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Director's preface

The year 2008 was very much marked by the moving of the department of Maritime Law to a new location due to the redecoration of our offices at Karl Johans gate 47. Needless to say, this took a lot of time and caused a lot of frustration, and did nothing to promote the research. We are therefore rather proud of the fact that we have managed to publish Simply with a lot of articles in spite of this effort.

During 2008 we finished the rush of doctoral theses from 2007. Mikaela Bjørkholm, Morten Kjelland and Beate Sjåfjell, who all handed in their doctoral or PhD theses in 2007, had their dissertations during 2008. 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.

Since there are now so many candidates in the maritime law fields with a doctoral or PhD degree, the institute decided that new positions would be offered to post doc candidates, as an alternative to PhD candidates. Two previous candidates from the Institute started as post doc during the winter of 2008, namely Alla Pozdnakova and Kristina Maria Siig. They are both participating in the Safety, Security and Discharge control at Sea project, which is chaired by Professor Erik Røsæg. The project has produced a series of master theses by research assistants in addition to the PhD project already started by Eve de Coning. One of these theses is financed by the Ministry of Fisheries and Coastal Affairs, which has also been involved in defining relevant research topics under this project in relation to the transport of oil from Russia along the Norwegian coast. Furthermore, two books have been published by guest researchers on the project: Iliana Christodoulou-Varotsi and Helena-Maria Rolim. More information about the project may be found at http://www.jus.uio.no/nifs/nifs/forskning/sjosikkerhet/

In 2008, the institute represented by Erik Røsæg also started cooperation with DNV in regard to a research project named MARLEN - Maritime Logistics Chains and the Environment. In this project, the institute is responsible for the definition and analysis of contractual agreements that could influence the possibility of establishing energy-efficient maritime logistics chains. During 2008, a pre study was written by Knut Erling Øyehaug of Nordisk Skibsrederforening in close cooperation with Erik Røsæg of Nordisk Institutt for Sjørett and Odd Torstein Mørkve of DNV ProNavis AS.

In 2008 we also had our first research assistant financed by the P&I club Skuld, who wrote about P&I insurance.

Further, during the fall of 2008, the institute has established a new international cooperation with the University of Southampton, UK and University of Tulane, US, to arrange a Biannual Colloquium in Maritime Law (IBCML). The plan is to arrange international colloquiums at the three participating institutions each second year. The colloquiums will be open for maritime law researchers from all the leading universities in the maritime law field. The first IBCML will concern issues on jurisdiction and take place in Southampton. We look very much forward to this cooperation.

Since Henrik Bjørnebye has now delivered her PhD thesis, post doc Alla Pozdnakova has taken over as editor of Simply.

As in previous years, the Institute in 2008 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
- Ministry of Fisheries and Coastal Affairs
- Skuld

We are very grateful to all our sponsors.

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. Three seminars should be mentioned in particular:

- Start up seminar for the Safety, Security and Discharge control at Sea project, held at Lysebu in Oslo 28-29 January 2008.
- The 5th European Colloquium on Maritime Law Research (ECMLR) was held in Athens in 29-30 May. The topic was Competition and Regulation in Shipping and Shipping Related Industries.
- 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 the annual edition of SIMPLY 2008, published by the Scandinavian Institute of Maritime Law. The wide range of topics presented in this yearbook follows the tradition established by the previous editions of SIMPLY and illustrates the variety of research currently being carried out at the Scandinavian Institute of Maritime Law.

A distinctive feature of this yearbook is an impressive contribution by our master students from the year 2007/2008. We publish four excellent master theses written by Siri Kvaløy, Caroline Rusniok, Cassia Ringås, and Joyce Souza Jacobsen.

As in earlier editions, the articles published in this yearbook focus primarily on topics related to maritime law. Professor Dr. Alexander Proelß (University of Kiel) contributes an article where he discusses the scope of the obligations of the flag and coastal states to rescue persons in distress at sea where they turn out to be refugees and analyses whether this obligation implies delivering them to a place of safety.

The next theme of this edition is insurance law, addressed by two articles. First, Professor Hans Jacob Bull contributes to this year's SIMPLY a discussion of CAR-insurance under fabrication contracts and analyses whether the operator is liable towards the contractor if the insurer goes into bankruptcy. Second, Siri Kvaløy, LL.M, has written a master thesis on the conditions of use at gas terminals and risk allocation and insurance coverage. In her work, she identifies shipowner risks arising from the standardized contracts ("conditions of use") at gas terminals and discusses possible insurance and charter party coverage of such risks.

Professor Erik Røsæg contributes a discussion of the organization of queuing for ships in ports where there is waiting time for loading and discharge, and in particular, how to do it in a more environment-friendly way. Erik points out the disadvantages of the existing

queuing system and proposes a new system based on trading turns between vessels.

The EU law theme is represented by two articles. Jens Karsten, LL.M, analyses the proposal for EU legislative action in the field of liability of carriers for maritime passengers. Jens Karsten discusses the forthcoming "Athens Regulation" within the context of European law and international law. Caroline Rusniok, LL.M, examines the EC's scope of action in preventing ship-source pollution by the introduction of penalties. Caroline analyses the question of criminal sanctions for ship-source pollution adopted by the EU and deals inter alia with the annulment by the ECJ of the Framework Decision on criminal sanctions for ship-source pollution. She also addresses the question of what would be the most effective means to achieve the aims of the annulled Decision and argues that administrative sanctions could be an alternative.

Cassia Ringås, LL.M, contributes to SIMPLY a master thesis on the Bunker convention. She discusses the legislation in place before entry into force of the Bunker Convention and seeks to determine whether State Parties, in their implementation legislation, can deviate from the measures set out in the Convention.

Finally, SIMPLY includes a master thesis by Joyce B. Souza Jacobsen, LL.M, who writes on the local content requirements (i.e. to procure certain amount of resources from suppliers in the host country) in the Brazilian upstream oil industry and points out weaknesses of the existing system of local content requirements in Brazil.

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 endnotes or in appendices to the individual articles.

Alla Pozdnakova

Overview of content

Table of content

PART III "CONDITIONS OF USE" AT GAS TERMINALS. RISK ALLOCATION AND INSURANCE COVERAGE

PART IV A SYSTEM FOR QUEUING IN PORTS

PART V THE ATHENS REGULATION IS HEADING INTO HARBOUR – THE EU ON THE POINT OF REGULATING LIABILITY FOR MARITIME PASSENGERS

PART VII THE BUNKER CONVENTION

PART VIII LOCAL CONTENT REQUIREMENTS IN THE BRAZILIAN UPSTREAM OIL INDUSTRY

Part I
Rescue at Sea Revisited: What Obligations exist towards Refugees?

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Christian-Albrechts-University *

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1 Introduction

Contrary to the views of many other commentators, *Erik Røsæg* concluded in his 2002 paper "Refugees as Rescuees"[1], which examined the M/V "Tampa" incident[2], that "the approach of the Australian Government was generally legally defensible from an international law perspective."[3] Until 2004, it seemed that no further arguments were to be raised in legal writings regarding the basis and scope of legal obligations of flag and coastal States towards refugees under international law of the sea. In that year, however, the International Maritime Organization (IMO) revived the discussion by adopting not only Guidelines on the Treatment of Persons Rescued at Sea[4] but also amendments to two relevant conventions, namely the International Convention on Maritime Search and Rescue of 27 April 1979 (SAR Convention)[5] and the International Convention for the Safety of Life at Sea of 1 November 1974 (SOLAS),[6] which entered into force on 1 July 2006.[7] These recent legal developments, together with the release in

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1 *Scandinavian Institute of Maritime Law Yearbook* 2002, 43-82.

2 For an overview on the facts see *id*., at 47-9.

3 *Id*., at 76 (footnote omitted).

4 IMO Doc. MSC 78/26/Add.2, Annex 34: Res. MSC.167(78) of 20 May 2004, Guidelines on the Treatment of Persons Rescued at Sea.

5 1184 *U.N.T.S.* 278.

6 1405 *U.N.T.S.* 97.

7 See IMO Doc. MSC 78/26/Add. 1, Annex 3: Res. MSC.153/78 of 20 May 2004, Adoption of Amendments to the International Convention for the Safety of Life at Sea, 1974, as Amended; IMO Doc. MSC 78/26/Add. 1, Annex 5: Res. MSC.155/78 of 20 May 2004, Adoption of Amendments to the International Convention on Maritime Search and Rescue, 1979, as Amended.

2007 by both the Commission of the European Community[8] and the German Institute for Human Rights[9] of studies addressing the relevant instruments in relation to immigration by sea, justify a re-examination of the current situation under the law of the sea.[10] If one further takes into account the fact that the geographical focus of the subject at hand seems to have shifted from South East Asia to Europe, as evidenced by the flood of refugees constantly streaming over the shores of Lampedusa and the Canary islands,[11] the need to address the issue of "refugees as rescuees" indeed becomes a necessity.

When addressing this issue from the perspective of the law of the sea, awareness of its delicate ethical dimension is certainly essential. Lawyers who base their conclusions on a strictly source-oriented approach will always face the danger of being accused of ignoring the moral fundamentals of law in general. Nevertheless, if looking at public international law, this author believes that overstretching the accepted rules of interpretation – even if done for good moral reason – brings with it the danger of weakening the normative claim of the relevant legal rules. According to this legal concept, approaches which ignore the sensitivities in the realm of political

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8 SEC (2007) 691 of 15 Mai 2007, Commission Staff working Document, Study on the International Law Instruments in Relation to Illegal Immigration by Sea.

9 *R. Weinzierl/U. Lisson*, Border Management and Human Rights (Study published by the German Institute for Human Rights), 2007.

10 *M. Jaguttis*, Freier Hafenzugang für Flüchtlingsschiffe?, 43 *Archiv des Völkerrechts* (2005), 90-128, at 92, mentions that different to the scope of the principle of non-refoulement, the relevant principles of international law of the sea are usually considered only peripherally. Significantly, *J.C. Hathaway* does not touch upon the subject at hand in his voluminous treatise "The Rights of Refugees under International Law" (2005).

11 Cf. *M. Pugh*, Europe´s Boat People, Maritime Cooperation in the Mediterranean, 2000, 19-39.

reality will not have any prospect of effective implementation, due to the consensual nature of this legal order.[12] Of course, this must not preclude consideration of the application of innovative solutions to the questions presented. However, one should refrain from cherishing hopes of the transformation of such solutions into "hard law". Thus, when addressing the legal standards relating to asylum seekers rescued at sea in the following, the conclusions reached will be strictly based on the *lex lata*, even if this leads to results which might, from a moral viewpoint, be difficult to accept.

2 Factual Background

Before addressing the applicability and appropriateness of the existing legal rules, we shall first look briefly at the factual situation. Reference has already been made to South East Asia where the stream of refugees grew to such an extent (more than 1.6 million) after the fall of Saigon on 30 April 1975 that it was widely referred to as the boat people problem.[13] In reaction to a dramatic increase of Haitian boats believed to be bringing illegal aliens to the country, the United States of America (U.S.) announced an interdiction policy as early as 1981,[14] as, in 2001, did Australia, which still today actively undertakes interception measures in order to prevent Indonesian boats from entering its territorial sea and internal waters.[15] The widely media-featured 2001 incident of the Norwegian

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[12] See, *e.g.*, the critique by *A. Proelss*, Die internationale Gemeinschaft im Völkerrecht: Normative Realität, konkrete Utopie oder "academic research tool"?, in: J. Badura (ed.), Mondialisierungen. „Globalisierung" im Lichte transdisziplinärer Reflexionen, 2004, 233-52.

[13] Cf. *B. Grant*, The Boat People, 1980.

[14] Executive Order No. 12324 of 29 September 1981.

[15] "Operation Relex II" was superseded by the more comprehensive "Operation Resolute" on 17 July 2006 which consolidates all former

ConRo vessel M/V Tampa which rescued 438 men, women, and children from a sinking ferry south of the Indonesian archipelago, brought the problem of refugees arriving by sea to the focus of public attention and initiated an academic debate on the tensions between competing legal norms as well as between moral and legal considerations.[16] Indeed, as one scholar rightly stated, "the crux of the matter has remained the same, reconciling the humanitarian plight of refugees and asylum-seekers with the destination States´ concerns about illegal immigration, mass migration of people, and the cost of asylum."[17]

Whereas "refugees as rescuees" was for a long time not considered a European problem, this has changed dramatically with the beginning of the 21st century.[18] Starting with Italy being forced to engage in attempts to turn back smuggling vessels from Albania, migration pressure in the Mediterranean has risen over the last few years. Particularly noteworthy, not to say critical, is the situation on the Spanish Canary Islands and on the Italian island of Lampedusa, which was reached from the Libyan coast by some 16,000 people over the first nine months in 2006.[19] In many cases, migrants taking the journey from the African coast to European Union (EU) territory in unseaworthy boats have gone missing. According to reports of the Spanish human rights organization "Asociación Pro

Australian Defence Forces operations to protect Australia´s offshore maritime areas; see http://www.defence.gov.au/opresolute/default.htm .

16 See *R. Barnes,* Refugee Law at Sea, 53 *ICLQ* (2004), 47-77, at 48.

17 *Id.,* at 47. See also *M. Pallis*, Obligations of States towards Asylum Seekers at Sea: Interactions and Conflicts between Legal Regimes, 14 *IJRL* (2002), 329-64, at 330: "[…] there seem to be conflicts between provisions of different legal regimes and gaps in the regime of protection for refugees." (footnote omitted).

18 As to the following see *Weinzierl/Lisson*, supra note 9, 18.

19 Human Rights Watch (ed.), World Report 2007, 2007, 381.

Derechos Humanos de Andalucía" (APDHA), 1,167 dead or missing were reported for the Canary Islands in 2006, compared to some 31,000 migrants who managed to survive the passage in the same year.[20] If one takes into account the presumed high number of undocumented cases, an estimated 7,000 people lost their lives or went missing on the journey.

Already in 2004, a broad European public had taken note of a second Tampa incident, this time in European waters involving several European States.[21] The vessel "Cap Anamur", owned by and named after the German aid organization "Komitee Cap Anamur", had left the port of La Valetta, Malta, on 19 June 2004 and one day later took some 37 African migrants, allegedly of Sudanese nationality, aboard. On June 24th, the "Cap Anamur" sailed through the Maltese territorial sea and contacted the harbor authorities of La Valetta, but did not attempt to enter the port. The ship subsequently floated in international waters in order to give the head of the organization, Mr. *Elias Bierdel*, the possibility to come aboard. On July 1st, the vessel, now joined by Mr. *Bierdel*, entered Italian territorial waters and requested the Italian authorities to allow for disembarkation of the migrants. However, the Italian Minister of Internal Affairs refused to grant permission to land by pointing to the fact that the vessel had already entered Maltese waters previously.[22] Thus, either Malta or Germany, under whose flag the

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20 http://www.apdha.org/media/fronterasur2006.pdf

21 See *S. Rah*, Kein Flüchtlingsschutz auf See? Flüchtlings- und seerechtliche Probleme am Beispiel der "Cap Anamur", 18 *JILPAC* (2005), 276-86, at 277.

22 Both the Italian and German Ministers of Internal Affairs invoked an alleged principle of public international law according to which only the nearest port to the place where distress occurred is to be considered competent and responsible for the handling of the rescued persons. However, basis as well as scope of such a principle remained unclear.

"Cap Anamur" was sailing, were to be considered the coastal State responsible for disembarkation. Ten days later, the vessel called at the Sicilian port of Porto Empedocle after the master had reported that the situation aboard was getting out of control – allegedly, several migrants had threatened to jump overboard –, but at first was blocked by Italian coast guard forces 200 metres ahead of the port entrance. Finally, the coast guard patrolled the "Cap Anamur" into the port where Mr. *Bierdel*, the master of the ship and his first officer were arrested and confronted with investigations for aiding and abetting illegal immigration. On 13 July 2004, the Italian authorities announced that 30 of the rescued persons were of Ghanaese, six of Nigerian, and one of Nigeran nationality. Except for one person, all migrants were refused asylum and, finally, were deported to their home countries. In a second try to conquer "fortress Europe", one of the 37 went missing, together with twenty other migrants, when their boat sank in a storm near Lampedusa two years later. While Mr. *Bierdel* was criticized for having worsened the situation for the sake of creating a high-profile event and, thus, refused to be re-elected as chairman by the executive board of the aid organization, court proceedings against the three crew members began on 27 November 2006 in Agrigento and were still pending at the beginning of 2008.

While it seems not unreasonable to conclude that media-featured events such as the "Cap Anamur" incident might, depending on the circumstances, threaten a just cause rather than conducing to it, this does certainly not apply in respect of the most recent example, in which a Maltese fishing vessel refused to let shipwrecked Africans on board in order to not endanger a valuable tuna catch.[23] The shipwrecked persons managed to save themselves by clinging to the nets cast by the fishing crew. Even though the master of the vessel

[23] *Weinzierl/Lisson*, supra note 9, 19.

had asked the Maltese authorities for assistance, nothing then happened for 24 hours, since Malta and Libya were unable to agree on which of the two States was responsible for the rescue. Eventually, Italy agreed to carry out the operation.

Irrespective of the ethical dimension, incidents like the ones just reported provoke a multitude of legal questions. For example, one cannot help asking whether the well-accepted duty to give assistance to persons in distress is accompanied by an obligation of flag States to deliver those rescued at sea to a place of safety as well as a corresponding obligation of coastal States to accept their disembarkation under the law of the sea and/or humanitarian law (in particular the principle of non-refoulement). Or are coastal States allowed to tow back refugee boats to the high seas following penetration of their territorial sea or internal waters? When addressing these questions below, attention shall primarily be directed at the law of the sea due to the recent amendments to SOLAS and the SAR Convention mentioned above. Having said that, the interrelationship, if any, between this legal matter and refugee law cannot be completely ignored.

3 Rescue at Sea under the LOS Convention

3.1 Scope of Flag and Coastal States Obligations

The general duty to rescue persons in distress is considered to be one of the most ancient and fundamental norms of international law of the sea.[24] *Emer de Vattel* emphasized the humanitarian foundation of this obligation in his treatise "Le droit des gens ou

[24] *Barnes*, supra note 16, 49.

principes de la loi naturelle", back in 1758.[25] Today, the duty to provide assistance to those in distress at sea is firmly established in both customary and treaty law. In general terms, it is codified in three relevant conventions, namely the United Nations Convention on the Law of the Sea of 10 December 1982 (LOS Convention),[26] the SAR Convention,[27] and SOLAS.[28] Art. 98 LOS Convention provides that

> "1. [e]very State shall require the master of a ship flying its flag, in so far as he can do so without serious danger to the ship, the crew or the passengers:
>
> (a) to render assistance to any person found at sea in danger of being lost;
>
> (b) to proceed with all possible speed to the rescue of persons in distress, if informed of their need of assistance, in so far as such action may reasonably be expected of him;
>
> (c) after a collision, to render assistance to the other ship, its crew and its passengers and, where possible, to inform the other ship of the name of his own ship, its port of registry and the nearest port at which it will call.
>
> 2. Every coastal State shall promote the establishment, operation and maintenance of an adequate and effective search and rescue service regarding safety on and over the sea and, where circumstances so require, by way of mutual regional arrangements cooperate with neighbouring States for this purpose."

