.[48]

The judgment in *Mox Plant* is not without problems. For example, the Court's reasoning raises the question as to whether the interpretation given would have been different if the dispute had been between a Member State and a non-EC State. Such a dispute, in the absence of a jurisdictional clause conferring jurisdiction on the ECJ, could not be heard before that Court. In these circumstances, a breach of Article 292 EC Treaty would not arise. However, if the *Mox Plant* judgment only applies to disputes between EC Member States, then the impact of the judgment is rather limited. Furthermore, the facts of the case support a restrictive application of the judgment. The Republic of Ireland had no Convention obligation to bring the dispute with the UK before an international tribunal. Article 282 of UNCLOS permits the resolution of disputes in other *fora* and so there was nothing to prevent the Republic of Ireland from bringing the litigation before the ECJ.

Moreover, the Republic of Ireland chose to plead Community directives before the international tribunal knowing that the ECJ has exclusive jurisdiction to interpret Community measures.[49]

46 Paragraph 120 of the judgment.

47 Paragraph 121.

48 Paragraph 123 et seq.

49 Community directives are recognised by UNCLOS as international standards that can be applied.

Finally, the Republic of Ireland failed to consult the Commission and other Member States before taking action in breach of the duty of cooperation within the meaning of Article 10 EC Treaty.

Another interesting feature of the judgment which may raise some difficulties in the future is that it presupposes that UNCLOS creates obligations between EC Member States imposed not by international law but by Community law. By exercising its external competence in the field of marine pollution when concluding UNCLOS, the Convention obligations became Community obligations which also apply in an intra-Community context since mixed agreements are fully incorporated within the Community's legal order. This raises the question as to whether the EC rather than individual EC Member States should bring cases against non-EC States when claiming the breach of UNCLOS obligations given that these fields are now within the Community's competence. This is a particular interesting aspect of the judgment but outside the scope of this paper.

4 Issues for further discussion

A question that immediately arises for consideration following *Opinion 1/03* and the *Mox Plant* judgment is how does a non-EC Member State determine, in advance, the scope of the EC competence in respect of an international agreement to which they are a party? What tools have been used to deal with this problem? How far have they succeeded?

There are two popular devices which will be considered. These are disconnection clauses which were reviewed by the ECJ in *Opinion 1/03*[50] and declarations of competence which are commonly found in international agreements such as UNCLOS to which the

[50] Such a clause was provided for in Article 54B of the Lugano Convention.

Community is a party. The ECJ considered the latter in its *Mox Plant* judgment.

Disconnection clauses

The objective of disconnecting clauses as far as the EC is concerned, is to ensure that certain international obligations do not apply in a Community context.[51] Thus in *Opinion 1/03* Member States argued that the inclusion of the disconnection clause was intended to ensure that in case of conflict between the Convention and Regulation 44/2001, the latter would prevail in relations between EC Member States. This interpretation was not, however, shared by the Commission which submitted that the disconnection clause was inserted by the EU Council in the negotiating guidelines as a 'misguided attempt to prejudge whether or not the agreement was mixed.'[52] Thus the Commission considered that the purpose was not to ensure that the Regulation has primacy, but rather to regulate the distributive application of the Regulation and of the envisaged Lugano Convention.

The wording of the disconnection clause used in the Lugano Convention was indeed different from the ones used in other international agreements.[53] Normally disconnection clauses state that Community law, not the international agreements, shall apply between EC Member States insofar as relevant Community law

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[51] Whilst the EC is bound in respect of a third party, the application of the international obligation between the EC Member States must not affect Community law, eg the UN Liner Conference Code where an EC regulation was adopted providing for the application of the Code, as between the Member States, in accordance with the principle of non discrimination on the grounds of nationality which is a fundamental principle of Community law.

[52] Paragraph 83 of the Opinion which summarized the Commission's submissions on the point.

[53] Art 54B of the Lugano Convention.

exists governing the issue. However, the disconnection clause in the Lugano Convention determines, that for certain cases, the Convention, and not the EC Regulation, should apply to the relations between Member States. The disconnection clause therefore removes the application of the EC Regulation in situations where it would normally apply.

It is not therefore surprising that the ECJ concluded that the disconnection clause in the Lugano Convention did not guarantee that Community rules were not affected but its very wording confirmed the opposite objective. Its very existence provided an indication that Community rules were indeed affected.[54] Thus it seems that disconnection clauses may not always be sufficient in themselves to avoid the provisions in mixed agreements affecting Community rules. If a possibility exists that Community law will be affected by the mixed agreement then that appears to be sufficient to confer exclusive competence on the Community.

Declaration of Competence

As far as the *Mox Plant* case is concerned it was agreed by all parties that UNCLOS was a mixed agreement. The issue that was raised for the Court to determine was the extent to which the EC had exercised its shared competence in matters of environment protection. As stated above, the content of the Declaration of Community's competence was one of the factors examined by the Court. Declarations of Competence are intended to indicate to third countries the distribution of competence. The Declaration specified the extent and nature of the areas of competence transferred by the Member States to the Community in the matters covered by the Convention in respect of which the Community accepted the rights and obligations provided by the Convention

[54] Paragraph 126 of Opinion 1/03.

The Declaration of Community competence in respect of UNCLOS and concerning marine pollution states that when

> Community rules exist but are not affected, in particular in cases of Community provisions establishing only minimum standards, the member States have competence, without prejudice to the competence of the Community to act in this field.

The Republic of Ireland submitted that the Declaration should be construed as confirming that in the absence of EC rules in the context of the *ERTA* doctrine, the competence of the Member States is not affected. Given that only minimum rules in this field had been adopted by the EC, shared competence remained.

The ECJ however read the Declaration as confirming that «a transfer of areas of shared competence, in particularly in regard to the prevention of marine pollution, took place within the framework of the Convention, and without any of the Community rules concerned being affected.»[55] Thus the ECJ adopted a broad approach towards determining to what extent the Community chose to exercise its shared competences in matters covered by UNCLOS.

These case law developments raises the question whether, given the uncertainty as to the meaning and effect of disconnecting clauses and declarations of competence, non-EC States should encourage the Community itself to be a party to all international agreements.

5 Concluding observations

As already noted above, the allocation of competences between the EC and its Member States is a complex matter and not always clear to third parties negotiating international agreements. As demonstrated above, traditional means of avoiding issues of

[55] Paragraph 105 of the judgment.

competence such as disconnection clauses, appear inadequate in respect of international agreements signed with the EC and its Member States. The determining factor as to whether the EC's competence to conclude the agreement is exclusive is solely the likelihood of the provisions in the international agreement affecting the uniform and consistent application of the Community rules.

The aggravating problem for the international community is that the fields covered by Community law is continuously widening. The international community is not dealing with a static legal order. Thus as the EC expands its activities by adopting legislative measures in areas where the competence is shared with its Member States, it will claim exclusive competence to conclude international agreements concerning these areas.

The Court, by expressly confirming that implied exclusive competence, as set out in *Opinion 1/76*, is an acceptable means under Community law for the EC to secure exclusivity in its external relations, is clearly unwilling to restrict the scope of the EC's external exclusive competence. The emphasis is on protecting the effectiveness of Community law and it may be that, in most areas of shared internal competences, at some future date, the only way of protecting Community law in those areas is by the Community, and not the Member States, concluding international agreements. Nevertheless, it is worth recalling that *Opinion 1/03* concerned a very specific field of Community activity where the internal legal regime already in existence was extensive.

The long term significance of the *Mox Plant* judgment is not likely to be the fact that the ECJ claimed jurisdiction in disputes arising from international conventions. As already noted the judgment is likely to be confined to disputes between Member States. The more interesting aspect of the judgment is the Court's affirmation that UNCLOS is an integral part of the Community's legal order. This means that the obligations and responsibilities

imposed by UNCLOS have become Community obligations as far as the relationship between the Member States are concerned. Failure to discharge them is a breach of Community law. It also raises questions as to whether the Community, rather than the Member States, is the more appropriate party to bring disputes before an international tribunal when a breach of UNCLOS obligations are alleged against a non-EC State.

The external competence of the European Community has always been one of the most interesting and complex areas of Community law. As its internal competences increase, either by conferment of new areas of competences or by occupying the field by adopting legislative measures, the more significant a player it will become on the international stage. No doubt further ECJ judgments will continue to refine the nature and scope of the Community's external exclusive competence.

Part VI
The end of the shipping pool as we know it?
– EC competition law and the legality of shipping pools

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1 Introduction

Under EC competition law, there has not only been a discrepancy between the shipping industry and other industries, but also a discrepancy within the industry itself. Between 1986 and 2006, there was a block exemption from competition law for liner conferences[1], which meant that participants in liner conferences were allowed to set conference tariffs and regulate capacity without interference from the authorities or competitors. Article 81(1) (ex Article 85) of the EC Treaty provides that:

> "The following shall be prohibited as incompatible with the common market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market, and in particular those which:
> (a) directly or indirectly fix purchase or selling prices or any other trading conditions;
> (b) limit or control production, markets, technical development, or investment;
> (c) share markets or sources of supply; […]".

Upon consideration of the wording of Article 81(1), it becomes apparent how favourable the block exemption was. However, on 18 October 2006, the block exemption was repealed and after a transitional period of two years, the liner industry will be subject to competition rules and regulations.[2]

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1 Regulation 4056/86 laying down detailed rules for the application of Articles 85 and 86 of the Treaty to maritime transport, as amended, [1986] O.J.L 378/4.

2 Council Regulation (EC) No 1419/2006 of 25 September 2006 repealing Regulation (EEC) No 4056/86 laying down detailed rules for the application of Articles 85 and 86 of the Treaty to maritime transport, and amending Regulation (EC) No 1/2003 as regards the extension of its scope

The situation has been different for tramp shipping compared with liner shipping. Broadly, tramp shipping can be defined as "the transport of a single commodity, which fills a single ship" where the "the ship is typically fixed by a shipbroker and performs a transport service in accordance with the terms of the relevant charterparty",[3] or we can apply the definition supplied by the EU[4]. In contrast to liner shipping, the tramp shipping industry has always been subject to EC competition law, but due to an exclusion in Regulation 1[5], the competition rules could not be implemented.[6] This was considered an anomaly by the European Commission ("The Commission") and Regulation 1 was therefore amended in connection with the repeal of Regulation 4056/86.[7] As opposed to the situation for liner shipping, no transitional period was granted.

The most widespread form of cooperation in the tramp shipping industry is the shipping pool, whereby two or more shipowners delegate the operational and commercial management of one or more of their ships to one of the pool members, or to a third party, typically called the pool manager.

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to include cabotage and international tramp services, [2006] O.J. L269/1 ("Regulation 1419/2006").

3 EU Report COMP/2006/D2/002 Legal and economic analysis of tramp maritime services, p. II, para. 3, ("The Fearnley Report").

4 See for example Article 1(3) (a) in Regulation 4056/86 "tramp vessel services" means the transport of goods in bulk or break-bulk in a vessel chartered wholly or partly to one or more shippers on the basis of a voyage or time charter or any other form of contract for non-regularly scheduled or non-advertised sailings where the freight rates are freely negotiated case by case in accordance with the conditions of supply and demand.

5 Regulation 1/2003 On the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty [2003] O.J.L 1/1 ("Regulation 1").

6 Article 32(a) of Regulation 1.

7 Article 2 of Regulation 1419/2006.

This form of horizontal cooperation has generated great interest from the Commission and the industry is currently awaiting final guidelines on how to assess the legality of existing pools in relation to the applicable competition law regime. The purpose of this article is to analyse whether shipping pools in the tramp shipping market will survive the (new) competition regime.

2 Relevant pool features

2.1 General

In the tramp shipping market there are approximately 40 pools trading in all parts of the world and in all segments, with the exception of the LNG market, where long-term contracts are common and the players in the market have not seen a need for pools.

The principal reasons why shipowners create shipping pools are to spread risk, achieve more efficient fleet deployment and be able to undertake large Contracts of Affreightment (CoAs) and thus meet customer demand.

2.2 Pool structures

There is no universal model for a shipping pool, although most pools are structured in one of two ways: "member controlled" or "administration controlled".[8] In addition, there are rare examples of pool-like structures where a ship management company charters in vessels from shipowners on a time-charter basis, with exclusive use of them for the duration of the time charter, and where the

[8] This terminology was originally introduced by Haralambides, H.E. "The Economics of bulk shipping pools", extract from Maritime Policy & Management, 23(3): 21-237 (1996).

shipowners do not exercise any influence over the decisions taken by the “pool”.

Usually, a member-controlled pool consists of two or more members (shipowners) with one of the (often larger) members acting as pool manager. Day-to-day decisions are dealt with by the pool manager, whereas decisions on new members, revenue sharing, the undertaking of CoAs longer than six or 12 months and strategic issues are often taken by a board or a committee appointed by the members. Occasionally, the pool manager manages more than one pool.

In an administration-controlled pool, the shipowning participants also delegate the pool management, but in this case to a third party, which is often a purpose-formed company. Decisions here concerning matters other than pure day-to-day decisions are also taken by a board or a committee.

The common feature of both types of pool is that vessels are made available to the pool either by pool participants time-chartering the vessels to the pool manger or by putting the vessels into the pool through another type of agreement.

2.3 Relevant pool clauses

There are no standard pool agreements, albeit most agreements have similar features, such as joint selling and marketing and centralisation of income and voyage costs. Some agreements contain provisions that may have an adverse effect on competition such as lay-up clauses, exit clauses, information-sharing clauses and non-compete clauses.

Probably the most important clauses for the participating members are those regarding sharing of revenue. All gross and net earnings made by the vessels are pooled and subsequently distributed to the members according to a formula, often referred to as the distribution key. There is no difference between the different

pool structures in how the income is distributed. There are no standard distribution keys used in pool agreements, save that most pools use either a weighted scale, which rewards the more efficient vessels, or a sheer tonnage- or liftings-based formula. The former system generally uses a reference ship to which all pool vessels are compared and assigned points in relation to which owners receive revenue.

Another relevant pool feature is joint selling and marketing. The function of joint selling and marketing is put in the hands of the pool manager, regardless of whether the pool manager is a third party or one of the members. It is the pool manager that fixes the vessels and negotiates freight rates with customers. As far as its customers are concerned, the pool is perceived as a single economic entity.

Provisions regarding lay-up seem less frequent. Those agreements that provide for it would have clauses where decisions are usually either taken by the pool manager or jointly by the board or a committee.

Exit clauses and/or termination provisions are handled differently. Pools rarely have a fixed term, but provide for withdrawal of the vessel or disbandment subject to a notice period of between six and 12 months. Some pools require owners who withdraw a vessel to substitute it with another, while others insist on minimum initial periods for new members.

As for information-sharing clauses, most pools restrict information to be shared between the pool manager and the individual members to a bare minimum, only to relate to the pool's performance.

Some pools request the individual members not to compete with the pool by using their vessels that are outside the pool.

3 Competition law

3.1 General

As mentioned above in the introduction in Chapter 1, agreements and concerted practices that have the object or effect of restricting competition are prohibited under Article 81(1). Examples of such agreements etc. are cartels between competitors where agreements are made on price-fixing, output limitation or market foreclosure. Some agreements may, however, be exempted either under a block exemption[9] or under Article 81(3)[10].

Agreements between competitors, actual or potential, are considered as horizontal agreements (as opposed to agreements between players at different levels of the market, which are vertical agreements and which will not be addressed in this article).

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9 See for example Regulation 2658/2000 on the application of Article 81(3) of the Treaty to Categories of specialisation agreements, [2000] O.J.L. 304/3 and Regulation 823/2000 on the application of Article 81(3) of the Treaty to certain categories of agreements, decisions and concerted practices between liner shipping consortia, [2000] O.J.L. 100/24. These will not be addressed in this article.

10 Article 81(3): "The provisions of paragraph 1 may, however, be declared inapplicable in the case of:

- any agreement or category of agreements between undertakings;
- any decision or category of decisions by associations of undertakings;
- any concerted practice or category of concerted practices,

which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefits, and which does not:

(a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives;

(b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question."

3.2 The Horizontal Guidelines

The European Commission ("the Commission") has issued guidelines on how to assess horizontal co-operation agreements under Article 81 ("the Horizontal Guidelines")[11]. The Horizontal Guidelines cover agreements relating to both products and services (collectively referred to as "products"), of which the latter are relevant to the shipping industry.[12].

The Commission has defined horizontal cooperation in the Horizontal Guidelines as follows:

> "A cooperation is of a "horizontal nature" if an agreement or concerted practice is entered into between companies operating at the same level(s) of the market. In most instances, horizontal cooperation amounts to co-operation between competitors. It covers for example areas such as research and development (R&D), production, purchasing or commercialisation."[13]

In order to analyse whether a horizontal agreement infringes Article 81(1), it is necessary to consider the market, the nature of the agreement, and the economic context in which the parties to the agreement operate.

3.2.1 Analysis of the market

"The market" in competition law, also known as "the relevant market", is the context in which to assess, systematically, the competitive constraints the undertakings involved face vis-à-vis their competitors. The Commission has issued a notice on the relevant market to offer guidance to facilitate the analysis.[14] The

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11 Commission Notice Guidelines on the applicability of Article 81 of the EC Treaty to horizontal co-operation agreements, [2001] O.J.C 3/2.

12 The Horizontal Guidelines, para. 13.

13 The Horizontal Guidelines, para. 1.

14 Commission Notice on the definition of the relevant market for the purposes of Community Competition law, [1997] OJC 372/5.

Commission has thus far not applied Article 81 to the tramp shipping market.

There are two main aspects to analyse: the product market (also applicable to services) and the geographical market. Occasionally there may also be a temporal dimension. The relevant product market comprises those products and/or services that are regarded as interchangeable or substitutable by the consumer, by reason of the products' characteristics, prices and intended use.

Undertakings face three main sources of competitive constraints: demand substitutability, supply substitutability and potential competition. Demand substitutability is sometimes measured based on the SSNIP test.[15] The SSNIP test tries to ascertain the relevant market as the smallest market where a 5-10% increase in price can be sustained, assuming that the terms of sale of all other products are held constant. An example would be canned soft drinks. If producers of Fanta were to increase their prices by 5-10%, would customers switch to Solo? If they would, Fanta and Solo would be considered as being in the same market.

Price, however, is not the only parameter. If the producers of Solo were to follow Fanta's price increase, would consumers switch to beer (not taking Norwegian beer prices into account)? Not necessarily, as alcoholic beverages compete with other alcoholic beverages and not with soft drinks. On the other hand, consumers may switch to Coca-Cola. If this is what happens, canned soft drinks in general may be considered as being in the same product market. If not, orange-flavoured soft drinks flavour may be in the same (narrower) product market. Apart from price, it is important to take the product's or service's characteristics into account such as, for example, whether they contain alcohol, have a specific flavour or are sparkling or still.

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[15] A Small but Significant Non-transitory Increase in Price.

In the Commissions Draft Guidelines, published on 14 September 2007, the starting point is "the main terms of an individual transport request; i.e. what does the customer regard as interchangeable or substitutable as to for example vessel size or vessel type. It is also mentioned that it could be relevant to ascertain whether the customer considers voyage charters and time charters or other contract types to be substitutable.[16]

Supply-side substitutability relates to the supply side of the market, i.e., where is it possible to buy soft drinks? Is it possible to choose from a variety of shops and/or other outlets?

In the case of tramp shipping, the physical and technical condition of the cargo to be carried and the vessel type required can provide an initial indication of the market to be analysed.[17]

As for the geographical dimension, the Commission Notice states that the relevant market comprises:

> "the area in which the undertakings concerned are involved in the supply and demand of products or services, in which the conditions of competition are sufficiently homogenous and which can be distinguished from neighbouring areas because the conditions of competition are appreciably different in those areas".[18]

Fixture notes usually contain information on loading ports and discharge ports, which may provide an initial indication on the demand side. Port substitutability may be affected by technical restrictions, such as terminal restrictions or environmental standards.

3.2.2 The nature of the agreement

The Horizontal Guidelines suggest that the nature of an agreement relates to factors such as the area and objectives of the co-

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[16] Guidelines on the application of Article 81 of the EC Treaty to maritime services, Draft, [2007] OJ C 215/3, p. 3 et seq. ("the Draft Guidelines").

[17] Ibid.

[18] The Notice on the relevant market, para. 8.

operation, the competitive relationship between the parties and the extent to which they combine their activities.[19] These factors indicate the likelihood of the parties coordinating their behaviour in the market.

Most pool agreements are horizontal in nature, i.e., between competitors or potential competitors, and contain provisions whereby certain tasks such as day-to-day operations, marketing and selling are delegated either to one of the pool members or to a third party, i.e., the pool manager. This means that the pool members no longer compete against each other with the vessels they have entered into the pool. When analysing the agreement, it is important to consider the impact in terms of possibly reduced competition in the relevant market.

3.2.3 The economic context

Once the relevant market has been determined in accordance with the existing guidance, the parties' market shares can be computed and the effect on the market assessed. The reason for this is to evaluate the parties' position in the market and determine whether they are likely to maintain, gain or increase market power through their co-operation, i.e., whether they have the ability to cause negative market effects as to prices, output, innovation or the variety or quality of the services.

The Commission states in the Horizontal Guidelines that: "If the parties together have a low combined market share, a restrictive effect of the co-operation is unlikely and no further analysis normally is required"[20]. It goes on to say that: "If one of just two parties has only an insignificant market share and if it does not possess important resources, even a high combined market share

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[19] The Horizontal Guidelines, para. 21.

[20] The Horizontal Guidelines, para. 27.

normally cannot be seen as indicating a restrictive effect on competition in the market”[21].

3.3 Article 81(3) EC

Article 81(3) is a rule that creates an exception that can be invoked as a defence against a finding of a breach of Article 81(1). If an agreement satisfies the conditions of Article 81(3), the agreement is valid under EC competition law.

The Commission has issued guidelines on how to assess an agreement under Article 81(3), a so called self-assessment.[22] These guidelines state that the prohibition in Article 81(1) may be declared inapplicable where agreements: contribute to improving the production or distribution of goods; allow consumers a fair share of the benefits of this improvement; do not impose restrictions that are not indispensable to the attainment of these objectives; and do not afford the undertakings concerned the possibility of eliminating competition in respect of a substantial part of the products concerned.

There are two parts to the assessment: the first is to determine whether the agreement in question has an anti-competitive objective or effect (it is presumed that the agreement is capable of affecting trade between EU Member States); and, if so, the second is to determine the pro-competitive benefits and to assess if the benefits outweigh the anti-competitive effects.

The four conditions in Article 81(3) are cumulative and must therefore all be fulfilled for the exception to apply.

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[21] The Horizontal Guidelines, para. 28

[22] Guidelines on the application of Article 81(3) of the Treaty, [2004] O.J.C 101/97.

3.3.1 The first condition: efficiency gains

Efficiency gains are assessed objectively.[23] Typical efficiencies are increased capacity utilisation and output, economies of scale and scope, lowering of trading risk, efficiency enhancement and technical improvements. If these efficiencies are the result of the mere exercise of market power, they cannot be taken into account, as this would indicate decreased competition.[24]

For pools, the benefits are particularly manifest in the case of CoAs, as pools can provide a large fleet in a large geographical area, which is required by many customers.

3.3.2 Second condition: fair share for consumers

The efficiency gains achieved under the first condition must be passed on to the consumers under this second condition. The concept of consumers encompasses all direct and indirect users of the products and/or services, including customers of the parties to the agreement and subsequent purchasers. The general assessment is that if the net effect of the agreement is neutral, i.e., consumers are compensated for any negative impact caused by the agreement, the condition has been fulfilled.

3.3.3 Third condition: indispensability

The third criterion is usually the most difficult to fulfil. The condition implies a two-fold test: the agreement as such must be reasonably necessary in order to achieve the efficiency gains and the individual restrictions on competition that flow from the

[23] This was established in joined cases 56/64 and 58/66, CONSTEN AND GRUNDIG, [1966] ECR 429.

[24] This follows from the Commission Decision in *Van den Bergh Foods*, [1998] O.J.L 246/1.

agreement must also be reasonably necessary for the attainment of the efficiency gains.

The main issue is whether the parties could have achieved the efficiency gains by means of another, less restrictive, type of agreement or if they could have achieved them on their own. If the answer is yes, the third condition is not fulfilled.

The Horizontal Guidelines states that the "question of indispensability is especially important for those agreements involving price fixing or the allocation of markets"[25]. It is also noted that the decisive factor when applying Article 81(3) to a restrictive agreement is not the assessment of the counterfactual situation[26], but whether more efficiency gains are produced with the agreement or restriction in place than would be the case in the absence of the restrictive agreement.[27]

3.3.4 Fourth condition: no elimination of competition

The fourth condition requires that the agreement must not afford the parties the possibility to eliminate competition in respect of a substantial part of the products/services concerned. The Commission recognises that rivalry between undertakings is an essential driver of economic efficiency. Whether competition is being eliminated within this criterion depends on the degree of competition existing prior to the agreement and on the reduction in competition that the agreement brings about.

Such an assessment requires an analysis of the existing competition in the market and both actual and potential competition must be considered. Where the consequence of the agreement is that an undertaking becomes dominant and where the agreement has

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25 The Horizontal Guidelines, para. 154 et seq.

26 How the market would have been in absence of the restrictive agreement.

27 The Horizontal Guidelines, para. 74.

anti-competitive effects within the meaning of Article 81(1), exemption under Article 81(3) is unlikely.

4 Legal analysis of shipping pools

4.1 General

In competition law terms, pools, i.e. arrangements whereby a pool manager fixes the vessels and negotiates prices on behalf of the pool members, are viewed by the Commission as price-fixing. Further, the pool manager provides information about the pool to the shipowners, which means that there is information-sharing between competitors or potential competitors. Moreover, the pool manager and/or a committee representing the pool members are able to decide on the lay-up of pool vessels, which means a possible restriction on output.

Apart from the fact that everyone in the industry is aware of the situation, and that many pools operate as any other entity, the arrangement could be considered to constitute a cartel. Cartels are prohibited under competition law and, as many companies have discovered, may lead to substantial fines of up to 10% of the previous year's turnover. It is therefore essential to determine whether or not pools are compliant with competition law.

4.2 Do/will shipping pools fall within Article 81(1)?

It is suggested in the Horizontal Guidelines that parties to restrictive agreements with small market shares may not be affected by Article 81(1) as a restrictive effect on competition is unlikely and no further analysis is therefore required. The findings of the

Fearnley Report show that the majority of pools have insignificant market shares[28], most of them below 5%.[29]

However, the problem with that suggestion is the De Minimis Notice.[30] The first part of the Notice accords with the Horizontal Guidelines, as the Commission states in the Notice that "agreements between undertakings which affect trade between Member States do not appreciably restrict competition within the meaning of Article 81(1): (a) if the aggregate market share held by the parties to the agreement does not exceed 10 % on any of the relevant markets affected by the agreement, where the agreement is made between undertakings which are actual or potential competitors on any of these markets […]"[31].

However, later in the Notice, the Commission states that the above does not apply to agreements containing so-called hardcore restrictions, such as price-fixing, limitations on output or sales and/or allocation of markets or customers.[32] The de Minimis Notice will therefore be of little use if the Commission maintains its view that pool managers price fix.

The Horizontal Guidelines and the de Minimis Notice will in such case be contradictory and pools cannot thus be certain of having a safe harbour based on small market shares. The Commission may therefore proceed against hardcore restrictions

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28 The Fearnley Report, section 5.7.2 et seq.

29 It should be noted, however, that the market shares in the Report were calculated on the basis of the number of vessels each pool had at its disposal, whereas the Commission recommends that market shares should be calculated based on the value, or volume, of sales,.

30 Commission Notice on agreements of minor importance which do not appreciably restrict competition under Article 81(1) of the Treaty establishing the European Community (*de minimis*) [2001] O.J.C 368/13.

31 De Minimis Notice, para. 7.

32 De Minimis Notice, para. 11

even if the undertakings involved have market shares of under 10%.[33]

This approach is further reiterated in the Draft Guidelines, where the Commission clearly states that pool agreements, which have as their object the restriction of competition by means of price-fixing, output limitation or sharing of markets and/or customers, will fall within Article 81(1), irrespective of the market power of the parties.[34]

A possible way to avoid falling within the ambit of Article 81(1), which was suggested in the Fearnley Report, is to classify the agreement as a joint production agreement.[35]

Footnote 18 to the Horizontal Guidelines states that production joint ventures are an exception to the "rule" that all agreements involving joint selling (because this involves price-fixing) fall *per se* under Article 81(1). The Commission remarks that it "is inherent to the functioning of such a joint venture that decisions on output are taken jointly by the parties. If the joint venture also markets the jointly manufactured goods, then decisions on prices need to be taken jointly by the parties to such an agreement. In this case, the inclusion of provisions on prices or output will have to be assessed together with the other effects of the joint venture on the market to determine the applicability of Article 81(1)."

This is further elaborated in the Horizontal Guidelines, which confirm that "where a production joint venture that also carries out the distribution of the manufactured products sets the sales prices for these products, provided that the price fixing by the joint

[33] One such example was the Greek Ferry Services Cartel, where the Commission imposed fines on shipowners who were party to price-fixing agreements, *Greek Ferry Services Cartel*, [1999] O.J.L 109/24.

[34] The Draft Guidelines, para. 67.

[35] The Fearnley Report, section 6.4.1.1, para. 1509 et seq.

venture is the effect of integrating the various functions.[36]". Such agreements will not fall under Article 81(1).

The authors of the Fearnley Report have taken the view that most pools could be categorised as joint production agreements, insofar as they enable services to be both produced and commercialised on a joint basis, and these two functions are integrated into the hands of the pool manager, although, the roles of the members and the pool manger are clearly separated, in that the members provide the pool vessels, i.e., the input to the service, whereas the pool manager produces and sells the service, hence a *joint* production of the service.

However, the Commission has clearly stated in the Draft Guidelines that most pool agreements would not qualify as joint production agreements, although the Commission has not specifically addressed the arguments in the Fearnley Report as to why a pool agreement could meet the requirements of footnote 18.

It is also worth observing that the Commission comments in footnote 41 that many of these arrangements [joint production agreements] would be considered to constitute full-function joint ventures, which are subject to different legislation (the EC Merger Regulation[37]). This may not be the preferred option for pools, either because notification may be required to national competition authorities/the Commission or for commercial reasons.

Should the agreement qualify as a joint production agreement, there may also be a possibility to block exempt it under the

[36] The Horizontal Guidelines, para. 90.

[37] "The ECMR", Council Regulation (EC) 139/2004 on the control of concentrations between undertakings (the EC Merger Regulation), [2004] O.J.L 24/1.

Specialisation Block Exemption[38], under which there is a market share cap of 20%.

4.3 Would shipping pools fulfil the criteria under Article 81(3)?

Assuming that pools nevertheless fall within the prohibition in Article 81(1), an assessment is needed in accordance with the conditions laid down in Article 81(3), unless the agreement is covered by a block exemption (such as the Specialisation Block Exemption). As explained in Section 3.3 above, the conditions are cumulative. This assessment is a so called self-assessment as it is undertaken by the parties to the agreement themselves.

A self-assessment obliges the parties to justify their agreements and to adduce evidence that the anti-competitive effects are outweighed by the economic efficiencies, that the agreement and the restrictions are indispensable and, in addition, that there is no risk of market power being exercised by the pool in such a way as to create a dominant position.

The Commission has not, thus far, provided any guidance in its Draft Guidelines as to which criteria to consider when undertaking a self-assessment, meaning that the general Guidelines on the application of Article 81(3) will have to be relied upon.

4.3.1 Economic efficiencies

There are several efficiencies applicable to pools, such as increased capacity utilisation and output, economies of scale, economies of scope, lowering of trading risk and efficiency enhancements.

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[38] The Specialisation Block Exemption (Regulation 2658/2000 on the application of Article 81(3) of the Treaty to categories of specialisation agreements [2000] OJ.L 304/3) will not be addressed further in this article.

From the shipowners' point of view, all these efficiencies are relevant: the pooled vessels generate a steady income and are well utilised, which in turn results in lower trading risks and means that the shipowner can use his other vessels for spot trading in order to spread the risk and benefit from periods when market rates are high. Some pools even offer various risk options to their members.

Shipowners who would not otherwise be able to offer a sufficient range of services are, by pooling their vessels, capable of offering the quality of service their customers require. A pool thus offers possibilities for better utilisation of vessel capacity, which in turn generates synergy and lower costs.

Examples of the ways in which synergy can lower costs include savings on administrative costs, such as salaries for IT and back-office staff, on crew training and on the procurement of supplies.

Further, pools will have a stronger position when negotiating with suppliers and will therefore be able to obtain better services in terminals, such as increased flexibility and storage possibilities.

However, the Commission is mainly interested in the benefits for consumers. Such benefits could include greater choice and flexibility and better quality service, as the shipowner could provide more extensive services through the pool, in addition to saving costs.

As pools usually offer a steady income to participants and a lower trading risk, shipowners may be able to increase their level of risk in other parts of their businesses, *inter alia* in the procurement of new vessels, which in turn may lead to greater output and possibly better services, provided the new vessels are better and faster.

Another argument is that a manager of a pool will have a greater choice of vessels at his disposal and will therefore be able to bid for more cargoes, filling vessels that would otherwise be in ballast.

Greater capacity utilisation makes the projected daily rate easier to attain, meaning that lower rates can be offered to customers.

Without going into the arguments concerning economic efficiencies in depth, it is likely that it will be possible to justify the existence of pools on the basis of economic efficiencies, although each pool has to be assessed on its own merits and the different factors weighed up.

4.3.2 Fair share of benefits to consumers

The second condition will also be relatively easy to satisfy. Pools will have to show that the economic efficiencies achieved under the first condition are passed on to their customer(s).

Examples of benefits that are passed on are: lower transaction costs, as customers will save time through having to deal with one person only (the pool manager), instead of several chartering departments; improved availability of vessels, i.e., a better and more flexible service with less waiting for capacity and hence faster deliveries; faster and lower-priced access to port facilities and port equipment because of the pool's stronger bargaining position; and greater capacity and more choice, which is essential for customers with large transport requirements who cannot risk non-, or even late, delivery.

It can be assumed that the second condition of Article 81(3) can be met, with the benefits of the pool arrangement being passed on to consumers, provided the benefits are achieved.

4.3.3 Indispensability

The application of the indispensability test will vary depending on whether the pool is to be considered as a joint production agreement or a commercialisation agreement. The former type of agreement has been discussed above and the Commission provides for restrictions in accordance with footnote 18 of the Horizontal

Guidelines and these restrictions are presumed to be ancillary to the agreement. The latter, however, must be analysed under Article 81(3) and the decisive factor will be whether more efficiencies are produced with the agreement or restriction in place than in the absence of the agreement or restriction.[39]

The most common restrictions in pool agreements are the non-compete clauses, whereby pool participants agree not to compete against the pool should the participants have vessels outside the pool that could operate in the same trade. Similar restrictions have been accepted as ancillary restrictions in joint ventures, although there are several pools that do not impose non-compete clauses on the participants and it could therefore be argued that such clauses are obviously not indispensable. The assessment of whether non-compete clauses are indispensable should, however, be made in the context of the relevant market. Another angle to non-compete clauses (sometimes described as exit clauses) is that some pools require members to commit their vessel(s) for a certain period and members are consequently not permitted to withdraw their vessel(s) without giving notice. Notice periods may be as long as 12 months. It would be easier to argue that this type of clause is indispensable, as pool managers must be able to know which vessels are available and for how long before committing them on longer time-charters or CoAs.

The main issue, however, as regards indispensability is whether the economic efficiencies could be achieved without the restrictive agreement or the individual restrictions.

Pools with small market shares, consisting of members/ shipowners with few vessels, will most likely be considered indispensable as the members would not have been able to provide a service comparable with that offered by the pool (in terms of

[39] Para. 74 of the Horizontal Guidelines.

capacity and flexibility) on their own. Even pools with large market shares may meet the indispensability test if it can be shown that customer demand could not be satisfied by (small) shipowners operating individually.

Other pools with members that own large numbers of vessels, may, on the other hand, not be considered to fulfil the indispensability test, as these members, provided they have a large fleet of similar vessels, would be able to provide customers with the required services on their own, without having to enter into restrictive agreements.

4.3.4 No elimination of competition

According to the Fearnley Report, the evidence gathered did not indicate that any pools had been able to use their joint resources and combined market power to push prices up at any time in any segment of the industry.[40] Pools seem to compete with other pools and individual entities on the same market conditions and freight rates appear to respond to normal forces of demand and supply. Pools do not seem to result in any distortion of the market and, provided the Fearnley Report is correct in that respect, pools will be able to show that there is no elimination of competition. However, it is relevant to verify whether there is any risk of abuse of market power and/or risk of foreclosure in relation to third parties, in particular in respect of those pools with higher market shares.

5 Conclusion

The legislation, as it stands today, is not particularly favourable to pools in their current form. Most pool agreements contain elements

[40] The Fearnley Report, p. 359, para. 1676.

of price-fixing, allocation of output, non-competition and information exchange and these features are not in accordance with competition law. *Prima facie* therefore, many pool agreements would appear to be restrictive under competition law and consequently fall within the scope of Article 81(1). This has also been confirmed by the recently published Draft Guidelines.

The question all pool members ask is whether it is possible to find a way through the legislation, either by classifying the agreement as a joint production agreement, thereby avoiding Article 81(1) and/or assessing whether the Specialisation Block Exemption is applicable, or by justifying the agreement under Article 81(3).

As with all assessments, one must start by defining the market, something that has proved difficult in the case of the tramp shipping industry. Once the market has been defined, the individual agreement must be assessed and, on the basis of the discussion in this article, some pool agreements may pass the competition law hurdle, although this is by no means certain, and "competition-law-approved" pool agreements may turn out to be few and far between.

To sum up, the legal situation of shipping pools is still unclear and, although the existing legislation is already applicable, there is no relevant case law, nor any Commissions decisions to rely on when undertaking an assessment. One extreme scenario is that a majority of the pools may be prohibited under Article 81(1) and will not be able to justify their existence under Article 81(3). Another possible scenario is that the majority of pools will continue their operations as before, without amending any structures or agreements. The Commission has indicated in its Draft Guidelines, however, that the latter scenario is not plausible. The conclusion must therefore be that pools should review their agreements and ensure that they avoid any obvious faux-pas by omitting any

unnecessary and restrictive clauses. The result may well be the end of the traditional shipping pool as we know it. What benefits this would bring to competition remains to be seen.

Part VII
Oil companies and human rights

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1 Introduction

1.1 Background

Oil companies operate in parts of the world where human rights are not always respected. States or governments may violate human rights or close their eyes to the violation of their citizens' rights by others, e.g., in relation to oil production. The inhabitants of an area may be forcibly relocated from areas where oil production is about to take place or kidnapped and forced to build the infrastructure for oil production or carry out other related work. Oil companies may also employ military or private security guards who may assault the inhabitants. To show that these scenarios are not implausible, I will start by referring to two examples where oil companies have been accused of human rights abuses.

One example came before the American courts in *Doe v. Unocal*[1] regarding the operations of Unocal in Burma. A related case has also been considered by the Council on Ethics of the Norwegian Governmental Pension Fund – Global ("the Council on Ethics") and actions for damages have been brought in courts in both Belgium and France in relation to the operations of the oil companies Total and Unocal in Burma. Total (and subsequently Unocal, which purchased shares in the Total project) entered into a production contract with Myanmar Oil which included the development of the Yadana gas field and the construction of a gas pipeline from Burma to Thailand. Through Myanmar Oil, Total/Unocal entered into a contract with military units to assist in the construction of the pipeline and to ensure security in the

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1 Decided by the US Court of Appeals 9th Circuit 18.09.2002. See 395 Federal Reporter 3rd series 932.

pipeline corridor. The military units were accused of carrying out the work by the use of forced labour from nearby villages. The military units were also accused of having forcibly relocated villages and arbitrarily committed crimes against the local population, including murder, rape and torture in connection with the construction work. The American courts found it proven that such violations had taken place and that Unocal must have been aware of the situation.

A second example is the case of *Wiwa v. Shell*.[2] In the mid-1990s, political demonstrations were taking place against Shell's activities in Nigeria and Shell was accused of having expropriated land in order to extract oil without paying sufficient compensation. Shell was also accused of having polluted the air and water of the Ogoni people. The authorities in Nigeria brutally suppressed the demonstrations and some of the demonstrators were jailed, beaten, raped or killed. Shell was accused of having requested the Nigerian police and military to quell the demonstrations. Two of the leaders of the demonstration and the campaign against Shell were eventually tried before a special military court and were hanged after being accused of murder. It was alleged that the court proceedings were based solely on false evidence in order to suppress political opposition to Shell and that the protesters' rights had not been safeguarded pursuant to international law. The plaintiffs asserted that both the court proceedings in Nigeria and the actions against the demonstrators had been staged by Shell and that Shell had contributed with both funding and equipment.

It was possible for the plaintiffs to sue the oil companies in the USA for alleged violations of human rights committed against the local populations in Burma and Nigeria because of the existence of a special American act, The Alien Tort Claims Act 1789. This act

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[2] Decided by the US Court of Appeals 2nd Circuit 14.09.2000.

grants foreigners the right to bring civil lawsuits before the American federal courts for breaches of human rights committed by American companies or companies that have long-term business relationships with the USA.[3]

Oil companies may possibly be accused of violating human rights as a direct result of their oil extraction or other business operations or, more indirectly, through their presence in countries where human rights are violated. Although the main topic of this presentation is human rights abusesdirectly associated with oil extraction operations, when addressing the issue of complicity in breaches of human rights, we will also touch on more indirect breaches by oil companies through their presence in countries where the state is responsible for human rights violations.

If oil companies are obligated to respect human rights, questions arise as to the potential consequences of breaches of their obligations. One might be criminal liability, another might be liability in tort. This presentation will show that the type of liability to which companies violating human rights may be exposed will depend on the rights that are violated and the enforcement action taken in respect of the violations.

The presence of oil companies in developing countries and in areas where there is little respect for human rights is not, of course, always negative. Their presence can contribute to the promotion of human rights and the improvement of living standards. Oil companies can also use their position to influence the authorities and oppose human rights abuses.

It is not only in poor and developing countries that human rights are violated by the state, or oil and other companies may directly

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[3] The relevant part of the law states: "The district courts shall have original jurisdiction of any civil action by an alien for tort only, committed in violation of the law of nations or a treaty of the United States."

violate, or be complicit in, such violations. A recent example would be the USA's treatment of prisoners at Guantanamo Bay, where the USA has been accused of violating human rights. Several companies, including a Norwegian company, have also been accused of human rights abuses, either directly or through complicity.[4] As the following will be show, complicity in human rights violations is especially relevant as a possible means of imposing liability on companies.

1.2 The relevant human rights

There are a number of different human rights, not all of which have the same potential to be affected by oil companies. The most obvious way in which oil companies may violate human rights is through violating the rights of their employees. For instance, the company may discriminate against its employees or deny them freedom of association or the right to organise. In addition, it is possible that the rights of people outside the company will be affected by its operations. The Total/Unocal case from Burma illustrates this, where it was claimed that the rights to life, freedom and personal integrity were violated.

The starting point for the following assessment is the UN Universal Declaration of Human Rights from 1948 (the "Universal Declaration"). The Universal Declaration lists a number of general rights, of which the right to life, freedom, non-discrimination, the freedom to organise and freedom of speech are relevant here. Together with the subsequent conventions for Economic, Social and Political rights (from 1966), and for Civil and Political Rights (from 1966), the Universal Declaration constitutes the so-called "international bill of rights".

4 See the report of 11.01.2007 from Amnesty International Norway "Kan Aker Kværner holdes strafferettslig ansvarlig for sin virksomhet på Guantanamo Bay?" written by Mette Yvone Larsen and Bendik Vedle Koslung.

Other important conventions based on the Universal Declaration are the International Covenant on the Elimination of All Forms of Racial Discrimination (1965), the UN Convention on the Elimination of All Forms of Discrimination against Women (1979), the Convention against Torture and Other Cruel, Inhuman or Degrading Treatment or Punishment (1984) and the UN Convention for the Rights of the Child (1989). Together with the ILO Convention for the Rights of Indigenous Peoples and the European Convention for the Protection of Human Rights and Fundamental Freedoms, these conventions are referred to, in the ethical guidelines for the Council on Ethics, as containing the most important statements on human rights. These conventions form the basis of the following assessment and will be referred to only to the extent necessary to assess the obligations of oil companies with regard to human rights. A general assessment of each convention and the rights and obligations under it will not be made in this presentation.

1.3 Only oil companies?

The fact that the title of this presentation is *oil* companies and human rights begs the question whether oil companies are in an exceptional position compared to other companies. To the best of my knowledge they are not. Oil companies have no greater or lesser obligation to respect human rights than other companies and have been chosen as the subject of this presentation simply because they are typical of large, international companies. In addition, as already mentioned, oil companies operate in parts of the world where respect for human rights is sometimes rather poor. When oil companies operate in these countries, they are often one of the largest players in the countries' economies, a factor that could give them significant influence. For instance was Total one of the largest companies in Burma at the time the military units were accused of

human rights violations. The following remarks on oil companies will also apply to companies in other sectors.

1.4 Outline of the presentation

The following discussion reviews possible ways in which oil companies may be held legally responsible for human rights violations. One possibility is that the human rights conventions may impose legal obligations directly on oil companies. Another possibility is that oil companies may be indirectly obligated to respect human rights through national legislation. We will then examine the issue of complicity as a possible means of holding oil companies responsible for human rights violations before considering various voluntary types of obligations. In addition to the formal obligations imposed on the companies, non-legal mechanisms, such as the market and public relations, will create incentives for companies to respect human rights. This will be briefly addressed at the end of this presentation.

The issue of human rights and companies' international legal obligations is a wide-ranging topic. As will be shown, there may be several possible ways of creating obligations for companies to respect human rights and all the possibilities deserve in-depth analysis. In this presentation, however, I have chosen to try to give an overall impression of the wider picture. As a consequence, the following is a rather superficial presentation of the possibilities of holding oil companies responsible for human rights abuses.

2 Direct obligations on oil companies

2.1 Introduction

It is a long-established principle in international law that the primary legal obligations lie with states – it is states that are bound by

international conventions.[5] In addition, the obligations contained in the human rights conventions are directed at states and political players, not companies. Despite this clear principle, it has been argued that the human rights conventions impose obligations directly on companies, as human rights have a direct effect that makes it possible for individuals to assert violations of human rights committed by companies.[6] Even if this is an attractive thought and that companies can be considered to have a moral obligation to respect human rights, in my opinion, the various arguments suggesting that this obligation is legally binding are not very convincing.

2.2 The UN's Universal Declaration

One frequently used argument in favour of the direct imposition of obligations on companies to observe human rights is the preamble to the Universal Declaration.[7] Reference is made in particular to the preamble, where it is stated that:

> "…every individual and every organ of society, keeping this Declaration constantly in mind, shall strive by teaching and education to promote respect for these rights and freedoms and by progressive measures, national and international, to secure their universal and effective recognition and observance".

The wording of the preamble is not directed exclusively at states, but also at other sections and members of society. It can also be argued that companies are included in this wording. As Louis Henkin expressed it:

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5 See*, inter alia*, NOU 2003:22 p. 96 and Cassese, International Law, 2nd edition (2005) p.71.

6 See, for example, the study, Beyond Voluntarism, carried out by the International Council on Human Rights on p.73.

7 See Beyond Voluntarism pp. 58-62.

> "Every individual includes juridical persons. Every individual and every organ of society excludes no one, no company, no market, no cyberspace. The Universal Declaration Applies to them all."[8]

Similar viewpoints have also been expressed by two former UN Commissioners for Human Rights (Mary Robinson and Sergio Vieira de Mello).[9]

Based on this wording, the Universal Declaration could be understood as having ambitions also to apply to companies. However, when other factors than the wording of this part of the preamble are considered, this becomes less clear. There are also several further obstacles to deriving binding obligations on companies from the Universal Declaration of Human Rights.

Firstly, the Universal Declaration is a resolution, rather than a convention that imposes legally binding obligations. For the Declaration to be considered legally binding it must be shown that, through repeated words and actions, states have accepted the Declaration as binding. The majority of states consider themselves bound by the Universal Declaration, something which was expressed at the first World Conference for Human Rights in Tehran in 1968, where it was stated that the Universal Declaration "constitutes an obligation for the members of the international community."[10]

However it is uncertain which parts of the Declaration should be considered legally binding. The preamble itself does not impose obligations, but it will, however, be a relevant factor for interpreting

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8 Louis Henkin, The Universal Declaration at 50 and the Challenge of Global Market. 17 Brooklyn Journal of International Law s. 25 (1999)

9 M.Robinson, "The business case for human rights" in Visions of Ethical Business, Financial Times Management 14-17 and Vieira de Mello. "Human rights: what role for business?" 2(1) New Academy Review (2003) 19-22. See also Andrew Clapham, Human rights obligations of non-state actors (2006) p. 228.

10 See Proclamation of Teheran, 13 May 1968 paragraph 2.

the individual provisions in the text.[11] In this context, the objectives of the Declaration, including the quoted part of the preamble, could imply that certain provisions should be interpreted as also applying to companies in order to ensure maximum protection of human rights for individuals.

It can further be shown that the majority of the rights in the Declaration are rights only, as obligations are not directed at specific subjects. Certain theorists have taken the view that it is therefore not only states that are subject to obligations pursuant to the Declaration.[12] However, the nature of the obligations implies that it is states that are responsible. In my opinion, the situation in which the Declaration was drafted supports such a view. After the Second World War, it was abuses by states that were particularly relevant and the Universal Declaration was an instrument to prevent a repetition of state-sponsored violations of human rights.

The fact that there are no systems to enforce companies' compliance with any obligations in the Declaration also supports this view. Although this is not in itself decisive, it suggests that the intention was that only states should be capable of being held responsible.

Therefore it is doubtful that whether companies can have obligations directly imposed on them under the provisions of the Universal Declaration, even though they are not explicitly excluded from its scope.

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[11] Pursuant to art. 31 of the Vienna Convention for the interpretation of treaties, introductions are deemed to be part of the relevant context for the interpretation of treaties, although they do not themselves create obligations.

[12] For example, Clapham.

2.3 International criminal law

In the debate on whether companies are subject to direct obligations, reference is often made to international criminal law. Under international criminal law, it has long been established that *individuals* can be directly liable for certain internationally punishable offences, such as slavery and piracy. The armistice agreement after the Second World War confirmed that individuals can be held responsible for violation of the peace, war crimes and crimes against humanity. An often quoted remark from the Nuremberg Tribunal stated:

> "Crimes against international law are committed by men, not abstract entities, and only by punishing individuals who commit such crimes can the provisions of international law be enforced."[13]

The basis for such liability is usually found in international common law, the so-called *jus cogens*.[14] This is also known in Norwegian case law relating to the armistice agreement, where the Supreme Court, in the *Klinge* case, found a war criminal liable under the provisions of international law.[15] It is not clear what obligations can be said to follow from *jus cogens*. Presumably they include obligations to abstain, *inter alia,* from genocide, systematic racial and religious discrimination, slavery and crimes against humanity.[16]

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[13] Trial of Major War Criminals (Goering et al), International Military Tribunal (Nuremberg). Judgment and Sentence 30 September and 1 October 1946.

[14] *Jus cogens* in Article 53 of the Vienna Treaty is defined as "a norm accepted and recognized by the international community of states as a whole as a norm from which no derogation is permitted and which can be modified only by a subsequent norm of general international law having the same character."

[15] See Rt. 1946 p.198.

[16] See Beyond Voluntarism, p.62 with additional references, Henkin p.18 and Clapham p.244.

The fact that international law/*jus cogens* imposes obligations on individuals in the field of international criminal law does not necessarily mean that companies are also directly subject to these obligations. There are no general instruments that impose criminal liability on companies for serious violations of human rights.

Companies do not, for instance, come within the jurisdiction of the International Criminal Court (ICC). A provision giving the ICC the right to hear criminal cases against companies was proposed in the statutes for the court, but was removed before the statutes was approved. This was apparently because there was insufficient time to reach agreement on the wording of the provision.[17]

The most practical way in which companies can be punished for human rights violations is through the criminalisation of such actions in each state. Companies will then be “indirectly obliged” to respect human rights. This will be addressed in more detail in Section 3.

In practice, however, it is not very likely that companies themselves will commit criminal acts such as those mentioned in this section. It is more likely that companies will benefit greatly from human rights abuses or even be complicit in violations of human rights. This can be illustrated by the fact that the majority of cases brought before American courts based on the Alien Tort Claims Act concern complicity in human rights violations rather than direct violations. An example of this would be companies that benefited from German forced labour during the Second World War, or oil companies that employ security forces that violate human rights. It is not inconceivable that companies could be held liable for these actions in tort law. For example, there is legislation that provides survivors of the Nazi labour camps, or those of their allies or sympathisers, with the right to claim compensation from

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[17] See Clapham p.246 with additional references.

the company, or its successors, for which the labour was carried out.[18] There are also examples of companies that have paid compensation to surviving forced labourers who worked in their factories. An example of this is Faber/Bayer, which established a fund for work camp survivors. Following the end of the Second World War, several members of the company's management were sentenced for slavery (among other crimes) by a temporary American war tribunal in Nuremberg.[19] The company itself was not accused of human rights violations.

2.4 The possibility of imposing direct legal obligations on companies on the basis of other conventions

It is sometimes argued that certain conventions that take into account the fact that companies or individuals may violate human rights impose obligations directly on companies. An example often referred to in this context is the Convention on the Elimination of all Forms of Discrimination against Women from 1979, of which Article 2 asserts that the states shall take:

> "all appropriate measures to eliminate discrimination against women by any *enterprise*".[20]

Under this wording, however, it is the state that has the direct obligation to ensure that rights are not violated, companies can only be indirectly obligated. I will return to this below.

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18 See Section 354.6 of the California Civil Code.

19 These hearings were held before the armistice at the "Nuremberg Tribunal".

20 See also Article 13 b) under which the states shall prevent discrimination in connection with bank loans, mortgages and other forms of financial credit.

Reference is also sometimes made to the fact that there are examples of international conventions under which companies are granted rights, for example, bilateral investment conventions, and that there are international environmental responsibility conventions that impose obligations on companies.[21] Consequently, it is argued, there is no conceptual bar to companies being deemed participants in international law.[22] The fact that companies are granted rights under certain international conventions and the fact that some conventions countenance the violation of human rights by companies, does not necessarily mean that companies are directly obligated. Companies will first be obligated either when international conventions directly impose obligations or when states fulfil their obligations by implementing the conventions into national law. I have not seen any human rights conventions that expressly impose obligations on companies. On the other hand, there are examples of conventions that recognise, in their introductions and preambles, the fact that individuals are bound by mutual obligations. However, such recognition is not expressed in the operative provisions of the conventions and they therefore do not give rise to direct obligations.[23]

During the 1990s, there were a number of statements from international UN conferences expressing a greater willingness to impose liability and obligations on companies.[24] Similar statements have been made in connection with the EU's work on Corporate

[21] See Ruggie, Section 20.

[22] See, *inter alia*, Beyond Voluntarism, p. 58.

[23] See, for example, Article 5 (1) of the Convention for Civil and Political Rights and the remarks on this in Nowak, United Nations Covenant on Civil and Political Rights pp. 111-119 and Ruggie, Section 38.

[24] This applies to, *inter alia*, the Rio Conference on the Environment in 1992, the Conference for Women in Beijing in 1992 and the Copenhagen Conference for Social Development in 1995.

Social Responsibility.[25] Although these statements are not legally binding, they do signal an expectation that companies should take on certain internationally agreed obligations.

> In the study "Beyond Voluntarism", the International Council on Human Rights analyses the issue of whether human rights are directly binding on international companies. The Council stresses that voluntary initiatives and market mechanisms are insufficient to prevent companies from violating human rights and that many international companies are so large that nation states have difficulties regulating them effectively. After a review of the various potential grounds for imposing obligations on companies, the Council concluded that what is seen is a gradual development of international law towards clear, binding norms which could be applied directly to companies. To support this conclusion, the Council referred *inter alia* to the OECD Guidelines for Multinational Companies, Article II.2, which is not binding on companies.[26]

The UN Special Representative of the Secretary-General on business and human rights, John Ruggie, concluded in his study of international companies and human rights to the Human Rights Council that companies do not have direct obligations in relation to human rights.[27] He substantiated this with the argument that the international human rights conventions directly bind states, while companies are only bound "indirectly" through the states' incorporation of conventions into national law.

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25 See, *inter alia*, Clapham p.228 and various recommendations to the EU Parliament during the winter of 2006-2007.

26 "[enterprises should] respect the human rights of those affected by their activities consistent with the host government's international obligations and commitments." Nicola Jagers also argues for such a gradual development of human rights obligations for companies, see Nicola Jagers, Corporate human rights obligations: in search of accountability.

27 See Ruggie, Section 44.

3 Indirect obligations through national legislation

Human rights have traditionally been intended to protect individuals against abuse by the state. However, several provisions in human rights conventions and interpretations of these require states to protect their citizens against abuse committed by both public and private institutions. This has typically been expressed in provisions stipulating that the state shall ensure that citizens have certain rights. One example is Article 2 of the UN Convention for Civil and Political Rights, which states that:

> "each state party to the present Covenant undertakes to respect and ensure to all individuals within its jurisdiction the rights recognized in the present Covenant…"

Another example stating that it is incumbent on states to ensure that companies do not breach certain human rights can be found in Article 2 (e) of the Convention for Women, as referred to above (the member states shall "take all appropriate measures to eliminate discrimination against women by any person, organization or enterprise.")[28]

The state fulfils its obligations under these conventions through national legislation and by enforcing this legislation as far as its jurisdiction allows. The obligation of the state pursuant to these conventions includes the prevention of violations committed by companies and private persons.

In connection with the above assessment of international criminal law, it was shown that companies are indirectly obligated to respect human rights where human rights violations are criminalised by individual states. In Norway, corporate penalties could be applied to companies that commit a punishable act, cf.

[28] See also Article 2 (1) d of the Discrimination Convention.

Section 48 of the Norwegian Criminal Code. For a company to be found guilty, it must have violated a penal provision. Not all violations of human rights have been criminalised and will therefore result in criminal liability in Norway. An example of a human rights violation that may give rise to criminal liability is illegal imprisonment (see Section 223 of the Criminal Code). This has, *inter alia*, been discussed in connection with Aker Kværner's activities in Guantanamo Bay. A report on this subject from Amnesty International concluded that Aker Kværner was not directly bound by human rights, as only states could have direct liability imposed upon them. Amnesty instead argued that Aker Kværner had been complicit in violations of human rights and that criminal liability could arise on this basis. I will return to the issue of complicity in section 4 below.

Another issue that arises in this connection (although it is not in fact central to this topic) is the extent to which a state is responsible for breaches of human rights that are committed outside the state's territory by companies that are domiciled in that state. Guidance for making this assessment can be found in guidelines pertaining to the responsibility of states for international wrongful acts prepared by the UN body known as the International Law Commission. Chapter II contains provisions on the types of conduct that could be attributed to a state. For instance, it states that the conduct of a person or a group of persons shall be considered an act of a state if the person or group of persons is in fact acting on the instructions of, or under the direct control of, a state in carrying out the conduct (article 8). For example, if the military, or a wholly owned state company, commit an international wrongful act, the state will be directly responsible. However if the connection with the violating party is more remote, it is more doubtful whether the state could be said to be responsible for infringements outside its territory. As a general rule, a state is not obligated to intervene and take enforcement action against violations of human rights on another state's territory. However, a state can have the right to intervene in the case of breaches of human rights (by companies) in other states. In this case, the state's ability to intervene is presumably limited by the principle of sovereignty.

The extent to which oil companies are obligated to respect human rights on this basis depends on how each state complies with its obligations and the relevant wording of the national regulations. A problem when oil companies are the major players in a state and are important to the state's economy is that the state will not want to "bite the hand that feeds it". Consequently, even though the state is obligated to prevent human rights violations, it may be reluctant to hold the company responsible for violations of national laws that incorporate the human rights conventions. In this situation, another state will not be obligated to intervene to stop these violations, but could be entitled to do so. Depending on the national regulations, the courts of a state may also be able to hear claims for damages for breach of human rights in another country, as is the case with the American courts through the Alien Tort Claims Act.

4 Complicity

4.1 Introduction

As previously mentioned, it is difficult successfully to argue that obligations concerning human rights can be directly imposed on companies. An alternative may be to argue on the basis of the concept of complicity, i.e., in favour of an obligation for companies not to be complicit in human rights violations. This would perhaps be the most practical course of action, as illustrated by the number of complicity cases brought in the USA based on the Alien Tort Claims Act.

There are four situations where the issue of complicity will be particularly relevant:[29]

[29] Similarly, Beyond Voluntarism pp. 126-133.

- where a company actively assists – directly or indirectly – in human rights violations committed by others;
- where a company participates in a "joint enterprise" with a government and the company could reasonably have been expected to predict that the government would commit abuses of human rights in carrying out its part of the joint enterprise;
- where a company benefits from human rights violations without actively participating in, or causing, these violations; and
- where a company remains silent/passive in the face of human rights violations.

In the guidelines from the International Law Commission on the responsibility of states for international wrongful acts, complicity in breaches of international law committed by other states is regulated in Chapter IV. According to the guidelines, there must be a close connection between the act of complicity and the other state's breach of its international obligations, something that is emphasised in the remarks to the guidelines.[30] Despite the fact that these guidelines are only meant to apply to states, they indicate the requirements for establishing the presence of complicity in relation to violations of human rights. I will return to the guidelines in more detail and how they can be adapted to companies in Section 4.3 below.

4.2 Case law regarding complicity

The issue of complicity in breaches of human rights has been addressed several times by international courts. The issue has been particularly relevant in international criminal law in connection with armistices (including the Nüremberg tribunal and post-war

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30 See the remarks on p. 154.

hearings in the Balkans and Rwanda). In these cases, an international standard has been developed for an individual's complicity in punishable offences under which it is required that that the individual must: "knowingly provide practical assistance, encouragement or moral support that has a substantial effect on the commission of the crime".[31]

This standard was also applied in the *Doe v. Unocal* case, referred to in the introduction to this presentation, despite the fact that the case concerned a claim for damages for breaches of human rights.

The *Doe v. Unocal* ruling is interesting for a number of reasons. Firstly, there was a very specific and detailed discussion of the issue of complicity, despite the fact that this was only a procedural ruling. Secondly, the majority directly and explicitly applied the standard for determining complicity as developed in international criminal law.[32] Since *Doe v. Unocal* was an action in tort, this may appear somewhat strange. However, since this is the only form of international law to deal with the issue of complicity, it must have been tempting to apply this standard when discussing liability in tort for similar human rights violations.

The minority based their ruling as to complicity on national tort law. When the issue was to be resolved pursuant to American federal tort law, Judge Reinhart established three tort law principles for determining complicity: joint venture, agency and reckless disregard. It is interesting to see that both methods led to the same result. If the argument of the minority were to be transferred to Norwegian law, the complicity issue would be resolved in

[31] See Ruggie, Section 31 with reference to ICTY Trial Chamber 10 December 1998, No. IT-95-17/1 (Prosecutor v. Furundzija) and ICTR Trial Chamber 2 September 1998, No. ICTR-96-4-T (Prosecutor v. Akayesu).

[32] See paragraph 7 in the ruling, where explicit reference is made to rulings by the court in respect of the former Yugoslavia and Rwanda.

accordance with standard Norwegian tort law and its doctrines of complicity. In Norwegian law, complicity in tort law has primarily been dealt with by applying the doctrine of “damage caused by many”. “Passivity” has also been relevant to the discussion of complicity (in Norwegian law). As of today, there has been no significant assessment of this issue and I will not go into more detail here.

4.3 Theory regarding complicity

Andrew Clapham has formulated the conditions for establishing complicity in breaches of human rights in tort somewhat differently than the minority in *Doe v. Unocal*.[33] Instead of building upon national tort law, he has used the above-mentioned guidelines from the International Law Commission on the Responsibility of States to formulate three conditions for establishing whether there has been complicity in breaches of international obligations by other states:

1) the company must have been aware of the human rights violations, although not necessarily have shared the violating party’s intention to breach human rights;
2) the company must have facilitated the human rights violations. It is not a requirement that the company’s actions were a necessary prerequisite for the human rights violations (i.e., it is irrelevant that the violations would not have occurred if it had not been for the company’s actions).
3) the company itself must have an obligation to respect the actual rights breached. This final condition is clearly based on the guidelines for establishing whether states are complicit in breaches of international law committed by other states. In

[33] See Clapham pages 263-264.

the situation that is assessed in this presentation, this condition will make liability for complicity difficult to establish as companies (as explained above), are not directly obligated by international law, but only by national law.

In his report, Ruggie builds upon the concept of complicity as it has been developed in international criminal law. The first two conditions from Clapham's overview are included in his interpretation. The third condition established by Clapham is outside the scope of the standard for complicity used by Ruggie.

4.4 Recommendations from the Council on Ethics

In Norway, the issue of complicity in breaches of human rights has been handled in particular by the Council on Ethics in connection with the issue of withdrawing investment from companies that commit, or are complicit in, serious breaches of human rights. The issue to be assessed by the Council on Ethics is whether there is an unacceptable risk of the fund being complicit in human rights violations through its investments. In a recommendation to the Ministry of Finance on 14 November 2005, in which the issue was whether the fund should sell its shares in Total because of Total's operations in Burma, four criteria were raised that were seen as decisive in an overall evaluation of whether there was a risk of the fund being complicit in breaches of human rights:

- there must be a connection between the company's operations and existing breaches of human rights standards that are visible to the fund;
- the breaches of standards must be made with a view to serving the interests of the company or catering for the company's operations;

- the company must have either actively been complicit in the breaches of standards or had knowledge of them and not attempted to prevent these; and
- the breaches of standards must either be recurring or there must be an unacceptable risk that breaches of standards will occur in the future.

In its assessment of the concept of complicity, the council builds primarily upon international criminal law and these criteria are to a large extent in accordance with Ruggie's report. The fact that the Council on Ethics only provides recommendations about whether the fund should withdraw its investment from a company means that the council is not required to consider whether these criteria apply to a criminal or tort assessment of complicity.

4.5 Conclusion

On the basis of the above, it is difficult to establish a clear standard for complicity pursuant to tort law. If we are to make a general statement, it must be that for liability for complicity to be established, there must be a close connection between the company and the human rights violations. The company must have had knowledge of the violations, benefited from them and possibly also facilitated the violations or actively participated in them. Simply operating in a state that violates human rights and paying tax to such a regime is not sufficient in itself to make the company liable for human rights violations on the basis of complicity.

5 "Voluntary" subjugation

5.1 Introduction

As is apparent from the above discussion, the extent of oil companies' obligations to respect human rights greatly depends on national laws. As not all states are very interested in respecting and maintaining human rights, oil companies' legal obligations will not necessarily be very comprehensive. This does not mean that oil companies will not respect human rights in practice or that they do not feel morally obliged to do so, as shown in recent years by companies' voluntarily pledges to respect human rights.