Much has been said elsewhere with regard to the interpretation of this provision which, as regards its substance, equates with the

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[25] *E. de Vattel,* Le droit des gens ou principes de la loi naturelle: appliqués à la conduite et aux affaires des nations et des souverains, Vol. 1, 1758, 170.

[26] 1833 *U.N.T.S.* 397.

[27] See supra note 5.

[28] See supra note 6.

corresponding obligations under the other two conventions.[29] Thus, it suffices to raise the following four points.

a) First, it should be noted that it is not the master of the vessel, but rather the flag State which is the subject of international law addressed by the provision. While it is true that the obligation codified in Art. 98 LOS Convention is to be implemented on a national level, the existing but rather indirect effect on private individuals does not justify the conclusion that "the masters of private vessels and government ships who must conduct rescue at sea are also especially obligated."[30] Neither Art. 98 LOS Convention nor its counterparts in the SAR Convention and SOLAS are self executing.[31] On the contrary, the wording of the relevant articles implies that flag States enjoy some discretion in deciding how to implement the obligation to rescue persons in distress.[32] Therefore, the master of a ship does not possess passive legal personality in the context at hand.

b) Secondly, although, as just stated, flag States enjoy a margin of discretion as to the implementation and execution of the duty to rescue, this margin does not, of course, extend to the legal status of shipwrecked persons.[33] The latter conclusion implies that a State is not allowed to refrain from rendering assistance to persons in

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29 Cf. Chapter V, Reg. 33 (1) Annex SOLAS; Art. 2.1.10 Annex SAR Convention.

30 *Weinzierl/Lisson*, supra note 9, 36.

31 A legal provision is self-executing when it is able to unfold direct effect and fully operative without implementation on the national plane. Cf. *A. Bleckmann,* Self-executing Treaty Provisions, IV *EPIL* (2000), 374-7; *T. Buergenthal,* Self-executing and Non-self-executing Treaties in National and International Law, 235 *RdC* (1992), 303-400.

32 See also *Barnes*, supra note 16, at 54.

33 See Nordquist et al. (eds.), United Nations Convention on the Law of the Sea 1982, A Commentary, Vol. III, 1995, 175.

distress based on the vessel´s master suspecting these persons to be economic refugees. In this regard, the SAR Convention as well as SOLAS contains an explicit prohibition of discrimination ("regardless of the nationality or status of such a person or the circumstances in which that person is found").[34] The Convention for the Unification of Certain Rules with Respect to Assistance and Salvage at Sea, concluded on 23 September 1910 in Brussels,[35] even obliges the master of a vessel to "render assistance to everybody, *even though an enemy*, found at sea in danger of being lost" (Art. 11).[36] Extending the flag State´s range of application under Art. 98 LOS Convention to the category of shipwrecked persons would naturally also conflict with the prerequisites of human rights law which are, arguably, generally applicable irrespective of the exact location of a violation.[37] Whether the same conclusion applies with regard to the Refugee Convention of 1951 will have to be addressed at a later stage.

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[34] Chapter V, Reg. 33 (1) Annex SOLAS; Art. 2.1.10 Annex SAR Convention.

[35] 212 *C.T.S.* 187.

[36] Italics added. See also Art. 16 of the Convention (X) for the Adaption to Maritime Warfare of the Principles of the Geneva Convention of 27 November 1909 (15 *L.N.T.S.* 340).

[37] But see Art. 2 (1) of the International Covenant on Civil and Political Rights of 16 December 1966: „Each State Party to the present Covenant undertakes to respect and to ensure to all individuals *within its territory and subject to its jurisdiction* the rights recognized in the present Covenant, without distinction of any kind, such as race, color, sex, language, religion, political or other opinion, national or social origin, property, birth or other status." (italics added). – In the majority of cases, the decisive question as to the applicability of human rights law to refugees will be whether the persons concerned fall within the jurisdiction of the acting State. Thus, with regard to shipwrecked persons, the principle of flag State jurisdiction is of central importance.

c) Thirdly, although Art. 98 LOS Convention is contained in Part VII of that agreement which deals with the regime of the high seas, it seems unjustifiable to hold that the geographical scope of the obligation concerned does not extend to maritime zones under the coastal States´ respective sovereignty or jurisdiction. This conclusion is self-evident as regards the contiguous zone and the exclusive economic zone (EEZ) which, seen from the territorial perspective, are to be considered as parts of the high seas.[38] Art. 58 (2) LOS Convention supports this view by stating that the provisions of Part VII LOS Convention are applicable to the EEZ "in so far as they are not incompatible with this Part." With regard to the coastal State´s territory, it has been argued that common law countries seem to have been more reluctant to accept the applicability of the obligation concerned in relation to their internal waters and territorial seas.[39] If this observation is accurate, it should be noted that Art. 98 LOS Convention speaks of "any person found *at sea* in danger of being lost" in rather general terms. Thus, the context of the provision clearly militates against that position. One should also not ignore the fact that under SOLAS and the SAR Convention, the duty to provide assistance to persons in distress at sea is not geographically limited at all. Art. 18 LOS Convention which states that innocent passage "includes stopping and anchoring, but only in so far as the same are incidental to ordinary navigation or are rendered necessary by *force majeure* or distress or for the purpose of rendering assistance to persons, ships or aircraft in danger or distress" does not support a restrictive interpretation of Art. 98 LOS Convention,[40] as it only defines the scope of innocent passage, and

[38] See *A. Proelss*, Ausschließliche Wirtschaftszone (AWZ), in: W. Graf Vitzthum (ed.), Handbuch des Seerechts, 2006, 222-64, at 228-30.

[39] Cf. *Pallis*, supra note 17, at 336.

[40] But see the line of argument considered by *Pallis*, supra note 17, at 336.

therefore, has no bearing on the existence of a duty to rescue persons in distress.

d) The fact that it is the flag State which is, as the subject of law, responsible for providing an effective implementation of Art. 98 LOS Convention, implies, fourthly, that with a view to the high seas, a State may not extend its national rescue laws to foreign ships. As evidenced by the wording of the provision ("[e]very State shall require the master of a ship *flying its flag"*), any such course of action would constitute a violation of the principle of flag State jurisdiction. Thus, sources claiming that States which limit the scope of their national laws relating to the duty to assist persons in distress to ships flying the respective States´ flags seriously undermine "this most fundamental of obligations",[41] do not seem to be correct. Having said that, the question of whether a coastal State is entitled to extend its national rescue legislation to foreign ships, as long as these are located in its territorial sea and internal waters, seems doubtful only at first glance. Art. 21 (1) LOS Convention authorizes the coastal State to adopt laws and regulations relating to innocent passage through the territorial sea in respect of, *inter alia*, "the safety of navigation and the regulation of maritime traffic" (lit. a), and it seems disproportionate to the central importance of the said obligation if these laws and regulations were precluded from encompassing the duty to give assistance. Additionally, the coastal State´s territorial jurisdiction generally supersedes flag State jurisdiction in case of conflict, unless innocent passage of foreign ships will be hampered or the exemption clauses contained in Art. 27 and 28 LOS Convention, dealing with criminal and civil jurisdiction in relation to foreign ships, apply.[42] Notwithstanding the

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41 *Barnes*, supra note 16, at 50 (note 15), 54.

42 For an overview on coastal States´ enforcement jurisdiction see *R.R. Churchill/A.V. Lowe*, The Law of the Sea, 3rd ed. 1999, 95-100. Note that

flag State being obliged to assist persons in distress also in a foreign territorial sea, the coastal State is not under a duty to extend its rescue legislation to foreign ships situated in its national waters.

3.2 Does the Obligation to Rescue Persons in Distress imply a Duty to deliver them to a Place of Safety?

When addressing the flag and coastal States´ obligations with regard to persons in distress, it should be noted that neither Art. 98 LOS Convention nor its counterparts in SOLAS and the SAR Convention contain any explicit reference to a duty to disembark persons rescued at sea. While it cannot be denied that some kind of general understanding exists under the rules of maritime *courtoisie*, that rescued persons should be disembarked at the next port of call,[43] scholars disagree as to whether this practice is reflected in terms of hard law.[44] This lack of clarity results from the fact that disembarkation first and foremost affects the coastal State. Any obligation of a flag State to disembark shipwrecked persons at the

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the general distribution of jurisdictional competences may be superposed by more specific treaty rules. In this respect, see, *e.g.*, the Convention on Certain Rules concerning Civil Jurisdiction in Matters of Collision of 10 May 1952 (439 *U.N.T.S.* 217).

[43] Cf. EXCOM, Conclusion No. 23 (XXXII) of 21 October 1981, Problems Related to the Rescue of Asylum-Seekers in Distress at Sea, § 3: "In accordance with established international practice, supported by the relevant international instruments, persons rescued at sea should normally be disembarked at the next port of call. This practice should also be applied in the case of asylum seekers rescued at sea. […]"

[44] In the affirmative *Weinzierl/Lisson*, supra note 9, 38. – Note that the term "next port of call" is not used in any relevant legal instruments but was introduced by the UNHCR; as to possible meanings, depending on the actual situation, see UNHCR, Background Note on the Protection of Asylum-Seekers and Refugees Rescued at Sea, 18 March 2002, § 30-1.

next port of call would turn out to be useless, were it not logically linked with a corresponding duty of the coastal State of the next port of call to temporarily accept the rescued persons on its territory.[45] In this respect, *Erik Røsæg* points to the fact that the general obligation to render assistance to shipwrecked people is often ignored,[46] and one cannot but speculate that the main reason for such disregard is presumably to be seen in the masters´ fears of being refused disembarkation of the rescuees at the next port of call. Indeed, in case rescuees turn out to be refugees, the lack of willingness amongst coastal States to accept entry into port of vessels concerned is widespread.

Against this background, the question of whether flag States are obliged to deliver persons rescued at sea to a place of safety takes centre stage in the context at hand. In this respect, it should be noted that the European Commission recently took the position that "[t]he obligations relating to search and rescue include the transport to a safe place."[47] Just as did the German Institute for Human Rights in its study "Border Management and Human Rights",[48] the Commission mainly based its conclusion on the recent amendments to SOLAS and the SAR Convention which, therefore, deserve particular attention.

a) As regards the former legal situation, some sources base their assumption that the duty to rescue includes transit to a place of safety, on Art. 1.3.2 Annex SAR Convention, and it seems that this has also been the Norwegian position taken in the course of the M/V Tampa incident.[49] Indeed, the said provision defines "rescue"

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45 Cf. the situation in the M/V Tampa and Cap Anamur incidents.

46 *Røsæg*, supra note 1, at 50-1.

47 SEC(2007) 691, supra note 8, § 2.3.2.

48 *Weinzierl/Lisson*, supra note 9, 39-40.

49 Cf. *Røsæg*, supra note 1, at 61 (note 58).

as "[a]n operation to retrieve persons in distress, provide for their initial medical or other needs, and deliver them to a place of safety". One should not ignore, however, the fact that Art. 1.3.2 Annex SAR Convention, being contained in the Convention´s chapter on "Terms and Definitions", does not oblige States parties to take specific measures.[50] While the provision substantiates the scope of the following operational regulations, it does not have any obligatory content of its own. Furthermore, it is interesting to note that Art. 2.1.10 Annex SAR Convention, being one of the central operational provisions of the Convention, only stipulates that "[p]arties shall ensure that assistance be provided to any person in distress at sea". By using the term "assistance" instead of "rescue", this article avoids incorporating the place of safety criterion laid down in Art. 1.3.2 Annex SAR Convention. The same applies with regard to Art. 2.1.1 Annex SAR Convention, which, again, obliges States parties only to "take urgent steps to ensure that the necessary *assistance* is provided."

Even the UNHCR, which generally strongly advocates prompt disembarkation at the next port of call, has carefully avoided claiming the existence of a corresponding duty under public international law. For example, in a preliminary report often quoted as an indicator of relevant State practice,[51] a Working Group of Government Representatives on the Question of Rescue of Asylum-Seekers at Sea stated in very soft terms that "[w]ith regard to the generally accepted principle, re-emphasized by the Working Group, that asylum-seekers rescued at sea *should normally* be disembarked

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[50] *Røsæg* also points to the fact that the new definition of "rescue" was adopted by tacit amendment, "which would be very unusual if the text really resolved the long-lasting controversy in international law on this point." (*id*., supra note 1, at 62).

[51] See, e.g., *H. von Brevern/J.M. Bopp*, Seenotrettung von Flüchtlingen, 62 *ZaöRV* (2002), 841-52, at 844.

at the next port of call, the Governments of the coastal States most concerned *generally* agreed with this view, provided that the port at which disembarkation is being sought is scheduled in the course of the ship´s normal business."[52] Similarly, in its background note on the protection of Asylum-seekers and refugees rescued at sea published subsequent to the expert roundtable "Rescue-at-Sea" held in Lisbon in 2002, the UNHCR explicitly acknowledged the "lack of clarity" as to whether rescue implies a duty to disembark.[53] In addition, the International Maritime Organization had dealt with the subject at hand for years and, eventually, adopted Guidelines on the Treatment of Persons Rescued at Sea in 2004.[54] In these non-binding guidelines, the IMO did not only offer a definition of the term "place of safety" as used in Art. 1.3.2 Annex SAR Convention,[55] but also made it clear that a place of safety need not necessarily be on land.[56] Furthermore, it was stated that "delivery to a place of safety should take into account the particular circumstances of the case."[57] If these statements as well as the wording of the SAR Convention are taken into consideration, it seems impossible to

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52 UNHCR Doc. EC/SCP/24 (1982), Preliminary Report on Suggestions Retained by the Working Group of Government Representatives on the Question of Rescue of Asylum-Seekers at Sea, § 3 (italics added).

53 UNHCR, supra note 44, § 11-2. For further references to UNHCR documents see *Røsæg*, supra note 1, at 59 (note 50).

54 IMO Doc. MSC 78/26/Add.2, Annex 34: Res. MSC.167(78) of 20 May 2004, Guidelines on the Treatment of Persons Rescued at Sea.

55 Res. MSC.167(78), supra note 54, Annex, § 6.12. See also *I. von Gadow-Stephani*, Der Zugang zu Nothäfen und sonstigen Notliegeplätzen für Schiffe in Seenot, 2006, 356-7.

56 *Ibid*., § 6.14: „A place of safety may be on land, or it may be aboard a rescue unit or other suitable vessel or facility at sea that can serve as a place of safety until the survivors are disembarked to their next destination." Unclear *Weinzierl/Lisson*, supra note 9, 38.

57 *Ibid*., § 6.15.

provide evidence of a sufficiently consistent State practice relating to a duty to deliver persons rescued at sea to a place of safety.

One must add that prior to the amendments to the SAR Convention, a corresponding obligation of coastal States to accept disembarkation of refugees in their ports also did not exist. The statement made by *von Brevern* and *Bopp,* whereby the rescue duty of masters and States implies a corresponding duty of coastal States to allow for disembarkation,[58] does not seem to be correct, since it ignores the fact that any right to enter a State´s territory directly affects the territorial sovereignty of that State. The same is true with regard to the alleged existence of relevant State practice for which the authors do not give any examples.[59] Even if such practice were determinable, *Røsæg* calls attention to the fact that

> "[a]ny state practice allowing disembarkation must also be viewed in the light of the fact that there has been a number of resettlement schemes and flag state guarantees in operation. Allowing disembarkation under such conditions does not imply that the state also recognizes a legal obligation to allow disembarkation when such schemes or guarantees do not apply."[60]

Finally, as regards treaty law, Art. 3.1.2 Annex SAR Convention appears to be relevant in the present context only at first sight.[61]

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[58] *von Brevern/Bopp*, supra note 51, at 842.

[59] Cf. *ibid*.

[60] *Røsæg*, supra note 1, at 60; see also *Barnes*, supra note 16, at 63.

[61] Art. 3.1.2 Annex SAR Convention reads: „Unless otherwise agreed between the States concerned, a Party should authorize, subject to applicable national laws, rules and regulations, immediate entry into or over its territorial sea or territory of rescue units of other Parties solely for the purpose of searching for the position of maritime casualties and rescuing the survivors of such casualties. In such cases, search and rescue operations shall, as far as practicable, be co-ordinated by the appropriate rescue co-ordination centre of the Party which has authorized entry, or such other authority as has been designated by that Party."

While the wording of this operational clause seems to address entry into the coastal State´s territorial sea in direct terms, a closer examination reveals that it only refers to "rescue units of other Parties" who "should" be given access to State territory "solely for the purpose of searching for the position of maritime casualties and rescuing the survivors of such casualties". Even if one were to hold that the phrase "rescuing the survivors" comprises the definition of "rescue" contained in Art. 1.3.2 Annex SAR Convention, this would not give rise to a duty to accept disembarkation, since the obligation contained in Art. 3.1.2 Annex SAR Convention only applies "subject to applicable national laws, rules and regulations".[62] Thus, one must conclude that at least prior to the amendments to SOLAS and the SAR Convention, it was neither the case that flag States were obliged to deliver rescuees to a place of safety, nor were coastal States bound to accept disembarkation of persons rescued at sea.

b) With regard to the 2004 amendments to SOLAS[63] and the SAR Convention,[64] the Maritime Safety Committee of the IMO made it

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[62] Cf. also *von Gadow-Stephani*, supra note 55, 359; *Røsæg*, supra note 1, at 62; *Barnes*, supra note 16, at 53.

[63] § 1-1 Regulation 33 Annex V SOLAS reads: „Contracting Governments shall co-ordinate and co-operate to ensure that masters of ships providing assistance by embarking persons in distress at sea are released from their obligations with minimum further deviation from the ships´ intended voyage, provided that releasing the master of the ship from the obligations under the current regulation does not further endanger the safety of life at sea. The Contracting Government responsible for the search and rescue region in which such assistance is rendered shall exercise primary responsibility for ensuring such co-ordination and co-operation occurs, so that survivors assisted are disembarked from the assisting ship and delivered to a place of safety, taking into account the particular circumstances of the case and guidelines developed by the Organization. In these cases the relevant Contracting Governments shall arrange for such disembarkation to be effected as soon as reasonably practicable."

clear in the two underlying resolutions that the intention in amending the two conventions was

> "to ensure that in every case a place of safety is provided within a reasonable time. It is further intended that the responsibility to provide a place of safety, or to ensure that a place of safety is provided, falls on the Contracting Government responsible for the search and rescue region in which the survivors were recovered".[65]

Thus, at first sight, it does not seem possible to maintain the interpretation of the relevant law in force prior to the amendments of the two conventions.[66] A closer analysis, however, does not support this conclusion. Neither of the two provisions (whose wording is largely identical) stipulates an obligation of flag States to deliver rescuees to a place of safety, let alone a duty of coastal States to accept disembarkation at one of their ports. While both articles do have mandatory character (as evidenced by the use of the word

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[64] Art. 3.1.9 Annex SAR Convention reads: „Parties shall co-ordinate and co-operate to ensure that masters of ships providing assistance by embarking persons in distress at sea are released from their obligations with minimum further deviation from the ships´ intended voyage, provided that releasing the master of the ship from these obligations does not further endanger the safety of life at sea. The Party responsible for the search and rescue region in which such assistance is rendered shall exercise primary responsibility for ensuring such co-ordination and co-operation occurs, so that survivors assisted are disembarked from the assisting ship and delivered to a place of safety, taking into account the particular circumstances of the case and guidelines developed by the Organization. In these cases, the relevant Parties shall arrange for such disembarkation to be effected as soon as reasonably practicable."