5.2 Participation in various programmes

There are a number of ways in which a company can undertake an obligation to respect human rights. One is through the company's Corporate Social Responsibility Policy. Another is that companies can participate in various programmes to ensure the observance of human rights. An example of such a voluntary programme is the Global Compact, established through a UN initiative in 2000. The principles established in connection with the Global Compact cover both the promotion of human rights and companies' duty to avoid complicity in breaches of them.

According to the first principle in the Global Compact, companies are asked to "support and respect the protection of international human rights within their sphere of influence". The general reference to international human rights places a very comprehensive obligation on the companies, which are to respect and protect all human rights. According to the Global Compact's website this includes, *inter alia*, an obligation to ensure a safe working environment, the right to organise, non-discrimination in respect of employees, no employment of forced or child labour and

rights to basic health, education and housing (if corporate operations are located in areas where this is not provided).[34] According to this principle, companies shall also respect international guidelines and standards regarding the use of force (the UN's Code of Conduct for Law Enforcement Officials and the UN's Basic Principles on the Use of Force and Firearms by Law Enforcement Officials), prevent the forced relocation of individuals, groups or communities and participate in public debate.

The second principle requires companies not to be complicit in breaches of human rights. The Global Compact website states that complicity can occur in several ways, of which three examples are given.[35] Most astounding is that silent/passive complicity, where the company is aware of long-term violations of human rights in its dealings with the authorities, but does not report or mention these, is also categorised as a form of complicity.

A number of companies participate in the Global Compact, including British Gas, BP, Shell, StatoilHydro, Petrobras, Total, Eni, Talisman and Hess. The problem with such programmes is that it is difficult to control whether companies are living up to their promises. In the case of the Global Compact, the idea is that companies will themselves report on their compliance. However, there is no mechanism to monitor whether compliance is actually taking place.

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34 http://www.unglobalcompact.org/AboutTheGC/TheTenPrinciples/principle1.html

35 http://www.unglobalcompact.org/AboutTheGC/TheTenPrinciples/Principle2.html
The basis for these three categories of complicity is a report from the UN's Commissioner for Human Rights, Mary Robinson, to the United Nations General Assembly in 2001.

5.3 Voluntary "Codes of Conduct"

Several companies have established so-called "codes of conduct" for their business operations. Such codes are intended as internal guidelines for management. The extent to which these codes impose obligations on the company and bring about increased respect for human rights is unclear.

In another context, such voluntary codes of conduct can be significant. They are good for the company's reputation and make the company appear socially responsible. This is illustrated by the fact that more and more large companies (including oil companies) have followed the example of Levis Strauss (which was one of the first large companies to prepare and publish a code of conduct) and have implemented codes of conduct in which they pledge to respect human rights. Whether these companies actually live up to their codes of conduct is, however, entirely another matter.

5.4 Regulation through contract

It is not unusual for oil companies to introduce a provision governing "business principles" in charterparties they conclude. An example of such a provision can be found in Clause 53 of *Shellvoy 6*:

> "Owners will cooperate with Charterers to ensure that the "Business Principles", as amended from time to time, of the Royal Dutch/Shell Group of companies, which are posted on the Shell World Wide Web (www.shell.com), are complied with."

A provision such as this obligates the parties to respect human rights. However, the repercussions if human rights are not respected are not entirely clear. If the owner/carrier breaches its obligation to cooperate with the charterer to uphold Shell's Business Principles it will be in breach. The charterers will therefore be entitled to terminate or claim damages for losses

resulting from the breach. However, as regards the individual(s) whose human rights may have been violated, the value of such a provision may be questioned. The contract binds the parties to it, but it is more difficult for third parties to claim under its terms.

6 "Bad for business"

In addition to the legal ramifications, there are other, more practical consequences of companies' failure to respect human rights. Put simply, the violation of human rights can be "bad for business".

One obvious consequence will be that publicity about an oil company's lack of respect for human rights will be negative advertising for the company concerned. Its customers may prefer other suppliers if human rights violations become known and the authorities may choose other contractors when new concessions are granted.

A further consequence may be that investors in the company will sell their shares. The past few years have seen the emergence of so-called ethical funds. Such funds will not invest in companies that do not respect human rights or, if they have already invested in such a company, will disinvest if it is discovered that the company is violating, or is complicit in violations of, human rights. For example, the Norwegian Governmental Pension Fund established its Council on Ethics in 2003. The council makes recommendations to the Ministry of Finance to disinvest from companies that, *inter alia*, violate human rights. For example, the council recommended that the Fund withdraw from Wal-Mart because the council was of the opinion that Wal-Mart abuses human rights through its use of

subcontractors whose employees work in appalling conditions.[36] An alternative to disinvestment by ethical funds is for the funds to use their voting rights as shareholders to demand that companies put in place procedures to ensure that human rights are respected.

Another possible consequence of a company's abuse of human rights is that it may have problems obtaining an export guarantee from the authorities. The British Government, *inter alia*, requires companies to respect human rights to obtain export guarantees.[37]

7 Conclusion

On the basis of the above discussion, we can conclude that the human rights conventions do not directly impose obligations on oil companies to respect human rights. However, obligations are indirectly imposed on the companies through national legislation that incorporates the human rights conventions. It has also been demonstrated that oil companies can incur liability for compliance, although it is unclear how the criteria for obtaining compensation

[36] Another example of such a withdrawal because of failure to respect human rights was when the largest American pension fund withdrew its investments in Thailand, the Philippines, Malaysia and Indonesia in 2002. Steinhardt, Corporate Social Responsibility and the International Law of Human Rights: The New Lex Mercantoria, in Non-State Actors and Human Rights on p. 185.

[37] See also Steinhardt, pp. 12-192 for similar possibilities in the USA.

for companies' complicity in violations of human rights should be formulated. Despite the fact that the oil companies are not subject to a clear legal obligation to respect human rights, companies undoubtedly have a moral obligation to respect and promote human rights.

Part VIII
The organisation of Norwegian gas sales and competition law

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1 Introduction

Competition law has become increasingly relevant for activities on the Norwegian Continental Shelf (NCS) over the last decade. The real wake-up call for both the Norwegian authorities and the oil companies active on the NCS as to the impact of competition law was the so-called *GFU case*[1], which was initiated by the European Commission ("the Commission") (i.e., DG Competition) and which mainly took place during 2000-2002.[2] The case centred on the allegation made by the Commission that the Gas Negotiating Committee (GFU), which jointly negotiated gas sales contracts on behalf of the producers of natural gas on the NCS for resource management purposes, was a sales cartel contrary to Art. 81 EC. Although the Commission's allegations were opposed on the basis of the doctrine of state compulsion[3], the case was settled out of court and was a major contributor to the reorganisation of the Norwegian gas sales regime that took place at approximately the same time. Even after the dissolution of the sales cartel (the GFU) and the introduction of a system of company-based sales (CBS) on the NCS, competition law still has to be considered by the oil companies when organising their activities on the NCS. This article

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1 IP/02/1084 of 17 July 2002

2 For a more detailed presentation of the GFU case, see part 3 below.

3 For a short presentation of the doctrine of state compulsion, see, e.g., Jonathan Faull & Ali Nikpay (editors), The EC Law of Competition (Oxford, 2nd Edition) ("Faull & Nikpay"), Chapter 3: Art. 81 pp. 217-218. See also Richard Whish, Competition Law (5th Edition) ("Whish") pp. 128-129.

therefore deals with the *competition law aspects of the organisation of the sales of natural gas produced on the NCS*.[4]

The *GFU case* illustrates the importance of Community legislation for the organisation of the gas sales regime on the NCS as well as any other economic activity. The focus of this article is *the sales market for natural gas*. A distinction has to be drawn between the transport market and the sales market for natural gas. However, there is a close connection between the transport market and the sales market, as a well functioning transport market is a prerequisite for a competitive sales market. Thus, extensive secondary legislation has been passed at the Community level in order to establish a transport market within the gas sector.[5] Experience from the ongoing process of liberalisation in respect of the energy sectors (i.e., both electricity and natural gas) has shown that simply facilitating competition through rules on third party access ("TPA") is not sufficient to ensure the development of a competitive sales market. Real competition requires sufficiently liquid markets.[6] However, as the bulk of gas reserves is sold under long-term sales agreements, the natural gas currently available cannot support sufficient trade, neither on a national nor on a

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4 For a general discussion of these questions (i.e., independent of the organisation of petroleum activities on the NCS), see, e.g., Christopher W. Jones (editor), EU Energy Law – Volume II, EU Competition Law & Energy Markets ("EU Energy Law II"), Part 3 – Articles 81 and 82 EC.

5 For a further presentation of the passing of secondary legislation in order to establish a transport market within the gas sector and its implications for the activities on the NCS, see Anne-Karin Nesdam, Third Party Access to Upstream Pipeline Networks on the Norwegian Continental Shelf ("Nesdam, Third Party Access"), Petroleum Law – Book 1, Chapter 5.

6 Here, the term "liquid markets" is only used to refer to the need for enough gas volumes free to trade in the market. Reference is not made to the existence of institutions (i.e., exchanges) which facilitate the trade of the gas volumes as such.

Community level.[7] In other words, the companies that participate in the sales market have to be forced to compete. While the rules on TPA, by their imposition of a duty to contract on the owners of infrastructure, provide the structural changes necessary for a transport market – and thus competition in the sales market – to develop, the ordinary competition rules and their enforcement both prevent and correct market-distorting behaviour by those companies participating in the sales market as such.

Policy considerations both explain the Commission's (initiative for the) passing of special competition legislation (i.e., DG Tren) and its enforcement of ordinary competition law (i.e., DG Competition) in the gas sector. Natural gas is one of the most widely used fuels in the European Union (EU), accounting for approximately a quarter of the primary energy used. Around 42% of this gas is produced within the EU, in particular in the UK, the Netherlands and Denmark. This means that 58% is imported, and this proportion is increasing. Norway, Algeria and, especially, Russia are traditionally the most important sources of gas imported to the EU, although imports of liquefied natural gas by ship are growing fast and are from a wider range of producing countries.[8]

Although this is expected to change somewhat with the future development of a national downstream sector, the vast majority of the gas volumes produced on the NCS is exported to customers on

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7 See, e.g., Communication from the Commission Inquiry pursuant to Art. 17 of Regulation (EC) No. 1/2003 into the European gas and electricity sectors. COM(2006)851 final, published at http://eurlex.europa.eu/LexUriServ/site/en/com/2006/com2006_0851en01.pdf, and IP/07/26 of 10 January 2007 (Competition: Commission energy sector inquiry confirms serious competition problems), published at http://europa.eu/rapid/pressReleasesAction.do?reference=IP/07/26&format=HTML&aged=0&language=EN&guiLanguage=en.

8 Factual information, published at http://ec.europa.eu/comm/competition/sectors/energy/gas/gas_en.html.

the European Continent. For all practical purposes, the gas produced on the NCS can be said to be sold to customers located within the boundaries of the EU.[9] Due to this fact, this article deals with the limitations on the gas undertakings' freedom of action that follows from *European competition law* when organising the sales of their share of the natural gas produced. In other words, the focus of this article is on the competition rules in the Treaty of Rome – or, more specifically, Art. 81 EC and Art. 82 EC and, to some extent, Art. 86(2) EC. It should be noted, however, that Norway is a party to the EEA Agreement, which incorporates Art. 81 EC, Art. 82 EC and Art. 86(2) EC in Art. 53 EEA, Art. 54 EEA and Art. 59(2) EEA respectively.

The main focus of the article is the limitations that follows from *Art 81 EC*. As competition law has only been applied to the gas sector (or rather, the energy sectors as a whole) for a relatively short period of time, its application to these sectors is still developing. Accordingly, both case law and administrative practice are rather limited. In terms of the administrative practice that does exist, the Commission has dealt mainly with alleged breaches of Art. 81 EC.[10] In any case, even though it still applies, Art. 82 EC has

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9 Producer companies active on the NCS have entered into gas sales contracts with customers in Germany, France, the UK, Belgium, the Netherlands, Italy, Spain, Czech Republic, Poland and Denmark. The majority of the gas produced, however, is delivered to customers in Germany and France, cf. Facts 2007 – the Norwegian Petroleum Sector ("Facts 2007") p. 4.4. Although not of particular interest for the issues addressed in this article, it has to be mentioned that gas sales contracts recently have been entered with buyers in the US as well.

10 For an incomplete overview, see e.g. MEMO/03/86, dated 16 April 2003, Application of competition rules to the gas sector, published at http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/03/86&format=HTML&aged=1&language=EN&guiLanguage=en, and MEMO /03/89, dated 24 April 2003, Application of competition rules to the gas

become of less practical importance following the passing of the Gas Directive[11] and the Gas Transmission Regulation[12] respectively.[13]

It should be emphasised that this article mainly formulates and addresses *possible issues relating to Community competition law,* rather providing definite answers on how these issues should be resolved. As previously mentioned, the future application of competition law to the gas sector has yet to be decided. Not only is the existing case law scarce, but most of what is available indicates the Commission's view on the application of the competition rules to the gas sector, as most cases so far have been settled out of court. The application of the law by the Commission (DG Competition) is not binding upon the European Court of Justice (the ECJ). Under

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sector, published at http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/03/89&format=HTML&aged=1&language=EN&guiLanguage=en.

11 Directive 2003/55/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in natural gas and repealing Directive 98/30/EC, OJ L 176, 15.7.2003, pp. 57–78

12 Regulation (EC) No. 1775/2005 of the European Parliament and of the Council of 28 September 2005 on conditions for access to the natural gas transmission networks, OJ L 289, 3.11.2005, pp. 1–13

13 As already mentioned, neither the transport market nor the sales agreements as such are dealt with in this article. Mainly, questions in relation to abusive practices such as excessive pricing practices, discrimination (in particular discrimination as regards access), long-term capacity reservations of infrastructure as well as long-term supply contracts have been assessed under Art. 82 EC. Apart from the question of long-term supply contracts, these questions have mainly risen in relation to the question of access to infrastructure (i.e. the transport market) and are now regulated in national law implementing the secondary legislation passed at Community level. For all practical reasons, the question of non-discriminationg access to infrastructure will be solved on the basis of this regulatory framework. For a presentation of the application of Art. 82 EC to the energy sector, see Faull & Nikpay, The EC Law of Competition Chapter 12 par G (pp 1450-1464).

Community law, it is the ECJ that establishes the law in cases of doubt. Because of the limited amount of practice, it is somewhat uncertain what approach the ECJ would take.

The organisation of the value chain in its entirety, i.e., from production via transport to marketing and sales, may influence market conditions in the sales market. Since transport is subject to a particular regulatory regime, however, this article focuses solely on production, marketing and sales. Firstly, the various types of co-operation that take place on the NCS due to the particular requirements of the petroleum sector as such will need to be addressed (in part **5**). The main question here is to what extent joint production is permissible under competition law. In addition to the question of joint production as such, circumstances related to the structure of the NCS that may jeopardise the joint production need to be mentioned. This discussion is related to the licencees` participation in several licences and the possibility of information exchange. Secondly, we examine the various types of co-operation that might need to take place on the NCS due to its particular conditions, especially as the NCS matures (part **6**). In practice, this is a question of whether, and under what circumstances, joint selling might take place.

Before the material questions are discussed (in parts **5-6**) and before conclusions are drawn on the basis of these discussions (in part **7**), both Community policy considerations (in part **3**) and jurisdictional issues (in part **4**) have to be dealt with. First, however, we start with a short presentation of the current Norwegian sales regime (in part **2**).

2 The current Norwegian sales regime: Company-based sales and portfolio considerations

The gas volumes available for sale at any given time are regulated by the production levels stipulated under each licence granted by the Ministry of Petroleum and Energy ("the Ministry"). According to the Petroleum Act ("the PA") Section 4-4(1), the Ministry shall – prior to or concurrently with approval pursuant to Section 4-2 or the granting of a licence pursuant to Section 4-3 – approve a production schedule. Furthermore, the Ministry shall stipulate, for fixed periods of time and based on the production schedule on which the development plan is based, the quantity that may be produced, injected or cold vented at all times, cf. PA Section 4-4(3). Adjustments can be made in the light of new information on the deposit or other circumstances, cf. PA Section 4-4(3) *in fine*.

Within the confines of the production levels determined in the production schedule and the use of petroleum based on the production schedule, the gas companies have full possession of the gas reserves. The current gas sales regime as such is mainly reflected in the contract regime that applies solely on the NCS. According to the Petroleum Production Licence ("PPL"), the licensees are obligated to enter into a Joint Operating Agreement ("JOA") within 30 days of the granting of the licence in question.[14] Under the current contract regime, the gas companies are both entitled and obligated to sell their gas individually. This follows directly from the JOA[15] Art. 23.1, which states that "[E]ach party has the right and obligation to take in kind and dispose of a share

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[14] See e.g. 19th Licensing round – Petroleum Production Licence for Petroleum Activities, Art. 6.

[15] See e.g. 19th Licensing Round – Joint Operating Agreement concerning Petroleum Activities ("JOA"), Part VI Disposal of Petroleum.

of *produced Natural Gas* which shall be equivalent to his Participating Interest [*author's italics*]."

The ownership rights, as well as the liability and risk pertaining to the natural gas, are transferred to the licensee upon lifting.[16] Accordingly, prior to the commencement of production, the management committee is required to determine the delivery point for the transferral of ownership and risk.[17] Also prior to the commencement of production, the licensees are under an obligation to enter into a gas lifting and balancing agreement that determines the method employed for lifting.[18] A unanimous vote by the management committee is required for the adoption of the gas lifting and balancing agreement.[19] Although they are agreed upon by the licensees, both the delivery point (cf. JOA Art. 23.1(2) i.f.) and the lifting agreement (cf. JOA Art. 23.2) need the approval of the Ministry.

There are two main types of lifting agreement in use on the NCS, i.e., so-called "flexible" agreements and "must take" agreements.[20] These categories of lifting agreements have been standardised and mainly differ as regards the licensees' freedom to determine their own gas lifting at any given time. The "flexible" agreements give each licensee the right, for certain periods of time, to lift lower gas volumes than their participating interest. However, this flexibility is rather constrained. According to these agreements, the field's longevity is divided into a "flexible" period, a "balancing" period and a "must take" period. Within the "flexible" period, the licensees

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16 JOA Art. 23.1(2)

17 Art 23.1(2) i.f.

18 JOA Art. 23.2

19 JOA Art. 23.2 i.f.

20 Olav Boge, Gassproduksjon og konkurranserett. En vurdering av produksjonssamarbeidet på norsk sokkel i forhold til EØS artikkel 53, MarIus nr 303, pp. 51-52.

are allowed to underlift, provided certain conditions are met. Firstly, the licensees are obligated to lift a daily minimum. If the daily minimum is not lifted, the operator must try to sell the gas volumes in question. If the operator is successful, the net sales are to cover operation costs in the balancing area. In any case, the volumes are debited from the account of the licensee, which consequently loses the right to lift such volumes at a later point in time. Secondly, each licensee is not permitted to lift less than an annual underlift cap. If this underlift cap is not respected, the licensee incurs a reservoir loss. While lower volumes can only be lifted in the flexible period, the licensees' lifting rights are adjusted annually in the balancing period in order to compensate for underlifting that has taken place in the flexible period.

"Must take" agreements, on the other hand, do not allow for such flexibility. According to "must take" agreements, each licensee both has the right to and is obligated to lift gas volumes equal to its share of the daily export volume from the balancing area.[21] Under "must take" agreements, the operator is obligated to try to sell gas not lifted. If the operator is successful, the compensation paid for the natural gas shall cover the additional costs incurred by the operator and the operating costs of the balancing area. If the gas is not sold, the licensee that underlifts is obligated to compensate the other licensees for any loss caused by the underlifting.

A prerequisite for a well functioning company-based sales regime is ensuring that the individual licensees have the necessary flexibility as regards sales of gas volumes in their portfolio. As the *traditional* gas sales agreements allow the purchasers to adjust their nomination of gas volumes according to their actual needs within the contractual framework, the licensees should have the corresponding right to lift gas volumes that are either smaller than ("underlifting")

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[21] Boge p. 52

or exceed ("overlifting") the participating interest in order to ensure the commercial flexibility of the licensees, as well as optimal utilisation of the production capacity of the field. Whether such lifting flexibility actually exists will vary depending on the reservoir characteristics and the particulars of the balancing area in each case. "Flexible" agreements are used where resource management considerations make it possible to adjust the production rate within the balancing area.[22] "Must take" agreements are used where a given gas withdrawal is necessary to ensure optimal oil production (which is typically the case in relation to so-called associated fields where the oil production is a priority) or to maintain operations on marginal fields.[23] Although "must take" agreements are only necessary where the need for optimal production dictates the lifting of gas, this type of agreements is the customary one if seen in relation to the number of fields. Accordingly, "flexible" agreements are applied at a few major fields only.[24]

The gas companies are now free to negotiate gas sales agreements based on each gas company's gas portfolio, i.e., their share of the gas produced in each and every licence they participate in, instead of being directly linked to the field's gas reserves. It should be noted that both portfolio considerations and market access considerations, i.e., the ability to use the transport infrastructure and thus be granted access, contribute to the individual gas company's decision on which volumes can be lifted and sold to which purchasers at any given time. In any case, the gas companies' freedom is not unlimited, as the sales agreements have to be negotiated and entered into within the scope of competition law.

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[22] Boge p. 51.

[23] Boge p. 51.

[24] I.e. the fields Troll, Oseberg and Åsgård are, to my knowledge, so-called flexible fields.

The relevant competition issues that arises at the NCS are ultimately determined and influenced by the portfolio based sales regime.

3 Policy considerations

Economists consider competition to lead to socio-efficient resource exploitation for the benefit of the consumer.[25] Competition between producers and suppliers of gas is anticipated to result in reduced gas prices. The economists' free competition model, however, is based on a number of preconditions that are generally not fulfilled in reality.[26] Competition rules are supposed to secure the market process based on the principle of supply and demand.[27] In other words, competition rules seek to correct market failure. This is achieved by prohibiting market behaviour that is considered to have a negative influence on market conditions.[28]

There is no question that the Community competition rules apply to the energy sector, which includes the gas sector as such.[29] In general, the market structure of the gas sector does not facilitate competition. This is because of market characteristics that differ

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25 See e.g Whish p. 2.

26 See e.g Whish p. 6 et seq. Perfect competition requires that in any particular market there is: 1) a very large number of buyers and sellers; 2) a homogeneity of products offered in the market; 3) perfect information for consumers about market conditions; 4) a free flow of resources from one area of economic activity to another; 5) an absence of barriers to entry that might prevent the emergence of new competition; and 6) an absence of barriers to exit that might hinder firms wishing to leave the industry.

27 See, e.g., Olav Kolstad, Anders Ryssdal, Hans Petter Graver og Erling Hjelmeng, Norsk Konkurranserett – Bind I Atferdsregler og strukturkontroll ("Norsk Konkurranserett I") p. 26.

28 For further details, see part 4.2 below.

29 For further details, see part 4.2 below.

somewhat upstream and downstream. Upstream, i.e. at the NCS in this context, there is a limited number of producers. Traditionally, the upstream sector has exhibited the characteristics of an oligopoly and the use of sales cartels has not been uncommon. As regards the producers that traditionally have conducted their business at the NCS, the degree of vertical integration in production, supply (at the wholesale level) and infrastructure has been extensive. Furthermore, the major producers active on the NCS are virtually active wherever gas resources are located globally. However, there is a tendency that smaller producers establish themselves and their interest area are naturally more limited, both activity wise and geographically. Downstream, i.e., on the continent, the gas sector has traditionally been organised as a formal monopoly. While one or a few transmission companies historically have been granted the exclusive right to sell gas nationally, distribution companies have similarly been granted the exclusive right to supply customers within the area in which each company is located. Even after liberalisation, there is a relatively limited number of gas suppliers active in the gas markets.

Due to the network-bound character of the gas sector, and the fact that the transport infrastructure has the characteristics of a natural monopoly, competition rules have traditionally not been applied to the gas sector. The Commission, however, has actively sought to bring the energy sector generally into line with other sectors of industry, by means of a three-pronged approach.

Firstly, the Commission has initiated cases against a number of Member States for breach of the Treaty provisions prohibiting import and export restrictions.[30]

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[30] See e.g. cases C-157/94 *Commission v Netherlands*, C-158/94 *Commission v Italy*, C-159/94 *Commission v France* and C-160/94 *Commission v Spain*, ECR [1997] I-5699.

Secondly, the Commission has initiated the establishment of a regulatory framework.[31] In order to change the market structure and achieve the break-up of historical cross-border trading patterns, the Gas Directive(s) and the Gas Transmission Regulation, ensuring third-party access to infrastructure, have been passed. This secondary regulatory framework both supplements and is supplemented by the application of Art. 82 EC. There are examples of the Commission applying Art. 82 EC to establish the principle of the right of third-party access in cases where refusal to grant access took place before the passing of the Gas Directive and the Gas Transmission Regulation.[32] There is also an example of the Commission challenging the conditions of an access regime concerning a particular pipeline.[33] Furthermore, the Commission has recently initiated proceedings against gas companies for market foreclosure in breach of Art. 82 EC in the form of capacity hoarding and strategic underinvestment in the transmission system.[34]

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[31] For further details, see Anne-Karin Nesdam, Third Party Access to Upstream Pipeline Networks on the Norwegian Continental Shelf, Petroleum Law – Book 1, chapter 5.

[32] COM/36.246 – Marathon/Ruhrgas/GdF et al. The Marathon case concerned the alleged joint refusal to grant the Norwegian subsidiary of the US oil and gas company Marathon access to continental European gas pipelines in the 1990s by a group of five European gas companies, i.e., the Dutch gas company Gasunie, the Franch gas comapny Gaz de France (GdF) and the German gas companies BEB, Thyssengas, Ruhrgas respectively, cf. IP/01/1641 of 23 November 2001 (Marathon/Thyssengas), IP/03/1129 dated 29/07/2003 (Marathon/BEB), IP/03/547 dated 16/04/2003 (Marathon/Gasunie) and IP/04/573 dated 30/04/2004 (Marathon/Ruhrgas and GdF).

[33] COMP/38.075 – PO/UK Gas Interconnector (IP/02/401 of 13 March 2002 – Commission closes investigation into UK/Belgium gas interconnector).

[34] COMP/39.315 – ENI (MEMO/07/187 of 11/05/2007).

Thirdly, the Commission has challenged the anti-competitive market behaviour of gas companies in individual cases.[35] With the explicit aim of establishing competition between both producers and suppliers respectively, both the organisation of the sales regime[36] and the design (i.e., both duration[37] and content[38]) of the gas sales agreements have been challenged.

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[35] For a non-exhaustive list of cases, see e.g. MEMO/03/86 of 16/04/2003 and MEMO/03/159 of 29/07/2003. Further cases are underway, cf. MEMO/06/205 of 17/05/2006 and MEMO/07/187 of 11/05/2007.

[36] The focus here has been on joint selling, cf. Case No. IV/E-3/35.354 – *Britannia gas condensate field* (Notice pursuant to Art. 19(3) of Regulation 17) OJ [1996] C291/10 (joint sales from a single field), COMP/37.708 – *PO/Corrib* (IP/01/578 of 20 April 2001) (joint sales from a single field), COMP/36.072 – *GFU – Norwegian Gas Negotiation Committee* (IP/02/1084 of 17 July 2002) (joint sale from several fields) and COMP/38.187 – *DONG/DUC* (IP/03/91 of 24 April 2003) (joint marketing).

[37] For an overview of the Commission's approach towards long-term and exclusive agreements, see e.g. Faull & Nikpay (1999) p. 709 et seq.

[38] The focus here has been mainly on anti-competitive provisions in supply contracts (use of restrictions clauses, reduction clauses, territorial restriction clauses and priority rights), see e.g. COMP/37.542 – Endesa/Gas Natural (IP/00/297 of 27 March 2000) (use of restriction clause), COMP/36.072 – GFU (IP/02/1084 of 17 July 2002) (commitments made by Statoil and Norsk Hydro, although it was emphasised that these commitments were not considered a part of the GFU case as such), COMP/36.559 – EdF Trading/WINGAS (IP/02/1293 of 12 September 2002) (reduction clause), Nigeria LNG (IP/02/1869 of 12 December 2002) (territorial restriction clause), COMP/38.187 – DONG/DUC (IP/03/91 of 24 April 2003) (use of restrictions, reduction clause and priority rights for DONG), COMP/38.308 – ENI/Gazprom (IP/03/1345 of 06/10/2003) (territorial restriction clauses), COMP/38.085 – OMV/Gazprom (IP/05/195 of 17/02/2005) (territorial restriction clauses), COMP/38.307 – E.On Ruhrgas/Gazprom (IP/05/710 of 10/06/2005) (territorial restriction clauses), COMP/38.662 – GdF (IP/04/1310 of 26 October 2004), and lastly, and still under consideration, COMP/39.401 – E.On/GdF collusion (MEMO/07/316 of 30/07/2007) (market sharing)

With the liberalisation of the gas sector, formal monopolies were abolished. However, despite the monopolies having been abolished legally, the monopoly structure still exists in practice because of the lack of any real competition that might lead to the erosion of the dominant position of the incumbents (i.e., the former monopolists). The sector inquiry launched in June 2005[39], having identified particular problems, such as: high levels of market concentration; the vertical integration of supply, generation and infrastructure leading to a lack of equal access to, and insufficient investment in, infrastructure; and possible collusion between incumbent operators to share markets.[40]

The Commission is certain to continue with its existing approach, i.e., a combination of regulatory measures and control of behaviour. As the internal market in natural gas was completed by 1 July 2007, the legal structural remedies to ensure competition may now be said to be in place. Control of the gas companies' market behaviour is thus increasingly important to facilitate competition in this sector. According to Regulation 1/2003[41], Community competition law is mainly to be enforced at the national level by national competition authorities ("NCAs")[42] and/or may be invoked before national courts[43]. It should be noted, however, that even though the enforcement of Community competition law primarily takes place at the national level, the practice of the Commission is of vital importance and gives guidance to both national competition authorities and national courts. Although the Commission has the

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39 IP/05/716 of 13 June 2005.

40 IP/07/26 of 10 January 2007.

41 Council Regulation (EC) No. 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty (Regulation 1/2003), OJ L 1, 4.1.2003, pp. 1–25.

42 Regulation 1/2003 Art. 5.

43 Regulation 1/2003 Art. 6.

legal authority to pursue cases and its legal authority precedes that of the NCAs[44], it will concentrate the use of its resources on the most serious infringements and the more fundamental issues.[45] However, the energy sector as such has been identified as a priority area.[46] As noted above, the Commission has already intensified its enforcement of the competition rules in relation to the gas sector. In the wake of the sector inquiry, the Commission made it clear that it would pursue follow-up action in individual cases under the competition rules (in relation to anti-trust, merger control and state aids) and act to improve the regulatory framework for energy liberalisation to handle the problems identified under the sector inquiry.[47]

That having been said, the competition rules cannot be applied in a policy vacuum. There is a great need to accommodate a broader range of public-interest factors in relation to the energy sectors in general and the gas sector in particular. Reference here is made to the energy sector's vital importance for the functioning of, and the (further) social development of, a modern society. In other words, when assessing how the competition rules will be applied to the gas sector, both considerations of security of supply and the need to

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[44] Regulation 1/2003 Art. 11(6).

[45] See e.g. Regulation 1/2003 preamble (3).

[46] In its Communication of 2 February 2005 to the Spring European Council "Working together for growth and jobs, a new start for the Lisbon strategy", the Commission endorsed a more proactive application of competition policy, in particular, by means of sectoral screenings for barriers to competition in, *inter alia*, the energy sector, see Communication to the Spring European Council – Working together for growth and jobs – A new start for the Lisbon Strategy – Communication from President Barroso in agreement with Vice-President Verheugen, COM/2005/0024 final, p. 16, published at http://ec.europa.eu/comm/competition/sectors/energy/inquiry/index.html.

[47] IP/07/26 of 10 January 2007.

accommodate social equity and national social cohesion must be taken into consideration. Another factor that should be taken into account is that the energy sector contributes significantly to the government revenues of the majority of the Community's Member States.

These factors are now explicitly acknowledged in the Community's energy policy. Within the energy sector, the EU now operates with three essential policy objectives, i.e., sustainability, security of supply and competitiveness.[48] The need to strike a balance between sustainability, security of supply and competitiveness has been emphasised at the Community level. The challenges involved in relation to the balancing of these three policy objectives has lead to a debate on the need for further liberalisation measures in the energy sector.[49] Both the establishment and the upholding of competition in the gas sector are still considered essential tasks. Competitiveness is considered both a goal in itself and a measure to achieve the (other) objectives of sustainability and security of supply.[50] However, the emphasis on striking a balance between sustainability, security of supply and competitiveness could be expected to influence the application of the competition rules.

In other words, from a producer perspective, there is a need for a functional and pragmatic approach, taking the characteristics of the gas markets into consideration when applying the competition rules to the gas sector. Although this is now expressed in the Community's energy policy, there is still a fear that lacking or limited knowledge of

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48 The Commission's 2006 Green Paper on energy. See also MEM/07/15, dated 10 January 2007.

49 Memo/07/15, dated 10 January 2007.

50 Commission Green Paper of 8 March 2006: "A European strategy for sustainable, competitive and secure energy", COM(2006) 105 final, e.g. p. 8.

the functioning of the gas markets may lead to the taking of a formalistic legal approach to the competition rules.[51]

The press releases published by the Commission whenever an out-of-court settlement is reached deal with the results of the negotiations rather than (the finer details of) the parties' legal argumentation. This makes it difficult to give an (inside) account of the legal approach of the Commission to these cases. It would also be natural to expect the Commission, when applying competition rules to the gas sector, for both policy reasons and negotiating purposes, to invoke more extensive claims than could necessarily be expected to follow from competition law. Still, in the wake of the sector inquiry and given the steady increase in the number of cases, the Commission is starting to acquire a deeper understanding of the particular characteristics of the gas sector. It seems safe to expect that this will have a clear influence on the legal reasoning of the Commission and allow for a more pragmatic approach when applying the competition rules to the gas sector.

[51] It is interesting to note that the majority, if not all, cases launched against gas undertakings for breach of the Community competition rules generally have been settled out of court. The settlement rate of the cases involving gas undertakings cannot be explained solely by traditional arguments concerning the time-consuming and costly nature of court proceedings. The reasons for the lack of litigation could perhaps be explained as mainly historical, as gas producers, to a large extent, are accustomed to co-operating with national authorities. However, this would be to simplify matters. It is more likely that the gas undertakings choose to enter into negotiations with the Commission because they lack confidence in the ECJ's insight into, and understanding of, the particular characteristics of the gas sector. In other words, the gas undertakings anticipate that both the predictability of, and their chances of influencing, the outcome of the case will be greater through negotiations with the Commission than in court proceedings before the Community courts.

4 General conditions for the application of the competition rules

4.1 Introduction

Neither the scope nor the purpose of this article allow for an exhaustive presentation of competition law. As such, this article to some extent assumes that the reader is familiar with the basics of competition law. In the following, the finer details of material law are only commented upon where necessary in relation to discussions of the particular challenges faced (in part 5-8). Even so, it is necessary to comment on some key issues of practical importance for the choice of rules and their application. Firstly, the "effect on trade" criterion and its role in relation to the question of jurisdiction need to be commented upon (in part **4.2**). Secondly, there is a discussion of restrictive trade practices and the question of market definition (in part **4.3**). These questions are closely interrelated, as market definition is of importance when establishing both whether an undertaking's behaviour is in breach of the prohibitions in Articles 81 and 82 EC and whether this behaviour has had, or is likely to have, a negative effect on trade. By way of introduction, however, there now follows a brief discussion of Art. 81 EC – and Art. 53(1) EEA.

4.2 Art 81 EC

Both Art. 81(1) EC and Art. 53(1) EEA prohibit "all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market". The provision lists examples of agreements that have as their object or effect restrictive practices in breach of the prohibition, cf. Art.

81(1) litra a)-e) and Art. 53(1) litra a)-e). While the list is not exhaustive, it mentions the most likely situations in practice.

The prohibition in Art. 81(1) EC – and Art. 53(1) EEA – is not absolute. Art. 81(3) EC – and Art. 53(3) EEA – provide that the prohibition contained in Art. 81(1) EC may be declared inapplicable in the case of agreements that contribute to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefits, and which do not impose restrictions that are not indispensable to the attainment of these objectives and do not afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products concerned. In other words, there are four cumulative conditions that have to be met before an exemption can be established.[52]

This means that the assessment under Art. 81 EC consists of two parts. The first step is to assess whether an agreement between undertakings, capable of affecting trade between Member States, has an anti-competitive objective or actual or potential anti-competitive effects. The second step, relevant only where an agreement is found to be restrictive in relation to competition, is to determine the pro-competitive benefits produced by that agreement and to assess whether these pro-competitive effects outweigh the anti-competitive effects. It is important to note that, while the anti-competitive effects are considered under Art. 81(1) EC, the balancing of anti-competitive and pro-competitive effects is conducted *exclusively* within the framework laid down by Art. 81(3).

[52] The Commission has issued guidelines that examine the four conditions of Art. 81(3) EC, cf. Communication from the Commission – Guidelines on the application of Art. 81(3) of the Treaty (the Exemption Guidelines), OJ [2004] C 101.

Agreements and/or practices in breach of the prohibition in Art. 81(1) EC and not exempted under Art. 81(3) EC are automatically void, cf. Art. 81(2) EC. It is basically left to the market participants to evaluate whether their practices are in breach of Art. 81 EC and to carry the risk of their evaluations being incorrect. According to Art. 1(1) of Regulation (EC) No 1/2003, agreements that are caught by Art. 81(1) EC and which do not satisfy the conditions of Art. 81(3) EC are prohibited. Similarly, according to Art. 1(2) of Regulation 1/2003, agreements that are caught by Art. 81(1), but which satisfy the conditions of Art. 81(3), are not prohibited. Whether prohibited or not, no prior decision to that effect is required - or even possible to obtain.

4.3 Cross-border trade: The relationship between the competition rules at national and European level and jurisdictional issues

4.3.1 Overview

By way of introduction (in part 1), it was stated that this article only deals with the application of European competition law and, in particular Art. 81 EC, to the gas sales regime on the NCS. However, as Norway is not a member of the EU, it is necessary to explain just why European competition law is discussed in the context of this article. This explanation is divided into five parts. Firstly, the particular characteristics of the Norwegian gas trade are dealt with (in part **4.3.2**). Secondly, there is a presentation of the different sets of general competition rules on both a national and a European level (in part **4.3.3**). Thirdly, the relationship between the sets of competition rules at the European level is accounted for (in part **4.3.4**). Fourthly, the "effect on trade" criterion is dealt with in further detail (in part **4.3.5**). Lastly, the implications for the

application of the competition rules in the context of this article are considered (in part **4.3.6**).

4.3.2 The particular characteristics of the Norwegian gas trade

Although it is under development, Norway as yet has no significant domestic sales market for gas. Approximately 90% of the gas produced on the NCS is exported. Norway is not only a major exporter of gas, but the gas is mainly exported to states within the EU.

Norwegian gas exports account for approximately 15% of European gas consumption.[53] The vast majority of the gas volumes exported is sold to Germany and France, where approximately 30% of consumption is accounted for by Norwegian gas.[54] However, gas producers located on the NCS have entered into gas sales agreements with purchasers in Germany, France, the United Kingdom, Belgium, the Netherlands, Italy, Spain, the Czech Republic, Poland and Denmark.[55]

With the Netherlands as the main exception, the gas-producing countries within the EU (i.e., Denmark, Germany, Italy and the United Kingdom) mainly produce for their own consumption.[56] As mentioned above, the EU imports more than 50% of the gas volumes needed to cover the total gas consumption within the

[53] Facts 2007 p. 44.

[54] Facts 2007 p. 44.

[55] Facts 2007 p. 44. From 2007, due to start-up of the production on Snøhvit, supplies of LNG (Liquefied Natural Gas) will also be shipped to the US, cf. Facts 2007 p. 44.

[56] The Netherlands is, in effect, the only gas-producing country where exports are significant.

Community, and its imports are increasing steadily.[57] Apart from the import of Norwegian gas, the EU covers the gap between its own gas production and its gas consumption needs through supplies from producers in Russia and Algeria.

To summarise, Norwegian gas is not only the subject of cross-border trade, but is also primarily sold to buyers located in the major EU states. Within the internal Community market, Norwegian producers compete with other producers located both within and outside the internal market. This strongly influences which set of competition rules will ultimately apply to the behaviour of the undertakings active on the NCS.

4.3.3 The different sets of competition rules relevant on the NCS

As Norway is a party to the EEA Agreement[58], there are two general bodies of competition rules that apply directly, i.e., the Competition Act ("the CA") of 5 March 2004 No 12[59] and the EEA Agreement's rules on competition which, in contrast to the other provisions of the Agreement, are not aimed at the Member States as such, but applies to undertakings directly.[60]

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57 The five major gas-supplying countries to Europe are Russia (26%), the UK (16%), Norway (16%), the Netherlands (12%) and Algeria (11%).

58 Agreement between the European Community and some members of the European Free Trade Association (EFTA), cf. [1994] OJ 1/03. At present the membership of the European Economic Area ("EEA") is limited to Norway, Iceland and Leichtenstein.

59 The Competition Act of 5 March 2004 No. 12 entered into force on 1 May 2004, replacing the Competition Act of 11 June 1993 No. 65.

60 This is also the case with Art. 81 EC and Art. 82 EC. Contrary to the other provisions of the Treaty of Rome, as revised by the Treaty of Nice, the Treaty of Maastricht and the Treaty of Amsterdam, which are binding upon the Member States as such, the competition rules address the behaviour of undertakings directly.

The Norwegian competition legislation was revised for harmonisation purposes in 2004.[61] Thus, the antitrust provisions of the CA, which entered into force on 1 May 2004, are based on the provisions of the EEA Agreement.[62] With the harmonisation of the CA[63], both the competition rules of the CA on the one hand and those of the EEA Agreement and the Treaty of Rome on the other are based on a *principle of prohibition*. In other words, specific types of anticompetitive behaviour on the part of *undertakings* active in the market in question are prohibited.

The *type of behaviour* prohibited is divided into two main categories in both bodies of competition rules. The CA Section

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61 With the passing of the Royal Decree of 24 November 2000, a committee was established for the purpose of undertaking an evaluation of Norwegian competition law and proposing a new legislative framework on this area of law (the competition committee). The competition committee was particularly required to consider the question whether, for the purposes of harmonisation, the Norwegian competition legislation should be designed based on the competition rules in the EEA Agreement. In its preliminary report, published in NOU 2001:28, the competition committee recommended such harmonisation.

62 It is fairly common, for Member States of the EU and/or the EEA either to have introduced or to have adapted existing national competition legislation take account of the provisions of the Treaty of Rome and/or the EEA Agreement respectively.

63 The Competition Act of 11 June 1963 No. 65 contained four prohibitions of specific types of anticompetitive behaviour (cooperation on price, cooperation on tendering, market sharing and the setting of binding resale prices), but was first and foremost an enabling act allowing the Norwegian Competition Act to intervene in the case of anticompetitive behaviour in general. Thus, it could be said that the Norwegian competition legislation was based on both a principle of prohibition and a principle of intervention. With the passing of the Competition Act of 5 March 2004 No. 12, harmonisation led to a transition being made from a system based on the principles of both prohibition and intervention to a system based on the principle of prohibition only.

10(1) prohibits restrictive practices between two or more undertakings. Dispensations can be made provided the terms and conditions in the CA Section 10(3) are fulfilled.[64] Agreements entered into and decisions made in breach of the CA Section 10(1) and without dispensation according to the CA Section 10(3) are without legal effect, cf. CA Section 10(2). According to the CA Section 11, any abuse by one or more undertakings of their dominant position is prohibited. The types of behaviour prohibited in the CA Section 10 and Section 11 respectively are parallel to those prohibited in Art. 53 EEA and Art. 54 EEA, which, in turn, are identical to Art. 81 EC and Art. 82 EC respectively. In other words, both national competition law and EEA and EC competition law prohibit anticompetitive co-operation and collaboration between several (two or more) undertakings as well as unilateral conduct by a single, dominant undertaking that has a similar anticompetitive objective or effect.

Although the type of behaviour prohibited by the respective sets of competition rules is identical, the CA and the EEA and/or the EC rules differ as to *under what circumstances* the prohibition applies, both geographically and objectively.

The rules apply regardless of whether an undertaking is privately or publicly owned. However, the rules only apply to undertakings that exercise an economic activity.[65]

Art. 1 EEA states that the aim of the EEA Agreement is to promote a continuous and balanced strengthening of trade and economic relations between the Contracting Parties with equal conditions of competition, and the respect of the same rules, with a

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64 Both block exemptions have been granted and individual dispensations can be made.

65 See both the CA Section 2 and Art. 56 EEA, cf. protocol 22 to the EEA Agreement.

view to creating a homogeneous European Economic Area (the EEA). Accordingly, the Agreement is assumed to apply to all economic activity not explicitly exempted in Art. 30 EEA.[66] Gas sales clearly constitute an economic activity, and are thus covered by the EEA Agreement.[67] It also follows from Art. 24 EEA, with further references to Appendix IV, that the energy sector as such is covered by the agreement.[68] Similarly, the ECJ has made it clear that the Treaty of Rome in general, including its competition rules, applies to the energy sector as such.[69]

In order to determine the geographical scope and range of the CA, the CA Sections 10 and 11 have to be read in correlation with the CA Section 5, according to which the scope and extent of the Act are limited to Norwegian territory. In contrast, the wording of Art. 53 EEA and Art. 54 EEA, as well as that of Art. 81 EC and Art. 82 EC, clearly implies that these provisions only apply provided the anticompetitive behaviour in question *may affect trade between Member States* (the "effect on trade" criterion). While national competition law applies to market behaviour that has a negative influence on market conditions within the nation's jurisdiction, EC and EEA competition law applies to anticompetitive market

66 Finn Arnesen, Statlig styring og EØS-rettslige skranker. Illustrert ved en studie i EØS-rettens betydning for styringen av norsk petroleumsvirksomhet ("Arnesen"), pp. 49 et seq.

67 Rune O. Pedersen, Den norske stats organisering av gassalget og konkurransebegrensningsreglene i EØS-avtalen, published in Are Brautaset, Eirik Høiby, Rune. O. Pedersen and Christian Fredrik Michelet, Norsk Gassavsetning. Rettslige hovedelementer ("Brautaset et al"), pp. 465-579, on pp. 474-475, with further references.

68 Appendix IV to the EEA Agreement lists the Directives and Regulations the EU has passed concerning the energy sector.

69 See e.g. case 6/64 *Costa v Enel*, ECR [1964] 1251, case C-393/92 *Municipality of Almelo and others v NV Energiebedrijf Ijsselmij*, ECR [1994] I-1477, case C-17/03 VEMW and case C-128/03 AEM.

behaviour that has a negative effect on the trade between the Member States of the respective treaties.

4.3.4 Norwegian gas sales and the application of the competition rules in the EEA agreement and the EC treaty: the "Effect on Trade" Criterion

It follows directly from the scope and extent of the CA that the national competition rules are of limited practical importance in relation to the gas sales regime, as Norway exports its gas to buyers on the European continent. However, the competition rules in both the EEA Agreement and the EC Treaty (hereinafter described generically as European competition law) may apply provided certain conditions are met.

Both Art. 53 EEA and Art. 81 EC apply wherever the agreement in question has an "effect on trade" between states that are members of the Agreement or the Treaty respectively. According to their wording, both Art. 53 EEA and Art. 81 EC only apply where trade between the Member States is affected. Art. 53 EEA specifies that it only applies to agreements between undertakings, decisions by associations of undertakings and concerted practices that may affect trade *between Contracting Parties.* Similarly, the main starting point under the EC Treaty is that the Community competition rules apply only to the internal market, and that the rules shall be applied within the Member States of the EU. According to their wording, neither Art. 53 EEA nor Art. 81 EC contain requirements as to the source of either the undertakings or the agreements, but rather focus on the place where the agreement's "objective" or "effect" is to distort competition. Insofar as an agreement or concerted practice has an effect on trade as described in the provisions, it follows explicitly from the wording of the provisions that the prohibition on anti-competitive agreements may apply.

In contrast to the EEA Agreement, the EC Treaty has been applied exterritorialy. It is not uncommon for the Community institutions to apply the competition rules to activities outside the scope of the European Community provided such activities are having anti-competitive effects within the internal market. In other words, the "effect on trade" criterion contained in both Art. 81 EC and Art. 82 EC is commonly used to claim jurisdiction.[70] It should be noted that the "effect on trade" criterion does not amount to a jurisdiction provision in the traditional sense. In principle, the "effect on trade" criterion only regulates the type of behaviour that may be subject to limitations under the competition rules of both the Treaty and/or the EEA Agreement.[71] However, the *Woodpulp* case[72] is an example of how the ECJ has found that agreements *implemented* in the internal market are to be considered covered by the *Community competition rules*. The exact criteria under which jurisdiction can be claimed are somewhat unclear. Firstly, the ECJ does not explicitly state when an agreement shall be considered implemented within the Community. Secondly, according to the reasoning of the ECJ in this case, the agreements' effect on trade within the EU market was *not in itself* considered sufficient to claim jurisdiction. Nevertheless, gas sales agreements where the delivery obligations are fulfilled within an EU Member State must clearly fall within the scope of the Community competition rules, even though the seller is located in a non-EU country (i.e., a so-called "third country").

As Norway is a member of the EEA, it could be expected that any case involving Norwegian gas sales would primarily be based upon the competition provisions in the EEA Agreement. Art. 56 EEA

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[70] Faull & Nikpay (1999), Chapter 10, p. 698.

[71] Norsk Konkurranserett I p. 200.

[72] Joint Cases C-89/85 etc. *Woodpulp*, ECR [1988] 5193.

contains rules on the allocation of authority between the EFTA Surveillance Agency ("the ESA") and the Commission when it comes to the application of the competition rules in the EEA Agreement. As a general rule, the ESA has authority in cases where competition within the EFTA market[73] is affected. The Commission, on the other hand, is granted authority in cases where only the EU market is affected. In mixed cases, i.e., where both the EFTA and EU markets are affected, the allocation of authority is based on the turnover of the undertaking(s) in question. In cases where 33% or more of the undertaking's turnover is related to its activities in the EFTA market, the ESA is granted authority. However, the competition rules in the EEA Agreement have never been applied to the Norwegian gas sector. Instead, the Commission can be said to have chosen to apply the competition rules contained in the EC Treaty.

With the *GFU case*[74], the Commission made it clear that it would not hesitate to apply European competition rules to activities on the NCS, in particular in order to improve market conditions within the Community. The Commission claimed authority in respect of Norwegian gas producers because their activities ultimately affected trade between Member States within the Community. To the extent that Norwegian gas competes with gas

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73 Iceland, Liechtenstein, Norway and Switzerland are members of the European Free Trade Association ("EFTA"). EFTA is served by three institutions: the EFTA Secretariat, the EFTA Surveillance Authority and the EFTA Court. For further information on EFTA, see http://www.efta.int.

74 Case 36.072. See IP/01/830 of 13 June 2001 (Commission objects to GFU joint gas sales in Norway), http://europa.eu/rapid/pressReleasesAction.do?reference=IP/01/830&format=HTML&aged=0&language=EN&guiLanguage=en, and IP/02/1084 dated 17 July 2002 (Commission successfully settles GFU case with Norwegian gas producers), published at http://europa.eu/rapid/pressReleasesAction.do?reference=IP/02/1084&format=HTML&aged=1&language=EN&guiLanguage=en.

volumes of different origins that are also sold in the Community market, the organisation of the sales regime, as well as the design of the sales agreements, may affect trade between EU Member States and thus fall within the scope of Community legislation.

As can be seen, the direct consequence of the "effect on trade" doctrine developed by the ECJ is that the European competition rules apply when the distorting market behaviour affects cross-border trade within the EU. The Commission claimed that the GFU regime constituted a sales cartel in breach of both Art. 81(1) EC and Art. 53(1) EEA.[75] In view of the account given of both the legislative situation and the approach adopted in the *GFU case*, however, it can be argued that the Commission in principle chose between these bodies of general competition rules based on considerations concerning the set of rules that would give it the greatest leeway to achieve its objective in this specific case. The particulars of the *GFU case* illustrate that the application of European competition law was, in reality, disengaged from Norway's position as a member of the EEA Agreement. Not only was Community competition law provisions applied, but the Commission also attacked the GFU regime (almost) from its beginnings (more precisely, from 1989 onwards).[76] As Norway first became a member of the EEA Agreement in 1994, only agreements entered into after this date would potentially have been in breach of Art. 53 EC. Thus one would have expected only the validity of gas sales agreements entered into from this point onwards to be questioned.

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[75] See IP/01/830 of 13 June 2001 (Commission objects to GFU joint gas sales in Norway).

[76] IP/02/1084 dated 17 July 2002, published at http://europa.eu/rapid/pressReleasesAction.do?reference=IP/02/1084&format=HTML&aged=1&language=EN&guiLanguage=en.

4.3.5 The "Effect on Trade" Criterion

It has already been established that nearly all natural gas produced on the NCS is exported to the EU. Thus, the organisation of the marketing and sales of these gas volumes will necessarily affect the market conditions within the EU. When elucidating the practice of the Community institutions thus far, the application of Art. 81 EC and Art. 82 EC in relation to activities on the NCS continues to be highly relevant. It is therefore important to establish the subject-matter of the "effect on trade" criterion.

According to existing case law, it does not take much to fulfil the "effect on trade" criterion.[77] It is sufficient that the anticompetitive behaviour in question directly or indirectly, actually or potentially, may influence the trading pattern between Member States. In other words, it is not necessary to establish an actual influence on trade. It is sufficient to establish that the behaviour may influence trade. Trade may be indirectly influenced, typically where a measure reduces the possibilities for access to a country, thus restricting imports to and exports from that country. An "effect on trade" exists where the restrictive practices directly concern imports or exports. A typical example would be where the agreement or the behaviour in question extends over the territory of several Member States. Measures that only have effect in the territory of a single Member State are also normally considered to have an effect on trade, since even though the measures will not directly concern imports and exports, segmentation into national markets in itself counteracts the objective of an internal market. Even measures that involve only parts of the territory of a Member States may be

[77] However, the Commission has issued guidelines as to its position on determining the effect on trade, cf. Commission Notice Guidelines on the "effect on trade" concept contained in Articles 81 and 82 of the Treaty ("Effect on Trade Notice"), OJ [2004] C 101/81.

considered to have an "effect on trade", insofar that the measures influence imports or the access of firms to the Member State in question. As the gas produced on the NCS is sold to purchasers within the EU, it is safe to say that trade between Member States is affected.

According to the practice of the ECJ, the restrictive practice and its "effect on trade" have to be *appreciable* in order to represent a breach of the prohibition. Whether there is an appreciable "effect on trade" depends upon an overall evaluation. The Commission has introduced quantitative thresholds to determine whether an agreement's restrictive effect on competition is appreciable or not.[78] The relevant Notice does not deal with the question of whether or not an agreement appreciably affects trade between Member States.[79] However, it follows from this Notice that it is acknowledged that agreements between small and medium-sized undertakings are rarely capable of appreciably affecting trade between Member States.[80] The small and medium-sized undertakings are defined based on quantitative thresholds.[81] As the size of the gas companies conducting activities on the NCS clearly exceeds these thresholds, it is also safe to assume that these companies appreciably affect trade between Member States.[82]

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78 Commission Notice on agreements of minor importance which do not appreciably restrict competition under Art. 81(1) of the Treaty establishing the European Community (*de minimis*) ("De Minimis Notice"), OJ [2001] C 368/13.

79 De Minimis Notice, preamble (3).

80 De Minimis Notice, preamble (3).

81 Small and medium-sized undertakings are currently defined as undertakings which have fewer than 250 employees and have either an annual turnover not exceeding EUR 40 million or an annual balance sheet total not exceeding EUR 27 million, cf. De Minimis Notice, preamble (3).

82 Similarly, see Boge p. 56.

4.3.6 The principle of homogeneous interpretation and application of the EEA agreement and the EC Treaty

In the following, any reference to and discussion of Art. 81 EC also applies to Art. 53 EEA. The competition rules in both the EEA Agreement and the EC Treaty may apply to activities on the NCS. At the same time, a homogeneous interpretation and application of the EEA Agreement and the EC Treaty is required.[83] Ultimately, it is of limited importance which set of competition rules is applied in evaluating the Norwegian gas sales regime.[84]

Although there are no major material differences between the general sets of competition rules, due to the harmonisation efforts described above, it is important to bear in mind that two conditions may lead to a differing interpretation and application of EC competition rules on the one hand and EEA competition rules on the other, and may ultimately result in different legislative assessments and solutions under the respective competition regimes.

Firstly, the legislative purpose of the rules differs slightly. A common denominator for competition rules at both a national and a Community level is that they seek to ensure socio-economic efficiency through effective competition. This explicitly follows from the CA Section 1, which states that the Act aims to promote competition in order to contribute to the effective use of society's resources. Although no such objects clause is found in either the EEA Agreement or the Treaty of Rome, the competition rules at the Community level are understood to have a similar purpose.

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83 Art 105(1) EEA.

84 See e.g. Fredrik Sejersted, Finn Arnesen, Ole-Andreas Rognstad, Sten Foyn and Olav Kolstad, EØS-rett (2. utgave) ("Sejersted et al"), in particular chapter 4.1 and chapter 9.2, for a presentation of the principle of homogeneity and the instruments provided to ensure this principle. See also Sejersted et al chapter 4.6.

Contrary to the CA, however, the competition rules at Community (European) level are also meant to contribute to the realisation and completion of the internal market.[85] It should be noted, however, that while the purpose of the EEA Agreement is still largely economic[86], the co-operation within the EU has been extended beyond co-operation of a solely economic nature.[87]

Secondly, the relevant sources of law and legal authority are not entirely identical. Formally, only EU law passed before Norway entered into the EEA Agreement is legally binding. The EEA Agreement explicitly states that provisions of the EEA Agreement that are identical to similar provisions in the Treaty establishing the European Community, and secondary legislation passed in relation to that Treaty, are to be interpreted in line with case law decided by the ECJ before the EEA Agreement was signed.[88] While (secondary) EU legislation passed at a later date has to be implemented into the EEA Agreement by the express decision of the EEA Committee[89], case law decided by the Community courts after the EEA Agreement was signed is not automatically recognised as a source of law under the EEA Agreement. Still, the EEA Committee is under an obligation to monitor the development of case law and to ensure the homogeneous interpretation of the provisions of the Agreement.[90] Thus, due to the principle of homogeneous interpretation of the EEA Agreement and the Treaty establishing the

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85 Art. 1 EEA.

86 Art. 1 EEA.

87 See e.g. Sejersted et al, p. 253 et seq, for a comparison of the scope of the EEA Agreement and the EC Treaty respectively.

88 Art. 6 EEA.

89 Art. 102 EEA.

90 Art. 105 EEA. In order to achieve this objective, an exchange system regarding case law has been established between the ECJ and the EFTA Court, cf. Art. 106 EEA. See also ODA art. 3 No. 2.

European Community, cases decided by the ECJ are still relevant. Similarly, the Commission's administrative practice in relation to the provisions of the Treaty must be taken into consideration.

4.4 The identification of the relevant gas markets

4.4.1 Overview

The identification of the relevant gas markets is of major importance. The relevant market functions as a frame of reference against which an undertaking's market behaviour can be measured.

Whether an agreement (or a practice) actually prevents, restricts or distorts competition, depends on whether the agreement affects the functioning of the market mechanism in such a way that competition in the market is curbed.[91] In order to determine what effect an agreement has on the function of the market mechanism, the market which the agreement may affect (i.e., the *relevant* market) must be determined. Similarly, identification of the market is necessary to determine whether the restrictive practices in question may actually affect trade between Member States.

Despite the importance of the market definition, there is limited practice giving guidance as to the definition of the relevant gas markets in particular. Due to the ongoing liberalisation process, one might say that both the principles for the evaluation of and the method for defining the relevant gas markets are still under development.[92] Neither the ECJ nor the Court of First Instance (CFI) has submitted a legal precedent as to the legal definition of

[91] Norsk Konkurranserett I p. 256.

[92] Anne-Karin Nesdam, Relevant Energy Markets – Network-bound sectors and market definition, article published in SIMPLY 2003 ("Nesdam, Relevant Energy Markets"), pp 307-356, on p. 320.

the relevant gas market.[93] Although it should be kept in mind that the practice of the Commission is without prejudice to both the Community courts, decisions made by the Commission may shed some light as to the factors that have so far has been relied upon when defining the relevant gas markets.

Based on its experiences from a number of sectors, the Commission has issued a notice on the definition of the relevant market *in general*.[94] This notice is supplemented by the Commission's decisions in individual cases related to the gas industry. As there are few antitrust cases in which the Commission defines the relevant market in relation to the gas sector, the Commission's decisions in *merger cases* have proved to be the main source to identify the factors relevant for the definition of gas markets as the liberalisation process progresses. Still, this case material needs to be applied with caution. Although it is clearly relevant, as the market definitions in antitrust cases and merger cases are based on parallel criteria, the Commission tends to use the market definition as a tool to achieve policy considerations. As the policy considerations in relation to the antitrust rules and the merger rules are not necessarily identical, this has to be taken into consideration when evaluating whether and – if possible – to what extent the

93 Nesdam, Relevant Energy Markets, p. 319.

94 Commission Notice on the definition of the relevant market for the purposes of Community competition law ("the Commission's Notice on the Relevant Market"), Official Journal C 372, 9.12.1997, pp. 5–13. The ESA has published a similar notice on market definition, cf. Decision of the EFTA Surveillance Authority No. 46/98/COL of 4 March 1998 on the issuing of two notices on the definition of the relevant market for the purpose of competition law within the European Economic Area (EEA), and on agreements of minor importance which do not fall under Art. 53(1) of the EEA Agreement, published in both EEA Supplement No. 28/3 1998 and OJ [1998] L 200, p. 46.

Commission's market definition in merger cases (without more ado) may be transferred to the application of the antitrust rules.[95]

The market definition has to be based on the specific factual and economic circumstances of each case. In general, the relevant market is divided into a relevant product market and a relevant geographic market. While the relevant product market is defined on the basis of the *types of products* that are considered substitutable by consumers, to define the geographic market, it is necessary to identify the suppliers, the consumers and the geographic location of the various market participants.[96] In other words, the market definition seeks to identify the products that are offered in the market, the geographic dimension of the market and whether there are temporal or seasonal market fluctuations.[97]

With regard to defining the relevant market in the gas sector, the Commission has applied a functional approach reflecting the supply structure in the gas market, both product-wise and geography-wise.[98] Consequently, a further distinction has been drawn between upstream markets and downstream markets. While the term "upstream activities" is used to describe all activity until the gas is sold to wholesalers for forward sales within the EU, the term "downstream activities" refers to all activities "below" the wholesale level.[99] Traditionally, Norwegian gas has been sold in the

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95 This matter will not be commented upon further in the following.

96 Norsk Konkurranserett I p. 268.

97 Thomas Bruusgaard Høgseth, Vertikale begrensninger i langvarige gassalgs-kontrakter. En vurdering av forholdet til EF- og EØS-rettens forbud mot konkurransebegrensende samarbeid, unpublished research paper, written while the author was attached to the Scandinavian Institute of Maritime Law 2006/2007 ("Høgseth"), p. 31.

98 Faull & Nikpay p. 1393, with further references, and Nesdam, Relevant Energy Markets, p. 327.

99 Høgseth, p. 33.

upstream markets and the competition challenges relating to the organisation of Norwegian gas sales (still) mainly arise in relation to these markets. As the producers that are active on the NCS following the liberalisation of the gas sector and the introduction of portfolio CBS increasingly sell their gas directly in the downstream markets, as well as upstream, it is necessary to examine the market definition on both levels for the purposes of this article.

Based on both the general guidelines issued and specific merger cases, the following will deal with the relevant product market (in part **4.4.2**) and the relevant geographic market (in part **4.4.3**) in the gas sector.[100] It should be noted, however, that rather than aiming at a thorough analysis of the market definition, this presentation will be confined to a statement of the main principles upon which the market definition must be made and the market distinctions with which the Commission has operated thus far.

4.4.2 The relevant product market

4.4.2.1 General

According to both the Commission's Notices on market definition, the relevant product market covers all goods that are interchangeable or substitutable due to their quality, price and area of use from a consumer perspective.[101]

Natural gas as a product has been distinguished from other energy sources. According to the practice of the Commission, a market with gas-to-gas competition has been identified. Furthermore, a separate market for forward sales of natural gas, i.e., the

[100] This part of the article is mainly based on Faull & Nikpay pp. 1392-1398, EU Energy Law II Part 2 The definition of the relevant market, Chapter 4 – The relevant product market – Gas, and Chapter 5 The relevant geographic market – Gas, Nesdam, Relevant Energy Markets, and, *in particular*, Høgseth.

[101] Similar considerations follow from the ESA notice.

sale of natural gas before field development and production in order to ensure the development of the reservoir in question, has been identified.

Within the market for natural gas, the production and supply chain has been distinguished into separate markets. According to Commission practice, both the existing market and the foreseeable degree of market opening have to be taken into account when defining these markets.[102] As the market conditions will change continuously as the liberalisation process progresses, the market must be defined based on the facts of the case at the given time. In other words, the gas undertakings must assess their market power on a continuing basis.

4.4.2.2 The Upstream Market

The Commission has applied a functional approach when defining the upstream markets. As the gas sector is network bound, the market participants are dependent on access to the various levels in the value chain.[103] Consequently, each level in the value chain has been identified as a separate market. Thus it is possible to distinguish between four product markets upstream: 1) a market for exploration;[104] 2) a market for the development, production and sale of natural gas at a wholesale level in general and to large industrial customers and gas-fired power generators.[105] As this market is a forward market, i.e., a market for the future delivery of natural gas from market participants active in gas production to market participants at the wholesale level, it is also known as the market

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[102] See case M.3440 ENI/EDP/GDP, paragraph 16 and the Commission's Notice on the Relevant Market, paragraph 32.

[103] See, e.g., Faull & Nikpay p. 1393, with further references.

[104] Case M.1383 *Exxon/Mobil*, paragraph 15 et seq.

[105] See i.e., cases M.1383 *Exxon/Mobil*, M.*3052 ENI/Fortum Gas*, M.3086 *Gaz de France/Preussag Energie*, and M.3293 *Shell/BEB*.

for forward gas. Natural gas are divided into two (main) categories of gas qualities, i.e., high calorific calue gas ("HCV gas") or low-calorific value gas ("LCV gas"). Although such a distinction has been introduced in the downstream gas markets, so far the Commission has refrained from differentiating the product market (for forward gas) based on gas quality considerations (i.e., based on variations in calorific value). However, the Commission has signaled, most recently in connection with the StatoilHydro merger, that a further distinction could be made between high calorific value gas and low calorific value gas in the market for development, production and sale of natural gas.[106] However, the question was left open as the final assessment was not affected regardless of the definition adopted. In relation to the question of the organisation of Norwegian gas sales, this product market is of the greatest importance;[107] 3) a market for the transport of gas through upstream gas pipelines;[108]and 4) based on case law, a separate market for the processing of gas can also be said to exist.[109]

4.4.2.3 The Downstream Markets

While the product markets upstream are identified on the basis of activity, the product markets downstream are defined on the basis of the *consumer group* that the natural gas is sold to. Based on, *inter alia*, volume demand, the need for flexibility and other contractual terms and conditions, the Commission distinguishes between four main groups of customers for the purposes of market definition: regional distributors; local distributors; industrial

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[106] Case No COMP/M.4545 - Statoil/Hydro, cf. http://ec.europa.eu/comm/competition/mergers/cases/decisions/m4545_20070503_20310_en.pdf.