[65] See IMO Doc. MSC 78/26/Add. 1, Annex 3: Res. MSC.153/78 of 20 May 2004, Adoption of Amendments to the International Convention for the Safety of Life at Sea, 1974, as Amended, § 8 of the recitals; IMO Doc. MSC 78/26/Add. 1, Annex 5: Res. MSC.155/78 of 20 May 2004, Adoption of Amendments to the International Convention on Maritime Search and Rescue, 1979, as Amended, § 8 of the recitals.

[66] See *Weinzierl/Lisson*, supra note 9, 39-40.

"shall", which is defined by Art. 1.1 Annex SAR Convention as indicating "a provision, the uniform application of which by all Parties is required in the interest of safety of life at sea"), the relevant obligation is, first, one to co-ordinate and co-operate and, thus, is comparatively soft.[67] Secondly, with a view to the place of safety criterion (which is not defined in the amendments), both provisions only apply subject to "the particular circumstances of the case" and guidelines developed by the IMO. Thirdly, disembarkation shall be arranged "to be effective as soon as reasonably practicable." The wording of the two provisions, therefore, clearly indicates that the obligations contained therein are not self-executing, and assigns States parties with a wide range of discretion as to their implementation in a particular case.[68] Finally, one should not ignore the fact that the amendments were adopted by reliance on the tacit acceptance procedure (cf. Art. VIII (b) SOLAS; Art. III (2) SAR Convention), which would, again, be very unusual if considerable substantive changes to the existing regime were to be introduced. Thus, as regards their substance, the amendments do not exceed the standards already prescribed in the 2004 IMO guidelines. One is forced to conclude that a clear-cut obligation to deliver persons rescued at sea to a place of safety (and a corresponding duty of coastal States to allow for disembarkation) does not exist.

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[67] Cf. *G.S. Goodwin-Gill/J. McAdam*, The Refugee in International Law, 3rd ed. 2007, 278: "[…] although it remains to be seen how this will operate in practice" (footnote omitted).

[68] See *von Gadow-Stephani*, supra note 55, 360-1; *Rah*, supra note 21, at 278 (note 12).

3.3 Access to Ports by Vessels in Distress

When addressing ways of filling this legal gap in the provisions of international law of the sea, it makes sense to refer to the concept of the port of refuge.[69] Under normal circumstances, coastal States are entitled to close their ports to foreign ships, provided that exercise of this right is committed in a non-discriminatory manner and no special rule of treaty law exists.[70] However, the concept of the port of refuge represents an exception to this general territorial sovereignty of coastal States over their internal waters. The exact scope of the right of entry into port is, however, still somewhat unclear. While both scholars and tribunals agree that reliance on this right presupposes the ship in question being "in distress", the meaning of the term "distress" is still subject to controversy.[71] Much has been said elsewhere about the development of the respective legal concept.[72] Here it suffices to say that State practice indicates that an unconditional right of entry into port necessarily requires

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[69] But see *Goodwin-Gill/McAdam*, supra note 67, 274, who state that "[t]he notion of distress, or *force majeure*, reflects not so much a right of entry, as a limited immunity for having so entered in fairly well-defined circumstances" (footnote omitted, original emphasis).

[70] *Military and Paramilitary Activities in and against Nicaragua* (Nicaragua v. USA) (Merits) [1986] *I.C.J. Reports* 14, at 111 (§ 213): "It is also by virtue of its sovereignty that the coastal State may regulate access to its ports." – Note that the International Convention and Statute on the International Régime of Maritime Ports of 9 December 1923 (58 *L.N.T.S.* 285) does not create a right of entry into port but rather serves to establish "equality of treatment with its own vessels […] as regards freedom of access to the port" (Art. 2).

[71] See the references given by *Jaguttis*, supra note 10, at 117-24; *Barnes*, supra note 16, at 58-61.

[72] See the detailed analysis by *A. Chircop*, The Customary Law of Refuge for Ships in Distress, in: id./O. Linden (eds.), Places of Refuge for Ships, 2006, 163-229, at 168-222; *von Gadow-Stephani*, supra note 55, 209-334; *von Brevern/Bopp*, supra note 51, at 845-6.

human life being at risk.[73] In this respect, the Irish High Court of Admiralty held that the right to seek refuge in a coastal State´s port

> "[…] is not an absolute right. If safety of life is not a factor, then there is a widely recognized practice amongst maritime states to have regard to their own interests and those of their citizens in deciding whether or not to accede to any such request [to enter port]."[74]

Thus, whether a coastal State is obliged to accept entry into port of a ship intending to disembark persons rescued at sea solely depends on whether the lives of the rescuees are inevitably threatened. With regard to the context at hand, it is important to note that unseaworthiness is not tantamount to distress. If one takes the M/V Tampa incident as example, there is no doubt that the vessel would have had the right to enter into an Australian port if, as the captain had concluded, some of the asylum seekers were in urgent need of medical treatment, provided that a life threatening situation could not be avoided by some other course of action.[75] Having said that, contrary to statements made by legal scholars,[76] the mere fact that the vessel did not carry adequate safety equipment for both crew and rescuees did not give rise to distress by itself. Art. IV (b) SOLAS makes this very clear by stating that

> "[p]ersons who are on board a ship by reason of *force majeure* or in consequence of the obligation laid upon the master to carry shipwrecked or other persons shall not be taken into account for the purpose of ascertaining the application to a ship of any provisions of the present Convention."

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[73] Cf. *Churchill/Lowe*, supra note 42, 63; *Barnes*, supra note 16, at 60.

[74] *ACT Shipping (OTE) Ltd. v. Minister for the Marine, Ireland and the Attorney-General (The M/V Toledo)*, [1995] 2 *I.L.R.M.* 30, at 48-9 (Barr J).

[75] See *Barnes*, supra note 16, at 60.

[76] *Jaguttis*, supra note 10, at 123-4; *Pallis*, supra note 17, at 338; *von Brevern/Bopp*, supra note 51, at 847.

There is, therefore, a clear need to differentiate between violations of the SOLAS requirements resulting from a rescue operation on the one hand and the prerequisites of distress under customary law on the other.

A different but difficult-to-answer question is whether a right of entry into port also exists when the threat to human life is provoked by the rescuees, e.g., by threatening to jump overboard. It seems difficult to argue that such situations also fall under the notion of distress,[77] since this would eventually enable potential refugees to compel the coastal State to accept disembarkation and, therefore, open the door for abuse.[78] While it is true that the conduct in question is not always easy to distinguish from situations in which a danger to safety of life has not been created deliberately,[79] a wider interpretation of what constitutes distress would ignore the historical emergence of the concept from the factual risks of navigation, arising from the confrontation with water and wind.[80] The traditional concept of the port of refuge would be changed in substance if one accepts that duress committed by rescuees could

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77 Contra *Jaguttis*, supra note 10, at 121-2; *Pallis*, supra note 17, at 339-40; *Rah*, supra note 21, at 280.

78 See *The Eleanor*, Edwards 135, 165 Reprints 1058: "[t]hen again, it must not be a distress which he [the master or owner of a ship] has created himself, by putting on board an insufficient quantity of water or of provisions for such a voyage, for there the distress is only a part of the mechanisms of the fraud and cannot be set up in excuse for it".

79 *Rah*, supra note 21, at 280.

80 See the significant references to 19th century legislation given by *von Gadow-Stephani*, supra note 55, 226-7; see also *The Rebecca*, RIAA IV, 444, 447 („a ship floundering in distress, resulting either from the weather or from other causes affecting management of the vessel"). Exceptions to this rule seem to have been accepted by tribunals in cases of piracy, mutiny or lack of supplies and/or food only. Cf. *von Gadow-Stephani*, supra note 55, 221-3.

give rise to a right of entry into port. One should also not forget that from a factual viewpoint, the decision as to whether the prerequisites of distress are fulfilled or not is not made by the master of a vessel but rather by the coastal State in deciding whether or not to admit vessels to enter its port.[81]

3.4 Legality of Interception Measures

The final law of the sea aspect to be raised here is whether interception measures such as, e.g., exercised by Australia in the M/V Tampa incident can be legally justified.[82] Whether a State has the authority to stop, turn back, or even escort back vessels suspected to be manned with refugees depends on the maritime zone in which the incident takes place.[83]

a) As regards the high seas, unless otherwise provided for in a treaty (cf. Art. 110 (1) LOS Convention: "[e]xcept where acts of interference derive from powers conferred by treaty […]"),[84] a State

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81 See *Barnes*, supra note 16, at 61.

82 While no generally accepted definition of the term "interception" exists, EXCOM uses it with a view to "all measures applied by a State, outside its national territory, in order to prevent, interrupt or stop the movement of persons without the required documentation crossing international borders by land, air or sea, and making their way to the country of prospective destination" (EC/50/SC/CRP.17 of 9 June 2000, Interception of Asylum-Seekers and Refugees: The International Framework and Recommendations for a Comprehensive Approach, § 10). Thus, a vessel responding to persons in distress at sea cannot be engaged in interception; cf. EXCOM, Conclusion No. 97 (LIV) of 10 October 2003, Protection Safeguards in Interception Measures, § 6 of the recitals.

83 See EC/50/SC/CRP.17 (supra note 85), § 12.

84 See, e.g., the Protocol against the Smuggling of Migrants by Land, Sea and Air, Supplementing the United Nations Convention against Transnational Organized Crime, of 15 November 2000, UN Doc. A/RES/55/25 (2001), Annex III. The protocol, which entered into force on 24 January 2004,

does not have the right to inspect or board a vessel flying a foreign flag as this would constitute a direct violation of flag State jurisdiction as well as the principle of freedom of navigation.[85] While it is true that stateless ships, i.e., ships not flying any State´s flag (cf. Art. 91 LOS Convention), to which many of the vessels concerned here are likely to belong,[86] may lawfully be stopped and controlled on the high seas by warships (Art. 110 (1) (d) LOS Convention),[87] this right does not authorize a warship to tow a flagless vessel to another part of the sea or to exercise any other kind of physical interdiction.[88] The contrary view held by *McDougal* and *Burke,* who state that "extraordinary deprivational measures are permitted with respect to stateless ships",[89] ignores the fact that on the high seas, a

allows for the stopping and boarding of foreign vessels, subject to the flag State´s individual approval (cf. Art. 8 (2)). – Programs dealing with the return of undocumented migrants intercepted on boats on the high seas from outside the region to the countries of origin have been discussed in Latin America; see EC/50/SC/CRP.17 (supra note 82), § 7.

85 Cf. *T. Giegerich*, Sicherheit auf See: Maßnahmen gegen die Verschiffung von Massenvernichtungswaffen an internationale Terroristen nach Völkerrecht und deutschem Recht, in: A. Zimmermann/C.J. Tams (eds.), Seesicherheit vor neuen Herausforderungen, 2008, 5-33, at 19-27; *A. Proelss*, Maritime Sicherheit im Blickfeld von Völker- und Verfassungsrecht, in: *ibid*., 69-78, at 70-74.

86 *Weinzierl/Lisson*, supra note 9, 33.

87 For a definition of "warship" see Art. 29 LOS Convention which reads: "For the purposes of this Convention, "warship" means a ship belonging to the armed forces of a State bearing the external marks distinguishing such ships of its nationality, under the command of an officer duly commissioned by the government of the State and whose name appears in the appropriate service list or its equivalent, and manned by a crew which is under regular armed forces discipline."

88 *Pallis*, supra note 17, at 351; *Goodwin-Gill/McAdam*, supra note 67, 271; *Churchill/Lowe*, supra note 42, 214.

89 *M.S. McDougal/W.T. Burke*, The Public Order of the Oceans, 1962, 1084.

State may only exercise authority over any other vessel if and to the extent it is explicitly entitled to do so by the provisions of the LOS Convention (as in the case of piracy, cf. Art. 105 LOS Convention).[90] Any other interpretation would constitute a violation of the status of the high seas as a common space,[91] a status which is manifest in the principle of freedom of navigation. Thus, a State is neither entitled to apply and enforce its immigration laws on the high seas nor to exercise jurisdiction over foreign vessels, even if the vessel concerned is generally without protection due to the lack of nationality.[92]

b) In the Contiguous Zone (if claimed[93]), the coastal State neither enjoys sovereignty nor sovereign rights but only a "limited right of police"[94]. In this respect, Art. 33 (1) LOS Convention states that "the coastal State may exercise the control necessary to […] prevent [and punish] infringements of its […] immigration laws and regulations within its territory or territorial sea." It follows from the wording and context of this provision that the coastal State is not authorized to exercise sovereign rights in the field of immigration but is restricted to exercising control over the seaward border of its

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90 See *Churchill/Lowe*, supra 42, 214: „a need for some jurisdictional nexus"; contra SEC(2007) 691, supra note 8, § 2.2.2.

91 *R. Wolfrum*, Hohe See und Tiefseeboden (Gebiet), in: Graf Vitzthum, supra note 38, 287-345, at 294-5.

92 See also *Pallis*, supra note 17, at 351.

93 *W. Graf Vitzthum*, Maritimes Aquitorium und Anschlusszone, in: id., supra note 38, 63-159, at 150. As to the Italian situation see *S. Trevisanut*, Le *Cap Anamur*: Profils de droit international et de droit de la mer, (2004) *ADM* 9, 49-64, at 58-61.

94 *D.P. O´Connell*, The International Law of the Sea, Vol. II, 1984 (ed. by I.A. Shearer), 1058.

territorial sea.[95] Thus, the necessary link between the measures taken by the coastal State on the one hand, and the issue of immigration on the other, lies in the danger of violations of the coastal State´s laws applicable in its territorial sea. Against this background, the practice by Australia of towing back suspected refugee vessels to the external border of the contiguous zone initiated subsequent to the M/V Tampa incident constitutes, arguably, a violation of the LOS Convention.[96] Having said that, it seems clear that if there are reasonable grounds to believe that a vessel is intending to enter into the coastal State´s territorial sea in breach of its immigration laws, interception measures may, under the given circumstances, lawfully be taken to prevent the vessel from entering the territory of the State.

c) Finally, as regards the territorial sea, this maritime zone falls under the sovereignty of the coastal State (cf. Art. 2 (1) LOS Convention), subject to the right of innocent passage of third States. In this respect, it should, first, be noted that vessels without a flag are not entitled to exercise the right of innocent passage (cf. Art. 17 LOS Convention: "ships of all States"). As a result, physical interdiction measures such as escorting a stateless ship out of the territorial sea seem to be lawful under the law of the sea as long as the coastal State´s rescue duty does not apply.[97] Secondly, Art. 19 (2) (g) LOS Convention regards the passage of a foreign ship through the territorial sea as prejudicial to the peace, good order or

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[95] *Graf Vitzthum*, supra note 93, at 151-3. See also *Weinzierl/Lisson*, supra note 9, 34; *Pallis*, supra note 17, at 353-5; *Goodwin-Gill/McAdam*, supra note 67, 276.

[96] Cf. *D.R. Rothwell*, The Law of the Sea and the MV Tampa Incident, (2002) *PLR* 13, 118-127.

[97] *Weinzierl/Lisson*, supra note 9, 33. Also the UNHCR seems to accept that interception measures undertaken within a State´s territory are not per se unlawful, cf. Conclusion No. 97 (LIV), supra note 82, (a) i.

security of the coastal State and, thus, not innocent if "it engages in […] the loading or unloading of any commodity, currency or person contrary to the customs, fiscal, immigration or sanitary laws and regulations of the coastal State." In such cases, innocent passage may be hampered or even fully prevented if necessary (cf. Art. 25 (1) LOS Convention).[98] The fact that the wording of Art. 19 (2) (g) LOS Convention is framed in the present tense ("engages in") and only refers to the actual loading or unloading of persons indicates, however, that the mere intent of persons aboard a ship to request the protection of the coastal State upon entering one of its ports does not render the passage non-innocent.[99] Having said that, the existence of a right of innocent passage does not generally entail a right of entry into port, provided the vessel concerned is not in a condition of distress.

3.5 The Relationship between the Law of the Sea and Refugee Law

The analysis of the relevant law of the sea provisions has shown that with regard to the subject at hand, a comprehensive legal regime does not exist. In particular, the missing duty to disembark persons rescued at sea leaves a considerable gap in the protection of these individuals. Against this background, one might ask whether the rules of international refugee law, if applicable, can be relied upon to fill this gap. This consideration appears to be reasonable due to the fact that refugee law aims at the protection of refugees

[98] But see the position taken by *Goodwin-Gill/McAdam*, supra note 67, 273, who argue that a State is not necessarily authorized "to remove a vessel engaged in non-innocent passage from the territorial sea, since States are only permitted to take such steps as are *necessary* to prevent that passage" (original emphasis, footnote omitted).

[99] *Pallis*, supra note 17, at 356-7; contra *Goodwin-Gill/McAdam*, supra note 67, 274.

irrespective of whether they enter the territory of a State via land, sea, or air. As a matter of logic, the rights contained in the Convention relating to the Status of Refugees of 25 July 1951 (Refugee Convention)[100] are applicable at least in the territorial sea as forming part of the coastal State´s territory. Furthermore, the law of the sea cannot be considered a self-contained regime, i.e., a sub-system of international law which contains all necessary secondary norms and explicitly prohibits application of secondary norms of general international law.[101] Therefore, the conclusion reached by the European Commission that "[a]ll rules have to be applied without prejudice to the obligations deriving from international humanitarian law and international human rights law, including in particular the prohibition of *refoulement*", appears to be correct.[102] While it does not follow from this conclusion that the relevant law of the sea provisions were to be interpreted in conformity with the prerequisites of refugee law, the fact that States are generally not obliged to accept disembarkation of rescuees at their ports under the terms of international law of the sea does not necessarily mean that the same is true with regard to humanitarian law. Thus, the issue raised here is not one of conflict of rules but rather one of complementation.

A study on the law of the sea is not the appropriate context to address the details of refugee law. Suffice it to say that the main rule which might be of relevance is the principle of *non-refoulement*

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100 189 *U.N.T.S.* 150. The Convention entered into force on 22 April 1954.

101 The notion of self-contained regimes is highly disputed; see *Case concerning United States Diplomatic and Consular Staff in Tehran* (USA v. Iran), [1980] *ICJ Reports* 3, 40 (§ 86) on the one hand and UN Doc. A/CN.4/444 and Add. 1-3, Fourth Report on State Responsibility, by Mr. *Gaetano Arangio-Ruiz*, Special Rapporteur, [1992-II (1)] *YILC*, 35-42 on the other.

102 SEC(2007) 691, supra note 8, § 2.1.

stipulated in Art. 33 (1) Refugee Convention. This provision states that

> "[n]o Contracting State shall expel or return ("refouler") a refugee in any manner whatsoever to the frontiers of territories where his life or freedom would be threatened on account of his race, religion, nationality, membership of a particular social group or political opinion."

Two aspects connected with this principle shall be addressed here. First, without going into detail as to possible interpretations of the scope of Art. 33 Refugee Convention which are discussed in legal literature,[103] it seems justified to conclude that the principle of *non-refoulement* is applicable, not only within a coastal State´s territory, but also at its seaward borders.[104] However, while *non-refoulement* does not imply a general right to enter the territorial sea (which is why a denial of entry of refugee vessels to territorial waters cannot be equated with a breach of humanitarian law),[105] it is not clear whether it includes a duty to temporarily admit the individual for the purpose of examining his or her protection needs and status once he or she has entered the coastal State´s territorial sea.[106]

The difficulty in answering that question becomes evident when considering the position taken by *Goodwin-Gill* and *McAdam*.