[107] Case IV/E-3/35.354 – *The Britannia Gas Condensate Field* – Notice pursuant to Art. 19(3) in Regulation 17, OJ [1996] C 291/10, paragraph 5.

[108] Case M.2745 *Shell/Enterprise Oil*, paragraph 10 et seq.

[109] Ibid.

customers and business users; and, lastly, small businesses and household customers.[110] While sales to the first three customer groups are characterised as sales at the wholesale level[111], the sale of natural gas to small businesses and household customers is considered to take place at the retail level.

The Commission has on a number of occasions divided the sale of natural gas at the wholesale level into three (occasionally four) separate markets.[112] These markets correspond to the customer groups, i.e., sales to gas-fired power generators, sales to large industrial customers and sales to local distributors.[113] Reference is generally made to the fact that these customers differ with respect to consumption levels, margins, tariffs for access to transport networks, prices, commercial and organisational aspects as well as special needs.[114] Other than to illustrate that the Commission based its market definitions on the specific market conditions in the Member States in question, these cases give little if any guidance on the definition of downstream markets across the board.[115]

The market participants argue that supply to all large users constitutes a single wholesale market. It has been argued that the

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[110] Faull & Nikpay p. 1395.

[111] Peter D. Cameron, Competition in Energy Markets – Law and Regulation in European Union (2nd Edition) ("Cameron") pp. 290-291.

[112] Case M.3440 ENI/EDP/GDP, upheld by the CFI in its judgment of 21 September 2005 in Case T-87/05 EDP, ECR [2005] II-3745. See also Case M.3696 E.ON/MOL, premises 100-124 and 141, and Case 37.966 *Distrigas*, OJ 2007 C77/14 and IP/07/490. Here, the Commission allows for the segmentation of the Belgian market into several markets based on consumer groups, i.e., industrial customers, gas-fired power generators and wholesalers (probably in the sense of national distributors).

[113] Case M.3440, ENI/EDP/GDP, paragraphs 217-270. See also EU Energy Law II p. 88.

[114] Ibid.

[115] Similarly, Høgseth p. 35.

fact that natural gas is a product with the same specifications for all consumers, which is supplied though the same distribution chain, supports the view of a homogeneous wholesale market.[116] If all consumers are free to choose their suppliers, the suppliers are free to choose where to conduct their activities and there are no barriers to entry between the different market segments, a further delineation of the market may seem artificial. In a liberalised market, different consumer groups will have to compete for the natural gas on an equal footing, without different commercial needs and assumptions being taken into consideration. The tendency for gas producers to offer natural gas directly to different groups of commercial buyers also supports the development of a homogeneous wholesale market. Although sales of natural gas to different consumer groups will give rise to price disparities on some occasions, these disparities will typically be linked to variations in the services offered in relation to, and other individual adaptations made to, the supply in question. As the gas markets mature, this tendency will probably strengthen. As the development towards more integrated markets is proving somewhat slow, however, the Commission for now is continuing to divide the downstream wholesale market into submarkets.[117]

As the production companies seek to optimise their gas portfolios by selling directly to gas-fired power generators and large industrial consumers, such sales are becoming increasingly common. Due to this development, it has been argued that the Commission in future will need to operate with two types of product market for natural

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[116] Høgseth p. 35.

[117] See e.g. Case 37.966 *Distrigas*, OJ [2007] C77/14. For a short presentation of the case, see IP/07/490. In this case, the Commission allowed for the segmentation of the Belgian market into several markets based on consumer groups, i.e., industrial customers, gas-fired power generators and wholesalers (probably in the sense of national distributors).

gas downstream.[118] Firstly, a market for wholesale supply to industrial customers, gas-fired power generators and local distributors directly attached to the national transmission network will have to be identified.[119] Depending on the degree of market opening, this market may be divided into three separate markets based on the consumer groups specified above. In order to be covered by the market definition, the undertakings in question would have to be of a certain size enabling them to import natural gas directly and to exercise individual buying power. Secondly, a market for the retail supply of natural gas, where customers first and foremost buy their gas from distributors or forward gas sales companies within the Member State in question, is likely to develop. Depending on the degree of market opening in the market in question, two submarkets may be identified, i.e., on the one hand, a market consisting of industrial buyers attached to the local and regional distribution network and, on the other, a market for small businesses and household consumers.[120]

4.4.3 The relevant geographical market

4.4.3.1 General

The relevant geographical market is defined as an area where the market conditions are sufficiently homogeneous that it can be separated from adjacent markets where the market conditions are noticeably (appreciably) different.[121]

The geographical dimensions of either the four different upstream markets or the downstream wholesale and retail markets do not

[118] Høgseth p. 37.

[119] Similarly, EU Energy Law II p. 90 and Høgseth s 37.

[120] Høgseth p. 37.

[121] The Commission Notice on the Relevant Market, paragraph 15.

coincide. The definition of the geographical market is of significance, as more is required to achieve an appreciable restrictive effect in a large geographical market than in a smaller one. Still, a (detailed) presentation of the geographical scope of all the relevant product markets would clearly be too extensive. For the purposes of this article, however, our main interest lies in the geographical scope of the market for field development, production and sale of natural gas upstream and the markets at the wholesale level downstream. The following presentation (in parts **4.3.3.2** and **4.3.3.3**) is thus limited to these two markets.

4.4.3.2 The Upstream Market

The geographical dimension of the market for field development and production of natural gas, as well as the sale of the gas to wholesalers, is *highly dynamic* in nature.

The starting point, however, must be that this market is considered to cover the entire EEA area and probably Russia and Algeria as well.[122] In legal theory it has been assumed that the European internal market is the relevant geographical market for the production and sale of natural gas to wholesale dealers.[123]

That this is just a starting point follows from the merger case *Norsk Hydro/Saga Petroleum*[124]. Although the Commission stated that the EEA States, together with Russia and Algeria, formed the relevant geographical market for exploration, production and sale of natural gas as seen from the perspective of European demand, the reason for this market definition was first and foremost the logistical problems connected with pipeline transport. Thus, the

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[122] See e.g. case M.1573 *Norsk Hydro/Saga Petroleum* and case M.3052 *ENI/Fortum Gas*, paragraph 14.

[123] See, *inter alia*, Cameron pp. 292-293 and Høgseth p. 39.

[124] *Case M.1573* Norsk Hydro/Saga Petroleum.

Commission allowed for the possibility that the geographical market could be confined due to differences in gas quality in different producer countries, constraints in existing transport infrastructure and the costs related to gas transport.[125] However, the Commission did not find it necessary to come to a final conclusion on these matters for the purposes of the case, as they did not consider that the merger would result in either the establishment or the strengthening of a dominant position even in the narrowest market, i.e., the market for sale of Norwegian gas alone.

In this context, however, the possibility that constraints in existing transport infrastructure may influence the market definition is of particular interest. It cannot be ruled out that the market definition may be narrower in situations where *temporary capacity constraints*, i.e., so-called bottlenecks, occur in the interconnectors linking the gas networks of the Member States. The nature of these temporary constraints may be both physical and contractual. While physical constraints in the interconnectors linking the national gas networks are not considered to be a major problem, contractual constraints commonly occur as the transport capacity is reserved through long-term transport contracts, often to the advantage of former monopolists (the incumbents), and is thus not available to new market participants.[126] However, there are examples where the Commission has found that a state is isolated from its neighbouring countries and thus not a part of the internal market due to lack of interconnectors or insufficient transport capacity (i.e., physical constraints) in the interconnectors.[127] The *Britannia case*[128] is of

[125] Case M.1573 *Norsk Hydro/Saga Petroleum*, paragraph 15.

[126] See case M.3440 ENI/EDP/GDP, paragraph 273, regarding the lack of available capacity in the interconnector between Spain and Portugal.

[127] Case IV/E-3/35.354 *Britannia gas condensate field*, OJ [1996] C291/10. This was also considered to be the case in case M.931 *Neste/Ivo*,

particular interest in this respect. Referring to the lack of transport infrastructure connecting Great Britain with the Continent, and referring to constraints in the existing pipeline between Ireland and England, the Commission found that Great Britain was a separate geographic market. As this case was decided upon before the British market was connected to the Continental market through the interconnector between Bacton and Zeebrügge in Belgium, this market segmentation cannot be upheld in today's situation. However, even though the British market and the Continental market are now connected from a technical point of view, one might still find that these markets are separate when the capacity in the Bacton-Zeebrügge pipeline is fully booked (i.e., due to contractual constraints) or the pipeline is closed for maintenance.

Assuming that varying capacity in the interconnectors will influence the market definition, the geographical market may change within a very short period under certain conditions.[129] As the market share of the gas producers and the gas suppliers, when the market definition is narrow, will be larger than is ordinarily the case, temporary markets are defined due to capacity constraints in the transport capacity. This leads to a greater need for vigilance on the part of the market participants involved in order to avoid breaching the competition rules.

4.4.3.3 The Downstream Markets

The geographical scope of the downstream markets at the wholesale level has not normally extended beyond the borders of a single Member State, both before[130] and after the liberalisation of

paragraphs 22-23, where the Commission based its decision on the fact that Finland was not connected to pipeline networks other than in Russia.

[128] Case IV/E-3/35.354 *Britannia gas condensate field*, OJ [1996] C291/10.

[129] Nesdam, Relevant Energy Markets, p. 347.

[130] Case M.493 *Tractebel/Diztrigaz,* paragraphs 21-25.

the European gas markets. Since the market opening and the implementation of the gas market directives, the Commission's starting point is that the wholesale markets downstream have remained national in character. Most of the Commission's decisions are rudimentary and only contain a rather superficial analysis of the definition of the relevant geographical market. Referring to the market structure, the Commission either states that the supply market is national because the wholesale supply of natural gas is mainly a national activity,[131] or that the incumbent still has a dominant position within its historical supply area in Member States where external market actors have yet to enter.[132] However, it has been argued that the narrow market definition may have its background in, and be said to express the policy considerations of, the Commission.[133] The more narrowly the market is defined, the more likely it is that the competition rules apply.[134]

It is too early to operate with a joint Community market downstream. At present, the existing conditions for third-party access to the transmission network are insufficient to support cross-border trade. Instead, the problem is contractual constraints, as the transport capacity is reserved through long-term transport contracts, often to the advantage of former monopolists (the incumbents), and capacity is thus not available to new actors.[135] When defining the

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[131] *Inter alia*, see cases M.3297 *Norsk Hydro/Duke Energy*, paragraph 14 and M.3294 *ExxonMobil/BEB*, paragraph 20.

[132] Cf. case M.3086 Gaz de France/Preussag Energie, paragraph 12-13.

[133] EU Energy Law II pp. 95-96.

[134] It should be noted, however, that the notifying parties in most cases have not considered the possibility of a market wider than the national market, thus not forcing the Commission to take a stand. See e.g Case M.3410 *Total/Gaz de France*, paragraph 32.

[135] See e.g. case M.3440 ENI/EDP/GDP, paragraph 273, regarding the lack of available capacity in the interconnector between Spain and Portugal.

relevant market, the Commission both needs to, and will, take the ongoing market integration in the EEA Area into consideration.[136] However, the Commission (or, for that matter, the ESA) cannot be at the forefront of these developments. The market must be analysed and defined as it is, taking into account the various initiatives intended to accelerate market integration. As numerous initiatives have been put in place to open the European gas market, it is only a question of time before a cross-border market definition may apply downstream as well. As is the case when defining the geographical scope of the markets upstream, the need for sufficient physical transport capacity is essential when defining the geographic scope of the downstream markets.[137]

4.4.4 Summary

Summarising, in relation to the organisation of the Norwegian gas sales regime, the market for the development, production and sale of natural gas at a wholesale level in general and to large industrial customers and gas-fired power generators (i.e., the market for forward gas) is of particular interest. In this product market, natural gas is considered a homogenous product as no distinction has been made based on gas quality considerations (as of yet). Furthermore, as the main rule, the geographic dimension of this product market is (at least) EEA wide.

[136] See e.g. case M.2684 EnBW/EDP/Cajastur/ Hidrocantábrico, paragraph 18, case M.3440 ENI/EDP/GDP, paragraph 16, and the Commission`s Notice on the Relevant Market, paragraph 32.

[137] EU Energy Law II p. 96.

5 Joint Production

5.1 Introduction

As mentioned above (in part **2**), the licensees are, according to the PPL, obliged to enter into JOAs. These JOAs cover all aspects of the production process until petroleum resources have been produced. While the licensees co-operate concerning the production process, they compete in the gas sales markets (upstream and downstream). As such, the JOA features the characteristics of a production joint venture between competitors.[138]

Co-operation between two or more firms actually or potentially operating at the same level in the market, i.e., firms which can or do produce or distribute identical or substitutable goods or services, raises competition concerns due to the possibilities for horizontal restrictions.[139] However, a distinction is drawn between full-function joint ventures, where the parties agree to co-operate on every aspect of the business, and production joint ventures, where the parties agree to co-operate only with respect to production or services. While full-function joint ventures are considered under the EC Merger Regulation, production joint ventures are considered under Art. 81 EC.

Although problematic under competition law, production joint ventures are generally looked upon favourably in the petroleum sector. This is reflected by the fact that the Hydrocarbon Licensing Directive[140] allows for the establishment of production joint

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138 For a thorough presentation of production joint ventures, see e.g. Norsk Konkurranserett I Chapter 35.

139 EU Energy Law II p. 113.

140 Directive 94/22/EC of the European Parliament and of the Council of 30 May 1994 on the conditions for granting and using authorisations for the

ventures in the petroleum sector. Provided the principle of non-discrimination, and the procedures established to ensure respect for this principle, have been followed, the Hydrocarbon Licensing Directive allows each Member State freely to decide whether a (production) licence should be granted to a single entity or a group of entities.[141] This follows from Art. 1, no. 2, read in correlation with Art. 5, no. 1(3), of the Hydrocarbon Licensing Directive.

However, both the design and the implementation of the collaboration between several producers have to take place within the framework of Community competition law in each individual case. Production agreements seldom have the objective of restricting competition[142], but they may still have the *effect* of restraining competition.[143] Although the case law of the Community Courts dealing specifically with the application of Art. 81 EC to horizontal co-operation agreements is limited[144], the Commission has issued Guidelines on Horizontal Cooperation Agreements, which are general in scope, stating its position in relation to such agreements and establishing an analytical framework for the most common types of such agreements.[145] According to these guidelines, Art. 81 EC only applies to production agreements that are instrumental in restricting output in the market or which serve the

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prospection, exploration and production of hydrocarbons, OJ [1994] L 164/3.

141 Boge p. 15, with further reference to Finn Arnesen, Statlig styring og EØS-rettslige skranker. Illustrert ved en studie i EØS-rettens betydning for norsk petroleumsvirksomhet ("Arnesen"), p. 156.

142 See part 6.2 below.

143 EU Energy Law II p. 144. Similarly Boge p. 20, with further references to Richard Whish, Competition Law (4th edition), p. 498.

144 Whish (5th edition) p. 547.

145 Guidelines on Horizontal Cooperation Agreements, OJ [2001] C 3/2.

purpose of fixing prices or partitioning markets.[146] Furthermore, the Specialisation block exemption Regulation[147] provides a safe harbour for production co-operations between competitors.[148] These safe harbour clauses are also considered to apply to collaborations relating to natural resources such as petroleum and natural gas.[149] It is hard to believe that the safe harbour is of significance for the activities on the NCS, however, mainly due to the market share thresholds[150]. Production co-operation arrangements that do not

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146 Commission Notice – Guidelines on the applicability of Art. 81 to horizontal co-operation agreements. Official Journal C 3 of 06.01.2001, p. 2. EU Energy Law II p. 144.

147 Commission Regulation (EC) No. 2658/2000 of 29 November 2000 on the application of Art. 81(3) of the Treaty to categories of specialisation agreements, OJ [2000] L 304.

148 In order to benefit from the safe harbour of the Specialisation block exemption Regulation, two cumulative conditions have to be met. The first condition is that the combined share of the parties to the agreement does not exceed 20% in the market directly affected by the co-operation. According to the Regulation, the market share is to be calculated on the basis of the value of the products sold the previous year. Furthermore, and of great importance, the sales of all companies belonging to the same group as each of the collaborating firms have to be included in the calculation. If, after a certain time, the market share exceeds the threshold of 20% but remains below 25%, the exemption continues to apply for two years. However, when the 25% threshold is exceeded, the exemption applies for only one year. The second condition is that the agreement must not contain any of the three hardcore restrictions, i.e., price fixing, output limitation or allocation of markets or customers (so-called black clauses). Provided that these conditions are met, an agreement providing for unilateral or reciprocal specialisation in the area of production or joint production is presumed to be valid and fully compatible with Art. 81(1).

149 EU Energy Law II p. 147.

150 Without having definite figures as to the market shares of the different companies active on the NCS, there are indications that the (main) gas undertakings conducting their business on the NCS might have market shares above 20%. In the GFU case, for instance, the Commission based its

benefit from the safe harbour clauses have to be examined to determine whether they are compatible with Community competition law.[151]

The following discussion focuses on the licensing system as such and the question of whether this may give rise to competition problems.[152] As already mentioned (in part 2), the undertakings conducting activities on the NCS are obliged to enter into production joint ventures under the licences granted by Norwegian authorities. Furthermore, the Norwegian authorities determine the output levels of each joint venture in order to maximise the longevity of the fields and ensure long-term revenues for Norwegian society. In other words, one might argue that the doctrine of state compulsion will apply in these cases.[153] However, there are uncertainties regarding

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reasoning on the fact that Norwegian gas in 1998 accounted for 36% of the consumption in Belgium, 28% in France, 25% in Germany, 18% in Spain, 13% in the Netherlands, as well as for minor market shares in Austria and the UK. As mentioned previously, the sales of all companies belonging to the same group as each collaborating firm have to be included in the calculation of the market share. As these figures apply to the sale of Norwegian gas only, and the gas undertakings are active in production outside the NCS as well, the market share thresholds may easily be exceeded (by some, if not all, of the gas undertakings in question).

151 EU Energy Law II p. 147. For a presentation of relevant actors when assessing the question of whether participants are likely to gain, maintain or increase market power through co-operation in the energy sector, see e.g. EU Energy Law II pp. 148-154.

152 For an in-depth analysis, see e.g., Christopher W. Jones (editor), EU Energy Law – Volume II EU Competition Law and Energy Markets. See also Olav Boge, Gassproduksjon og konkurranserett. En vurdering av produksjons-samarbeidet på norsk sokkel i forhold til EØS artikkel 53. MarIus 303. For a more general presentation on the rules on production co-operation in general, see Norsk Konkurranserett I Chapter 35.

153 See, e.g., Boge p. 60 et seq, who concludes that both the fact that gas undertakings enter into production joint ventures and the content of the JOA fall outside the scope of Art. 53(1) EEA, due to the state compulsion

the scope of the state compulsion doctrine.[154] In particular, there is a debate over whether, and to what extent, an undertaking is obliged to withstand an obligation imposed on it by the state that is in breach of the Community competition rules.[155] Against this background, a further analysis of the situation seems to be justified.

It should be noted, however, that case law directly dealing with this question is limited.[156] Neither the ECJ nor the Commission has explicitly evaluated joint production in relation to Art. 81(1) EC.[157] However, in connection with the *Britannia case,* the Commission specifically addressed the scope of the co-operation agreement between the licensees of the field, without raising competition concerns.[158] The validity of the JOA entered into by the licensees of the Britannia gas condensate field under Community competition

doctrine, but raises the question of whether the same can be said as regards to the lifting agreement entered into in accordance with the JOA.

154 The case law concerning this doctrine is rather limited. The doctrine was established in the following cases, cases C-359 & 379/95 *Commission and France vs Ladbrooke Racing* and case T-387/94 *Asia Motor France vs Commission*. According to these cases, three conditions have to be met: 1) the authorities have to make a particular practice comprehensive; 2) a legal basis has to be found for the practice the undertaking considers itself bound to exercise; and 3) the undertaking(s) in question must have no choice as regards the implementation of the behaviour.

155 See e.g. Boge p. 61.

156 COMP/37.732 – *Synergen* (IP/02/792 of 31 May 2002), dealt with the question of joint venture agreements and gas-fired power plants. The Synergen venture was cleared only following strict commitments by the parties. However, this case is of no direct relevance in the context of this article.

157 However, the presentation of this issue in EU Energy Law II Part 3, Chapter 2, point 5, might be said to reflect the Commission's view on the matter.

158 Case IV/E-3/35.354 – *Britannia Gas Condensate Field* (Notice pursuant to Art. 19(3) in Regulation 17), OJ [1996] C291/10, part 3.

law was not, however, the question addressed in the *Britannia case*. The lack of a critique on the part of the Commission in this particular case does not necessarily imply, however, that the Commission does not consider that such agreements may give rise to competition concerns in the petroleum sector.

The following presentation is divided into three parts. Firstly, there is a presentation of the reasons for joint production (in part **5.2**). Secondly, there is an account of the competition concerns that arise in relation to joint production (in part **5.3**), and thirdly, joint production on the NCS is evaluated (in part **5.4**).

5.2 The rationale behind joint production in the gas sector

The use of JOAs is not peculiar to the NCS. Production joint ventures can be said to be the norm in the petroleum sector[159] and their objective is not to restrict competition, but to spread risk.

One might argue that, in the petroleum sector, joint operations are necessary for management purposes. If this line of argument is followed, a distinction might have to be drawn between mature areas and frontier areas. As mentioned above, the demands with regard to the licensees' technical experience, as well as their financial strength, are particularly high when licences are being allocated for exploration and development in respect of petroleum resources in frontier areas. The combined expertise of several undertakings may be needed to ensure efficient field development. As all areas have been considered frontier areas at some point, this

[159] EU Energy Law II p. 142, where it is stated that "[c]ollaboration in the area of production can probably be said to be a wide-spread feature in the energy industry. Indeed, joint production of power, gas or petroleum products by competing suppliers are perhaps among the, if not the most, frequent category of co-operation to be found in the energy industry."

argument may explain the existence of joint operations in existing fields on the NCS. Such considerations concerning efficiency could be said to have been accepted, to some extent, by the Community legislator.[160]

That the main reason for the licencing system is economic is reflected in the fact that joint operation is the rule even when new licences are granted in areas now considered mature. Although the major gas companies have the financial strength to undertake the investments (in infrastructure for both production and transport) necessary to develop the petroleum resources in a single reservoir, they are reluctant to take on the risk of single-handedly making such an investment. The producers are not willing to "put all their eggs in one basket", so to speak, but choose to participate in several licences in order to spread their risk and to achieve the (particularly) high revenue demands (which these undertakings operate with). If they were not allowed to co-operate, the gas undertakings could not necessarily be expected to be willing to undertake the necessary investments and operations on their own. Risk sharing seems to be acknowledged as a relevant factor when balancing negative and positive effects on competition.[161]

5.3 Joint production and competition concerns

The use of JOAs is not peculiar to the NCS. Production joint ventures can be said to be the norm in the petroleum sector.[162] Still,

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160 EU Energy Law II p. 143, where it is stated that production agreements "also generate efficiencies, e.g in the form of economies of scale or scope or better production technologies."

161 EU Energy Law II p. 143, where it is stated that "[r]isk sharing as practiced in production co-operations of the gas sector may also be an economic benefit to be taken into account."

162 EU Energy Law II p. 142, where it is stated that "[c]ollaboration in the area of production can probably be said to be a wide-spread feature in the

the production joint ventures may have restrictive effects in the market.

Normally, producers of goods or service providers may compete both on quality and price. As already mentioned, the gas sales market differs somewhat, since the quality of the gas offered in the market is standardised in the gas sales agreements (gas sales quality) and is more-or-less the same for all customers. While both quality issues[163] and security of supply considerations may affect the choice between competing producers located in different producer regions (i.e., Norway, Russia and Algeria), the producers located on the NCS are basically left to compete between themselves on the basis of price alone. Still, it should be kept in mind that a producer`s flexibility as well as the gas volumes it has available for sale are factors that will also contribute to the producer`s competitiveness.

At the same time, the scope for price competition between the parties to a production agreement may be constrained due to commonality of costs.[164] Production joint ventures are characterised by the fact that the producers working together necessarily share a common cost profile (a commonality of costs).[165] Under the JOAs, the field owners' influence on production and the production process is rather limited. The role of the field owners (i.e. licensees) is really that of distributors. This results in a standardisation of both costs and products.

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energy industry. Indeed, joint production of power, gas or petroleum products by competing suppliers are perhaps among the, if not the most, frequent category of co-operation to be found in the energy industry. "

163 See e.g. *Norsk Hydro/Saga*, referred to above, where the different quality of gas from, e.g., Norway, Russia and Algeria was mentioned as one of the factors that could limit the market definition.

164 EU Energy Law II p. 145.

165 EU Energy Law II p. 145.

In general, a substantial degree of commonality of costs is likely to be the result where two conditions are in place.[166] A first prerequisite is that production must account for a high proportion of the total costs of the energy product.[167] The next is that the providers must combine their production activities to a significant extent.[168] These conditions clearly exist in relation to the joint production taking place on the NCS.

It should be noted that the system of CBS as a starting point allows for competition between producers participating in the same licence group. However, due to the problem of commonality of costs, the competition between products produced under the same licence is in reality rather marginal. Where competition between the producers active on the NCS still exists, this is because, under a portfolio-based sales regime, it is not the cost profile of one JOA, but of the portfolio of JOAs that the producers have licences to, that determines the cost profile of a particular producer, and thus the margins on which the producer may compete in the gas sales market. Thus, the introduction of portfolio-based sales might be said to reduce the problem of commonality of costs, allowing the producers still to compete on price. Still, the introduction of portfolio CBS cannot be said to solve all concerns relating to co-operation agreements between the gas undertakings.

The JOAs and/or associated agreements might be found to be designed in a way that reduces the parties' freedom to act more extensively than is necessary to achieve the joint production. The

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166 EU Energy Law II p. 145.

167 According to the Commission, production accounts for a high percentage of the total costs when production costs are, e.g., 50% or 65-70% of the total costs of the final goods, see Guidelines on Horizontal Co-operation, paragraphs 112 and 113, Appendix 3 and paragraphs 107 and 108, and Appendix 3.

168 EU Energy Law II p. 145

JOA necessarily covers both technical and commercial aspects. This fact was highlighted in the *Britannia case*, where the Commission stated, when commenting upon the scope of the co-operation agreement between the licensees in the Britannia gas condensate field, that the licensees had jointly made both technical and commercial decisions.[169] The licensees' choices regarding the infrastructure to be used for the development of the field, i.e., their decisions on the size of the well, its location, pipe size etc., were referred to as technical choices. However, the management committee's decision on such issues as the day of start-up (of production), the field's plateau period, and swing production, as well as decisions on periods for production stops and maintenance schemes, might seem to have been considered to be of a commercial nature. The JOA and its associated agreements (i.e., the lifting agreement) both contained provisions that restricted the licensees' freedom in relation investments if not production and sales.

The price of goods or services can be manipulated, either indirectly (by restricting output) or directly (by raising prices). According to Art. 81(1)(2) EC litra b), restrictions on production are particularly problematic. In relation to production co-operations in the energy sector in general, it has been argued that "[i]t is important for collaborators that their decisions regarding output levels necessary for the functioning of the production co-operation do not constitute a hardcore restriction of EC competition law."[170] In the gas sector, however, the production level is primarily predetermined by reservoir conditions. Furthermore, as mentioned above (in part **2**), according to the PA Section 4-4, the Ministry ultimately stipulates the production level under each licence.

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[169] Case IV/E-3/35.354 – *Britannia Gas Condensate Field* (Notice pursuant to Art. 19(3) in Regulation 17), OJ [1996] C291/10, part 3.

[170] EU Energy Law II p. 144.

5.4 Evaluation of joint production on NCS

5.4.1 Overview

Following the introduction of CBS, the main question is whether the JOA and its associated agreements may directly and/or indirectly result in a restriction on production levels. The JOA, which is a standard agreement, contains provisions on each licensee's freedom as to sales, investments and production under the licence in question. As regards the prohibition in Art. 81(1), agreements that limit or control production, markets, technical development or investment are listed in Art. 81(1)(b) EC as particularly problematic. As mentioned previously, output may be limited in order to raise the prices of the goods or services in question and all the factors listed in Art. 81(2)(b) EC influence the production level, directly or indirectly. Investments made by the parties to the production joint venture are decisive for the gas volumes that can be offered in the market in the future. Accordingly, the agreements have to be examined in order to determine whether their provisions on either investments or production within the joint venture may have anti-competitive effects. The following discussion addresses the possible anti-competitive effects of the JOAs' provisions on investments (in part **5.4.2**), before examining the effects of the provisions on production in the lifting agreements (in part **5.4.3**).[171] Then, problems related to the company structure on the NCS due to the licence system are mentioned (in part **5.4.4**).

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[171] This part of the presentation is, to a large extent, based on Olav Boge, Gassproduksjon og konkurranserett. En vurdering av produksjonssamarbeidet på norsk sokkel i forhold til EØS artikkel 53, MarIus 303.

5.4.2 Possible restrictions on investments

Art 81(1) EC requires that the participants' freedom to act is not limited in a way that harms competition. At the same time, the investment provisions of the JOA have to be designed taking into account the fact that the joint venture is a co-operation between several gas undertakings, where all participants are to have a say in key decisions and where such decisions shall ensure the common interest.

Under Art. 81(1) EC, each party is required to have an independent right to invest in increased production capacity for the joint business. However, it is not required that this right to make individual investments should be unlimited. It must be possible for the party proposing such investment to make it independently, provided the operation of the plant is not jeopardised and the other party refuses to participate in the proposed investment. This principle was laid down by the Commission in the *Exxon/Shell* case[172].

These criteria are met in the production joint ventures taking place on the NCS. Investment decisions in relation to the production joint venture are regulated in JOA Chapter IV Field Development and Chapter V Sole Risk Operations. However, these provisions differ depending on the stage that has been reached in the life of the field. When addressing the question of investment, a distinction has to be drawn between the exploration phase (prospection) and the development phase.

Activities in *the exploration phase* are regulated in the work program determined in accordance with JOA Art. 12. This program is adopted by the management committee in accordance with the ordinary voting rules established in JOA Art. 2.2. According to JOA Art. 192, each licensee also has the right to supplement the jointly

[172] Case IV/33.640, *Exxon/Shell*, OJ [1994] L 144.

conducted surveys, tests and drilling activities with similar operations that the party undertakes at its own risk.[173] However, this right to seek and obtain supplementary information is clearly a secondary one. Such sole risk operations cannot take place either before the obligatory work commitment in the PPL has been completed or if they interfere with plans or work programs, or if they endanger production from deposits that have already been developed.[174] This is in line with the principle laid down in the *Exxon/Shell case*, i.e., limitations on the right to undertake individual investments are accepted provided they are to protect the interests of the other licensees.[175]

When it comes to investments in *the development phase*, these are regulated in the JOA Chapter IV Field Development and Chapter V Sole Risk Operations. A field development may consist of several development steps. The gains may differ in each of the steps. Furthermore, the licensees may operate with different risk profiles as well as different rate-on-return requirements. Consequently, the licensees may not agree on whether and how a field should be developed. However, under the JOA, a single licensee can neither be forced to participate in the joint venture nor can it, alone or together with other participants, veto the development of a field.[176] According to the JOA Art. 16.3, the operator shall prepare a field development plan in close co-operation with the (other) licensees. This field development plan is submitted to the management committee, which decides whether the plan shall be adopted. The

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[173] It should be noted, however, that such sole risk projects shall be carried out by the operator, cf. JOA Art. 19.7. In other words, the licensees that participate in the sole risk project have only undertaken an obligation to pay the cost in relation to the project and not to carry it out.

[174] JOA Art. 19.3.

[175] Similarly, see Boge pp. 43-45.

[176] Similarly, see Boge pp. 45-46.

plan is then submitted to the Ministry and other relevant authorities (i.e., the environmental authorities) together with a field development application, cf. JOA Art. 17.2. Once the field development plan has been adopted by the management committee, each licensee shall, within a period of three months, notify the Ministry and the other licensees whether or not it accedes to the field development plan, cf. JOA Art. 17.3. A licensee's accession to the field development plan is binding in relation to the other licensees.[177] If all licensees have not acceded to the development plan within the time limit given in Art. 17.3, those parties that have acceded to the plan may propose that the development is carried out on a sole risk basis.[178] The licensees that wish to participate in a sole risk project have to notify the Ministry and the other relevant parties in writing, cf. JOA Art. 20.2.

This indicates that the provisions of the JOA do not limit investments and thus do not restrict production.

5.4.3 Possible restrictions on production

Once the necessary investments for the field's development have been made, the question is whether, and to what extent, Art. 81(1) EC applies to the agreement's provisions on production in the field's production phase. The question arises in two contexts. The first question is whether the regulation of the joint venture's total production may have anti-competitive effects. It is only limitations in the production level that exceeds whats necessary from a technical point of view and/or the framework established by the MPE, that might raise competition concerns. The second is whether the regulation of each licensee's individual gas lifting may have restrictive effects.

[177] JOA Art. 17.4.

[178] JOA Art. 20.1.