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[103] See *Goodwin-Gill/McAdam*, supra note 67, 244-67.

[104] *E. Lauterpacht/D. Bethlehem*, The Scope and Content of the Principle of *Non-Refoulement*: Opinion, in: E. Feller/V. Türk/F. Nicholson (eds.), Refugee Protection in International Law: UNHCR's Global Consultations on International Protection, 2003, 87-177, at 113-5; *Barnes*, supra 16, at 67-71; *Pallis*, supra note 17, 342-4; *Rah*, supra note 21, 281-2; *Weinzierl/Lisson*, supra note 9, 45 with further references. Cf. also the slightly more conservative position taken by *Røsæg*, supra note 1, 72-4.

[105] *Goodwin-Gill/McAdam*, supra note 67, 277; *Barnes*, supra note 16, at 64.

[106] In the affirmative *A. Fischer-Lescano/T. Löhr*, Menschen- und flüchtlingsrechtliche Anforderungen an Maßnahmen der Grenzkontrolle auf See, Opinion, 2007, 23-5 ("implicit right"); *Weinzierl/Lisson*, supra note 9, 45.

These authors state, on the one hand, that "the principle of non-rejection at the frontier implies at least temporary admission to determine an individual´s status",[107] but, on the other hand, conclude with regard to the situation at hand, after referring to the 1950 comments on the draft Refugee Convention made by the Ad hoc Committee on Refugees and Stateless Persons, that even in a situation of actual, physical return of passengers to their country of origin, "the principle of *non-refoulement* would come into play only in the presence of certain objective conditions indicating the possibility of danger befalling those returned."[108] Indeed, while the wording of Art. 33 (1) Refugee Convention ("territories") does not exclude an interpretation according to which the principle of *non-refoulement* would also cover the return of a refugee ship to the high seas,[109] it is difficult to see how a "mere" towing back of a ship to the high seas, if viewed individually, could result in a threat of life or freedom on account of "race, religion, nationality, membership of a particular social group or political opinion". Subject to an interpretation under which flight would be considered as a continuous process, the principle of *non-refoulement* does not generally preclude the coastal State from taking interception measures, even after the potential refugees have entered the territorial sea,[110]

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[107] *Goodwin-Gill/McAdam*, supra note 67, 215 (footnote omitted); see also *Hathaway*, supra note 10, 301: "de facto duty to admit the refugee".

[108] *Ibid*., 277 (original emphasis, footnote omitted). See also *Pallis*, supra note 17, at 342.

[109] Cf. Lauterpacht/Bethlehem, supra note 104, at 122: "Secondly, it must be noted that the word used is 'territories' as opposed to 'countries' or 'States'. The implication of this is that the legal status of the place to which the individual may be sent is not material."

[110] The contrary is true if the coastal State directly or indirectly ("chain refoulement") plans to repatriate the individuals concerned to the country of origin or any other State where they may be persecuted. In such cases, it

provided that the right of innocent passage is not applicable. Having said that, any such course of action would clearly raise the question of its compatibility with human rights law or other relevant legal instruments.[111]

The same conclusion applies *a fortiori* to the contiguous zone, the exclusive economic zone, or the high seas, neither of which belongs to the territory of a State. While it has rightly been stated that this conclusion might result in the unsatisfactory situation that refugees are being "left to orbit" if no State is willing to admit them,[112] the relevant prerequisites of international refugee law do not address this situation in positive terms. In contrast to the International Covenant on Civil and Political Rights (Art. 2 (1))[113] and the European Convention for the Protection of Human Rights and Fundamental Freedoms (Art. 1: "everyone within their

is beyond doubt that the prohibition of *refoulement* implies a duty to accept and examine applications for international protection.

111 In this respect, it should be noted that within the EU, Directive 2005/85/EC on Minimum Standards in Asylum Procedures (Asylum Procedures Directive, OJ L 326, 13.12.2005, 13-34) is applicable to all requests for asylum made "in the territory, including at the border or in the transit zones of the Member States", and, therefore, also extends to the territorial sea. As the notion "application for asylum" encompasses "any claim for international protection from a Member State under the Geneva Convention" (Art. 2 (b)), member States are at least obliged to refrain from interception measures until the protection needs and status of the individuals asking for protection have been examined in accordance with the procedures foreseen by the directive. On the other hand, the position taken by Weinzierl/Lisson, supra note 9, 56, that "the term 'at the border' also includes the patrols of border protection ships or government ships involved in rescue at sea when they are in the contiguous zone" does not seem to be compatible with the status of the contiguous zone which, from a territorial viewpoint, forms part of the high seas.

112 *Barnes*, supra note 16, at 64.

113 999 *U.N.T.S.* 171.

jurisdiction"),[114] the Refugee Convention does not contain any provision providing for its extraterritorial application. Thus, under a positivistic interpretation, it does not seem permissible to accept the applicability of the *non-refoulement* principle whenever persons rescued at sea come under the jurisdiction of the flag State of the vessel which has conducted the rescue operation.[115]

Even if one were to consider an extension of the scope of the Refugee Convention in conformity with the human rights instruments just mentioned, one would have to further substantiate which situations are subject to the acting State´s jurisdiction.[116] In this respect, while Art. 94 LOS Convention cannot be interpreted as limiting the principle of flag State jurisdiction to administrative, technical and social matters,[117] it seems a point open to debate whether the flag State of a ship exercises jurisdiction if the ship simply ignores a refugee boat without intercepting it on the high seas. One should also not overlook the fact that the effective control test, introduced by the European Court of Human Rights in order to establish whether a State has exercised jurisdiction or not,[118]

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[114] 213 *U.N.T.S.* 222.

[115] Contra UNHCR, Advisory Opinion on the Extraterritorial Application of *Non-Refoulement* Obligations under the 1951 Convention relating to the Status of Refugees and its 1967 Protocol, 26 January 2007, §§ 23-43; *Goodwin-Gill/McAdam*, supra note 67, 248; *Fischer-Lescano/Löhr*, supra note 106, 6-12; *Weinzierl/Lisson*, supra note 9, 57-60 with further references.

[116] More optimistic Lauterpacht/Bethlehem, supra note 104, at 114: "Conduct amounting to rejection at the frontier – as also in transit zones or on the high seas – will in all likelihood come within the jurisdiction of the State and would engage its responsibility." See also Fischer-Lescano/Löhr, supra note 106, 14-5.

[117] Contra *Pallis*, supra note 17, at 348. See Nordquist, supra note 33, at 137, 144 for a review of the travaux préparatoires.

[118] Loizidou v. Turkey (Preliminary Objections), [1995] Ser. A, No. 310 (§ 63).

originates from the *Nicaragua* judgment of the International Court of Justice,[119] where it was used *de jure*, however, in the narrower context of establishing whether an act of private individuals is attributable to a State.[120] Thus, even a categorical refusal of disembarkation does not necessarily amount to a breach of the principle of *non-refoulement*.[121] Against this background, the conclusion drawn by *Goodwin-Gill* and *McAdam* that "[r]efugee law […] remains an incomplete legal regime of protection, imperfectly covering what ought to be a situation of exception",[122] seems to be true also with regard to the particular situation at hand.

4 Conclusions

When summarizing what has been stated above, two main conclusions may be drawn. First, that a general duty to disembark persons rescued at sea does not exist. Secondly, that as far as the areas outside the limits of national jurisdiction are concerned, the relevant prerequisites of the law of the sea and refugee law constitute a patchwork rather than a comprehensive regime. As evidenced by the latest amendments to SOLAS and the SAR Convention, approaches aiming at incorporating a next port of call approach or humanitarian requirements into the existing instruments do not appear promising, due to persisting opposition of most industrialized countries. It therefore seems that "more creative and less

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[119] *Military and Paramilitary Activities in and against Nicaragua* (Nicaragua v. USA) (Merits) [1986] *I.C.J. Reports* 14, at 64-5 (§ 115).

[120] Cf. *Lauterpacht/Bethlehem*, supra note 104, at 108-9, who draw a different conclusion.

[121] *Goodwin-Gill/McAdam*, supra note 67, 278.

[122] *Ibid.*, 1.

legalistic measures would be better suited to the problem."[123] A possible means of successful implementation which could, arguably, be adopted by way of a non-binding memorandum of understanding, might be to combine the concept of temporary refuge strongly advocated by the UNHCR[124] with a regime of equitable burden-sharing between coastal and flag States.

With regard to the EU, one can only agree with the European Commission that "the issue of repartition of responsibilities between the different countries with regard to the protection of refugees is still open."[125] Up to the present day, challenges resulting from the European boat people problem have solely been met by combining restrictive measures, such as improving cooperation in the area of management of external borders, with approaches to combat the causes for migration within the countries of origin.[126] To this end, the European Agency for the Management of Operational Cooperation at the External Borders (FRONTEX) was established in 2005.[127] While this agency, whose main task is to coordinate operational cooperation between the Member States in the field of

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123 *Barnes*, supra note 16, at 72.

124 See EXCOM, Conclusion No. 19 (XXXI) of 16 October 1980, Temporary Refuge; Conclusion No. 22 (XXXII) of 21 October 1981, Protection of Asylum-Seekers in Situations of Large-Scale Influx; Conclusion No. 71 (XLIV) of 8 October 1993, International Protection; Conclusion No. 74 (XLV) of 7 October 1994, International Protection; Conclusion No. 85 (XLIX) of 9 October 1998, International Protection.

125 SEC(2007) 691, supra note 8, § 2.3.4.

126 See *Weinzierl/Lisson*, supra note 9, 28-31; cf. also COM(2006) 733 final of 30 November 2006, Reinforcing the Management of the European Union´s Southern Maritime Borders, § 8.

127 Regulation (EC) No 2007/2004 of 26 October 2004 establishing a European Agency for the Management of Operational Cooperation at the External Borders of the Member States of the European Union (OJ L 349, 25.11.2004, 1-11).

management of external borders, was not assigned any operational competences, a recent amendment of 2007[128] has dynamized the common policy by introducing

> "a mechanism for the purposes of providing rapid operational assistance for a limited period to a requesting Member State facing a situation of urgent and exceptional pressure, especially the arrival at points of the external borders of large numbers of third-country nationals trying to enter the territory of the Member State illegally, in the form of Rapid Border Intervention Teams."[129]
>
> When exercising their powers for border checks or border surveillance in accordance with Regulation (EC) No 562/2006 ("Schengen Borders Code"),[130]
>
> "[m]embers of the teams shall, in the performance of their tasks and in the exercise of their powers, fully respect human dignity. Any measures taken in the performance of their tasks and in the exercise of their powers shall be proportionate to the objectives pursued by such measures. While performing their tasks and exercising their powers, members of the teams shall not discriminate against persons on grounds of sex, racial or ethnic origin, religion or belief, disability, age or sexual orientation."

As regards the law of the sea, current Community policy as expressed by the Council aims at

> "the development of guidelines on the legal scope for action to be taken by the Community and its Member States to counter migration flows on the high seas without prejudice to the principles laid down

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[128] Regulation (EC) No 863/2007 of 11 July 2007 establishing a Mechanism for the Creation of Rapid Border Intervention Teams and amending Council Regulation (EC) No 2007/2004 as regards that Mechanism and regulating the Tasks and Powers of Guest Officers (OJ L 199, 31.7.2007, 30-9).

[129] Art. 1 of Regulation (EC) No 863/2007.

[130] Regulation (EC) No 562/2006 of 15 March 2006 establishing a Community Code on the Rules governing the Movement of Persons across Borders (OJ L 105, 13.4.2006, 1-32).

> in the international legal framework on the law of the sea and the protection of refugees."[131]

Therefore, even though amendments to the law of the sea are apparently being considered, the issue identified by the European Commission is not addressed in any of the relevant communications or instruments. Attention should henceforth not only be drawn to restrictive measures such as strengthening the role and competences of FRONTEX and introducing new instruments of integrated border patrol,[132] but first and foremost to the establishment of a comprehensive regime of allocation of responsebilities.[133] In this respect, a proposal of the European Commission for a Council Directive[134] was considered by the UNHCR as providing a sound basis for establishing a European approach to temporary protecttion,135 but this has not yet been enacted by the Council.136 It

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131 Council of the European Union Doc. 13559/06 of 4 October 2006, Draft Council Conclusions on reinforcing the southern external maritime border, § 5.

132 Cf. COM(2006) 733 final, supra note 126.

133 Council Directive 2005/85/EC (supra note 111) only deals with minimum standards on procedures in Member States for granting and withdrawing refugee status.

134 COM(2000) 303 final of 24 May 2000, Proposal for a Council Directive on Minimum Standards for giving temporary Protection in the Event of a Mass Influx of displaced Persons and on Measures promoting a Balance of Efforts between Member States in receiving such Persons and bearing the Consequences thereof.

135 See Council of the European Union Doc. 11620/00 of 26 September 2000, Annex I and II.

136 See COM(2000) 303 final, supra note 124, § 1.2: "The Commission is aware of the difficulties of the temporary protection project. It has drawn the conclusions from three consecutive years of failed negotiations in the Council. Even so, acting on the basis of the mandate given by the Tampere European Council and of the Treaty, it has not abandoned its ambitions." – Note that two former instruments adopted by the council in 1995 and

therefore remains to be seen whether the member States of the EU will ultimately find the willingness to implement a common and comprehensive European policy with regard to asylum seekers rescued at sea.

1996, dealing with burden-sharing with regard to the admission and residence of displaced persons on a temporary basis, were never implemented; see ibid., § 3.1; Pugh, supra note 11, 43.

Part II
The company's duty to provide CAR-insurance under a fabrication contract: What is the situation if the insurer goes into bankruptcy?

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1 Introduction

In this article, I want to discuss whether the operator is liable towards the contractor where the CAR-insurance he is supposed to provide under the fabrication contract becomes unenforceable because the insurer goes into liquidation or bankruptcy.

The background for the article is a judgment from Stavanger District Court in July 2007. The facts were as follows: On April 3, 1997 the contractor Kværner Rosenberg AS (later Kværner) and the company Esso Exploration and Production Norway AS (later Esso) entered into a so-called EPCRIC contract, covering engineering, procurement, construction, relocation, installation and commissioning regarding the production vessel Jotun A. In the contract, Esso took upon itself to provide and maintain for the duration of the contract a CAR-insurance (Construction All Risks-insurance). The insurance should be on an all risks basis, and cover i.a. the contract object during construction, relocation and installation. The insurance should be placed in the joint names of company, contractor and subcontractors and contain a waiver of subrogation against any member of the contractor group.

Esso used the brokerage firm Aon Group Limited to place the insurance in the market. As for the first 5 million USD, 49% of the insurance was placed with Independent Insurance Company Limited (later Independent). In August 2001, Kværner was informed by Esso that Independent had gone into "Provisional Liquidation". By May 2007, the liquidation process was still undecided, but Esso and Kværner agreed that there was little reason to believe that any money would be paid by Independent.

When Independent went into liquidation, Kværner had accrued two claims which Esso agreed fell under the insurance. After the

other insurers had paid their part, Kværner was left with an uncovered claim of almost USD 2 mill.

Kværner asserted that it was the risk of Esso if an insurer under the CAR insurance was unable to fulfill its obligations. Esso disagreed with this assertation. Since the parties were unable to reach an agreement, Kværner started proceedings against Esso in Stavanger District Court, claiming that Esso should be obliged to pay the outstanding amount.

In its judgment of July 4, 2007, the District Court found in favour of Esso. The judgment was appealed against by Kværner, but the parties reached an agreement before the Court of Appeal had rendered its judgment. The content of this agreement is not known.

2 The legal background

The question raised in the judgment of the Stavanger District Court seems to arise under most of the fabrication contracts used under licences awarded on the Norwegian Continental Shelf. Since the terms of the contract between Esso and Kværner are not cited in full in the judgment, I will use as the starting point for the discussion the terms found in the Norwegian standard contract NF 05, which was prepared in cooperation between Statoil and Norsk Hydro on the one side and the federation Norwegian Industry on the other.

The relevant provisions in the NF 05 arts. 29 and 31 read as follows (the parts of the provisions that only relate to the insurances to be taken out by the contractor are not cited):

> ART. 29 LOSS OF OR DAMAGE TO THE CONTRACT OBJECT OR COMPANY PROVIDED ITEMS
>
> 29.1 If loss of damage to the Contract Object occurs between the start of the Work until the time when the Delivery Protocol has been signed or should have been signed in accordance with Art. 19.1 and 19.2, Contractor shall carry out necessary measures to ensure that

the Work is completed in accordance with the Contract. The same applies if any loss of or damage to Materials or Company Provided Items occurs while they are at Site under Contractor Group's safekeeping and control.

Contractor's obligation to carry out measures stated herein applies regardless of whether negligence in any form has been shown by Company Group.

29.2 The costs of carrying out such measures as are stated in Art. 29.1 shall be borne by . Contractor

Contractor's liability for such costs for any one occurrence is, however, limited to the deductibles for [the assured's] own risk under Company's insurance policies set forth in Art. 31.1, and in any event limited to a maximum of NOK 100.000, provided that:

the loss or damage is covered by Company's insurance policies mentioned above, or

the loss or damage is not covered by Company's insurance policies, mentioned above, as a result of circumstances for which Company carries the risk, or

the loss or damage originates from any form of liability, whether strict or by negligence, of Company Group.

ART. 31 INSURANCES

31.1 Company shall provide and maintain the insurances described below and in Appendix 1 – Company's insurances etc.

Builder's all risk insurance, or equivalent insurance, covering the Contract Object, Materials and Company Provided Items against physical loss or damage, in accordance with the insurance conditions.

Transport insurance covering the Contract Object, Materials and Company Provided Items against physical loss or damage during transportation, in accordance with the insurance conditions.

Liability insurance covering Company's liability under Art. 30.3 for a minimum amount of NOK 500.000.000 for claims arising from each accident.

Such insurance shall be effective from the start of the Work and shall not expire until issue of the Acceptance Certificate.

The policies shall state that Company Group and Contractor Group are co-insured, and the insurers shall waive any right of subrogation against Contractor Group.

31.2 …..

> 31.3 Contractor shall, at the request of Company, produce certified copies of the policies or insurance certificates with the necessary information, including the expiry date, relating to all insurances taken out by Contractor Group in accordance with Art. 31.2. The same obligation applies to Company for the insurances Company shall take out in accordance with the Contract.
>
> ….
>
> If one of the parties fails to take out insurance according to its obligations of this Article, then the other party is entitled to take out such insurance and claim a refund of the costs from the party in default.
>
> When any incident occurs for which cover is granted under one of the parties' insurance policies, the other party shall notify that party without undue delay, enclosing a description of the incident that gives rise to the insurance claim. When the party whose insurance policy covers the claim, handles the claim, the other party shall provide it with reasonable assistance, without claiming compensation.

The two provisions may be summarized as follows: The contractor has a duty to take the necessary measures to overcome loss or damage to the contract object, and to ensure that the work is carried out in accordance with the contract, see art. 29.1. The costs incurred in this respect shall be born by him, see art. 29.2.1, but his obligation to cover the costs is limited to the deductible under the insurance taken out by the company, provided that the loss or damage is covered by this insurance, see art. 29.2.2.a. With regards to insurance, the company is under a duty to take out and maintain a CAR-insurance, see art. 31.1.1.a-c. The CAR-insurance shall be in force from the start of the work and shall not expire until the issuance of the Acceptance certificate, see art. 31.1.2. The contractor group shall be co-insured under the CAR-insurance, see art. 31.1.3.

The contract provisions do not give a direct answer to the question posed in this article. The reason seems fairly obvious: The contracting parties have – perhaps a bit naïve in hindsight – taken

for granted that the insurance companies will always be able to cover their debts. I say naïve, because experience from later years tends to demonstrate that financial difficulties for insurers are not an uncommon feature.

However, two elements in the text of the two provisions should be highlighted when dealing with the problem raised. Art. 29.2.2.a limits the contractor's liability to a maximum of NOK 100.000, provided the loss or damage is "covered by" the company's insurance policies. This expression may be understood as a reference to the cover *incorporated in* the insurance conditions. If this is accepted as the sound interpretation, the insolvency of the insurer seems to be a risk that would lie with the company, since it is undisputed that the insurance conditions as such do cover the actual loss or damage. On the other side, it is possible to read the expression as a reference to the *actual* cover given by the insurer in a case where a loss or damage is falling under the conditions. Such an understanding would imply that the contractor should pick up the loss where the insurer is unable to cover his obligations under the insurance policy. Of the two possible readings of the provision, I would tend to favour the first one, although it must be admitted that we are not talking about a "strong" interpretation.

The other element worth mentioning is found in art. 31.1. The provision establishes that the company shall provide "and maintain" the relevant CAR-insurance during the full life of the work. It may be argued, as Kværner did in the Stavanger District Court case, that the company is not fulfilling its obligations in this respect, if in fact the insurance taken out does not provide the contractor with the promised cover because of the insolvency of the chosen insurer. In my opinion, the validity of such an argument may be questioned.

It is true that where the insurer goes into liquidation or bankruptcy, the company must be under a duty to take out relevant insurance cover with another insurer, regardless how expensive

such a new insurance would prove to be. Clearly, such new insurance will apply to loss or damage that might occur in the period after the new insurance was established. It seems to follow that if in fact the company has not taken out such new insurance, the company must be liable to cover "new" losses which the insurance would have covered.

However, it is difficult to see that it follows from the expression used that the company should be obliged also to take out a new insurance with a retrospective cover. Such a solution does not fit well into the system of insurance. Insurance is taken out to cover possible future loss or damage, and not loss or damage that has already occurred. But it may perhaps be argued that it is an implied term in the expressions used that the company should provide and maintain a *valid insurance* for the period set out in the contract. This obligation is not fulfilled by the company where the chosen insurer is under liquidation or bankruptcy, and the company must take upon itself to provide the contractor with the cover he might expect according to the contract.

The contract also gives rise to two other reflections, both supporting a solution where the risk of the insurer's insolvency is placed with the company. Art. 8.2.2.2 prescribes that the contractor is entitled to an adjustment in the contract schedule and the contract price, pursuant to the rules in arts. 12-16 on variations to the work, where a subcontractor assigned or appointed by the company goes into liquidation and the subcontract delivery in question is annulled. The reasoning behind this solution is clearly that the use of such subcontractors instead of the contractor's own subcontractors is in the interest of the company, and therefore is a risk that should rest with the company. The solution supports a solution where the company is left with the insolvency risk for the CAR-insurer, since in both cases the contractor should not suffer for economical problems incurred by the company's appointee.

The second reflection relates directly to art. 29. Under art. 29.1 and 29.2.1 the contractor has *both* the obligation to carry out necessary measures to overcome loss or damage to the contract object *and* the obligation to pay for the costs of performing such measures. In principle, these obligations are unaffected by the reason why such measures have proved themselves necessary. They may be due to the contractor's or his subcontractors' faults or neglects, but may also originate from a force majeure event or an incident for which the company group is liable. In the latter case, the contractor's liability is limited to the deductible under the CAR-insurance, maximised to NOK 100.000, see art. 29.2.2.c. The same rule does not apply where the loss or damage is due to a force majeure event. Here, the contractor will have to carry the costs in full unless they can be placed under the CAR-insurance. The effect of the CAR-insurer's insolvency may be then that the contractor has to cover in full *not only* the costs related to loss or damage to the contract object caused by anyone in the contractor group, *but also* costs due to a force majeure event. This seems like an unjust and unhappy result. Since it is difficult to construct a free-standing rule for the force majeure event without clear and strong support in the contract text itself, the only viable solution to the problem would be to let the risk of the insurer's insolvency rest with the company *in tutu*.

3 Does the preparatory work, court practice or other practice or relevant theory provide an answer?

Inquiries to members of the group preparing the NF 05 have revealed that the question posed was not raised or discussed during the preparatory work on the agreed conditions.

On the other hand, the decision in the Stavanger District Court apparently has led parties to some contracts, entered into after the court's decision, to regulate explicitly how the risk of the insurer's insolvency should be distributed among the contracting parties. The content of such a regulation is not publicly known.

Except for the decision in the Stavanger District Court, there is to my knowledge no other cases tried in the ordinary Norwegian courts or in arbitration on the question raised.

In his extensive commentary to NF 05 (Petroleumskontrakter, med kommentarer til NF 05 og NTK 05, Oslo 2006), *Knut Kaasen* has not raised or commented on the question. This is of particular interest, since Kaasen chaired the committee that prepared the NF 05. However, it is worth mentioning that the Stavanger District Court in its judgment made several references to Kaasen's book, and apparently found support for its result in the citations made. However, in my opinion, these citations provide limited or no help to solve the problem.

In my doctoral thesis Tredjemannsdekninger i forsikringsforhold, Oslo 1988, I discussed in some detail the parallel provisions in the agreed standard fabrication contracts used on the Norwegian continental shelf at that time (Statoil Fabrication Contract 1983; Norsk Hydro Fabrication Contract 1983; North Sea Offshore Lump Sum Construction Contract, 1983). However, I did not touch upon the question of bankruptcy/liquidation of the insurer of the CAR-insurance in the dissertation, and the book is hardly of any help when discussing the present problem.

4 Distribution of the insolvency risk between the parties – other relevant arguments

Since neither the contracts themselves nor other written sources provide good answers, it is necessary to discuss the problem based on "best solution"- arguments.

1. The contract provides for the company to select the CAR-insurer and to pay the premium charged. There is every reason to believe that the company and its broker normally will take precautions to place the CAR-insurance with an economically sound insurer. The company has a self-interest in securing that the insurer is in a position to provide the contractor with the necessary means to cover the costs of replacing or repairing the contract object after it has suffered a possible loss or damage. At the same time, one cannot disregard the possibility that the company will be less inclined to take the insurer's financial strength into consideration where the CAR-insurance is split into several layers. This is true particularly if the relevant insurer is placed in a bottom layer with a small amount and his participation is limited. The reason for this proposition is simple: The chances that the contractor (or the company) would have sufficient economic muscles to carry the loss is normally greater if the insurer that goes into liquidation is placed in such a category. Therefore, the insolvency of such an insurer will seldom affect the company negatively.

Another important factor to be underlined is that although the insurance covers a risk that the contractor will be liable for under the contract, he has in fact no influence on the placing of the insurance. The contract presupposes that placing of the CAR-insurance is a privilege for the company to decide, without any interference from the contractor. But this being the case, it favours a

solution where the risk of the insurer not being able to fulfil his commitment is in fact placed with the company.

The parties in the Stavanger District Court case seem to have been in agreement that if the company and its broker could be blamed for having placed the insurance with a subsequently insolvent insurer, the company might have to cover the insurance revenue that would have been due from this insurer. On the other hand, they disagreed as to whether the company had given necessary proof to establish no negligence on its part… In my opinion, it may well be argued that the company should cover the insurance revenue lost, even if negligence cannot be proved on its part. A solution where the risk of the insurer's insolvency is placed with the company, will – on a general basis – have the effect that the company uses every possible effort to secure that the insurer chosen will in fact have the economic standing necessary to be able to cover the risk he has written. This solution also means that the contractor is excepted from the very difficult task of proving negligence from the company in order to have the company foot the bill.

This argument is supported by the fact that the company has an obvious interest in minimising the costs of the insurance taken out. Since the costs of the CAR-insurance will be placed with the company, it may be inclined to choose an insurance cover that is as inexpensive as possible. An effective way to minimise the insurance costs will be by splitting the total sum of insurance into separate layers, placing each separate layer with different sets of insurers. The Stavanger District Court case is illustrative on this point. Although the details of the insurance scheme is not reported, the total sum of insurance was evidently divided into (several) layers, since it is said that an insurer in the first layer went into liquidation. As already indicated, there is reason to believe that the company and its broker in the typical situation will be more concerned with

the price of the cover on the first layer than with the solidity of the insurers involved, since the amounts at risk are fairly small (in the Stavanger case: 49% of USD 5 mill.).

In concluding this line of argument, it should also be pointed out that the company's right to organise the insurance arrangements is clearly advantageous to the company. It enables the company to choose a coordinated insurance cover where all its interests during the fabrication phase are seen in conjunction. The difficulties of ironing out the effects of a lack of necessary coordination, which might be present where all the involved contractors are forced to make their own insurance arrangements, are thereby avoided.

2. Another line of argument may also support a solution where the company is left with the risk of the CAR-insurer's insolvency. We have seen that art. 29 prescribes that the *contractor* carries the risk if the contract object is suffering loss or damage. Likewise, the *contractor* is under the obligation to carry out at his own costs measures necessary to ensure that the work is completed in accordance with the contract. On the other hand, art. 31.1 prescribes that the *company* is to provide a CAR-insurance, whereby the contractor's costs of carrying out the measures necessary will be covered by this insurance. A similar split is not found under the other articles in NF 05 Part VIII Liability and Insurances. The knock for knock-arrangement in art. 30.1 and 30.2 provides that each party bears the risk of injury to or loss of life of its "own" personnel and the risk of damage to or loss of its "own" property. The contractor is therefore under an obligation to indemnify the company group from and against any claims concerning such losses suffered by a member of the contractor group as this concept is defined in the contract. To support this obligation, and to secure that the contractor is in fact financially able to cover such claims from members of the contractor group, the contractor is under a duty to take out insurance to cover these risks. Thus, under

the knock for knock-arrangement, the duty to insure goes hand in hand with the underlying risk distribution: The obligation to take out insurance is placed with the same party that bears the risk for the relevant interest. .

Under the knock for knock-arrangement it may be argued convincingly that the contractor should bear the risk if "his" insurer goes into liquidation, leaving the loss/damage or the injury/loss of life uncovered. He has taken upon himself to carry this risk, and he is in full control of the insurance arrangements. Accordingly, there is little reason why the company should stand unprotected if the insurers picked by the contractor is financially unable to deliver the amount due to the company.

If the argument in the preceding paragraph regarding the knock for knock-arrangement is accepted, it offers good support for a similar solution where the CAR-insurer goes into liquidation. There is no reason why the contractor should find himself unprotected because the CAR-insurer is not able to cover his debts. The company has chosen the insurer and the contractor has had no opportunity to influence the insurance arrangement and the insurer. The CAR-insurer's ability to pay the insurance claims is absolute essential to the contractor, as he is not supposed to have and will in fact not have insurance cover on his own. The balance found in arts. 29 and 31 would be seriously shaken if the contractor was left with a risk which – according to the contract provisions – should have been covered by a CAR-insurer brought in by the company.

3. Although the CAR-insurance is labelled as an all risks insurance, there are important limitations in the insurance cover. The way arts. 29 and 31 are formulated, the risk of "holes" in the insurance cover will normally rest with the contractor, although art. 29.2.2.b-c provides for important exceptions. Placing the risk of the insurer's insolvency with the contractor leaves him with yet another risk. As experience tends to show that this risk will seldom material-

lise and lead to an economic loss for the contractor, it may be argued that placing the risk with him is a small extra burden on his shoulders.

In my opinion, such an argument is not convincing. There is an important difference between the insolvency risk and the risks which fall outside the insurance cover due to exceptions in the insurance conditions themselves. These latter exceptions will normally be known to the contractor when the fabrication contract is signed, since the relevant insurance conditions often – if not always - will be incorporated in and form a part of the fabrication contract itself (see art. 31.1.1, which refers to Appendix I – Company's Insurances). The contractor will have the opportunity to evaluate the cover offered him under the insurance contract. And although he will not normally be in a position to protect himself from risks not covered by the CAR-insurance, for instance through self-provided insurances, at least he will be able to set a price to the uncertainty when making his bid for the contract. This is different when it comes to the insolvency risk. It has neither been highlighted in the contract itself nor in the preceding negotiations, as have the exclusions from cover in the insurance contract. The contractor will not have had an opportunity to set a price on this risk in his bid for the contract, and even if he had been offered the opportunity to do so, it would also have been difficult, if not impossible, for him to set a valid price tag on the risk.

5 Conclusion

Based on the arguments above, it is my opinion that the risk of the CAR-insurer under a fabrication contract going into liquidation should be placed with the company and not the contractor. The company will have to reimburse the contractor for losses the contractor has suffered as a result of his duty to carry out necessary

measures to ensure that the work is completed in accordance with the contract, where loss or damage to the contract object has occurred. Although the study has been based on the Norwegian standard fabrication contract NF 05, it is my opinion that the same result must apply under other fabrication contracts, unless the contract text materially differs from the relevant provisions in NF 05.

Part III
"Conditions of use" at gas terminals. Risk allocation and insurance coverage

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1 Introduction

1.1 Topic and background

The topic of this thesis is to identify shipowner[1] risks arising from 'Conditions of Use' (CoU) at gas terminals and subsequently to discuss possible insurance and charter party coverage of such risks.

CoU are standardised contracts issued by the port to the shipowner, allocating risks arising during the vessel's port call. Many incidents may occur in relation to port calls, giving rise to a number of risks. Most ports require compulsory pilotage and tugs, and collision or striking may occur either between vessel and tug or between vessel and berth or other vessels. Furthermore, there may be accidents related to mooring, pollution, cargo operations and treatment of explosive substances, the last of which is particularly relevant in the oil and gas trade.

The contracts are characterised by far-reaching liability provisions which often work to the effect that the shipowner becomes unlimitedly liable for all and any damage both to its own and the terminal's interests, as well as for third party liabilities. The ordinary shipowner insurances do not cover liability which is more onerous than what follows from ordinary law, and this creates the need for additional insurance and charter party cover.

Since Norway has a world-leading position in the field of carriage of natural gas, CoU are frequently encountered by Norwegian

[1] The term *'shipowner'* is used throughout this thesis instead of the wider Norwegian term *'reder'*. In the context of international contracts, it seems justifiable and appropriate. For the legal distinction between the two terms, cf. *Falkanger/Bull/Brautaset:* Scandinavian Maritime Law – The Norwegian Perspective 2nd edition (2004) pp. 139 et seq.

vessels. Norway is the fifth largest shipping nation in the world, and holds significant market shares in the carriage of oil, gas and chemical as well as offshore services.[2] The petroleum industry contributes approximately one fourth of Norway's total value added.[3]

In an attempt to initiate dialogue between shipowners and terminals, Norwegian shipowners have tried to raise the issue of the CoU in SIGTTO[4], but due to its non-technical nature, the topic was deemed to be outside the scope of the society's work. It should be noted that there is a clash of interest in SIGTTO, since both sides of the table are represented there.

On the other hand, gas charterers have a stronger negotiating position than shipowners, due to the fact that the charterers are usually large international petroleum companies, frequently with an ownership interest in the terminals. The charterers have proven successful e.g. in Ras Laffan,[5] where the conditions have been amended and subsequently approved by the P&I insurers.

1.2 The outline of the thesis

In order to facilitate an examination of this topic, the contracts will be placed in a legal, practical, geographical and historical context.

Section 2 outlines the legal framework, i.e. contractual freedom, relevant background law and jurisprudence.

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2 *Norwegian Shipowners' Association:* Norsk skipsfart (URL: www.rederi.no/ default.asp?V_ITEM_ID=501)

3 *Statistics Norway:* Naturressurser og miljø (URL: www.ssb.no/vis/magasinet/miljo/art-2007-01-24-01.html)

4 The Society of International Gas Tanker and Terminal Operators (URL: http://sigtto.re-invent.net/DNN)

5 Examined CoU are enclosed as an annex. Cf. page A at the back for an alphabetical list.

Section 3 provides the practical and geographical context, with a description of the gas industry and markets.

Section 4 outlines characteristic features, historical background, similar practices and the contents of the contracts.

Section 5 discusses certain issues related to contract formation, more specifically the contract's binding effect and application, with and without the master's signature.

Section 6 firstly contains a detailed discussion of the liability provisions, with a view to examining their legal consequences for the shipowner, and subsequently discusses whether such terms may be set aside or adjusted under Norwegian law.

Section 7 discusses insurance coverage and risk allocation between shipowner and charterer. Problems in relation to P&I[6] insurance and hull insurance are examined separately, and the presentation also includes a suggested charter party provision drawn up by Nordisk Defence Club[7] (Nordisk).

The final section summarises the main points of the thesis with an emphasis on how the contracts may be adjusted to obtain insurance cover.

[6] Protection and Indemnity, cf. 7.2 below

[7] A mutual freight, demurrage and defence club which also acts as a maritime law firm for its members and other clients. Nordisk's main office is in Oslo, Norway (URL: www.nordisk.org)

2 Legal sources

2.1 Contractual freedom and relevant background law

Four different contracts are involved during a gas carrier's port call: i) the underlying sales contract, ii) the terminal's CoU, iii) the charter party and iv) the insurance contract(s).

With respect to i), it is sufficient to note that the natural gas charterer is also often the buyer, or sometimes the seller, of the cargo and has signed long-term charter agreements with independent carriers.

With respect to ii), the majority of the CoU stipulate local choice of law and jurisdiction, while the remaining stipulate English law and courts. Considering the various terminal contracts on the basis of their local jurisdictions is outside the scope of this thesis. Thus, Norwegian law will be used as the legal framework.

The Formation of Contracts Act of 31 May 1918 (No. 4) is the basis for Norwegian contract law. § 1 establishes the principle of contractual freedom, which gives the parties the freedom to decide on the contents of the contract. Nevertheless, § 36 of this act provides the courts with a discretionary measure for adjusting or setting aside contracts if the contractual freedom has been misused.

The main legal source of maritime law is the Norwegian Maritime Code (NMC) of 24 June 1994 (No. 39). CoU are not regulated in this statute, and thus there are not specific requirements as to contents, making the Formation of Contracts Act § 36 the legal basis for setting aside or adjusting such terms.

There will also be references to English law, particularly in the discussions of the contract's binding effect and whether such contracts constitute general trade practice.

With respect to iii), NMC § 322 establishes freedom of contract in the charter party trade unless the trade is domestic, where certain restrictions apply. There is a widespread use of standard forms in the charter party trade, and these forms are often biased either in favour of the shipowner or the charterer. In the LNG trade the form ShellLNGTime1 is frequently used.

With respect to iv), the Insurance Contracts Act of 16 June 1989 (No. 69) is compulsory for Norwegian insurance contracts, but § 1-3 second subparagraph letter c) stipulates that it is supplementary for shipowner insurances. The contractual freedom in this area stems from the high level of professionalism dominating the trade, its international character as well as a particular legislative technique where represented interests together have drafted the insurance conditions.[8]

In relation to the CoU, two different types of insurance are relevant, namely hull and P&I insurance, and these two are regulated by different conditions.