Agreements that limit production are prohibited under Art. 81(1) EC. The Guidelines on Horizontal Co-operations, however, exempt agreements concerning the production that is directly affected by the agreement on production cooperation.[179] Such agreements shall be evaluated in the light of the joint effects on competition of the joint venture. This must be seen in connection with the Norwegian authorities' regulation of the production level. The PPL regulates the supply of gas volumes to the market and a predetermined production profile takes the joint interests of the licensees into account. This production level is determined in order to optimise production. It is of little practical significance that the licensees are able to reduce production to lower levels than those allowed under the PPL in order to manipulate the gas price.

In this context, the regulation of the parties' individual lifting of gas is of greater practical interest. The individual lifting is regulated in the Lifting Agreement. As mentioned above (in **part 2**), there are two types of lifting agreement. In this context, flexible lifting agreements are of interest, as they allow for underlifting of gas. Although the participants are obliged to follow the production program, according to these agreements, each licensee is allowed to underlift gas to some extent. At the same time, the right to underlift is not accompanied by a right for the other licensees to overlift. The result of a prohibition on overlifting is that total production from the field is limited once a single licensee chooses to underlift. If overlifting is permitted, however, the utilisation of the field's entire production capacity is ensured. The question is whether a prohibition on overlifting is problematic under Art. 81(1) EC. In the *Exxon/Shell* case, the Commission laid down the principle that each participant has the right to utilise production rights not utilised by other participants. A general prohibition on overlifting

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[179] Guidelines on Horizontal Cooperation Agreements, paragraph 90.

may thus appear problematic. However, natural gas is a non-renewable resource. As the possibility of overlifiting is restricted in order to ensure the balancing of ownership interests in the end-phase of the field, such a restriction appears to be legitimate.[180] Furthermore, it is highly unlikely that any possible anti-competitive effects of a prohibition on overlifting will have an appreciable effect.

5.4.4 The problem of information exchange between the licencees

As seen above, joint production in itself is not a particular problem in light of how the activities on the NCS are organised and conducted. The main competition concern arises due to the possibilities for information exhange between the licencees allowing competitors to foresee each others future business strategies and, thus, to adjust their business activities accordingly.[181]

In order for there to be competition, the market must not be too transparent. The market actors need to be uncertain as regards the market behaviour of their competitors. If not, tacit collusion between competitors, through adjustments to their behaviour, is likely. Information exchange increases transparency in the market, thus making such adjustment easier. This problem is especially relevant in oligopolistic markets (i.e., markets with few participants).

The number of undertakings presented in the development, production and sales of natural gas on the NCS, and thus competing in the market for forward gas, is rather limited. This is even more the case because of a market structure where the producers are closely connected through cross ownership. A

[180] Boge p. 54.

[181] For a general presentation of the question of information exchange, see Norsk Konkurranserett I Chapter 37.

particular feature of the NCS is that, in order to spread risk, single undertakings are applying for licences in several fields and thus entering into JOAs if a licence is granted. In other words, the gas undertakings active on the NCS participate in numerous JOAs. Even though each production joint venture as such might not be considered appreciably to prevent or restrict competition in the gas sales market, the structure of joint ventures across the NCS might have such an effect.

This is due to the fact that the particular characteristics of the market structure on the NCS may give rise to transparency concerns. Information about one licence may be exchanged with another within the organisation of a single licensee. The network of joint ventures, and the extensive degree of cross-ownership, implies that the gas undertakings have access to information about plans for investment and production across the NCS. As such exchanges of information reduce, or even eliminate, uncertainties as regards competitors' plans for future investments, production and sales, the effect may be anti-competitive. Exchanges of information that may give rise to co-ordination of market behaviour may therefore infringe Art. 81(1) EC.

The particular characteristics of the market structure on the NCS make information exchange a relevant problem. As each gas undertaking is involved in the production of gas on several fields, this gives the gas undertakings knowledge of the production profile across the NCS and allows them to consider the totality of interests when making commercial decisions. It is thus important to distinguish between information that is market relevant and information that is production relevant. The *Britannia case* once again provides an illustration (cf. part **5.3** above). The problem of

information exchange between competitors means that the allocation of functions within the joint venture has to be examined.[182]

As work programs and budgets are adopted by the management committee, the licensees are mainly given access to information on major economic as well as strategic issues. Still, the information exchange between licencees may be a problem when *deciding on investments* in either the development of a field or the building of transport infrastructure. The licencees are clearly aware of this. In order to avoid to be in breach of Art 81(1) EC, the licencees as a main rule may make joint assessments as regards the costs of the project. However, each licencee seek to base its investment decision on individual assumptions as regards markets prospects. In other words, although the licencees` assesment of the market prospects (seen in relation to the costs of the project) clearly influences their voting within the management committee, each licencee must not only make its individual assessment but also keep this assessment to itself.

Although the problem of information exchange arises within the management committee as such, this is a problem in relation to *the functions of the operator* in particular. The operator is in a special position when it comes to access to information. As the operator carries out all activities related to production, it has access to technically and commercially relevant information on both a short-term and long-term basis.

In this respect, the authorities' policy with regard to the award of operatorships on the NCS has exacerbated the problem. Although this has changed over the years, for a long while, only a limited number of companies were appointed operators. Consequently, Statoil and Hydro (now StatoilHydro) still have a special position as both operators for gas fields and major sellers of gas in the gas

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[182] See EU Energy Law II p. 141 and Boge p. 91.

market. In other words, the operators gain a valuable insight into activities on a number of fields. This gives the operator an information advantage compared to other gas undertakings active on the NCS, i.e., the operator's competitors in the gas sales market.[183]

Although the increase in the number of gas undertakings becoming operators may eliminate such information advantages, this also contributes to a more transparent market as regards investments and production decisions.[184] Access to, and exchange of, information thus needs to be controlled in order to avoid competition concerns. This is particularly true when it comes to information on each undertaking's lifting of gas. This is reflected in the lifting- and balancing agreements.

In order to avoid information being exchanged on the future gas lifting of each gas undertaking, the lifting- and balancing agreements contains a nomination procedure. This nomination procedure is designed to avoid the licensees and the operator gaining insight as regards the gas volumes each gas undertaking has lifted and has the right to lift for the remaining part of the production year.

Under today's regime, the gas purchasers nominate their desired volumes under their respective gas sales contracts with a particular producer. This nomination is made through Gassco, which informs the field operator of the gas volumes that are to be lifted during a given production day. The field operator only receives information as to which licensee has lifted which gas volumes the day after the gas volumes have actually been lifted. Accordingly, the licensees do not receive information about which licensee withdraws which gas volumes and the field operator only receives such information following a delay.

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[183] Boge pp. 93-94.

[184] Boge p. 94.

The operator is obliged to keep a lifting and balancing account for each licensee. This account contains information on the volumes that have been lifted and the volumes that remain for lifting. These accounts are kept individually. While the licensees are kept informed of their own gas lifting record and the aggregated lifting in relation to the field, they are not given detailed information on the spread of gas volumes between the licensees.

In a transparent market with few market participants such as the NCS, it is difficult to avoid information on the parties entering into contracts becoming common knowledge. However, the commercial conditions in the gas sales agreements need to be kept confidential in order to maintain competition. In this respect, it is a problem that the gas sales agreements are relatively standardised. This relates to the fact that the gas undertakings share the main infrastructure. As this article (as mentioned in **part 1**) deals with the organisation of the gas sales regime and not the gas sales agreements themselves, this problem will not be discussed further here.

5.5 Summary

In view of the line of argument above, it seems fair to conclude that the production joint ventures entered into on the NCS are unlikely to have anti-competitive effects. While production within the scope of the licence as such probably does not infringe Art. 81(1) EC, the introduction of portfolio sales has resulted in the differentiation of products and different cost profiles among the gas undertakings, thus facilitating competition between these undertakings. Agreements entered into outside the scope of the licence, i.e., production caps, lifting agreements, balancing agreements and/or joint buying of injection gas, may, depending on the circumstances, be exposed in relation to Art. 81(1) EC. These agreements have to be evaluated on an individual basis.

On balance, most production agreements are considered economically beneficial.[185] More often than not, the efficiencies and risk sharing enabled through production agreements are considered to outweigh the possible negative competition effects of such co-operation.[186] This is particularly true in the case of co-operation agreements that significantly increase production capacity and output for a specific form of energy.[187] This explains why such production agreements, if they are deemed to be in breach of Art. 81(1) EC, are exempted in accordance with Art. 81(3) EC. In principle, the favourable view of production agreements does not depend on the structure that producers give to their collaborations, i.e., whether the producers consent to share a production facility, for instance through the creation of a joint venture (as is done on the NCS), or enter into specialisation or subcontracting agreements.[188] However, under the current system, particular attention must be paid to the information exchange both between the licensees within a joint venture and inbetween the joint ventures to avoid that a production joint venture in a particular case is considered to be in breach of Art. 81(1) EC.

6 Joint selling

6.1 Introduction

At Community level, the question of joint selling has been a major issue.

185 EU Energy Law II p. 143.

186 EU Energy Law II p. 143.

187 EU Energy Law II p. 143.

188 EU Energy Law II p. 143.

Joint selling is clearly prohibited under Art. 81(1) EC/Art 53(1) EEA. However, the prohibition in Art. 81(1)/Art 53(1) EEA applies only where joint selling cannot be objectively justified. The Commission has dealt with quite a number of cases concerning the question of joint selling over the years.[189] The *general policy* of the Commission is *not to tolerate* joint selling, unless *compelling reasons* are provided as a justification.[190] This case material constitutes the basis for the following analysis of whether, and under what circumstances, joint selling can be considered justified.

In relation to the particulars of the NCS, however, the starting point is quite clear. With the dissolution of the sales cartel that was constituted by the GFU and the introduction of a CBS regime, portfolio sales and portfolio considerations. In other words, the question of joint selling is no longer particularly relevant to activities on the NCS. When the question of joint selling nonetheless is being adressed, this has to do with the fact that this issue, under certain conditions, might still be pertinent a system of company-based sales.

Firstly, with the maturing of the NCS, the major finds have already been done and the remaining gas resources are proving to be mainly marginal. As a main rule, protfolio considerations apply

[189] So far, the Commission has dealt with four cases concerning joint marketing and selling of natural gas, i.e., Case No. IV/E-3/35.354 – *Britannia gas condensate field* (Notice pursuant to Art. 19(3) of Regulation 17) OJ [1996] C291/10, COMP/37.708 – *PO/Corrib* (IP/01/578 of 20 April 2001) (joint sales from a single field), COMP/36.072 – GFU – *Norwegian Gas Negotiation Committee* (IP/02/1084 of 17 July 2002) (joint sale from several fields) and COMP/38.187 – *DONG/DUC* (IP/03/91 of 24 April 2003) (joint marketing).

[190] Cf. the statement made by then Commissioner Mario Monti in relation to the closure of the *Corrib* case, IP/01/578 of 20 April 2001 (Enterprise Oil, Statoil and Marathon to market Irish Corrib gas separately). See also EU Energy Law II p. 157.

here as well. Where portfolio considerations for some reason do not apply, joint selling from a single field could still be considered a prerequisite for the development of these marginal fields. To what extent this is true and what significance this will have when applying competition rules, needs to be adressed.

Secondly, the question of joint selling has been and might also in the future be of practical interest in relation to the development of LNG-projects. In particular, this question has occured where major investments in the development of dedicated infrastructure are required.[191]

Thirdly, under the existing CBS regime, gas producers are known to buy gas produced by other producers. Regardless of the reasons for such concerted buying practices, the end result is that gas produced by several producers is offered to the market by a single producer and under the same terms and conditions (i.e., at a single price). Such practices thus have sufficient similarities with joint selling to necessitate further analysis to determine whether this is in breach of the prohibition on such sales.

In the following, the questions of joint selling from several fields (part **6.2**), joint selling from a single field (part **6.3**) and concerted buying (part **6.4**) will be dealt with respectively. The issue of joint selling from several fields are dealt with mainly to illustrate the reasoning of the Commission and give a backdrop against which the question of joint selling can be understood. However, it should be noted that in relation to the current situation at the NCS, it is the question of whether and to what extent joint selling from a single field or concerted buying is allowed that is of practical

[191] The gas volumes from the Snohvit field is marketed by StatoilHydro in the US, see http://www.statoil.com/snohvit. However, Total and Gaz de France will handle their own gas volumes.

interest. In this discussion, the presentation and analysis of the available case material will feature prominently.

6.2 Joint selling from several fields – illustrated by the GFU case and the DONG/DUC case

6.2.1 Overview

Not only did the *GFU case*[192] represent a turning point concerning the application of European competition rules to activities on the NCS, but it also illustrates *jurisdictional*, as well as *material*, aspects of the application of European competition law to the activities on the NCS. While the jurisdictional issues have been dealt with above (in **part 4.3**), the following focuses upon the material aspects of the case. In short, the *GFU case* concerned the former practice of the *joint selling* of natural gas produced from *several fields*. Although the case dealt with anti-competitive practices that are now *history* on the NCS, it is desirable to present the case reasonably thoroughly (in part **6.2.2**) to show the reasoning of the Commission. Furthermore, a special case of joint selling that still occurs should be mentioned breifly (in part **6.2.3**).

6.2.2 The GFU case and the DONG/DUC case

Traditionally, the natural gas produced on the NCS has been sold under long-term gas sales agreements. Due to the enormous costs related to the development of infrastructure and the production of

[192] IP/01/830 of 13 June 2001 (Commission objects to GFU joint gas sales in Norway), published at http://europa.eu/rapid/pressReleasesAction.do?reference=IP/01/830&format=HTML&aged=0&language=EN&guiLanguage=en, and IP/02/1084 dated 17 July 2002 (Commission successfully settles GFU case with Norwegian gas producers), published at http://europa.eu/rapid/pressReleasesAction.do?reference=IP/02/1084&format=HTML&aged=1&language=EN&guiLanguage=en.

gas, the field owners need to be certain that the gas produced will be sold in the market. Hence, the field owners have entered into long-term gas sales agreements prior to the development of the gas reservoirs. Until 2001, joint gas sales have been practised on the NCS. The methods employed, however, have differed over the years.

Initially, the licensees of a single field entered into depletion contracts with their customers downstream ("field depletion contracts"). Later on, the field licensees' freedom to enter into gas sales agreements on their own was eliminated, as all gas sales agreements were negotiated and entered into by the gas negotiations committee (the "GFU").[193] While only the Norwegian gas producers[194] operating on the NCS were members of the GFU on a permanent basis, other gas producers could be involved on a temporary basis in relation to specific negotiations if it was deemed necessary. Due to the advisory role of the GFU, the contracts negotiated by the GFU were only binding following the Ministry's approval. The fulfilment of the delivery obligations was not decided upon in the gas sales agreements as such. Instead, the delivery obligations under the gas sales agreements were transferred to a contract field, subject to the recommendations of the negotiations

[193] The GFU was established in 1987 as an advisory committee to the Ministry of Petroleum and Energy ("MPE"). See, e.g., St. meld. nr. 39 (1999-2000) Olje- og gassvirksomheten, pkt 5 Gassvirksomheten, pkt 5.4 Det norske gassforvaltningssystemet, pkt 5.4.1 Organisering av gassvirksomheten.

[194] At the time the GFU was established, these were Statoil, Norsk Hydro and Saga Petroleum. With Norsk Hydro's acquisition of Saga Petroleum in 1999, the members of the GFU were reduced from three to two. See, e.g., St. meld. Nr. 39 (1999-2000) Olje- og gassvirksomheten, pkt 5 Gassvirksomheten, pkt 5.4 Det norske gassforvaltningssystemet, pkt 5.4.1 Organisering av gassvirksomheten.

committee (the "FU")[195], which consisted of the 10 major resource owners and operators active on the NCS, and the discretion of the Ministry.[196] Due to the gas volumes involved, the contract field was normally unable to meet the delivery obligations under the gas sales agreement on its own. Hence, in order to be able to fulfil the delivery obligations, the contract field would enter into supply contracts with a number of supply fields, again subject to the recommendations of

[195] The supply committee ("FU") was established in 1993 at the initiative of the authorities and with the purpose of advising the Ministry on how alternative supply obligations could and would contribute to efficient resource management. Decisions as to how different supply solutions would contribute to efficient resource management must be based on considerations of how the different alternatives affect the production of liquids, time-critical reserves (tidskritiske reserver), resource management, utilisation of existing and planned infrastructure as well as risk assessment of the technical alternatives in relation to the gas activities upstream, cf. St. meld. nr. 39 (1999-2000) Olje- og gassvirksomheten, pkt 5 Gassvirksomheten/pkt 5.4 Det norske gassforvlatningssystemet/pkt 5.4.1. Organisering av gassvirksomheten.

[196] The GFU/FU scheme was based upon a close co-operation between the licensees, the GFU, the FU and the authorities. Each licence group was obligated to report to the FU, on a continuing basis, what volumes they could produce. Based on the data received, the FU made estimates on the volumes the NCS potentially could supply. These estimates in turn were the foundation upon which the GFU negotiated gas sales agreements with Continental buyers. The agreements negotiated by the GFU and approved by the Ministry were then submitted to the FU for advice on how the delivery obligations should be fulfilled. The FU's proposal was then sent the Ministry, which ultimately decided upon the field and transport solution to be developed in order to fulfil the gas sales agreement in question. During this entire process, the authorities and the undertakings active on the NCS met on a regular basis for exchange of information and views.

the negotiations committee ("FU") and the discretion of the Ministry.[197]

The Norwegian authorities initiated the joint selling of gas through a single body for resource management purposes. The main purpose of the GFU – and the FU – was to ensure the development of infrastructure as well as advantageous marketing possibilities for Norwegian gas in the long term.[198] This was an important part of the safeguarding aspect of the overall policy for resource management, as it enabled the authorities not only to develop the available *gas resources* gradually over time, and thus secure Norway a steady and reliable income over time (purposes relating to production and income), but also to establish the *infrastructure* necessary to utilise these resources in a co-ordinated manner (purposes relating to infrastructure). Due to the joint selling scheme, it was possible first to develop the gas fields considered most profitable from a socio-economic perspective and to ensure cost-effective development of both transport pipelines and processing terminals as the fields in question were developed.[199] In other words, the GFU/FU scheme facilitated the co-ordinated development of gas fields on the NCS based on socio-economic considerations (development purposes).[200] At the same time, the gas produced on the NCS was sold to monopsonies on the Continent. The establishment of a sales monopoly thus also contributed to the

[197] St. meld. nr. 39 (1999-2000) Olje- og Gassvirksomheten, pkt 5 Gass-virksomheten/pkt 5.4 Det norske gassforvaltningssystemet/pkt 5.4.1 Organisering av gassvirksomheten.

[198] St. meld. nr 39 (1999-2000) Olje- og gassvirksomheten, pkt 5 Gass-virksomheten, pkt 5.4 Det norske gassforvaltningssystemet, pkt 5.4.1 Organisering av gassvirksomheten. Similarly, St.meld. nr. 38 (2001-2002) pkt 7.1.1.

[199] St.meld. nr. 38 (2001-2002) pkt 7.1.1.

[200] St.meld. nr. 38 (2001-2002) pkt 7.1.1.

attainment of a more equal bargaining position, thereby facilitating, from a producer perspective, favourable sales conditions in general and gas prices in particular.

Although the GFU/FU scheme was advantageous from a Norwegian point of view, the joint selling of gas through a single body was heavily criticised at the Community level. In June and July 2001, after years of bickering, the Commission initiated formal proceedings against approximately 30 Norwegian gas companies, arguing that the GFU scheme was incompatible with European competition law.[201] The Commission challenged the validity of every gas sales agreement entered into under the GFU regime from 1989 onwards, arguing that the GFU constituted a sales cartel in breach of Art. 81 EC. It should be noted, however, that an undertaking's anti-competitive behaviour constitutes a breach of Art. 81 EC only if that undertaking's behaviour is a result of its private autonomy, rather than because it has been imposed by the state (the "state compulsion" doctrine).[202] Both the gas companies and the Norwegian Government, which intervened in favour of the gas producers, claimed that Art. 81 EC should not be applied in view of the Commission's practice of closing cases as soon as the anti-competitive activities in question had been aborted, since the GFU scheme had been discontinued for sales to the EEA as of June 2001, following the issuance of a Royal Decree of 1 June 2001.[203] It

[201] IP/01/830 of 13 June 2001 (Commission objects to GFU joint gas sales in Norway) and IP/02/1084 dated 17 July 2002 (Commission successfully settles GFU case with Norwegian gas producers).

[202] For a detailed presentation of the state compulsion doctrine, see e.g. Faull & Nikpay, The EC Law of Competition, Chapter 3 Article 81, pp. 217-218.

[203] Under this Royal Decree, the joint selling of gas through the GFU within the EEA was immediately suspended and the GFU dissolved altogether from 1 January 2002, cf. St. prp. nr 1 (2001-2002) Budsjetterminen 2002, Del 5, Pkt 8 Nytt gassforvaltningssystem.

was also argued that Art. 81 EC could not be applied, since the Norwegian gas producers had been compelled by the Norwegian Government to sell gas through the GFU system it had established.[204]

It should be noted that the Commission attacked the system established by Norwegian authorities by making their case against the gas companies directly. In the light of the history, set out above, of the development of an integrated selling regime based on close co-operation between the licensees, the GFU, the FU and the authorities, it should be clear that the Norwegian authorities not only requested the gas producers to develop the GFU/FU scheme for resource management purposes but also took an active part in the system as such. A weakness in the state compulsion defence, however, was the lack of any *formal imposition* of the scheme by the Norwegian authorities.[205] The initial development of the scheme took place without any formal (binding) imposition being made by the authorities.[206] This was sufficient to ensure the establishment of the GFU/FU scheme in close co-operation between the undertakings and the Ministry, due to the Norwegian authorities' tradition of informal management based on the threat of a refusal to award licences in the "next round" if the undertakings did not comply with the authorities' wishes concerning the undertakings' conduct

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[204] For a more detailed presentation of the particulars of the GFU case, albeit from a producer perspective, see Jan Peter Jebsen, The GFU Case, published in Industribygging og rettsutvikling – Juridisk festskrift i anledning Hydros 100-årsjubileum, pp. 131-144. The GFU case is also commented upon in EU Energy Law II pp. 127-131.

[205] Under the case law of the ECJ, a formal imposition by the government in one way or the other seems to be required, cf. Whish pp. 129 with reference to *Aluminium Producers*, OJ [1985] L 92/1. It is not sufficient for the undertakings to fall into line with what they consider the government expects of them, which might be said to have been the case in relation to the GFU.

[206] St. meld. nr 46 (1986-87).

under the licences already awarded. A formal requirement was first imposed 14 years after the GFU was established, with the passing of the Royal Decree of 28 December 2000.[207]

After a comprehensive oral hearing in December 2001, negotiations for an out-of-court settlement were instigated. For the purposes of the settlement negotiations, the gas producers were distinguished into three categories based on their active involvement in the GFU regime. While the permanent members of the GFU constituted a category of their own, the six companies (actually) selling gas through contracts negotiated by the GFU (i.e., ExxonMobil, Shell, TotalFinaElf, Conoco, Fortum and Agip) were placed in a second category. The last group was made up of all the other Norwegian gas producers in respect of whom formal proceedings had been opened. The content and extent of the commitments made under the settlement agreement entered into between the Commission and the gas producers differed between the three categories of gas producers. While commitments had to be made by the first two groups of gas producers as part of the out-of-court settlement,[208] the case was closed under the assumption that gas would be sold individually in the future by the last group of producers.

Both the content and the extent of the written commitments also differed between the categories of gas producers, as the main

[207] This Royal Decree was passed in connection with Norsk Hydro's acquisition of Saga Petroleum in 1999, as the acquisition reduced the members of the GFU from three to two, and basically stated that the GFU scheme should continue with Statoil and Norsk Nydro as the only members, cf., e.g., St. meld. nr. 39 (1999-2000) Olje og Gassvirksomheten, Pkt 5 Gassvirksomheten/pkt 5.4 Det norske gassforvaltningssystemet/pkt 5.4.1 Organisering av gassvirksomheten.

[208] IP/02/1084 dated 17 July 2002, published at http://europa.eu/rapid/pressReleasesAction.do?reference=IP/02/1084&format=HTML&aged=1&language=EN&guiLanguage=en.

commitments were made by Statoil and Norsk Hydro in their capacity as permanent members of the GFU.[209] Accordingly, the commitments made may be divided into two parts. Firstly, and common to both Statoil and Hydro, as permanent members of the GFU, and the gas producers, selling gas under contracts negotiated by the GFU, written commitments to discontinue all joint marketing and sales activities had to be given. According to the settlement agreement, joint marketing and sales of gas were prohibited, but only as far as this was not compatible with European competition law. This means that existing supply contracts have to be individually renegotiated when they come up for review. Secondly, and only affecting Statoil and Norsk Hydro, written commitments had to be given to reserve certain gas volumes for sale to new customers, i.e., customers who in the past had not bought gas from Norwegian gas producers.[210]

Although it was specified that this was not a part of the *GFU case*, Statoil and Norsk Hydro also confirmed in writing that they would not introduce territorial sales restrictions and/or use restrictions in their gas supply contracts. As both types of clause are considered to prevent the creation of a single market, they are considered incompatible with European competition law. Still, such clauses are considered necessary by certain market operators. Thus, the Commission made a point of emphasising that Statoil's and Norsk Hydro's position "demonstrates that gas can indeed be

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209 IP/02/1084 dated 17 July 2002, published at http://europa.eu/rapid/pressReleasesAction.do?reference=IP/02/1084&format=HTML&aged=1&language=EN&guiLanguage=en.

210 The commitments were limited in terms of both volume and time, as Statoil and Norsk Hydro, monitored by external auditors, within a commitment period from June 2001 to September 2005, undertook to offer for sale 13 and 2.2 billion cubic metres (BMC) of gas respectively to new customers on commercially competitive terms.

marketed in the Community without these anti-competitive clauses."

The *GFU case* may be seen as an attack on long-term gas sales agreements as such. As mentioned by way of introduction, despite access to transport infrastructure, competition cannot develop unless there is gas free to be sold in the market.[211] The commitments made by Statoil and Norsk Hydro, to offer gas for sale to *new customers* over a period of approximately four years, clearly address the need for liquid markets. Both the Commission's approach and the commitments made to ensure the settlement of the case suggest that the aim of the case was broader than breaking up the sales cartel. Not only did the Commission attack the gas sales agreements entered into by gas producers from 1989 onwards, but it continued the proceedings even after the dissolution of the GFU, in breach with its own practice. In particular, the commitments accepted by the Commission as part of the (out-of-court) settlement, substantiate that the *GFU case* must be seen in to the context of the liberalisation efforts reflected in the Gas Directive and the Gas Transmission Regulation. The arguments put forward by the Commission in favour the commitments accepted to a great extent confirm this interpretation of the *GFU case.*[212] When accepting the commitments on the volumes for new customers, the Commission noted that a significant number of European customers (most

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[211] This is not the official interpretation though, see EU Energy Law II p. 159, where it is stated that the GFU case and the DONG/DUC case illustrate that the Commission was ready to leave the past alone (i.e., by *not* unravelling existing long-term gas contracts) in exchange for the possibility to develop gas-to-gas competition through the sales of some amounts of gas to customers other than the traditional clients.

[212] IP/02/1084 dated 17 July 2002, published at http://europa.eu/rapid/pressReleasesAction.do?reference=IP/02/1084&format=HTML&aged=1&language=EN&guiLanguage=en.

prominently large industrial users, electricity producers and new trading houses) were known to have actively looked for alternative sources of supply in the past and continued to do so today. It was thus argued that these commitments would facilitate the establishment of new supply relationships. It was further underlined that such new supply relationships should also have a positive impact on the European market structure, which is still characterised by dominant suppliers in almost all markets. It was noted that most of these dominant suppliers were already customers of the Norwegian gas companies and had bought significant gas volumes under existing contracts, which still had many years to run and which, in general, contained price review clauses.

This interpretation is supported by the fact that the Commission applied a similar approach in the *DONG/DUC case*[213]. The investigation by the Commission's Competition Directorate General (DG Competition) of the joint marketing of North Sea gas by the parties to the Danish Underground Consortium (DUC) started in July 2001. The DUC, which accounts for 90% of Danish gas production, is composed of Shell (46%), A.P Møller (39%) and ChevronTexaco (15%). The investigation also concerned certain aspects of the supply relationship between DUC and DONG, as established in Gas Sales Agreements in 1979, 1990 and 1993 between DONG and each of the DUC partners. By means of these contracts, the DUC partners sold DONG enough gas to satisfy the entire Danish demand and to supply additional volumes to Sweden and Germany.

The antitrust investigation involving the incumbent Danish gas supplier DONG and the country's main gas producers, Shell, A.P Møller and ChevronTexaco, was settled after the latter committed

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[213] IP/03/566 of 24 April 2003 (Commission and Danish competition authorities jointly open up Danish gas market).

themselves to market their production individually and to offer gas for sale to new customers over a five-year period.[214] The outcome of the *GFU case* was used to support the Commission's legal position as well as to supply a model for the out-of-court settlement reached in the *DONG/DUC case*.

As the Gas Supply Agreements had been notified to the Danish Competition Authority, the Commission (initially) focused its attention on the joint marketing arrangements and the DUC's understanding that the scheme was covered by EU Regulation 2658/2000, which exempts certain forms of joint distribution (so-called Specialisation Block Exemptions). DG Competition disagreed with the parties' assessment and, following the example of the Norwegian gas companies in the *GFU case* (IP/02/1084 of 17.7.2002), the DUC partners – whilst maintaining their legal position – agreed to cease their joint marketing arrangements and to market their gas individually in future.

In summary, the Commission has thus far *not accepted* arguments put forward to justify joint selling or joint marketing schemes. As we have seen, the Commission did not place any significance whatsoever on the fact that the GFU regime was motivated by resource management considerations. Similarly, in the *DONG/DUC case* the Commission dismissed a defence based on block exemptions.

6.2.3 The gas volumes of the Norwegian state

Under the current CBS regime, joint selling (of gas volumes which technically stems from several fields) still takes place in one

[214] The DUC partners agreed to offer a total of 7 BCM of gas for sale to new customers over a five-year period starting 1st January 2005, or earlier if possible, i.e., when new gas volumes were available. On an annual basis, this corresponded to approximately 1.4 BCM, i.e., 17% of the total production of the DUC partners.

particular situation, i.e., the sale of the gas volumes (or rather; the produced petroleum) belonging to the Norwegian State.

The Norwegian State participates directly as well as indirectly in the petroleum activities. The State retains an interest when production licences are granted. The State`s interests are owned by the State´s Direct Financial Interest (SDFI) and managed by Petoro AS, which is fully owned by the State. However, Petoro does not market and sell the SDFI petroleum produced. Instead, StatoilHydro ASA is responsible for the marketing and selling of the State`s oil and gas.[215] StatoilHydros obligations in this respect is regulated by (Avsetningsinstruksen), which sets pricing principles for transfer of the income from SDFI, and audited by Petoro AS.

This means that the gas volumes of the Norwegian State is a part of the portfoilio marketed and sold by StatoilHydro. One might ask whether the joint marketing and selling of the Norwegian State`s gas is in breach of the prohibition against joint selling. However, the Norwegian State, SDFI and StatoilHydro form a single economic entity. The State, represented by the MEP, is the "parent company" for both SDFI and Petoro AS. Furthermore, the State is a majority owner of the shares in StatoilHydro.[216] This is intentional[217], as it means that the single entity doctrine applies to this sales arrangement.[218] According to this doctrine, Art. 81(1) EC does not apply if the undertakings "form an economic unit within

[215] For a further presentation of the relationship between the two companies, see e.g Eva Kantanen, Petoro – partner og verdiforvalter. En rettslig analyse av den nye forvalterordningen for SDØE, MarIus 304, pp. 54-63.

[216] The State currently holds 62,5 percent of the shares in StatoilHydro, but has ambitions to increase its shares to 67 percent.

[217] The other commercial interests of the Norwegian State is managed by the Ministry of Trade and Industry.

[218] For a detailed presentation of the single entity doctrine, see e.g. Faull & Nikpay, the EC Law of Competition, Chapter 3 Article 81, pp 206-208.

which the subsidiary has no real freedom to determine its course of action on the market, and if the agreements and practices are concerned merely with the internal allocation of tasks as between the undertakings."[219] In other words, companies within the same corporate group are not considered to have independent decision-making rights (i.e., to enjoy real autonomy) when the parent company has a majority shareholding in its subsidiaries. Concequently, the joint sales of the oil and gas of the Norwegian State are not caught by Art. 81(1) EC.

6.3 Joint selling from a single field – illustrated by the Britannia case and the Corrib case

6.3.1 Overview

As previously mentioned, the introduction of an individual sales regime and a meshed transport network allow the producers to sell their gas where it is most profitable. Portfoilo considerations is decisive. Still, joint selling from *a single field* might still be considered desirable under certain conditions. Above (in part **6.1**), two situations was mentioned. Firstly, in relation to marginal fields. Secondly, in relation to the development of LNG-projects.

In the same way as joint marketing and selling from several fields, joint selling from a single field is, in principle, prohibited under Art. 81(1) EC. The general policy of the Commission is *not to tolerate* joint selling, unless compelling reasons are provided to justify it.[220] This has been the conclusion in both the *Britannia* and

[219] Case 30/87 Corinne Bodson, ECR [1988] 2479.

[220] Cf. the statement made by then Commissioner Mario Monti in relation to the closure of the *Corrib case*, IP/01/578 of 20 April 2001 (Enterprise Oil, Statoil and Marathon to market Irish Corrib gas separately).

Corrib cases[221]. However, these cases also illustrate that joint selling from a single field might be justified in special circumstances. Based on the case material available, a distinction can be drawn between fields that are deemed commercial (part **6.3.2**) and fields that are marginal (part **6.3.3**).