Hull insurance is regulated under the Norwegian Marine Insurance Plan 1996 version 2007 (NMIP). The NMIP regulates most aspects of marine insurance and has extensive commentaries which are to be regarded as part of the conditions.[9] Although the NMIP is not binding and insurance may thus be effected on other conditions, it is in widespread use among Norwegian shipowners, and for the purpose of this thesis hull insurance will be discussed on the basis of the NMIP.

The main legal source for P&I insurance is the private conditions issued by the mutual P&I societies. For the purpose of this thesis, reference will be made to Gard[10] Statutes and Rules 2008 (GR).

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[8] *Wilhelmsen/Bull:* Handbook in hull insurance (2007), pp. 27 – 28

[9] *Wilhelmsen/Bull*, p. 29 cf. the Commentary to NMIP § 1-4

[10] The world's second largest P&I club (URL: www.gard.no)

2.2 Case law

Case law is an important source for interpretation of contractual provisions, but so far there are no Scandinavian decisions on Conditions of Use. However, some aspects of relevance for this thesis have been discussed in English case law.

In addition, reference will be made to Scandinavian case law in the discussions of whether the contracts apply without the master's signature and whether such liability provisions may be set aside or adjusted by a Norwegian court.

2.3 Legal literature

Legal literature, although not a source of law in the strictest sense, is useful for finding arguments either for or against a position, and the arguments are particularly relevant if written by a person of authority in the field. The literature also gives a systematic presentation and review of the relevant legal sources.

Relevant literature will be discussed and cited where appropriate.

3 The gas industry

3.1 Gas processing and transportation

The gas trade is divided into two main categories: LNG[11] and LPG[12]. This thesis will concentrate mainly on the LNG trade, but will include examples from the LPG trade where relevant.

Natural gases are extracted from underground gas fields through wells in a gaseous state.[13] Before sea carriage can take place, the

[11] Liquefied natural gas

[12] Liquefied petroleum gas

gases must be refined and liquefied at processing plants. The gaseous mixture consists of approximately 82 per cent methane, which is merchandised as 'natural gas' (LNG) and 18 percent is a blend of ethane, nitrogen, propane, carbon dioxide, butane and pentane in decreasing order.[14] Before LNG can be transported and utilised, the petroleum gases (LPG), which are slightly heavier than methane, must be extracted. When LNG has been refined, it consists of approximately 95 per cent methane and 5 per cent other substances.

The liquefied petroleum gases are mainly propane and butane and are natural derivatives from the refining of either LNG or crude oil. Gas processing is the source of approximately 60 per cent of petroleum gas production, and crude oil refining constitutes the origin of the remaining 40 per cent.

Pipeline transportation is increasing its market share, but sea carriage is still the most common means of transportation due to lower costs. Pre-liquefied gas is led via terminals into large gas carriers, through loading arms connected to the vessel's piping system.

During transportation, the gas is kept at boiling point by removing the vaporised gas from the tanks and either running it through a reliquefaction plant and returning it to the tanks (typical on LPG carriers), or channelling the vapour into the vessel's boilers, thus utilising it for main propulsion (typical on LNG carriers). The

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[13] *Younger, A. H.:* 'Natural gas – processing principles and technology', lecture (URL: www.ucalgary.ca/ENCH/class_notes/ench607/mainmenu.pdf)

[14] *University of Texas, Bureau of Economic Geology:* Introduction to LNG (URL: www.beg.utexas.edu/energyecon/lng/documents/CEE_INTRODUCTION_TO_LNG_FINAL.pdf)

boiling point of LNG at ambient pressure is -160ºC. Such low temperatures require special design materials and safety measures.

The LNG trade is predominantly a charter party trade, characterised by long-term charter parties, and it is comparable to liner shipping with its 20-year long charter parties and a few regular ports. In the LPG trade, on the other hand, contracts of affreightment are in widespread use.

3.2 The LNG market

Hydrocarbon gases are used for generating electricity and as raw material for fibres, clothing, plastic, health care, computing and furnishing. In the USA these gases are also utilised in private households for cooking and heating.[15]

The LNG shipping market is continuously expanding, with 275 tankers in operation and 102 on order as of August 2008.[16]

Worldwide, there are 26 existing export or liquefaction terminals, located on or off shore, in 15 countries.[17] Contrastingly, there are 60 existing import or regasification terminals, on or off shore, in 18 countries. In addition to these existing terminals, there are approximately 65 liquefaction terminal projects and approximately 181 regasification terminal projects, either proposed or under construction all around the world, although it is not expected that all proposed terminals will be constructed.

The following nations export LNG (start-up year in parenthesis):

- Algeria (1971)
- Australia (1989)

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[15] *University of Texas, Bureau of Economic Geology:* Introduction to LNG

[16] *Shipbuilding history:* The order book of LNG carriers (URL: www.shipbuildinghistory.com/world/highvalueships/lngorderbook.htm)

[17] *The California Energy Commission*: LNG international (URL: www.energy.ca.gov/lng/international.html)

- Brunei (1972)
- Equatorial Guinea (2007)
- Egypt (2004)
- Indonesia (1977)
- Libya (1970)
- Malaysia (1983)
- Nigeria (1999)
- Norway (2007)
- Oman (2000)
- Qatar (1997)
- Trinidad and Tobago (1999)
- United Arab Emirates (1977)
- United States of America (1969)

The following nations import LNG:

- Belgium (1987)
- China, People's Republic of (2006)
- Dominican Republic (2003)
- France (1972)
- Greece (2000)
- India (2004)
- Italy (1971)
- Japan (1969)
- Mexico (2006)
- Portugal (2003)
- Puerto Rico (U.S. outlying territory) (2000)
- South Korea (1986)
- Spain (1969)
- Taiwan (Republic of China) (1990)
- Turkey (1992)
- United Kingdom (2005)
- United States of America (1971)

Experts predict that by 2030 natural gas will be meeting 25 per cent of global energy needs.[18] Obviously, this places the export ports in an increasingly strong negotiating position with respect to the Conditions of Use.

4 An outline of the Conditions of Use

This section outlines the characteristic features and historical background of the CoU and provides an overview of their contents.

4.1 Characteristic features

Conditions of Use in gas carriage are standardised contracts for use of LNG and LPG ports. Such conditions are mainly found at export terminals in Africa, the Middle East, Indonesia and Mexico.

These contracts often imply unlimited and strict, or far-reaching, liability for the shipowner and entail wide disclaimers on behalf of the terminal, thus resulting in a channelling of all liability under the contract to the shipowner. Moreover, the contracts are so general and comprehensive in their form that it is difficult to quantify the extent of exposure. Furthermore, the requirement for causation is limited or non-existent, and the fact that the contracts are often subject to local law, implying a wide range of exotic laws, makes this risk more difficult to determine.

A descriptive comment about the Conditions of Use is found in the English Court of First Instance decision *The Polyduke*,[19] concerning berth damage covered by an indemnity provision used by an oil terminal.

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[18] *Ahsan, Muhammad Farooque:* LNG re-enters the world energy market, Pipeline and Gas Journal (URL: http://findarticles.com/p/articles/mi_m3251/is_11_233/ai_n24996339?tag=artBody;col1)

[19] [1978] 1 Lloyd's Rep 2-11 (Bahamas Oil Refining Co. vs. Kristiansands Tankrederi A/S and Others and Shell International Marine Ltd.), Kerr J presiding

> '[A] common pattern of these conditions is to purport to cast upon the shipowner an extremely wide measure of risks and liabilities. Although the documents vary in their form and content, their general effect is to seek to cast upon the shipowners all risks of loss and damage to the vessel or to their owners, and all liability for loss or damage to the installations and to their owners or occupiers which might arise in connection with the vessel's user [sic] of the terminal, howsoever such loss or damage might be caused, and even if the cause might be some negligence or default on the part of the owners or occupiers of the terminal.' [20]

4.2 Background and similar practices

It is likely that Conditions of Use found their way into the gas trade from the oil trade. *The Polyduke* decision contains a statement to the effect that CoU were employed by oil terminals already in the 1950s.[21]

The decision also states that the employment of such contracts in the oil trade *'follows that of a number of widely used and somewhat notorious conditions in other fields concerning shipping.'*[22]

Equally imbalanced conditions are found in contracts regulating pilotage and tug hire. Tug contracts are standardised contracts which protect the tug company from liability to a significant extent and impose a considerable degree of liability on the shipowner for damage caused to the tug company.[23] The shipowner may also be forced to accept contractual collision liability and waiver of the right to claim damages in so-called *'Let Pass Agreements'* or *'Port conditions'* in order to use a canal or waterway to enter a port.[24]

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[20] p. 214

[21] p. 214

[22] p. 214

[23] *Falkanger/Bull/Brautaset*, p. 156

[24] *Wilhelmsen/Bull*, p. 287

Nevertheless, according to the court in *The Polyduke* case,

> 'whereas the shipowners and their insurers have come to accept similar conditions in relation to tug contracts, perhaps because they are so widespread and do not give rise to risks of the same magnitude, there has been a considerable measure of resistance to the unqualified acceptance of such conditions when sought to be imposed by oil terminals,' quoting as reason that the P&I insurance 'cover will not extend to liabilities arising under contractual indemnities […] unless their terms have previously been approved' by the insurers.[25]

This has led to the development of side letters in the oil trade, whereby the P&I insurers have made the terminals agree not to rely on the terms of the indemnity clauses if the loss is resulting from negligence or default on the part of the terminal.[26] However, side letters are not common in the gas trade.

4.3 Contractual contents

The Conditions of Use may differ in structure, but the contents are very similar.

Firstly, there is an indemnity provision implying strict liability for the shipowner arising out of any loss or damage to the terminal facilities or injury or death of any person employed there. In the majority of the contracts, this provision expressly states that liability applies regardless of any negligence or default by the vessel, shipowner or its servants.[27]

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[25] p. 214

[26] p. 214

[27] The shipowner's servants include inter alia the master, crew and agent, and the terminal's servants include inter alia mooring and cargo personnel. The position of pilots and tug crew is unclear, as they may be regarded as either the shipowner's or terminal's servants under the contract, cf. 6.3.1 below.

Secondly, the contracts normally include an indemnity provision stipulating that the shipowner must hold the terminal harmless from any claim by third parties.

Thirdly, the terminal disclaims all liability for any loss, damage or delay on the part of the shipowner arising from the use of the terminal, even where it is due to the terminal's own fault.

Fourthly, there is a warranty disclaimer for the safety and suitability of the port. There is also normally a separate disclaimer related to losses caused by pilots, tugs and other navigational services.

Fifthly, the contracts often include a warranty by the shipowner for the suitability and capability of the vessel.

Sixthly, the majority of the conditions include provisions granting the terminal the right to remove any sunken or grounded vessel, placing all expenses incurred thereby with the shipowner.

Seventhly, the contracts often require indemnification for pollution or discharge.

Finally, several contracts stipulate that the vessel may be detained until sufficient security can be posted.[28] This may lead to offhire losses for the shipowner.

5 Contract formation

This section discusses certain issues related to contract formation, more specifically the contracts' binding effect and application with and without the master's signature.

Under Norwegian law the legal basis for contract formation is found in the Formation of Contracts Act Chapter 1. This statute draws on common Scandinavian principles of contract formation,

[28] Sharjah Clause 2 and *'Conditions binding upon all users of Port Rashid Dubai'* Clause c)

and the starting point is freedom of contract, cf. § 1. In commercial contracts this freedom is frequently used to agree on separate terms for creating a legally binding agreement.[29]

CoU are not agreed documents, but should rather be regarded as a type of standard form contract, which are often used to impose liability exclusions which have not been negotiated.[30] Although legislation has been adapted to protect consumers from unreasonable contract terms,[31] this does not apply to the shipowner, since contracting parties in shipping are traditionally regarded as equal commercial parties, bargaining freely to reach an optimal result.[32] However, in this case neither negotiations nor rejection is available.

The contractual relationship between shipowner and terminal is formed via the master when the vessel enters the port. During the initial phase of the port call the local authorities will present the master with the contract for signing and stamping. The master's signature is compulsory, and there is no room for negotiations. Unless the master signs he will not be allowed to berth, and it is not an option to go to another port.

Several CoU also expressly apply regardless of the master's signature.[33]

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29 *Woxholth:* Avtalerett, 6th edition (2006), p. 149

30 *Poole:* Textbook on contract law 8th edition (2006)

31 The Norwegian Marketing Act of 16 June 1972 (No. 47) § 9 a.

32 Rt. 1948.370 NSC is authority to the fact that the freedom of contract is almost unlimited in professional relationships, particularly with respect to standard contracts

33 Cf. 5.3 below

5.1 The contract's binding effect - the English position

CoU have never been discussed by a Norwegian court, but their binding effect has been considered under English law.

The owner of *The Polyduke* contended that the contract's indemnity clause was not binding, using the following arguments:

1) the clause had no contractual effect at all because
   a) the provision, being extremely wide and wholly unreasonable, required special notification
   b) the word *'Received'* above the master's signature did not imply assent
   c) the document was not a contract, but rather an administrative paper[34]
2) or if the contract did have legal effect, it was not binding because the master had no authority to sign the document.[35]

The court held that the wording of the contract proved that it was clearly intended to have legal effect.[36] In the absence of any evidence by the master that he had sought to displace the contractual effect of his signature or that he had not understood the contractual terms, the court had to assume that the contract was entered into intentionally. In any case, any lack of understanding or intention on the part of the master would have failed as a legal argument. This was not a 'ticket' case, where some document, like a receipt, was merely handed over, which would require prior or special notice. Under English law, in the absence of fraud or misrepresentation, a signature binds and signifies knowledge and assent.

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[34] p. 215

[35] Cf. 5.2 below

[36] p. 215

A corresponding dispute under Norwegian law would have been treated as a question of setting aside or adjusting an already existing contract under the Formation of Contracts Act § 36, where formation is one of several elements of censorship.[37] However, as long as the contract is signed by the master within his scope of authority, it is not likely that the word 'received' would influence the binding effect of his signature.

5.2 The master's authority to enter into contracts

Questions of validity may also arise in relation to the master's authority to enter into contracts on behalf of the shipowner, particularly if he accepts extra burdensome conditions.

Under Norwegian law, the provisions pertaining to the master's authority are found in NMC Chapter 6. § 137 gives the master far-reaching authority to enter into contracts on behalf of the shipowner, including towage contracts.[38] Moreover, the master may conclude contracts relating to *'the performance of the voyage and to make agreements for the carriage of goods on the voyage'*. CoU are agreements that need to be entered into in order to be allowed to berth, and should thus be considered as necessary both for the performance of the voyage and the carriage of goods. Thus, the master has authority to bind the shipowner when signing the CoU. The master himself, however, is not bound, cf. § 139.

The English position on the master's authority to bind the shipowner is made clear by *The Polyduke* decision.[39] The shipowner contended that the contract was not binding because the master had not had the authority to accept such extra burdensome conditions on its behalf. However, based on the evidence the court

[37] Cf. 6.4 below

[38] *Falkanger/Bull/Brautaset*, p. 235

[39] Cf. 5.1 above

held that i) in the tanker trade there is a general practice of masters being required to sign such CoU, thus giving the master implied and ostensible authority to do so, and ii) such documents are generally regarded as liable to have contractual effect.[40]

The evidence also showed that it was left to the discretion of the master to conclude contracts on behalf of the shipowner, providing the master with the express authority to do so. Moreover, the evidence showed that the CoU were of a class which it was customary to sign, and the master's orders were to berth at the terminal, which he could not have done without signing this document, providing him with implied authority.[41] Furthermore, no action had been taken against this master for having signed such contracts, neither on this occasion nor any other.[42]

The fact that there is a general practice for masters to sign such documents, also supports the master's authority under the NMC § 137.

Nevertheless, on a general note it may be argued that the reasoning behind § 137 has become somewhat outdated, because § 137 was formed at a time when instant communication with the head office was not available. Today, after the ICT revolution, it may be argued that it is no longer necessary, or even right, to burden the master with such comprehensive responsibility since the head office with its many resources, including legal expertise, is always within reach.

5.3 Application without the master's signature

Many contracts contain provisions to ensure application even in the absence of the master's signature: '[T]he following shall be deemed

[40] p. 215

[41] p. 216

[42] p. 216

to have been specifically accepted by any vessel visiting the port regardless of whether such acceptance is specific, in writing or otherwise.'[43]

Another example:

> 'Use of the Terminal (including use of services) shall constitute acceptance by the Owners of the Conditions of Use […] regardless of whether the Master has executed the Master's Acknowledgement.' [44]

Thus, the contracts apply even if not signed, as they shall be deemed to have been specifically accepted by any visiting vessel.

A parallel may be drawn to parking conditions under Scandinavian law, where the rationale is that when a driver parks his car, he is complying with the expectation from the owner of the premises that an agreement for remuneration has been formed. Both a Swedish Supreme Court decision[45] and a Norwegian Court of Appeal decision[46] constitute authority that a binding agreement is being formed by the act of parking the car without the need for a signature. By analogy, the master's 'parking' of the vessel may be regarded as eliminating the need for his signature.

The CoU may also be compared to standard terms, which are customarily introduced by a party in addition to the signed contract. The Formation of Contracts Act is silent upon the subject of standard terms, but case law gives guidelines concerning the terms of acceptance.[47] The main rule with respect to standard terms is that in order to apply, they must have been brought to the other party's attention before signing,[48] which is the case for the CoU.

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43 Hazira Clause 2. 1st subparagraph, last sentence

44 Punta Europa Clause 2.6 2nd subparagraph

45 NJA 1981.323 SSC

46 RG 1991.736 NCA

47 *Woxholth*, p. 192

48 *Woxholth*, p. 192

Such contracts may also have been pre-approved as part of the charter party. There are examples where long-term charter parties, in relation to carriage from specific terminals, implement the conditions as an addendum to the charter party stating that they have been accepted by the shipowner.[49]

6 The liability provisions – indemnities and disclaimers

6.1 Two approaches: Indemnification and disclaimer clauses

The focus of this thesis is on the liability provisions of the contracts, although several of the CoU also include technical guidelines and procedures for use of the terminal. This section will discuss the main principles of allocation of liability in the CoU and look at the differences and similarities between the contracts from a comparative angle.

The liability provisions are structured in two different ways: either as indemnity or disclaimer clauses. Indemnification renders a party harmless from expenses that would otherwise have fallen on it, whereas a disclaimer clause disclaims liabilities that would otherwise have attached to the disclaiming party. Consequently, if a clause indemnifies a party from a liability, this indemnity clause operates as a disclaimer for that party. A far-reaching indemnity clause removes the need for a disclaimer because it is sufficient for the indemnified party to require indemnification from damages and losses to its own interests and from expenses imposed by others as well as from liabilities towards the contractual partner and third

[49] *Rygh (Nordisk Defence Club):* Terminalvilkår "Conditions of Use", lecture at a meeting in CMI Norway (31 March 2008)

parties. As a result, indemnity and disclaimer clauses sometimes overlap and different contracts may use either an indemnity or a disclaimer clause to allocate the very same liability.

Usually, the indemnity clauses regulate the shipowner's liability for terminal interests and the disclaimers regulate the terminal's disclaiming of liability for shipowner interests. Third party liabilities may be allocated either as indemnities or disclaimers. However, the indemnity and disclaimer clauses produce the joint effect that all liability rests with the shipowner. Nonetheless, despite this difference in structure, the allocation of liability is generally the same in all the CoU.

In traditional contractual relationships allocation of risk is based on compensation for damages. There must be a causal link between the damaging incident and the ensuing loss, and if there is no such link, the loss will lie where it falls.[50]

The CoU, however, are based on the concept of an economic allocation of risk independently of the principle of liability in negligence. The risk allocation of such contracts implies a marked departure from what is usual in the background law. Under such an *allocation of risk model*, commonly used in petroleum contracts,[51] the procedure is to allocate the losses not only of the contractual parties but also of third parties.[52] As regards the latter, the contractual parties may not reduce a third party's rights, but may freely regulate recourse and indemnity provisions.[53] Thus, the risk allocation in the CoU in principle covers all losses arising from the contract.

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50 *Bull:* Tredjemannsdekninger i forsikringsforhold (1988), p. 337

51 *Bull*, p. 337

52 *Bull*, p. 338

53 *Bull*, p. 339

Under an *allocation of risk model* a central point is that risk allocated to one of the parties lies there regardless of fault. This may cause more liability to lie with one party than what follows from background law.[54] Furthermore, the far-reaching disclaimer clauses for damage to the other party's property results in less liability than what would otherwise have been imposed on it.[55]

A model where all risk has been allocated to one of the parties has been called *the unilateral strict liability model*.[56] Under this model one contractual party must bear all losses to its own interests as well as to the other party's interests regardless of cause, provided that the losses may in any way be related to activities under the contract. Hence, such contracts imply strict liability regardless of fault. The CoU follow the principles of the *unilateral strict liability model*.

In this section a distinguishing line will be drawn between the shipowner's liability for terminal interests on the one hand (6.2) and the terminal's disclaiming of liability for shipowner interests on the other hand (6.3). The last subsection will discuss whether such provisions may be set aside or adjusted under Norwegian law (6.4).

6.2 The shipowner's liability for terminal/port interests

Under Norwegian law the starting point for establishing liability is i) basis of liability, ii) causation and iii) economic loss. Liability may be based in statute, contract or tort and is either *strict* or *in negligence*.

54 *Bull*, p. 353

55 *Bull*, p. 346

56 *Bull*, p. 357

The traditional approach under Norwegian law is that liability for damages is triggered by negligence.[57] The alternative is strict liability, which arises without fault.[58]

In contracts, liability in negligence is sometimes replaced by liability in negligence with a reversed burden of proof. The latter lies between strict liability and negligence-based liability,[59] since a reversed burden of proof may be impossible to lift, thus rendering a person liable without fault.[60]

Moreover, a person is also vicariously liable for the faults of its employees and contractors[61] under Norwegian law.[62] Vicarious liability is a form of strict liability in the sense that the liable person itself has not been negligent.[63] However, the person is only liable if the fault is such that the servant would have been personally liable.[64]

In maritime law vicarious liability is contained in NMC § 151, which stipulates that the shipowner is liable for *'the fault or neglect of the master, crew, pilot, tug or others performing work in the service of the ship.'* It follows from this definition that the vicarious liability encompasses both regular employees, self-employed personnel and sometimes even other people's employees, like pilots and tugs, as long as they are *performing work in the service of the ship*.[65] There is some disagreement concerning whether § 151 includes

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57 *Falkanger/Bull/Brautaset*, p. 161

58 *Lødrup:* Lærebok i erstatningsrett 5th edition (2006), p. 35

59 *Lødrup*, p. 35

60 *Falkanger/Bull/Brautaset*, p. 163

61 A *'contractor'* is a person or a company that contracts to supply materials or labour and thus becomes a self-employed servant of the contractee.

62 Cf. Torts Act of 13 June 1969 (No. 26) § 2-1 and ordinary background law

63 *Falkanger/Bull/Brautaset*, p. 163

64 *Falkanger/Bull/Brautaset*, p. 163

65 *Falkanger/Bull/Brautaset*, p. 174

contractual liability, but this issue is less practical since there is general consensus that contractual liability extends at least as far as the tort liability under § 151.[66]

This subchapter will discuss the practical solutions in the contracts with respect to the shipowner's liability for terminal/port interests. 6.2.1 will present the parties liable under the contracts, 6.2.2 will examine the basis of liability including vicarious liability, 6.2.3 will discuss causation, 6.2.4 will present indemnified parties and losses covered and 6.2.5 will examine possible limitations of the shipowner's liability.

6.2.1 Liable parties

The shipowner is always liable for the terminal's losses.[67] Furthermore, some contracts in addition stipulate direct liability for other parties.

The Kuwait Conditions contain the widest scope of liable parties: The vessel or its owners, charterers, managers or operators are liable for terminal damage, whereas the same entities are *jointly and severally* liable for third party damage.[68] It is not clear whether this distinction is intentional.

This raises the question of whether joint and several liability should be read into the contract where not specified. The starting point under Norwegian tort law is that where there is more than one tortfeasor, there is joint and several liability.[69] Thus, where there are several liable parties, joint and several liability should be assumed.

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66 *Falkanger/Bull/Brautaset*, pp. 175 – 176

67 Inter alia Punta Europa Clause 2.1 (a)

68 Clause 4

69 Torts Act § 5-3

The majority of the contracts stipulate that the vessel and the shipowner shall hold the terminal harmless.[70] Under Norwegian law, the starting point is that if a vessel is held liable, the shipowner is held liable, since the vessel is identified with its owner. However, if the shipowner has outsourced a broad range of management functions, liabilities incurred by the ship will be channelled to the manager.[71]

The Ras Laffan and Sharjah Conditions stipulate joint and several liability between master and shipowner,[72] and Port Rashid defines the liable party as inter alia *'any person, vessel'*[73] which may implicate anyone on board ship, as well as the shipowner. Direct action against the master and other crew members is possible under ordinary law, but is less practical due to limited possibilities of full recovery.

6.2.2 Basis of liability

As mentioned, the first requirement for compensation under Norwegian law is that there is a basis of liability.

All the CoU are to a certain extent built on the principle of unilateral liability. In the majority of the contracts the shipowner is required to pay for any loss

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[70] Qalhat Clause 1c), Escravos Clause 5, Bonny Clause 5.1 4th subparagraph, Altamira Clause 5, Braefoot Bay Section A (a) (ii), Abu Dhabi Clause 4 and Kharg Clause 4

[71] *Falkanger/Bull/Brautaset*, p. 141, cf. Punta Europa Clause 1 7th subparagraph: *'Owners'* means *'the owners or managers (as relevant) of any vessel using the Terminal.'*

[72] Clauses 6 and 2, respectively

[73] *'Conditions binding upon all users of Port Rashid Dubai'* 1st subparagraph

> 'due to whatever reason and irrespective of whether there has been any negligence or default on the part of the vessel or the owners, their servants, agents[74] or contractors'.[75]

The expression '*irrespective of whether there has been any negligence or default*' implies strict liability for the shipowner, since the terminal is to be indemnified for any loss regardless of fault by the shipowner or its servants. Strict liability constitutes a marked deviation from ordinary Norwegian law of damages, where the starting point is that negligence is a prerequisite of liability.

Other CoU may contain less explicit formulations, like *'howsoever and by whomsoever caused'*,[76] but these expressions should also be interpreted to imply strict liability. Moreover, *'howsoever caused'* also implies that it is irrelevant whether liability is incurred in contract or in tort,[77] and the same interpretation must also apply to the other contracts as a consequence of their structure.

The Punta Europa Conditions open up the possibility of liability on the part of the terminal in one instance, namely in respect of LPG vessels where *'Losses arise as a direct result of the sole fault of the Company Indemnity Group.'*[78] This is an exception to the general rule of strict liability, and at the same time an exception to the rule of liability without causation, discussed further in 6.2.3 below.

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[74] The vessel's agent is the local company which renders assistance to the vessel in port, inter alia in relation to port entry, provisions, bunkers and repatriation (*Falkanger/Bull/Brautaset*, p. 155). Thus, the agent is one of the shipowner's servants.

[75] Qalhat Clause 1 (c), Bonny Clause 5.1 4th subparagraph, Braefoot Bay Section A (a) (ii). *'Conditions binding upon all users of Port Rashid Dubai'* Clause c) also falls into this category but has a different wording.

[76] Sharjah Clause 3 a)

[77] *Bull*, p. 362

[78] Clause 2.1 (b) (ii)

A minority of the contracts stipulate ordinary negligence-based liability. The Ras Laffan, Altamira and Hazira Conditions, which are approved by the P&I insurers,[79] state that the shipowner is liable for any loss suffered by the terminal or third parties *'which involves the fault, wholly or partially, of the Master, officers or crew […], including negligent navigation'*.[80] This brings us to the question of vicarious liability under the CoU. All the contracts hold the shipowner vicariously liable to some extent. In the indemnity clauses the shipowner is identified with either i) the faults of its servants[81] or ii) the faults of its servants *as well as* the faults of the terminal and the terminal's servants.[82]

As regards i), this is in line with Norwegian law in the sense that the shipowner is vicariously liable for the faults of its servants. However, it is also possible to imagine a situation where the terminal's servants may inflict damage to the terminal's interests *'in the service of the ship'*, for which the shipowner would be liable under Norwegian law. Such damage may for instance be caused during mooring operations, by pilots and tugs or by shore personnel connecting loading arms on board ship. In this respect, the scope of vicarious liability under these contracts is actually more limited than what follows from NMC § 151.

The narrowest scope of vicarious liability is found in the three P&I-approved contracts, which merely require indemnification for

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79 Cf. 7.2.2 below

80 Ras Laffan Clause 6 (i), Altamira Clause 5 a) and Hazira Clause 2.8

81 Qalhat Clause 1 (c), Bonny Clause 5.1 4th subparagraph, Braefoot Bay Section A (a) (ii), Kuwait Clause 4, Ras Laffan Clause 6 (i) and (ii), Altamira Clause 5 a) and b) and Hazira Clause 2.8 a) and b)

82 Abu Dhabi Clause 4, Escravos Clauses 5 – 6 and Kharg Clause 4, Sharjah Clause 2, Port Rashid *'Port and Customs Dept.: Conditions of use of any premises…'* and *'Conditions binding upon all users of Port Rashid Dubai'* Clause c)

faults by the vessel's own personnel and make no reference to negligence either by the shipowner's other servants, agents and contractors or by the terminal's servants.

As regards ii), whether the shipowner would also be liable for the faults of the terminal's servants under Norwegian law depends on whether they were working *in the service of the ship*. If not, such liability would be a departure from ordinary law, and the mere possibility in this case opens the way for a wider scope of liability. Notably, an indemnification of the terminal's faults would work as a disclaimer if the clause also included shipowner losses.

Punta Europa's exemption for the sole fault of the terminal would imply a departure from Norwegian law if the servants of the shipowner and terminal caused a loss together, for which the shipowner must bear the full liability.

6.2.3 Causation

The second requirement for compensation under Norwegian law is that there be a causal link between the damage and the injurious act. The basis of causation is the *but for* test: A is the cause of B if A is a necessary prerequisite of B's occurrence.[83] Causation is a requirement both in contract and tort.

A closer examination of the Conditions of Use shows that the requirement for a causal link is either limited or non-existent. This has found somewhat different expressions in the contracts, and the same contract may use several expressions. However, where causation is mentioned, it is generally somehow related to *'the use'* of the port or terminal.

The Sharjah Conditions use the expression *'during'* in relation to pilotage, whereby the port *'accepts no responsibility for any damage*

[83] *Lødrup*, pp. 254 et seq.

occurring during berthing or unberthing'.[84] The object of potential damage is not specified, but it is likely that this clause is intended to exclude liability for damage to both terminal and shipowner interests. The expression *'during'* is also found in the Port Rashid Conditions.[85]

The expression *'during'* has been interpreted under English law in *The Polyduke* case. The below clause was described by the court as *'a far-reaching indemnity in favour of the plaintiffs'* (the terminal):

> 'If during, or by reason of the use by the vessel of the berths or other facilities […] any of them shall be damaged from whatsoever cause arising and notwithstanding that such damage be contributed to or by the negligence of the Company or its servant [sic] the vessel and her Owners shall hold the Company harmless and indemnified against all such loss or damage…'.[86]

Prima facie, the expression *'during'* is much wider than *'in connection with'*. There is no requirement for causation, only a limitation in time, whereas *'in connection with'* indicates a more functional approach. Furthermore, the connector 'or' indicates that the damage may take place *either* during the vessel's stay *or* as a consequence of the vessel's use of the premises.

The owner of the "Polyduke" pointed out that the word *'during'* was not found in any other similar contracts, contending that this wording would lead to unreasonable risks, effectively placing the shipowner in the position of the terminal's insurers and even making it liable for damage by exceptional tidal waves. The court conceded that the word *'during'* could imply a more extreme meaning, but nevertheless held that this was not probable because

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84 Clause 1

85 *'Port and Customs Dept.: Conditions of use of any premises…'*. This is primarily a disclaimer clause, but works as an indemnity inter alia where it disclaims liability damage to the terminal's own property.

86 Clause 2 (d)

no sensible court would construe the clause in such a manner, since this would lead to an absurd result that none of the parties could have intended. Interestingly, the court added that in the context, the word *'during'* must connote *'in connection with', which 'would bring the clause–however harsh and one-sided–in line with many similar provisions'*.[87] Thus, under English law *'during'* is interpreted to connote *'in connection with'*, the latter of which is frequently found in the CoU.[88] *The Polyduke* decision implies a restrictive interpretation of the word *'during'*, and this indemnity clause was upheld by the court.[89]

The wording *'in connection with'* implies that the causal requirement is very weak, thus opening the way for a wide range of circumstances. There is no requirement for causation in the traditional sense; instead a natural and reasonable connection between the damage or loss and the vessel's use of the terminal will suffice.[90]

Moreover, the triggering element is very comprehensive, insofar as it is sufficient that the damage or loss has occurred in connection with *'the [vessel's] use'*. Since in most of these contracts liability occurs regardless of fault on the part of the shipowner, the expression also clearly implies damage caused by third parties. Any act or omission reasonably connected with *'the use'* is included.[91]

Any temporal limitations within this expression are more or less given; if the damage occurs during the vessel's arrival, stay or departure, such limitations are satisfied.

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87 p. 216

88 Bonny Clause 5.1 4th subparagraph, Braefoot Bay Section A (a) (ii) and Qalhat Clause 1 (c)

89 6.4 below discusses the possibility of setting aside or adjusting such liability clauses under Norwegian law.

90 *Bull*, p. 385

91 *Bull*, p. 386

The expression *'arising out of or in connection with the use'* is found in the Punta Europa Conditions.[92] *'Arising out of'* is narrower, suggesting an element of causation between the damage and the vessel's presence. However, since the expression is followed by the wording *'or in connection with'* as well as a disclaimer of negligence on the part of the terminal, it is clear that all liability is nevertheless meant to lie with the shipowner.[93]

Another usual expression is *'in connection with or by reason of the use'*.[94] *'By reason of'* is more limited than *'in connection with'* and, similarly to *'arising out of'*, suggests an element of causation, but to an even greater extent. When damage occurs *'by reason of the use'*, the vessel's mere presence is not enough to trigger liability; the expression suggests some causal activity on the vessel's side.

The Port Rashid Conditions use the expression *'directly or indirectly attributable to'*,[95] which in my opinion equals *'by reason of the use'*. However, since these expressions never occur alone but are always accompanied by *'in connection with'*, this legal distinction does not have any practical effect.

The Port Rashid Conditions also contain several other, seemingly redundant causal expressions. While in one place there is a requirement for causation by the shipowner, stating that the user shall be liable for *'any loss or damage directly or indirectly caused by them or their servants'*,[96] this requirement is neutralised by another provision in the same contract which makes the shipowner

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92 Clause 2.1 (a)

93 *Bull*, p. 386

94 Escravos Clause 5, Kharg Clause 4, Kuwait Clause 4 and Abu Dhabi Clause 4

95 *'Port and Customs Dept.: Conditions of use of any premises…'*

96 *'Conditions binding upon all users of Port Rashid Dubai'* Clause c)

liable *'from what-so-ever cause'*.[97] Still, the aggregate effect is that the terminal will be held harmless in any case.

More interestingly, the same contract opens up the way for liability on behalf of the port in relation to tug damage if

> 'caused by want of reasonable care on the part of the Port to make its tugs seaworthy for the navigation of the tugs during the towing or their services'.[98]

However, *'the burden of proving any failure to exercise such reasonable care'* lies with the shipowner, and this reversed burden creates a more stringent form of liability than the ordinary negligence-based one.[99]

The Sharjah Conditions also contain one unclarity. The shipowner and/or charterer are to be held liable *'[i]n the event of any accident occurring, howsoever caused, which involves port stevedores'* or others during cargo operations or shifting/hauling.[100] It is not clear from the context whether the accident is *inflicted on* the stevedores or *caused by* them, and thus the shipowner should be prepared for both interpretations.

Generally, it appears that as long as the loss or damage is in any way related to the vessel, the shipowner is liable even if other causes have contributed or the damage appears to be an unforeseeable consequence of the vessel's actions. Simply put, the shipowner is liable even if external circumstances like the weather or other injurious parties like the terminal or third parties have contributed.

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97 *'Port and Customs Dept.: Conditions of use of any premises…'*

98 *'Conditions of tug hire'* Clause 2 2nd subparagraph

99 This clause is working both as an indemnity and disclaimer and is thus also discussed in 6.3.2 below

100 Clause 3 b)

Nevertheless, in the Ras Laffan, Hazira and Altamira Conditions liability is negligence-based,[101] and these contracts do not use the expression *'in connection with the use'*. Admittedly, the Ras Laffan and Altamira Conditions use the wording *'related to the vessel's use'*[102] but supply it with a requirement for negligence. Thus, in this respect these three contracts follow the Norwegian rules on compensation; i.e. the shipowner is liable for damage caused by fault or neglect in accordance with ordinary principles of causation.

As mentioned in 6.2.2, Punta Europa exempts the shipowner from liability in one instance, namely where the losses are caused exclusively by the terminal. This constitutes an exception from the general liability regardless of causation. The shipowner is still liable for damage caused by its servants as well as for damage caused together with another party, either the terminal or a third party, but not for damage caused by the terminal alone.

6.2.4 Indemnified parties. Losses covered

The third prerequisite for compensation under Norwegian law is that there is a real and measurable economic loss. This section firstly presents the indemnified parties and secondly examines what losses are covered by the indemnification.

In the contracts *'the Company'*, i.e. the terminal's owner/operator, is the object of indemnification. The owner/operator is typically one or several large petroleum companies, which are either private or state-owned. Exceptions are the Sharjah and Port Rashid Conditions where the contractual partner is the public port authorities. In the Hazira Conditions the contractual partner also appears to be the port, but in the form of a

[101] Cf. 6.2.2 above

[102] Clauses 6 (i) and 5 (b), respectively

privatised company called *'Hazira Port Private Limited'*.[103] Sometimes associated companies, etc. are also included in the indemnification. Inter alia the Punta Europa Conditions specify several layers of corporate entities on the terminal side,[104] all of which are to be indemnified.[105]

As regards losses, the starting point under Norwegian law is that the injured party is entitled to have all losses covered, although contributory negligence by the injured party may reduce compensation.[106] Losses covered are often divided into direct losses, extraordinary expenses and consequential losses. However, the principle of foreseeability limits recovery of losses with respect to adequate causation and foreseeability of loss. Thus, there is a close connection between causation and losses covered.