6.3.2 Commercial fields

The existing case material, i.e., the *Britannia*[222] and *Corrib cases*[223], relates to fields deemed commercial. In accordance with the Commission's general policy not to tolerate joint selling unless compelling reasons are provided as a justification, these cases illustrate how an overall evaluation based on the specifics of each case is conducted. At the same time, these cases prove that, at least in relation to commercial fields, economic and financial considerations are generally not considered relevant as an objective justification and thus as grounds for an exemption under Art. 81(3) EC.[224]

6.3.2.1 The Britannia case

The Britannia field is located centrally on the Continental Shelf of the United Kingdom ("UKCS"). At the time of notification, the field was owned by Amerada Hess Ltd, Chevron UK, Conoco (UK) Ltd, Conoco Petroleum Ltd, Phillips Petroleum Company United Kingdom Ltd, Texaco North Sea UK Company, Santa Fe Exploration

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[221] IP/01/578 of 20 April 2001 (Enterprise Oil, Statoil and Marathon to market Irish Corrib gas separately).

[222] Case No. IV/E-3/35.354 – *Britannia gas condensate field* (Notice pursuant to Art. 19(3) of Regulation 17) OJ [1996] C291/10.

[223] IP/01/578 of 20 April 2001 (Enterprise Oil, Statoil and Marathon to market Irish Corrib gas separately).

[224] This substantiates the findings in the GFU and DONG/DUC cases.

(UK) Ltd and Union Texas Britannia Ltd. The gas reserves of the Britannia field itself were deemed considerable.[225]

The field owners had entered into an agreement for joint marketing and selling.[226] The gas volumes were sold in the market for forward gas, i.e., the market for future deliveries of natural gas from producers at the wholesale level. According to this agreement, the field owners were to designate one of the owners to negotiate sales agreements with potential purchasers on behalf of the production joint venture as such. Each field owner still had the right to participate in the negotiations. The negotiator's authority was limited, as it could not act to bind the other field owners legally.[227] Based on the concerted negotiations, each field owner entered into separate gas sales agreements with the purchasers in accordance with its participating interest in the field. The field owners' motivation for establishing the joint marketing scheme was not explicitly specified (in the notification published by the Commission). Based on the facts of the case, however, the main reasoning behind the scheme seems to have been to strengthen the bargaining power of the gas companies in general and to facilitate the investments necessary to develop the field through generating as high an income as possible.

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225 The reserves were estimated at 2.3 BCM, which at peak production (in the period between 1998-2004) would mean a daily production of 740 MCM or an annual production of 7.4 BCM.

226 This agreement was in force between 1992 and 1994. Based on this agreement, joint sales agreements between the field owners and purchasers were entered into between July 1994 and December 1994.

227 Each field owner had the right to be informed and to give instructions during the negotiations. Each field owner could veto the gas sales agreements negotiated. Each field owner could also withdraw from the joint sales regime and offer its share of the gas individually on the market in competition with the other gas owners.

The joint marketing and selling scheme was notified to the Commission. The field owners applied for an exemption under Art. 85(3) EC (now Art. 81(3) EC), as well as a negative clearance in accordance with Art. 2 of Regulation 17/62. Although a negative clearance was granted, the Commission clearly had a negative attitude to the joint marketing and selling scheme as such. After having examined possible competition concerns, however, the Commission accepted the agreement. The Commission found that the agreement between the field owners was not in breach of Art. 85(1) EC (now Art. 85(1) EC) as it was considered *not to have an appreciable effect* on the trade between Member States.

The effect of the agreement was evaluated on the basis both of its duration and the market conditions during the period when the agreement was in effect. Of vital importance in this respect was the Commission's conclusion that the UK and the Continental European markets constituted separate markets due to the lack of transportation means between them.[228] The Commission noted that there was no Continental competitor present in the UK forward sales market. Similarly, it noted that gas from the Britannia field could not have been forwarded to the European market via the UK market due to the lack of infrastructure and uncertainty concerning future infrastructure. This line of reasoning might be considered questionable, as the UK Interconnector, linking the UK with the Continent, was being planned at the time. In any event, as this interconnector now is in place, and given today's liberalised market, one could hardly expect a similar line of reasoning, or a

[228] The pipeline to Ireland was explicitly disregarded. It was pointed out that, in addition to the limited capacity of this pipeline, it was only meant to ensure security of supply in the case of disrupted production in the Irish market.

similar result, today.[229] This is, to a great extent, confirmed by the Commission's line of argument in the *Corrib case*.

6.3.2.2 The Corrib case

The Corrib gas field is located off the west coast of Ireland[230] and is owned by three oil and gas companies, Enterprise Energy Ireland Limited, Statoil and Marathon. The field was declared to be commercial. However, the field owners applied for an exemption under Art. 81(3) EC to market gas produced from the Corrib field *jointly* for the *first five years* of production. It was argued that joint marketing would be *necessary to counterbalance* the purchasing power of the incumbent Irish energy companies.[231]

Whilst recognising the strong market position of the purchasers, the Commission raised competition concerns. In particular, it questioned *whether joint marketing* would bring about such *economic benefits* as were required under Community competition law. In this regard, the Commission took into account the fact that an increasing number of gas consumers would become "eligible", i.e., free to choose between suppliers, due to the ongoing liberalisation process. At the time, only power generators and energy-intensive industrial consumers were considered eligible in the Irish market. However, the Commission noted that the Irish customer-based power market was particularly likely to continue its rapid growth and thus offer *potential* sales outlets for gas suppliers. In other words, the ongoing liberalisation process was crucial to the

229 Reference is made here to the account of relevant gas markets in part 4.3.

230 The Corrib gas field is of particular importance as it will be Ireland's only indigenous gas field following the depletion of the field at Kinsale in the next few years.

231 These are Bord Gais Eirean (BGE), the state owned-gas company, and the Electricity Supply Board (ESB), the state-owned electricity company that uses large quantities of gas for electricity production.

result. One might say that the Commission, in its evaluation, placed emphasis on the need for a liquid market in order to support the ongoing liberalisation process. In doing so, the Commission based its decision on long-term considerations. Under the Gas Directive, Ireland was under a formal obligation to fully liberalise its gas market by 1 July 2007.

Because of the objections raised by the Commission, the field owners in the end withdrew their application for an exemption in respect of their joint marketing of the Corrib gas. As they had refrained from actually implementing the joint marketing arrangements, the Commission closed its investigation in the wake of their withdrawal.

6.3.2.3 The development of LNG-projects as a particular case

As regards the activities on the NCS, the possibility of joint selling might be decisive for the development of LNG-projects that are located far away from the markets. Provided joint marketing and selling is deemed necessary to carry out the project as such, one might argue that the block exemptions in the Regulation 2658/2000 on specialisation agreements apply. However, whether this will be considered to be the case is highly uncertain. Therefore, it is more likely that the licencees will chose to establish a full function joint venture (i.e., covering both production and sales) and notify this to the Commission under the EC Merger Regulation (EMCR)[232], which permits full function joint ventures for the production and sale of natural gas unless they will "significantly impede effective competition, in particular as a result of the creation of strengthening of a dominant position". The question of setting up

[232] Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (the EC Merger Regulation)

full function joint ventures as an alternative to joint selling will not be developed further here.

6.3.3 Marginal fields

Although the Commission has clearly stated that joint selling is prohibited under Art. 81(1) EC, it has implicitly accepted the necessity of joint sales under certain conditions. It is expressly stated that compelling reasons for justification need to be provided. However, it is uncertain what circumstances (in the Commission's view) will qualify.

In this context, (so-called) marginal fields deserve particular attention. As the NCS is relatively mature, many of the new fields being located are so-called marginal fields. The development of all petroleum reserves depends upon the cost of development and production in relation to the price available for the produced petroleum in the sales market. However, the term "marginal fields" is used to describe fields where the cost/benefit ratio of development is marginal and the return on investment is thus particularly vulnerable to price fluctuations. In other words, the cost profile of these fields is such that oil companies will not make the necessary investments unless they have a guarantee that the gas produced will be sold and, furthermore, sold at a price that justifies the development. Furthermore, as the reserves on these fields are (often) relatively modest, a stable and continuous withdrawal of gas is necessary to maintain efficient operation. The lack of flexibility in production from marginal fields implies that each licensee's individual portfolio considerations cannot be taken into consideration when selling the gas produced. Thus, it has been argued that the development of such fields may depend on the joint marketing and selling of the field's gas reserves.

Although it is clear that the Britannia gas field was deemed commercial, the particulars of the *Britannia case*[233] are of special interest for identifying compelling reasons to justify joint marketing and selling, both in general and in relation to marginal fields in particular. Two lines of reasoning may be identified.

One possible approach is the "appreciable effect on trade" defence under Art. 81(1) EC.[234] As mentioned above, negative clearance was granted by the Commission in the *Britannia case,* as no appreciable effect on trade could be established.[235] Whether a particular agreement will have an appreciable effect on trade will depend on an overall evaluation based on the specifics of the case in question.[236] Under the *de minimis* doctrine, the Commission has established market share thresholds to determine what is not to be considered an appreciable restriction of competition under Art. 81 EC.[237] However, this negative definition of appreciability does not imply that agreements between undertakings which exceed the thresholds will appreciably restrict competition.[238] In other words, the concept of appreciability and the concept of market power are not synonymous.[239] In the *Britannia case,* the lack of both an actual and (because of uncertainties concerning its construction) potential (future) transport infrastructure prohibiting both the potential establishment of a Continental competitor in the British market

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233 Case No. IV/E-3/35.354 – *Britannia gas condensate field* (Notice pursuant to Art. 19(3) of Regulation 17), OJ [1996] C291/10.

234 For a presentation of the "appreciable effect on trade" criterion, see e.g. Faull & Nikpay p. 227 et seq and p. 250 et seq.

235 Case No. IV/E-3/35.354 – *Britannia gas condensate field* (Notice pursuant to Art. 19(3) of Regulation 17), OJ [1996] C291/10, part [6].

236 For further details, se e.g. Faull & Nikpay p. 227 et seq and p. 250 et seq.

237 Faull & Nikpay pp. 250-251.

238 Faull & Nikpay p. 251.

239 Faull & Nikpay p. 251.

and the sale of Britannia gas on the Continental market, was crucial when determining that the agreement had no appreciable effect on the trade between Member States.[240] As the gas markets gradually become more integrated, it could be argued that lack of transport infrastructure could be expected to be a less effective argument in today's market. In relation to marginal fields in particular, it could perhaps be asked whether the gas volumes in question (i.e., limited gas volumes) might be relevant in the evaluation of appreciability. Under a portfolio based regime, however, it is the volumes in the portfolio of each licensee and not the share of the volumes from a single field that is considered decisive.

The second possible approach is the "necessary to develop" defence under Art. 81(3) EC. While the particulars of, and the reasoning in, the *Corrib case* make it clear that joint selling in order to establish an equal bargaining position between sellers and buyers of gas is not considered a compelling reason for justification, the Commission's reasoning in the *Britannia case* still allowed for joint selling in order to ensure the development and utilisation of the located reserves. The *Britannia case* dealt with the market for the supply of natural gas from producers to buyers at the wholesale level (so-called forward gas). In this particular market, the producers compete to sell their *potential production* to buyers, i.e., the development of production at a field and the sale of the produced gas for delivery at a time in the future.[241] Although it was not explicitly stated in the Commission's communication in the *Britannia case*, that joint selling from the field was necessary for

[240] Case No. IV/E-3/35.354 – *Britannia gas condensate field* (Notice pursuant to Art. 19(3) of Regulation 17), OJ [1996] C291/10, part [6].

[241] Case No. IV/E-3/35.354 – *Britannia gas condensate field* (Notice pursuant to Art. 19(3) of Regulation 17), OJ [1996] C291/10, part [5].

the development of the field seems (based on the context of the case) to have been an underlying argument on the part of the field owners. It is clear that the Commission in the *Britannia case* found that the objective (i.e., the development of the field as such) could be achieved in other ways than joint selling, although in what way was not explicitly stated. This follows from the fact that the Commission pointed out that each licensee could withdraw from the joint marketing and selling scheme at will and that the sales contracts, although jointly negotiated, were entered into by the field owners individually.[242] Although not accepting this line of defence in the *Britannia case* as such, the Commission did not rule out this line of argumentation as irrelevant.

However, under current the portfolio sales regime and a sufficiently meshed network in place on the NCS, the "necessary to develop" line of defence will only be possible to invoke in a very limited number of cases. A prerequisite for such a defence to under a portfolio based regime, is that portfolio considerations can not be made in relation to the individual licencees.[243] This will only be the case where the licence group consists of smaller producers which recently have established themselves on the NCS and thus do not have interests in a (sufficently) broad range of fields to have the necessary flexibility.

Even though protfolio considerations do not apply and a "necessary to develop" defence thus might seem to be relevant at

[242] Case No. IV/E-3/35.354 – *Britannia gas condensate field* (Notice pursuant to Art. 19(3) of Regulation 17), OJ [1996] C291/10, part [4].

[243] One might also argue that smaller producers without a portfolio or a portfolio combination which allows flexibility might not only be interested in selling joinly from a singe field but also from several fields. This would be the case where joint selling from several fields would be necessary to achieve large enough gas volumes in order to enter the sales market. However, this is not very practical.

the first glance, the mere existence of a marginal field as such is not, in itself, sufficient. Apart from substantiating that joint selling is necessary based on the specifics of the case, the criteria in Art. 81(3) EC must be fulfilled. According to Art. 81(3) EC, the agreement must contribute to improving the production or distribution of goods or contribute to promoting technical and economic progress. Furthermore, consumers must receive a fair share of the resulting benefits. The evaluation of these criteria, which are particularly important, is illustrated by the *Corrib case*. In relation to the *Corrib case*, the Commission focused particularly on whether joint marketing would bring about economic benefits as required under Community competition law. The conclusion was negative. When it can be determined that joint selling is decisive for the development of a marginal field, it could be argued that economic benefits will necessarily be a direct result of the agreement on joint selling. Still, as the consumers are required to benefit from the development as well, it has to be considered whether, and in what way, this could be said to be the case. If the joint selling based on the specifics of the case can still be said to result in economic benefits of which the consumers receive a fair share, there is an additional criteria that the restrictions must be indispensable to the attainment of these objectives. In other words, proportionality considerations will be important under such a line of defence. And last, but not least, the agreement must not afford the parties the possibility of eliminating competition in respect of a substantial part of the products in question.[244]

Thus, in practice, joint selling has not been an issue in relation to the marginal fields on the NCS. Instead, it is not uncommon that smaller producers active on the NCS sell their gas volumes to larger

[244] Here, again, the gas volumes in question might come into play.

ones. Thus, concerted buying practices will be examined further in the following (part **6.4**).

6.4 Indirect joint selling: A producer's buying of forward gas from other producers

6.4.1 Overview

As mentioned above, the buying of gas by one or more producers from other producers is a not uncommon feature of the activities taking place on the NCS. The reasons for such buying may differ. First, concerted buying for production purposes (i.e., the buying of injection gas) does occur. Next, buying for resale purposes commonly takes place.

An undertaking's buying of gas from its competitors might raise competition concerns. This is because this situation resembles joint sales, as the gas volumes will ultimately be offered to the market through the same sales channel and at a single price.

In light of the context of this article, only (single) buying for resale purposes will be discussed further. The buying of forward gas typically takes place in two different situations. As mentioned above, in relation to the definition of relevant gas markets (in part **4.4.2.2**), the term forward gas is used in relation to the future delivery of gas from producers to the wholesale level (cf. the *Britannia case*[245]). Firstly, gas volumes might be bought in order to fulfil obligations under existing gas sales agreements entered into by a producer (part **6.4.2**). Secondly, such buying might take place in relation to later forward sales (part **6.4.3**). The main difference between these situations is, in other words, whether or not the gas

[245] Case IV/E-3/35.354 – *The Britannia Gas Condensate Field* – Notice pursuant to Art. 19(3) in Regulation 17, OJ [1996] C291/10.

volumes are bought in order to fulfil contractual sales obligations the producer *has entered into* before or at the time of buying.

As far as I have been able to determine, neither the ECJ, nor the CFI nor the Commission have dealt with this question in their case law. Thus, these situations must be assessed on the basis of the wording and objectives of European competition law and considered in the light of the Commission's view on joint selling (as described in part **6.2** and part **6.3** above).

6.4.2 Buying in order to fulfil the producer's own delivery obligations

The fulfilment of the delivery obligations of the producers active on the NCS is partly based on the buying up of forward gas in the upstream market. Under a system of portfolio sales, the gas undertakings enter into contractual obligations based on the estimated production from each licence at a given time in the future. These estimates may not be achieved, either because of stops in production due to maintenance or other situations that could not have been foreseen. Thus, in order to avoid being in breach of the gas sales agreements entered into, the buying of external gas might prove necessary to fulfil delivery obligations under existing contracts.

It is clear that the *objective* of single buying in these cases is not to restrict competition as prohibited under Art. 81(1) EC. The question remains, however, whether such purchases may still have a restrictive *effect* on competition and thus be in breach of Art. 81(1) EC. In this respect, a crucial factor would seem to be whether the gas volumes are purchased at market price. If so, the cost profile of the producers' gas portfolios will continue to differ, thus allowing for competition on price between the gas producers. In other words, provided the price risk is located with the buyer of the gas volumes, *ad hoc solutions* could be expected to be accepted

under European competition law. However, more fixed delivery solutions between certain producers will need to be evaluated further, taking into account the specific market conditions.

6.4.3 Buying for later forward sales

These situations are characterised by the fact that the gas volumes are not bought to fulfil existing contractual obligations, but in order to be resold in the product markets upstream or downstream at a later point in time. In other words, such buying may more easily be said to have the objective or effect of restricting or distorting competition, cf. Art. 81(1) EC.

That having been said, buying for later forward sales may be considered justified under certain conditions. The main question is whether the sellers have sufficient market power to influence gas prices in the market.

Buying for later forward sales does not seem to be a particularly common feature on the NCS. However, such practices may still occur in two situations.

Buying for later forward sales is of particular interest in relation to associated fields, i.e., fields with both oil and gas. As production of associated gas depends on the oil production, it is normally not possible to achieve a commercial production profile for associated gas volumes alone. Due to the portfolio regime on the NCS, however, this only holds true where the licencees do no have portfolios or the composition of their portfolios does not allow for the necessary flexibility. In these cases, production from associated fields may depend on the existence of larger fields that "swing" their production in line with the production of the associated fields. The bargaining position of sellers of associated gas is normally quite weak. The sellers have to get rid of the gas volumes in question, but the burning of the gas volumes – as an alternative to the sale of the gas – requires a special permit. Consequently, it has been argued

that the sale of associated gas through a joint sales channel is not likely to affect the market.[246]

Buying for later forward sales is not limited to the situation of associated fields. Purchasers may be interested in larger volumes than a producer can provide based on its production portfolio. It seems to be expected that such volume issues can, and will, be resolved by the aggregation of gas, either within the group of producing companies or through selling to a bigger producer.[247] The sales organisation of the first seller may be of importance when evaluating the competitive constraints of a producer's buying of gas volumes for later forward sales. To the extent that the producer (initially) selling the gas volumes lacks a sales organisation, it might be said that it was not likely to compete in the market anyway. This argument may apply to the situation on the NCS.

Traditionally, the gas undertakings granted licences on the NCS have typically been major companies, with experience from production of oil and gas globally and with great financial strength. While this is still the case, the number of smaller gas undertakings participating in a few licences and, thus, with rather restricted gas portfolios, has increased over the last couple of years. Depending on the degree of maturity of the different areas, there is some variation in the types of challenges faced in realising the commercial potential of (the undiscovered) resources of the NCS.[248] This is reflected in the awarding of licences by the Norwegian authorities. While only undertakings with broad-based experience, technical and geological expertise and strong finances are considered capable of exploring for, and developing, resources in frontier areas, smaller undertakings are increasingly granted

[246] Boge p. 40.

[247] EU Energy Law II p. 158.

[248] Facts 2007 p. 26.

licences in more mature areas with well-known geology and well-developed and/or planned infrastructure. Consequently, the organisation and the professionalism of these different categories of gas undertakings is bound to differ.

The limited gas portfolios of some of the smaller undertakings active on the NCS may be a practical barrier to trade for these companies. On the NCS, the location of the field, and the infrastructure developed in the area where the field is located, may be decisive for the undertaking's market prospects. If the pressure in the field is insufficient, the gas undertaking may not be able to fulfil the technical requirements for the use of the network infrastructure (the "ability to use" requirements). Norwegian gas is either sold to the UK or to the Continent, and gas prices in the two markets differ. While the margins in one market may not commercially justify the production and/or lifting of gas for one producer, the composition of another producer's gas portfolio, and thus possibilities for gas swapping, may allow that other producer to sell the gas volumes in question.

Still, as with the case of buying in order to fulfil existing delivery obligations, the location of the price risk may be of importance. The question to be assessed is whether the competition constraints will vary depending on whether the purchase price in the gas sales agreements between the producers is dependent on, or independent of, the forward gas sales price.

6.5 Summary

Based on the above analysis, it can be concluded that, as a general rule, joint selling, as well as practices with similar effects to joint selling, are prohibited under European competition law. Due to the introduction of a company based sales regime, the question of joint selling, whether from several fields or a single field, is of little practical importance in relation to the activities on the NCS.

However, in the rare situations where portfolio considerations do not apply, as has been shown above, exemptions may be granted. Compared to this, the buying of other producers gas in order to fulfil current or future delivery obligations, is of far greater importance under a portfolio based sales regime. As shown above, this kind of practice stays clear of the prohibition in Art. 81(1) EC provided the price risk is placed with the buyer.

7 Conclusions

In general, the provisions of the EC Treaty apply to the Member States and restrict their freedom of action. The competition rules differ as they apply to, and regulate the conduct of, the undertakings active in any market. The above presentation of the organisation of the gas sales regime on the NCS highlights the fact that the competition rules are of great importance, both for the Norwegian authorities and the undertakings active in the gas industry.

While the analysis has shown that the gas sales regime is organised in a way that in general is not in breach of Art. 81 EC, or is likely to give incentives for behaviour in breach of Art. 81 EC, it also illustrates that it is important that both the authorities and the gas undertakings are aware of and address these questions when designing the regulatory framework and/or conduct business within that regulatory framework. Not only are the Norwegian authorities obligated to implement all measures necessary to fulfil their obligations under the EEA Agreement, but they must also refrain from implementing measures endangering the objectives of the EEA Agreement.[249] To the extent that the Norwegian authorities pass legislation or other measures in breach of the provisions of the EEA Agreement, including the competition rules, Norway may be

[249] Art. 3 EEA.

brought before the EFTA Court.[250] More importantly, as illustrated by the presentation above, the gas undertakings may be held directly responsible. Although the scope of the state compulsion doctrine is subject to debate, it is clear, based on the current case law of the Community institutions, that this doctrine will only assist the gas undertakings in a minority of situations. Thus, the undertakings must themselves ensure that their behaviour does not have an anti-competitive objective or effect in breach of the competition rules. Although the system in general seems to steer clear of the scope of Art. 81 EC, this might change given the facts of a particular situation. Thus, each gas undertaking needs to stay vigilant in order to avoid breaching the competition rules. As the gas sales market becomes increasingly dynamic as the liberalisation process continues, this becomes even more important.

[250] Art. 31 ODA.

Part IX
Legal agenda for the review of the EU emissions trading scheme

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1 Introduction

On 4 May 2007 the contribution of Working Group III to the Fourth Assessment Report of the Intergovernmental Panel on Climate Change (IPCC) was made public. The report reflects the state of scientific research on the mitigation of climate change and, in doing so, assesses options for limiting greenhouse gas emissions.[1]

In particular, the Report underlines the 70% increase between 1970 and 2004 in global greenhouse gas (GHG) emissions. The largest growth in global GHG during this period originated from the energy supply sector, with the growth rate estimated at 145%. This draws particular attention to the contribution of energy intensive industries to global warming, as well as suggesting the most appropriate way of reducing emissions from more diffuse sources, such as transport.

The Report also stresses the role played by mitigation instruments, their variety and dependency on national circumstances. Originating in the USA, the cap-and-trade system is now the major tool of the European Union in its efforts to limit GHG emissions from industry under the EU Emission Trading Scheme (EU ETS), as regulated by Directive 2003/87/EC.[2] The purpose of the scheme is to promote

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[1] Contribution of Working Group III to the Fourth Assessment Report of the Intergovernmental Panel on Climate Change, 4 May 2007. Available at: http://www.ipcc.ch/

This Third Contribution to the Fourth Assessment Report has been integrated in the synthesis report presented on 16 November 2007 by the IPCC scientists gathered in Valencia, Spain. See IPCC, Fourth Assessment Report, Climate Change 2007: Synthesis Report, Summary for Policy-makers, November 2007.

[2] Directive 2003/87/EC of the European Parliament and of the Council of 13 October 2003 establishing a scheme for greenhouse gas emission

reductions in greenhouse gas emissions in a cost-effective and economically efficient manner.

The EU ETS has been operative since January 2005 under a Phase I commitment (2005-2007), which functioned as a learning period. Phase I revealed the complexity of such an instrument and the strategic role of the European Commission in supervising the scheme and ensuring the cooperation of Member States. Before entering Phase II (2008-2012), which coincides with the first commitment period under the Kyoto Protocol,[3] the European Commission has initiated discussions to review the EU scheme both in order to draw lessons from Phase I and to prepare for the international regime post-2012, when the Kyoto Protocol's emissions targets expire.[4]

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allowance trading within the Community and amending Council Directive 96/61/EC (OJ L 275 of 25.10.2003.

3 The Kyoto Protocol to the United Nations Framework Convention on Climate Change (UNFCCC) was adopted in December 1997 and entered into force on 16 February 2005. It completes the UNFCCC by setting legally binding limits on GHG emissions for industrialised countries.

4 To achieve the overall reduction required, emissions will have to be cut to around 5% below the level in the chosen base year (often 1990). This is to be achieved during the Kyoto Protocol commitment period (2008-2012). The post-2012 regime is currently being discussed at the international level, and is first expected to be outlined at the COP13/CMP3 in Bali, Indonesia, in December 2007.

Regarding the overall Kyoto target, see Article 3.1 of the Kyoto Protocol:

'The Parties included in Annex I shall, individually or jointly, ensure that their aggregate anthropogenic carbon dioxide equivalent emissions of the greenhouse gases listed in Annex A do not exceed their assigned amounts, calculated pursuant to their quantified emission limitation and reduction commitments inscribed in Annex B and in accordance with the provisions of this Article, with a view to reducing their overall emissions of such gases by at least 5 per cent below 1990 levels in the commitment period 2008 to 2012.'

On the design of the future international climate change regime, the European Commission expressed its preliminary position in January 2007, as part of the Energy and Climate Package.[5] The 2007 Spring European Council backed the approach proposed by the European Commission which consisted, for the EU, of:

> '[…] [pursuing] in the context of international negotiations the objective of 30 % reduction in greenhouse gas emissions (GHG) by developed countries by 2020 (compared to 1990 levels). This is necessary to ensure that the world stays within the 2ºC limit. Until an international agreement is concluded, and without prejudice to its position in international negotiations, the EU should already now take on a firm independent commitment to achieve at least a 20 % reduction of GHG emissions by 2020, by the EU emission trading scheme (EU ETS), other climate change policies and actions in the context of the energy policy. This approach will allow the EU to demonstrate international leadership on climate issues. It will also give a signal to industry that the ETS will continue beyond 2012 and will encourage investment in emission reduction technologies and low carbon alternatives.
>
> After 2020, developing country emissions will overtake those of the developed world. In the meanwhile, the rate of growth of overall developing country emissions should start to fall, followed by an overall absolute reduction from 2020 onwards.'[6]

Against this background, the European Commission is working on the provisions of the next proposal for the revision of Directive 2003/87/EC. The Commission's Communication entitled *Building a global carbon market*[7] proposes a wide framework for the review,

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5 Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions, *Limiting global climate change to 2 degrees Celsius - The way ahead for 2020 and beyond*, COM (2007) 0002 final, 10 January 2007.

6 Op. cit., p. 2.

7 Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the

insisting on the strategic role played by the EU ETS in achieving the medium- and long-term goal of abatement of GHG emissions. In order to involve the largest possible number of parties in the review process, the Commission has been working within the framework of the European Climate Change Programme (ECCP II),[8] where a temporary Working Group on the review of the EU ETS has been set up ('the ECCP Working Group'). The ECCP Working Group was active from March to June 2007, when it delivered its conclusions. Further consultations conducted by the European Commission on the review of the EU ETS will now take place within the pre-existing ECCP sub-group on emissions trading.

This article presents the central factors that contributed to the use of a market-based instrument for regulating the abatement of climate change at the EU level (2) and underlines the major reasons for reviewing the EU ETS (3). The agenda and components of this review are then described in detail (4), before discussing the significance of the review exercise for the main emitting sector covered under the scheme, i.e., the energy sector (5).

2 Emissions trading as the main instrument of the EU's climate change policy

Under the Kyoto Protocol, the European Community committed itself to reducing its emissions of greenhouse gases by 8% during

Committee of the Regions, *Building a global market – Report pursuant to Article 30 of Directive 2003/87/EC*, COM(2006) 676 final, Brussels, 13.11.2006.

[8] The European Commission launched the European Climate Change Programme (ECCP) in June 2000. It aims to identify and develop all the necessary elements of an EU strategy to implement the Kyoto Protocol. The first ECCP lasted from 2000 to 2004. The ongoing second ECCP was launched in October 2005. See the ECCP website: http://ec.europa.eu/environment/climat/eccp.htm.

the period 2008-2012, compared to its emissions in 1990. This meant that the EU Member States decided to fulfil their Kyoto Protocol commitments jointly, as allowed under Article 4 of the Protocol. The decision was made binding under the so-called 'burden-sharing agreement' comprised in Council Decision 2002/358/EC.[9]

The European Union has decided to use emissions trading as its primary instrument for reducing GHG emissions.[10] This policy orientation was announced by the European Commission in its 1998 Communication dedicated to the way *Towards an EU Post-Kyoto Strategy*,[11] and reaffirmed in the more recent Communication *Winning the Battle Against Global Climate Change*.[12] It should, however, be remembered that emissions trading was first introduced in the USA, which argued for its inclusion in the Kyoto Protocol, and that it is not the EU's sole instrument for bringing about climate change abatement.

In its 2000 *Green Paper on greenhouse gas emissions trading*, the European Commission defined the purpose of the scheme in the following terms:

> 'Emissions trading, whether domestic or international, is a scheme whereby entities such as companies are allocated allowances for their emissions. Companies that reduce their emissions by more than their allocated allowance can sell their "surplus" to others who are not able

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9 Following adoption of Council Decision 94/69/EC (OJ 1994 L 33/11), the European Community became a Party to the UNFCCC and ratified the Kyoto Protocol in 2002. See Council Decision 2002/358, OJ L 130 of 15.05.2002, pp. 1-20.

10 See *Green Paper on greenhouse gas emissions trading within the European Union*, European Commission, COM(2000) 87 final, 08.03.2000, Brussels.

11 *Climate Change – Towards Post-Kyoto Strategy*, Communication from the European Commission, 03.06.1998, COM(1998) 353 final.

12 *Winning the Battle Against Global Climate Change*, Communication from the European Commission, 09.02.2005, Brussels, COM(2005) 35 final.

> to reach their target so easily. This trading does not undermine the environmental objective, since the overall amount of allowances is fixed. Rather, it enables cost-effective implementation of the overall target and provides incentives to invest in environmentally sound technologies.'[13]

At the same time, the European Commission recognised the lack of experience of European countries in relation to the use of such instruments, and proposed a preliminary experimental phase before the international emissions trading scheme commences in 2008 under Article 17 of the Kyoto Protocol.

The review of the EU ETS is based on this preliminary phase of the system's existence. In particular, the exercise aims to assess the provisions of Directive 2003/87/EC of 13 October 2003, which defines the scheme for greenhouse gas emission allowances within the Community. Directive 2003/87/EC entered into force on 25 October 2003 and the scheme became operative on 1 January 2005.

The European scheme is based on the trading of EU allowances, defined as the entitlement to emit one tonne of carbon dioxide equivalent or an amount of any other greenhouse gas, as listed in Annex II to the Directive. The allowance is limited to a specific period of time and is valid only for the purposes of meeting the requirements of Directive 2003/87/EC.[14]

The trading scheme is based on a permit system.[15] Operators of installations carrying out activities listed in Annex I to the Directive (identified as energy intensive and, consequently, emitting large amounts of CO_2) must obtain an emissions permit before entering the scheme. National authorities are responsible for issuing the

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13 See footnote 10, p. 4.

14 Article 3 (a) of Directive 2003/87/EC.

15 According to Article 6.1 of Directive 2003/87/EC, a greenhouse gas emissions permit grants authorisation to emit greenhouse gases from all or part of an installation.

permit, once it has been established that the operator has the capacity to monitor and report emissions from its installation(s).[16] Each Member State will then elaborate a National Allocation Plan (NAP) for each commitment period, describing in detail the manner in which it intends to allocate allowances to the different installations.[17] By 30 April each year, operators of installations covered by the plan must surrender a number of allowances equal to the total emissions from the installations during the preceding calendar year, as verified in accordance with Article 15 of the Directive. Once surrendered, these allowances are cancelled. The ownership and trading of allowances are recorded at a national level, in a national registry, as well as at a Community level, in the Community Independent Transaction Log (CITL), which coordinates the transfers.

3 On the necessity of reviewing the European emission trading scheme

Before entering a new phase of compliance, some adaptations are necessary in order to make the scheme as efficient as possible. 'Efficient' should be understood as meaning simpler, transparent, more consistent, contributing to reductions in emissions, while ensuring European competitiveness, and potentially exportable to third countries in order to build up a larger trading scheme.

Greater legal certainty is also required concerning the scope of application of the scheme. Certain definitions need to be clarified regarding the identification of installations covered by the scheme

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[16] The greenhouse gas emissions permit may cover one or more installations on the same site operated by the same operator.

[17] This is done in accordance with the criteria set out in Annex III of Directive 2003/87/EC.

and new installations entering the scheme. In particular, the allocation procedure has led to over-allocation of allowances by Member States. A consequence of this was the drop in allowance prices following publication of the first emissions data report in May 2005. Over-allocation will ultimately undermine the scheme's credibility and efficiency. This requires the Commission to take a strong line when analysing the NAPs for forthcoming periods and to clarify the method of calculation for the EU emissions cap under the Directive.[18]

Finally, it is of the view of the European Commission services and of the ECCP Working Group shows that 'the most important feature of the EU ETS is to send a strong signal on carbon price.'[19]

4 Items on the agenda: major legal challenges for the review exercise

The mandate for the review of Directive 2003/87/EC was preliminarily set in its Article 30.2 and encompassed 15 pre-identified items. The European Commission set the agenda for the review accordingly, and all topics mentioned in Article 30.2 were discussed by the ECCP Working Group. Nevertheless, the Commission left a wide margin of initiative to the ECCP Working Group's participants.

Based on this agenda, the European Commission identified four categories of issues on which the review would focus, namely:

- **The scope of the Directive** – The revision of the scope of the Directive focuses on the integration of new sectors and gases,

[18] See point 4.2.1. below.

[19] Quotation from Mr. Peter Carl, DG ENV, Final Report of the first meeting of the ECCP Working Group on emissions trading on the review of the EU ETS on the Scope of the Directive, held on 8-9 March 2007. Available on: http://ec.europa.eu/environment/climat/emission/review_en.htm

and the workability of the scheme after such expansion. (4.1)
- **Further harmonisation and increased predictability**. Harmonisation is seen by the ECCP Working Group as the best way of preventing inconsistency and distortion in the application of the scheme by Member States. This also encompasses the harmonisation of cap-setting. The modalities of such harmonisation are however not fixed. (4.2)
- **Robust compliance and enforcement**. This entails the evaluation of current and future tools for compliance, including monitoring instruments and sanctions provided for by the Directive and/or applied by Member States. (4.3)
- **Linking the EU ETS to other existing schemes outside the EU**. Linking is another ambitious proposal announced by the Commission with, in the words of the Commission, Clean Development Mechanisms (CDM) projects working as a 'cement'. (4.4)

The following sections analyse the consequences for each one of these issues of the conclusions of the ECCP Working Group.

4.1 Review of the scope of the Directive

According to the ECCP Working Group, an expansion of the EU ETS to new sectors and gases would further reduce abatement costs and render the scheme more efficient. This applies to both the sectors and the gases covered.

4.1.1 Initial sector coverage

Article 2.1 of Directive 2003/87/EC defines emissions from activities listed in Annex I as covered by the scope of the scheme. These include: power and heat generation; production and processing of ferrous metals; refining of mineral oil; ore, iron and steel processing; the production of building materials (cement, glass and ceramic); and the production of pulp and paper. This original scope of coverage was intended to focus on the so-called 'critical mass', i.e., mainly stationary sources of emissions where large reductions could be achieved and monitored accurately. Under Phase I, approximately

10,800 installations were covered, which represented approximately half of the total EU GHG emissions.[20]

However, during the negotiations, Member States obtained a series of derogations from the scheme that are reflected in the text of the directive. Firstly, a number of sectors that are large emitters are not covered, such as transportation and housing/building. Secondly, Member States can apply temporarily to exclude certain installations under Phase I (the opt-out procedure under Article 27). Thirdly, a 'force majeure' provision may apply under Phase I for the allocation of supplementary allowances, for example, in the case of low winter temperatures (Article 29).

This situation is counterbalanced by Member States' possibility to exceed their obligations by including a wider range of installations. For example, under Phase I, Member States could include within the scheme installations carrying out activities listed in Annex I but operating below the capacity limits referred to in the Annex (Article 24.1). From 2008, national governments will be able to include additional activities, installations and gases than those mentioned in the Annex to the Directive under the comitology procedure.

4.1.2 Towards a streamlined scope of application

'Streamlining the scope of application' has been declared one of the major goals of the review and appears as a *leitmotiv* in the words of the European Commission. Based on the initial sector coverage referred to above, the review aims to clarify certain concepts such as 'combustion installations', which were subject to divergent

[20] Figures from the European Environment Agency, Greenhouse gas emissions trends and projections in Europe 2007, EEA Report No 5/2007, ISSN 1725-9177, p.45. The EEA reports that 2,080 Mt of CO2 emissions rights were allocated to these installations per year and on average emitted 3% less.

interpretations by Member States, thus creating legal uncertainty for participants.

Another point in need of clarification is the treatment of small installations. The ECCP Working Group recognised the specificities of such installations and the higher compliance costs related to the monitoring, reporting and verification of their site emissions. One option identified here is to define small installations by applying a capacity and/or emissions threshold. The opting-out of small installations has to be measured against the employment of alternative instruments, while the possibility of opting in (under Article 24) should be maintained as an effective way of bringing about emission reductions.

The way in which new entrants are treated will also affect the predictability of the scheme and the understanding of its scope of application. The definition of new entrants is provided in Article 3 of Directive 2003/87/EC and covers installations starting operations in the course of a trading period.[21] According to Article 11.3 of Directive 2003/87/EC, new entrants must be given 'access to allowances' by Member States. Provision for a number of allowances to form a 'new entrants' reserve' must be taken into account in the NAP, although the Directive does not detail the procedure for doing so. The 2005 guidance document drafted by

[21] The European Commission has commented on this definition, saying that it puts new installations on an equal footing with existing installations, thereby extending capacity. It added that the definition in relation to an updated permit applies only to the extension of an installation, and not to the entire installation, nor to increased capacity utilisation at an existing installation. See Communication from the Commission on guidance to assist Member States in the implementation of the criteria listed in Annex III to Directive 2003/87/EC establishing a scheme for greenhouse gas emission allowance trading within the Community and amending Council Directive 96/61/EC, and on the circumstances under which *force majeure* is demonstrated, COM(2003) 830 final.

the European Commission on allocation plans for Phase II also provides little information, stating that: 'The Commission considers it premature to draw conclusions and identify best practice with respect to new entrants and closures.'[22] But national rules on new entrants may seriously affect competition in the internal market, and some coordination is required. Three basic options are available to Member States to secure 'access to allowances' for new entrants: 1) allow the installations to buy all their allowances on the market; 2) set aside some allowances for periodic auctioning; or 3) establish a reserve in the NAP from which allowances can be issued to new entrants free of charge.[23]

4.1.3 New sectors evaluated

New sectors are being evaluated for inclusion within the scope of the directive. After energy, transportation represents the second major source of greenhouse gas emissions in the EU.[24] Identical regulatory measures cannot be adopted for all means of transportation and many challenges remain, such as high administrative costs for the monitoring of direct emissions from road and maritime transport.[25]

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22 *Further guidance on allocation plans for the 2008-2012 trading period of the EU Emission Trading Scheme*, Communication from the European Commission, COM(2005) 703 final, 22.12.2005, Brussels.

23 Op. cit., p. 19.

24 European Environment Agency, *Shares by sector in EU-15 greenhouse gas emissions in 2004*, based on EU-15 Member States' greenhouse gas inventories provided before 6 June 2006 in respect of major sources of emissions: 59% energy use (excluding transport); 21% transport; 9% agriculture; 8% industrial processes; 3% waste.

25 The European Commission proceeded to a public consultation at the end of 2007 on the available policy options to internalise the external costs of EU transport use. Based on the result of this consultation, a Commission's policy paper is expected to be published in 2008, with possible legislative

However, progress has been made regarding the inclusion of two specific sectors: aviation and carbon capture and storage.

The plans to integrate the aviation sector into the EU scheme are the most advanced and a proposal for a directive was adopted by the European Commission on 20 December 2006.[26] Under the terms of the proposal, aviation will be brought into the EU ETS in two consecutive steps: from 2011, emissions from all domestic and international flights between EU airports will be covered; one year later, in 2012, the scope will be expanded to cover emissions from all international flights, i.e., to or from anywhere in the world, that arrive at or depart from an EU airport. The European Commission unsuccessfully put forward its ideas for cutting emissions from aviation before the International Civil Aviation Organisation (ICAO) in September 2007. A majority of delegates at the ICAO refused to adopt targets in terms of reduction of aviation emissions.[27]

The European Commission, which is currently working on a regulatory framework for Carbon Capture and Storage (CCS) activities,[28] is evaluating potential interactions between CCS and the EU ETS. The EU ETS might cover the full chain of CCS and credits could be allocated for the quantity of CO_2 emissions avoided. The creation of a new type of credit is envisaged, i.e.,

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proposals. See Consultation Webpage: http://ec.europa.eu/transport/white_paper/consultations/index_en.htm

[26] Proposal for a Directive of the European Parliament and of the Council amending Directive 2003/87/EC so as to include aviation activities in the scheme for greenhouse gas emission allowance trading within the Community, COM (2006) 818 final, 20 December 2006.

[27] See press release from the European Commission, *Europe stands firm on ambitious action to cut Aviation Emissions*, 28 September 2007, IP/07/1420. It concerned the 36th Assembly of the ICAO held in Montreal on 28 September 2007.

[28] See the website of the European Commission: http://ec.europa.eu/environment/climat/ccs/index_en.htm

storage credits, which could be integrated into the allocation plan. The ECCP Working Group generally considered it very important formally to recognise CCS in the EU ETS Directive from the third trading period onwards on an EU-wide basis, rather than relying on an opt-in approach by individual Member States.

4.1.4 New gases

Similarly, and pursuant to Article 2.1 of the Directive, the scheme of Directive 2003/87/EC is theoretically limited to the greenhouses gases listed in Annex II: carbon dioxide (CO_2); methane (CH_4), nitrous oxide (N_2O); hydrofluorocarbons (HFCs); perfluorocarbons (PFCs); and sulphur hexafluoride (SF_6). These six types of gases correspond to those included in the Kyoto Protocol. In practice, the scheme has been preliminarily limited to CO_2, as referred to in the table of activities in Annex I. But N_2O from the production of ammonia and CH_4 from coal mines may be integrated in the near future.

Some trading schemes in other parts of the world already cover other gases than CO_2. In the USA, for example, sulphur dioxide (SO_2) comes within the framework of the Acid Rain Program and volatile organic compounds are covered in Illinois.

The ECCP Working Group concluded here that, with respect to N_2O from the chemical industry, a number of specific issues needed to be considered, of which some could be readily resolved. Some States, like France, anticipate the inclusion of N_2O from the chemical industry in their NAPs notified to the Commission for Phase II. The ECCP Working Group took a favourable view of opt-in in respect of new gases, while arguing in favour of coordination between Member States in order to prevent distortion of competition.

4.2 Further harmonisation and increased predictability

4.2.1 Strengthening predictability in relation to the allocation procedure.

The review of Phase I of the functioning of the EU ETS did reveal divergences and potential distortions in relation to the allocation of allowances under the NAPs. There was also a tendency to over-allocate allowances under Phase I.

Under Articles 9 to 11 of Directive 2003/87/EC, NAPs play a central role in defining the 'cap' – the quantitative target to be achieved under the trading scheme. This responsibility lies within the competence of Member States, but the NAP is subject to the Commission's approval. The Commission issued guidance documents to assist Member States in elaborating NAPs in accordance with the allocation criteria set out in Annex III to the Directive.[29]

Both Member States and the European Commission have to take responsibility for the accuracy of the cap set and the allocation plans, although they are defending different interests. For that reason, some tensions became apparent between the European Commission and national authorities, in particular in a case brought by the UK against the Commission before the Court of First Instance (CFI).

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[29] See Communication from the European Commission on guidance to assist Member States in the implementation of the criteria listed in Annex III to Directive 2003/87/EC, and on the circumstances under which *force majeure* is demonstrated, COM (2003) 803, and Communication from the European Commission on *Further guidance on allocation plans for the 2008 to 2012 trading period of the EU Emission Trading Scheme*, COM(2005) 703, 22.12.2005.

In *UK v. Commission* (T-178/05),[30] the Court pronounced on the conditions under which a Member State could modify the NAP notified to the European Commission. The UK had notified its NAP for the period 2005-2007, stating that it must be considered as provisional, due to ongoing data revision work. During a preliminary examination of the UK NAP as notified, the Commission qualified the notification as incomplete on two grounds: lack of information on the way in which new entrants would be able to begin participating in the Community scheme; and lack on information concerning installations located within the territory of Gibraltar.[31] The Commission required amendments to be made accordingly to the UK NAP by 30 September 2004, a deadline that the British government was unable to comply with, as data revision work was still ongoing. On the basis of this revision work, the UK expressed on 10 November 2004 its wish to notify its pre-notified NAP and proposed an increase in the total quantity of allowances to 756.1 million tonnes of CO_2. The Commission stated these amendments to be 'inadmissible' and, by its Decision of 12 April 2005, rejected the UK NAP.[32] On the basis of both the general structure and the objectives of Directive 2003/87/EC, the Court of First Instance found that the Commission had made an error of law in declaring the amendments proposed by the UK to be inadmissible. This was firstly because the Commission could not restrict a Member State's right to propose amendments, or categories of amendments (a different question to that of the compatibility of the NAP with the criteria of Annex III of the Directive), after the NAP had been

30 Case T-178/05, *United Kingdom v. European Commission* [2005] ECR II-0000.

31 Decision C (2004) 2515/4 final of 7 July 2004 concerning the national allocation plan for the allocation of greenhouse gas emission allowances notified by the United Kingdom in according with Directive 2003/87/EC.

32 Commission Decision C (2005) 1081 final of 12 April 2005.

notified to the Commission and until its adoption under Article 11.1. The second reason was that the Commission's arguments were contradictory: by previously drawing attention to the omission of installations located on Gibraltar, the Commission had implicitly recognised a potential increase in allowances once such installations were included.

UK v. Commission is not an isolated case and there are other ongoing cases challenging NAPs before both domestic and European Courts.

In *Germany v. Commission* (T-374/04),[33] the issue of ex-post adjustments in the first commitment period is addressed. By its ruling of 7 November 2007, the Court of First Instance annulled the Commission Decision on the first German NAP,[34] in which the Commission argued that ex-post adjustments foreseen by Germany authorities to GHG allowances were incompatible with Community law. At issue was whether a Member State could modify the amount of permits allocated to an installation after the starting of an allocation period, referred to as ex-post adjustments.[35] The

[33] Case T-374/04, *Federal Republic of Germany v. Commission* of 7 November 2007 [2007] ECR-0000.

[34] Commission Decision of 7 July 2004 concerning the national allocation plan for the allocation of greenhouse gas emission allowances notified by Germany in accordance with Directive 2003/87/EC of the European Parliament and of the Council, C(2004) 2515/2 final, 07.07.2004.

[35] In the case of the German NAP for the first allocation period (2005-2007), ex-post adjustments were primary envisaged for: new entrants; new installations operated following a transfer of allowances initially allocated to a closed installation; installations whose production capacity is lower than that initially foreseen; installations whose annual emissions are less than 60% of their base-period emissions; and cogeneration installations producing a smaller quantity of energy than that recorded in the base period. See National Allocation Plan for the Federal Republic of Germany 2005-2007, Federal Ministry for the Environment, Nature conservation and Nuclear Safety. The reasoning behind ex-post adjustments is explained

Commission defended its position in a communication published on the same day, detailing the side effects of ex-post adjustments, and in particular the uncertainty that they could create for operators and why it sees them to be detrimental to investment decisions and the trading market.[36] In the view of the Commission, the directive only allows ex-post adjustments in case of *force majeure* subject to the procedure laid down in Article 29 of the directive. The legality of the contested Commission's decision with criteria 10 and 5 of Annex III to Directive 2003/87/EC is taken as a basis for the CFI's ruling, as well as the overall objectives of the directive. The Court concluded that the Commission has not demonstrated the unlawfulness of the German NAP. In particular, the Commission failed to demonstrate that the deterrent effect of ex-post adjustments linked to falls in production volume is contrary to the objective of maintaining effective and economically efficient conditions as regards the sectors of activity and markets for goods (§138). The ex-post adjustments are not judged contrary to the objective of reducing emissions by means of investment in more energy-efficient technologies within the meaning of recital 20 in the preamble to Directive 2003/87/EC (§142). As well, the Commission failed to demonstrate to what extent ex-post adjustments are contrary to the objectives of preserving the integrity of the internal market and maintaining conditions of competition (§147). The ruling of the CFI also clarifies the implementation conditions of

in the German NAP I as follows: 'The purpose of the ex-post adjustment is to ensure that forecast activity data reflects realistic expectations and is not systematically overestimated in order to obtain a greater allowance.'

[36] Commission Communication to the Council and to the European Parliament on Commission Decisions of 7 July 2004 concerning national allocation plans for the allocation of greenhouse gas emission allowances of Austria, Denmark, Germany, Ireland, the Netherlands, Slovenia, Sweden and the United Kingdom in accordance with Directive 2003/87/EC, COM(2004) 500 final, 07.07.2007, section 3.2.2.

Directive 2003/87/EC and the allocation of tasks and powers between the Commission and the Member States, by saying that the Commission has not demonstrated that criterion 10 of Annex III reduced the Member States' freedom of action to the forms and methods for transposing the directive into national law so as to prohibit application of the ex-post adjustments. The implications of this ruling have however not been clearly assessed for the second period of trading.

Several new Member States have challenged the decisions of the European Commission on their NAPs for the second commitment period. Latvia announced in July 2007 its intention to sue the European Commission after the Commission ordered it to lower its proposed cap for CO_2 emissions for the second period (2008-2012).[37] The Commission proposed a cut from 6.25 million tonnes to 3.43 million tonnes annually. The outcome of these cases is of tremendous importance for confidence in the carbon market, which would potentially be seen as unreliable if the quantities of allowances were further increased.

Most recently, the Court of First Instance rejected Poland's request for a temporary suspension of a cut in its NAP for the second commitment period (2008-2012) before the final ruling of the court on a separate legal action on the validity of the GHG

[37] 'Latvia will litigate over the EC assigned total amount of emission quotas for 2008 – 2012 at court', Press release, Ministry of the Environment, Latvia, 31 July 2007. See precedent suits against the European Commission on NAPs: *Slovak Republic v. European Commission*, T-32/07, action brought on 7 February 2007; *Republic of Poland v. European Commission*, T-183/07, action brought on 28 May 2007; *Czech Republic v. European Commission*, T-194/07, action brought on 4 June 2007; *Republic of Hungary v. European Commission*, T-221/07, brought on 26 June 2007; and *Republic of Estonia v. European Commission*, T-263/07, action brought on 17 July 2007.

limits themselves.[38] Poland failed to prove the urgency of its request and to provide a sufficient level of certainty concerning the economic impacts on the national industry, which was the major argument of the Government. Poland must consequently implement its NAP as amended until the CFI's final decision. Interestingly, the Court recalled[39] that Poland could in any case modify the manner how the allowances are allocated, but not the total amount of them along the allocation period. Nothing prevents Poland from allocating more allowances to certain installations during the first years of the commitment period if, and only if, it is compensated by fewer allowances in the following years, in order to reach a global balance and not affect the total amount of allowances.

4.2.2 Towards harmonisation of cap-setting and allocation procedures

Increased predictability and consolidation of the rules under which the scheme functions would both increase legal certainty and benefit the EU allowances market. Such a goal can only be achieved through a careful analysis of experiences gained under Phase I and the distortions that have so far become apparent. Greater confidence in the EU ETS, through common cap-setting and a transparent allocation procedure, would also contribute to the fostering of exchanges on the market for EU allowances and contribute to the most cost-effective financing of GHG reductions. This, at least, is the rationale for emissions trading as argued for by the European Commission.

The way in which the caps were set under Phase I was

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[38] Republic of Poland v. European Commission, T-183/07 R, action brought on 28 May 2007. Order of the Court of First instance of 9 November 2007.

[39] See two orders of the Court of First Instance, *U.S. Steel Košice v. Commission*, T-489/04 and T-27/07 of 1 October 2007, not yet published.

challenged both by participants in the scheme and national authorities. Participants view harmonisation as a way to strengthen the international dimension of the EU ETS and to create links with other schemes, while national authorities argue in favour of a same level playing field. That cap harmonisation would be a tool to reduce distorting effects and is one of the clearest conclusions of the ECCP Working Group's work. Nevertheless, the question remains how to harmonise cap-setting in practice. Harmonisation by sector was retained as a viable option, in particular with respect to benchmarking.[40] Under Article 10 of Directive 2003/87/EC, at least 95% of the allowances were allocated free of charge by the Member States under Phase I. Under Phase II, at least 90% of the allowances must be allocated free of charge. This means that Member States may auction a maximum of 10% of their allocations under the second NAP. Member States have adopted diverse positions in relation to auctioning and grandfathering for the second phase. The European Commission underlined in some of its decisions the potential competition distorting effects of allocating 100% of the allowances free of charge. An allocation that was totally free of charge would raise State Aids concerns under Article 87 and 88 of the EC Treaty. No clear agreement has been reached so far during the ECCP Working Group's deliberations and there are still divergences in the NAPs.

[40] The ECCP Working Group's conclusions underlined that allocation through benchmarking will require extensive work. In addition, the European Commission invited all industrial sectors to envisage benchmarking, and stressed that ex-post benchmarks are not compatible with the way the EU ETS is conceived.

4.3 Legal compliance and enforcement

4.3.1 The need for harmonised monitoring procedures

Phase I of the EU ETS saw divergent interpretations and implementations of the Monitoring Protocols by Member States. This represents an additional obstacle both to the building of confidence of the actors in the scheme and to linkage with international schemes. The European Commission has recently updated the Monitoring and Reporting Guidelines (MRG) in its Decision 2007/589/EC of 18 July 2007 for the period 2008-2012. But further guidance might be necessary. Harmonisation of approaches to monitoring and the accreditation of independent verifiers of emissions in the form of a regulation have been proposed by the ECCP Working Group, as well as the establishment of a European Agency. As has happened in other sectors, harmonisation of monitoring procedures may lead to centralisation of decision-making processes. The participants in the ECCP Working Group did not oppose such a move, seeing it as a way to prevent distortion and fraud.

According to Article 30 (f) of Directive 2003/87/EC, the review must also consider the relevance of a single Community emissions registry. Under the current scheme, national registries and the Community Independent Transaction Log (CITL) co-exist. The CITL records the issuance, transfer, cancellation, retirement and banking of allowances that take place at the national level. The review exercise underlined two issues in relation to a potential Community Registry: first, whether exchanges of allowances should only be tracked through a single registry for reasons of cost efficiency; and second, whether national registries should first report to an international registry under the UNFCCC infrastructure or to the CITL. Even if transactions between registries were to be facilitated under an international trading scheme, the independence of the EU

scheme is considered crucial, which does not argue in favour of full reliance upon an international registry.

4.3.2 Towards further harmonisation of the sanctions regime

Article 16.3 of Directive 2003/87/EC already provides for a harmonised system of penalties for non-compliance in situations where operators fail to surrender sufficient allowances by 30 April each year in order to cover their emissions for the previous year. The financial penalty is set at EUR 100 for each tonne of carbon dioxide equivalent (EUR 40 during the initial three-year period). This can be considered a real incentive in the light of current carbon prices.[41]

In addition to the common level of penalties, each Member State has adopted domestic rules regarding infringements of the provisions of the Directive, as transposed into national orders. In practice, the level of sanctions varies widely between Member States.[42] Once again, this increases the scheme's inconsistency. The ECCP Working Group concluded on this point that penalties must be included in the revised Directive in order 'to ensure a platform in which Member States could further build upon.' The exact nature of such penalties has still to be established. But any decision on sanctions must be evaluated in the light of the subsidiarity principle and the division of competence between the Community and Member States.

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[41] As a point of reference, the price of the EU allowance oscillated between EUR 21 and EUR 23 in October 2007. See Point Carbon Website: www.pointcarbon.com

[42] See Technical Report of the European Environment Agency, Application of the emissions trading directive by EU Member States, No 2/2006, ISSN 1725-2237, p. 36.

4.3.3 Relationship between the EU ETS and other regulatory tools

The issue of interaction between the EU ETS and other regulatory tools is particularly acute in the context of environmental taxation, which is another way of achieving the goals of the Kyoto Protocol. The taxation of energy products and electricity is regulated at the EC level by Council Directive 2003/96/EC of 27 October 2003, which restructured the Community framework for taxation of energy products and electricity.[43] Energy taxation and emission trading must be seen as complementary tools, but the expansion of the scope of application of the EU ETS may affect the consistency of the taxation regime.

The EU ETS currently applies to emissions from certain combustion and industrial installations, as provided for in Annex I of Directive 2003/87/EC. The Energy Taxation Directive 2003/96/EC applies to energy products and electricity used as motor or heating fuel. It sets a common minimum rate of taxation for motor fuel for private use, motor fuel for industrial or commercial use, heating fuel and electricity across EC Member States. The consequence is twofold: first, emissions from energy intensive installations fall outside the scope of application of the Energy Taxation Directive; second, other environmental and energy components of the same installations are also excluded from taxation. In its 2007 *Green Paper on market-based instruments for environment and related policies*,[44] the European Commission suggested amending Directive 2003/96/EC to divide the Community minimum levels of taxation into two different energy and

[43] OJ L 283, 31.10.2003 p. 51. Last amended by Directives 2004/74/EC and 2004/75/EC (OJ L 157, 30.4.2004, p. 87 and p. 100).

[44] Green Paper on market-based instruments for environment and related policies, COM (2007) 140 final, of 28.03.2007.

environmental elements. This would be mirrored at national level in the form of an energy tax and an environmental emissions tax. In particular, the environmental element would distinguish GHG emissions covered by the EU ETS from other gas emissions. The consequence would be that energy intensive installations would remain excluded from the scope of Energy Taxation Directive to the extent that their greenhouse gas impact is adequately addressed by the EU ETS. Other installations, because smaller and/or exempted from the EU ETS, would be subject to the environmental element of the Energy Taxation Directive. In the same time, energy intensive installations covered by the EU ETS would be subject to the energy based element as well as to other environmental elements. The idea behind this is to ensure the widespread application of the polluter-pays principle.

The ECCP Working Group viewed the exclusion of the environmental impacts addressed by the EU ETS from the scope of the Energy Taxation Directive as a viable solution. It could also contribute to clarifying the potential overlap between the two instruments, while ensuring that the remaining objectives of energy taxation were observed. In the words of the ECCP Working Group, this solution could also avoid difficulties stemming from differences between the EU ETS (that sets a common price across Europe, subject to fluctuations in the carbon market) and energy taxation (where rates differ and reflect the freedom of Member States to set tax rates above the minimum levels). Such an orientation is still to be confirmed and the effects on the scope of the energy taxation directive examined.

It is anticipated that the EU ETS will not be extended to road transport at the expense of current taxation regimes, as this would be environmentally detrimental. As for shipping, it has been confirmed that the European Commission is currently studying three options: 1) the inclusion of shipping in the EU ETS; 2) variations in

harbour dues; or 3) a mandatory CO_2 index limit, which would involve the International Maritime Organisation.

This level of complexity in the review of the European scheme raises additional concerns in relation to expansion through links with third-country schemes.

4.4 Linkage with emissions trading schemes of third countries

Article 17 of the Kyoto Protocol provides for the establishment of an international trading scheme, and encourages trade in emission reductions between the Parties. Such a trade will be facilitated by the International Transaction Log (ITL) which became operational on 14 November 2007.[45] It opens the way to the fusion, or at least the linking, of national or regional schemes.

A first and obvious observation is that, in order to link emission trading schemes, they must be relatively similar in their objectives, scope and the rules under which they function. The level of detail and complexity involved in a European scheme might be a barrier to creating further links. On the other hand, it is this level of detail that ensures the scheme's consistency among all the Member States, avoiding potential distorting effects. In an international context, the nature of the emission reductions traded should be clarified. Two main alternatives exist as of today, i.e. consider

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45 The International Transaction Log (ITL) will play a central role in the practical implementation of the Kyoto Protocol's emissions trading system. It is a computerised system which checks the consistency of traded emissions credits with Kyoto Protocol's rules. As mentioned already, the EU has implemented its own transaction log, the Community Independent Transaction Log (CITL) which acts as a supplementary check to the Kyoto Protocol's ITL and as a necessary tool for the functioning of the EU ETS. See UNFCCC Website on the registry systems: http://unfccc.int/kyoto_protocol/registry_systems/items/2723.php

allowances as financial instruments or as commodities. This would also be related to the nature of the parties to a possible linking agreement, the nature of the project from which are issued reductions, and the nature of the possible linking agreement. Both Directive 2003/87/EC and the Linking Directive 2004/101/EC provide for some limitations on linkages to countries that have not yet ratified the Kyoto Protocol. The first question here would concern the model to be adopted in cases of linking. A second question would concern the level of detail required for such linking.

A first linkage has been realised between the EU ETS and Norway, Iceland and Liechtenstein. On 26 October 2007, Directive 2003/87/EC was officially incorporated into the European Economic Area (EEA) Agreement by a Decision of the EEA Joint Committee. This will subject installations in the three EEA countries to similar rules that apply to those in the EU. The three EEA governments will also have to submit NAPs that will be assessed by the European Free Trade Area (EFTA) Surveillance Authority in collaboration with the European Commission. Linkage with other countries and regional authorities is also anticipated in the future, through formal or informal linkage mechanisms.

5 Impact on the energy sector

As mentioned in the introduction, the energy sector is significantly affected by the European emissions trading framework. It is estimated that the power sector represents around 30% of allowances under Phase I of the EU ETS. The rationale behind EU allowances trading is that a high carbon price will motivate power generators to switch their energy source, as dirty fuels will be more costly and clean energy will become more attractive. Setting a price for carbon and supporting renewable energy technologies will

contribute to the wider use of green energy, which is necessary for environmental reasons and to ensure security of energy supply.[46]

Like other sectors, the energy sector expects greater predictability to result from the review of the scheme. The same is true of concerns about competitiveness. Harmonisation between Member States is important for companies that operate similar facilities in different countries, but which are nonetheless subject to divergent regulatory frameworks, including divergent sanction regimes. For that reason, the allocation of emission allowances at an EU level, to replace NAPs, would be particularly challenging. Legal certainty is essential for the energy sector. Better predictability is a necessity here, with longer commitment periods to avoid over-frequent revisions. The interaction with the Energy Taxation Directive 2003/96/EC is another area of concern for the energy sector, as detailed above. Transparency requirements concerning data availability have been challenged by energy companies because of confidentiality issues. This is particularly relevant regarding the method of allocation of allowances, the cap-setting calculation and benchmarking. On the other hand, power companies have been criticised for passing on the costs of carbon to customers, despite the free allocation of allowances. A better way of allocating costs should be considered during the review of the scheme.

6 The way forward

Emission trading will remain a major instrument of EU climate policy. This was endorsed by the European Commission and backed by the 2007 Spring Council in the following terms:

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[46] See Green Paper on *A European Strategy for a Sustainable, Competitive and Secure Energy*, European Commission, COM(2006) 105 final, 08.03.2006.

> 'Market based instruments such as the EU ETS will be a key tool to ensure that Europe and other countries reach their targets at least cost. The post-2012 framework should enable comparable domestic trading schemes to be linked with one another, with the EU ETS as the pillar of the future global carbon market. The EU ETS will continue to be open after 2012 to carbon credits from the Clean Development Mechanism and Joint Implementation projects under the Kyoto Protocol.'[47]

But confidence in emissions trading and ensuring legal consistency are crucial to the survival of the scheme and achieving subsequent reductions in emissions. Any modification of the scheme must be done with reference to the latter environmental imperative as well as the international legal regime and national implementation constraints.

The European Commission stated in its 2006 Report *Building a global carbon market* that it was 'premature for the Commission to make legislative proposals at this stage'. The publication of a major energy and climate package, including legislative proposals, was originally scheduled for December 2007, before the UN climate conference in Bali, but the European Commission has delayed its publication until the beginning of 2008. The reasons given for the delay mainly refer to the complexity and level of ambition of the proposals and, in particular, the allocation between the 27 Member States of the overall EU targets for GHG emissions and renewable energy production. The delay could also be justified by negotiations that are taking place in other sectors, as the package was expected to incorporate plans to introduce legally-binding caps on CO_2 emissions from cars and to boost the consumption of biofuels in transport from

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[47] Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions, *Limiting global climate change to 2 degrees Celsius - The way ahead for 2020 and beyond*, COM (2007) 0002 final, 10 January 2007, p. 3.

their current level of less than 2% to 10% by 2020. Any further plan must also address the case of Malta and Cyprus. These two EU Member States implement Directive 2003/87/EC and form part of the EU emissions trading scheme, but their status as non-Annex I parties to the UNFCCC has to be solved in order to allow transactions in Assigned Amount Units (AAUs).

The post-2012 perspective will be the subject of a separate communication from the European Commission, as well as a forthcoming Green Paper on costs and benefits for post-2012 climate policy. The European Parliament has called for an agreement on the future international regime for climate change by 2009 at the latest, with binding targets for all industrialised countries.[48]

The Commission therefore estimates that 'for reasons of regulatory stability and predictability, any changes to the Directive emanating from this review should take effect at the start of the third trading period in 2013.'[49]

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48 Draft Motion for a Resolution on limiting global climate change to 2 degrees Celsius – the way ahead for the Bali Conference on Climate Change and beyond (COP 13 and COP/MOP3), by Satu Hassi on behalf of the Temporary Committee on Climate Change, 27.07.2007, PE 392.180v01-00. Adopted on 22 October 2007.

49 Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions, Building a global market – Report pursuant to Article 30 of Directive 2003/87/EC, COM(2006 676 final, Brussels, 13.11.2006, p. 2.

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