The starting point under the CoU is that all losses are to be indemnified irrespective of foreseeability and size. The Punta Europa Conditions define losses as follows:

> '"Losses" means any claims, actions, demands, losses, liabilities, damages, costs and/or expenses (including legal fees on a full indemnity basis and sums by way of settlement or compromise) of whatever nature'.[107]

Types of loss to be indemnified fall into three main categories, namely i) loss and damage to port/terminal interests, ii) third party liabilities and iii) expenses related to pollution and wreck removal.

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[103] Clause 2. 4th subparagraph

[104] Clause 1 stipulates that '*Company Group*' consists of a large number of listed international petroleum companies, which again form part of a '*Company Indemnity Group*', including the group's affiliates, contractors and sub-contractors as well as their respective employees.

[105] Clause 2.1

[106] Torts Act § 5-1

[107] Clause 1 5th subparagraph

As regards category i), indemnification of terminal interests comprises any loss or damage to the terminal's property as well as *'injury or death to any person employed on the premises'*.[108] It is clear that all types of claim arising from such damage and loss are covered.

The Sharjah Conditions specifically mention indemnification of consequential damage.[109] Any consequential damage whatsoever is to be indemnified, which may include losses both in production and profits. Also the Port Rashid Conditions mention consequential losses in one instance, namely in relation to the use of tugs.[110] Nevertheless, in my opinion consequential losses are also covered under the other contracts by the wording *'any loss'*, which should be interpreted to mean both direct and consequential losses. The same line of reasoning applies to delay, which is specifically mentioned in the Escravos Conditions.[111]

Consequential losses are as a starting point considered sufficiently foreseeable under Norwegian law,[112] which makes these provisions in line with ordinary legal principles. Case law supports that loss of profits are generally recoverable.[113] However, the requirement for causation must be satisfied, and the more indirect a loss is, the less likely it is to be recoverable. Since the requirement for causation is limited under these contracts, their liability for consequential losses may well exceed what would be recoverable under Norwegian law.

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[108] Bonny Clause 5.1 4th subparagraph, Braefoot Bay Section A (a) (ii) and Qalhat Clause 1 (c)

[109] Clause 2

[110] *'Conditions of tug hire'* Clause 2

[111] Clause 6 b)

[112] *Falkanger/Bull/Brautaset*, p. 287

[113] Rt. 1987.1649 NSC Ny Dolsøy, which concerned an interpretation of the standardised loss rule in the NMC (current § 279).

Moreover, consequential losses may also be considered in relation to the widened scope of liability in the CoU. Strict liability for damage to terminal property may lead to severe losses. Explosions in shoreside LNG tanks have caused serious harm to life and property in countries like Algeria, Belgium and Ohio, and explosion debris has been known to reach several kilometres away.[114] Obviously, if the shipowner is held liable for such damage, its liability for conesquential losses will be extreme. Therefore, the question may be raised whether such extended basis of liability, as well as lack of causation, should limit recovery of consequential losses.

As regards category ii), the terminal may require indemnification in two different instances, either from damage imposed by the terminal to third parties, or from damage caused by the shipowner to third parties where the terminal and shipowner are held jointly and severally liable.

All the Conditions except Punta Europa require indemnification of third party liabilities to some extent.

The Escravos Conditions are the most comprehensive and require both types of third party indemnification. Firstly, the terminal is to be held harmless from any damage or injury caused by the vessel to any third party,[115] which applies if the terminal is held jointly and severally liable with the shipowner. Secondly, the terminal requires indemnification from

> 'all and any action, liabilities, claims, damages, cost, awards and expenses arising whether directly or indirectly out of any loss, damage, personal injury, including death, or delay, of whatsoever nature, occasioned to any third party or any vessel (her Owners and crew)'

[114] IoMosaic Corp.: *Managing LNG Risks* (url: www.iomosaic.com/docs/training/Managing_LNG_Risks.pdf)

[115] Clause 5

whether or not caused by the terminal or its servants.[116] This implies an indemnification of damages caused by the terminal.

The far-reaching disclaimer by Port Rashid requires indemnification of damage to

> 'other vessels and or cargo and or other property ashore or afloat or fixed or movable and loss of life of and or personal injury to any person or persons what-so-ever, and or any legal liability'

regardless of own fault[117] and thereby includes any third party damage regardless of who caused it. The contract also requires indemnification of tug damage to third parties, but only related to claims for personal injury and loss of life.[118]

The third party indemnification in Sharjah appears to be slightly narrower, since the only third party objects mentioned are *'other vessels and craft'*.[119] Theoretically, there may be other third party damage which is not covered. On the other hand, such indemnification includes damage both by vessel and tugs.

However, the majority of the Conditions only require indemnification of 'all and any claim, damages, costs and expenses arising out of any loss, injury, death or damage caused to any third party by the Vessel',[120] i.e. indemnification from the shipowner's liability if the terminal is held jointly and severally liable. Under Norwegian law, if there is joint and several liability the injured party may claim the entire compensation from either party,[121] with a subsequent

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116 Clause 6 a)

117 *'Port and Customs Dept.: Conditions of use of any premises…'*

118 '*Conditions of tug hire*' Clause 2

119 Sharjah Clause 2

120 Qalhat Clause 1 d), Kuwait Clause 4, Bonny Clause 5.1 5th subparagraph, Braefoot Bay Section A, (a) (ii), Kharg Clause 4 2nd subparagraph, Abu Dhabi Clause 4, Ras Laffan Clause 6 (ii), Altamira Clause 5 b) and Hazira Clause 2.8 d)

121 Torts Act § 5-3,1

redistribution between shipowner and terminal in recourse. Thus, if the entire loss is channelled directly to the shipowner, this is a deviation from ordinary background law.

The Punta Europa Conditions do not mention third parties, apart from stipulating that the terminal's associates shall obtain third party rights under the English Contracts (Rights of Third Parties) Act 1999.[122] Thus, if third party damage occurs in connection with this contractual relationship, there is an actual possibility that the loss will lie where it falls, which is in accordance with traditional contract law.

The last category iii) comprises expenses related to wreck removal and pollution.

As a starting point, liability for wreck removal may be either statutory or contractual.[123] Under Norwegian law, public authorities may instruct the shipowner to remove a wreck within certain time limits,[124] but if the matter is urgent and the shipowner does not comply or there is not sufficient time to give notice, the authorities may remove the wreck themselves.[125] Furthermore, the shipowner's non-compliance with notice of wreck removal is a criminal offence, punishable by fines.[126]

The majority of the CoU contain specific wreck removal clauses, and the wording is almost identical in all contracts:

> 'If any vessel sinks, grounds, or otherwise becomes in the opinion of the Company an obstruction or danger […] and the owner of the vessel fails to remove [it] within a period stipulated by the Company, the Company shall be empowered to take any steps it may deem

[122] Clause 1 (a) gives a third party the right to enforce a contractual term *'if the contract expressly provides that he may'*.

[123] *Falkanger/Bull/Brautaset*, p. 184

[124] The Harbour Act of 8 June 1984 (No. 51) § 18 3rd subparagraph

[125] The Harbour Act § 20

[126] The Harbour Act § 28 b.

> necessary to remove the obstruction or danger. Any expenses of such removal shall be recoverable from the owner of the vessel.'[127]

This liability presupposes prior notification of the shipowner, which is thus less far-reaching than Norwegian legislation.

However, the Kharg and Abu Dhabi Conditions have stricter wreck removal provisions than the others. The former stipulate that the wreck may at any time be blown up or otherwise destroyed at the shipowner's expense,[128] and the latter states that the shipowner is not automatically entitled to notification before wreck removal, and if notified, non-compliance with instructions of wreck removal is a criminal offence.[129] Thus, these provisions are in line with Norwegian legislation.

The Escravos, Port Rashid, Qalhat and Sharjah Conditions contain no mention of wreck removal. However, it should be noted that their general indemnity clauses cover any damage and loss, and should thus be assumed to cover wreck removal on such basis.

As regards pollution, liability for environmental damage is statutory in most shipping nations, which have ratified conventions or passed national legislation in order to prevent pollution incidents, effectively manage such incidents and ensure that the damage and necessary measures are aptly compensated for.[130]

The MARPOL 1973/78 Convention identifies five main marine pollutants: i) oil, ii) liquid substances in bulk (e.g. gases and chem.-icals), iii) harmful substances in packaged form, iv) sewage and v)

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[127] Punta Europa Section *'Assistance, Advice or Instruction'* 3rd subparagraph cf. Kuwait Clause 5, Braefoot Bay Section A (a) Clause (iv), Ras Laffan Clause 7, Altamira Clause 6 cf. Clause 5 (c), Hazira Clause 2.9 and Bonny Clause 5.1 6th subparagraph

[128] Clause 6 (a) and (b)

[129] Clauses 5 and 6

[130] *Falkanger/Bull/Brautaset*, p. 195

garbage. The IMO[131] has also recently approved conventions regulating pollution from ballast water and anti-fouling[132] systems.

Approximately half of the examined CoU specifically require indemnification from pollution from the vessel.[133] In Norway the main legislation on pollution is the Pollution Act of 13 March 1981 (No. 6), which stipulates that a person is strictly liable for pollution,[134] and thus these provisions are in line with ordinary legal principles.

The Kharg Conditions contain an indemnity provision exclusively against *oil pollution*, comprising pollution from the terminal's loading arms, which is normally the terminal's responsibility according to standard risk allocation in the trade. The provision requires indemnification of damages including full cost of preventive measures to avoid fire hazards as well as any clean-up costs, and *'such cost shall constitute a debt payable by the vessel or her Owners to the Company.'*[135] NMC Chapter 10 regulates oil pollution from ships under Norwegian law. The applicable legal provision for non-oil tankers is NMC § 208, which makes the shipowner strictly liable for oil pollution and preventive measures, cf. § 191.

Thus, with respect to oil pollution the Kharg Conditions are in line with Norwegian law. However, despite the extended physical area of application, this provision is more limited than the legislation with regard to scope of pollutants.

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131 The International Maritime Organization is the United Nations specialised agency for the safety and security in shipping and prevention of marine pollution by ships (URL: www.imo.org)

132 A type of paint which prevents growth on the ship's underwater surfaces

133 Inter alia Escravos Clause 6 b) and Punta Europa Clause 2.1 (a) (ii)

134 § 55,1

135 Clause 5

The Kuwait Conditions require indemnification for pollution to the environment including the territorial waters of Kuwait.[136] This inclusion of the territorial waters is actually less stringent than Norwegian legislation, which imposes liability for pollution on the Norwegian part of the continental shelf.[137]

The Sharjah Conditions stipulate that *'any kind of pollution is strictly prohibited'*.[138] The master, shipowner, charterer and/or operator are jointly and severally liable to a fine up to Dhs 500,000 in addition to any other expenses incurred towards removal, clean-up and potential third party damage. The fine is not an indemnity since it applies regardless of actual costs incurred, but it will also work towards paying off the shipowner's pollution liability.

Along the same lines of reasoning as for wreck removal, it must be assumed that pollution is covered under the general indemnity clauses in the contracts where it is not specifically regulated.

6.2.5 Limitation of liability

The starting point under Norwegian law of damages is that liability is unlimited when the conditions for compensation have been met.

However, in maritime law there is a strong tradition for limiting the shipowner's liability, and Norway has ratified international convention-based limitation regimes. These rules, being an exception to the general rule of unlimited liability, give the shipowner a *right* of limitation.

The rules concerning the shipowner's right of limitation are found in the NMC. Chapter 9 contains the global limitation rules, Chapter 10 contains the oil pollution limitation rules, Chapter 12 contains rules on limitation funds and proceedings and Chapter 13 regulates

[136] Clause 4

[137] Cf. NMC § 208,1

[138] Clause 10

the carrier's right to limit its liability. Limitation of liability for oil pollution from non-tankers is regulated by the global limitation rules.[139]

The CoU do not discuss the relationship between the contractual liability and the international limitation regime. The general rule under these contracts is that the size of the claim is irrelevant, and there is unlimited liability for the shipowner[140] and sometimes also for the charterer and/or master.

As a starting point the shipowner's statutory right of limitation applies also to contractual liabilities. On the other hand, the global limitation rules are not compulsory in favour of the shipowner: NMC § 171 merely states that the shipowner *can* limit its liability under Chapter 9. Thus, it is quite clear that the shipowner is entitled to waive such rights towards a contractual party.[141] Consequently, in legal proceedings the court would have to examine whether the signed contract evidences an explicit waiver of such rights, and if this requirement for a waiver is not found to be satisfied, then the shipowner's right must be upheld.[142]

As regards the shipowner's liability for wreck removal, the starting point under Norwegian law is that it may be limited under the global limitation regime,[143] and it is not a precondition for limitation that the liability is based in statute.[144] In the context of gas carriers, the right of limitation for expenses related to removal of dangerous cargo may also arise[145] as well as measures to avert

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139 NMC § 208,3 cf. Chapter 9

140 *'…the vessel and the Owners shall hold The Company […] and affiliates, harmless from and indemnified without limitation…'* (Escravos Clause 4)

141 *Bull*, p. 375

142 *Bull*, p. 376

143 NMC § 172a 1)

144 *Falkanger/Bull/Brautaset*, p. 184

145 NMC § 172a 2)

associated losses.[146] Consequently, the unlimited liability for wreck removal arising from the CoU is not in line with Norwegian law, and in legal proceedings the court would have to consider whether the shipowner has explicitly waived its right of limitation.

It should be noted that the three P&I-approved CoU contain liability limitations, and the limitation amount is set to USD 150 million.[147] Moreover, the Punta Europa Conditions stipulate a limit of USD 50 million for LPG vessels only *'or such higher amount as is available by way of insurance coverage from a recognised P&I club'.*[148] Notably, the Punta Europa Conditions, the only ones in the selection, specifically require the shipowner to have proper P&I insurance in place,[149] but are not approved by the clubs.[150]

6.3 The terminal's disclaiming of liability for shipowner interests

The CoU contain far-reaching disclaimers on the part of the terminal concerning liability for shipowner interests. Disclaimer clauses are widespread in international contract law, and they operate to such effect as to disclaim some or all liability of one of the parties. Far-reaching disclaimer clauses on behalf of one contractual party suggest that the contract is biased in favour of that party.

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146 NMC § 172a 3)

147 Ras Laffan Clause 11, Altamira Clause 10 and Hazira Clause 2.10. Note: The Altamira Conditions Clause 11 establishes that such limitation of liability shall not prejudice any claim by the Company under general principles of law or equity.

148 Clause 2.1 (b) (i)

149 Clause 2.4

150 Cf. 7.2.2 below

This section will discuss the practical solutions in the contracts with respect to the terminal's disclaiming of liability for shipowner interests. In 6.3.1 the various forms of disclaimed liability will be outlined, whereas 6.3.2 analyses the importance of fault. 6.3.3 presents the different areas covered by the disclaimers and 6.3.4 examines disclaimed losses.

6.3.1 Forms of disclaimed liability

In the CoU liability is disclaimed on behalf of i) the terminal owner/ operator and associates, ii) public bodies and iii) employees and contractors including pilots and tugs.

As regards i), when the terminal disclaims liability on behalf of itself and associated companies it disclaims direct liability (as opposed to vicarious liability for servants). Gross negligence and intent are not exempted from the disclaimers, and thus it must be assumed that the terminal disclaims all degrees of fault.[151]

The terminals always disclaim their own direct liability, and the majority also disclaim direct liability on behalf of associated companies.

However, the issue of whose liability is disclaimed may vary along with what areas the disclaimers apply to. The Punta Europa Conditions serve as a good example: With regard to navigational assistance, the terminal, any associated company, any other owner of property used at the terminal as well as its agents and servants (in whatever capacity they may be acting) all disclaim liability.[152] With respect to the general safety of the port, only the Company

[151] Cf. 6.3.2 below

[152] *'Assistance, Advice or Instruction'* 1st subparagraph

disclaims liability,[153] and concerning liability for vessel, crew and cargo, the entire Company Indemnity Group disclaims liability.[154]

In the Sharjah, Port Rashid and Hazira Conditions the contractual partner disclaiming liability is not the terminal, but the port.[155] The Port Rashid Conditions firstly disclaim liability on the part of the entire

> 'Government of Dubai and those acting under its authority' for any liability occurring at the premises.[156] Secondly, 'neither the Government of His Highness the Emir of Dubai nor the Port Operators appointed thereby nor their [sic] nor either of their servants or agents'

is liable for any losses whatsoever.[157]

As regards ii), some of the terminals disclaim liability on behalf of public bodies. In such a case the public bodies are third parties to the contract,[158] and the disclaimers apply on their behalf. Contractual parties may freely allocate third party liabilities arising from ordinary principles of torts and damages.[159] Such third party disclaimers must be distinguished from the disclaiming of *vicarious liability* in the Sharjah and Port Rashid Conditions, where the

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153 *'Use of Sea berths, Loading Lines, Facilities, Gear and Equipment'* 2nd subparagraph

154 Clause 2.2. Cf. footnote 97

155 Cf. 6.2.4 above

156 Port and Customs Dept.: *'Conditions of use of any premises…'*

157 *'Conditions binding upon all users of Port Rashid Dubai'* Clause a)

158 Cf. Qalhat Clause 1 (f), which disclaims liability on behalf of the Government of Oman. Cf. also Braefoot Bay Section A Clause (v), which disclaim liability for any delay caused by the faults of the port and its vessel traffic services

159 Cf. 6.1 above

public authorities *are* the contractual partners, thus disclaiming faults on behalf of their servants and contractors.[160]

In relation to pilots and tugs, the terminals disclaim liability in one of two ways, either a) as vicarious liability for their faults as contractors, which would be the case under Norwegian law, or b) on behalf of the pilot/tug as a third party. In the latter case, the shipowner promises not to hold the pilot/tug responsible for damage, which serves as third party promise under the contract. Thus, the terminal is the party issuing the disclaimer, but the disclaimer also applies on behalf of the pilot and/or tug.

As regards iii), all contracts disclaim vicarious liability for the faults of any and all persons working for the terminal or the port, including servants, agents and contractors.[161] The CoU do not contain exhaustive lists of servants, but they all mention the faults of pilots, tugs and other navigational services.[162] Typically, the faults of pilots, tugs and mooring personnel are disclaimed in relation to port safety and navigational services, whereas the disclaimers concerning damage caused by the terminal more generally exclude the faults of *'any servant, agent or contractor'*.[163]

Also the P&I-approved contracts disclaim liability for the faults of servants. For instance Altamira disclaims the faults of the *'Company*

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[160] Sharjah Clause 3 c) and *'Conditions binding upon all users of Port Rashid Dubai'* Clause b)

[161] Inter alia Escravos Clauses 2 – 3 and Abu Dhabi Clause 1 (b)

[162] Escravos, Punta Europa, Hazira and Port Rashid disclaim liability for pilotage, tugs, berthing services and other navigational facilities by stating that the pilots, loading masters and crews of pilot and mooring boats, etc. become the servants of the vessel's master for the duration of the operation. Cf. Sharjah Clause 1, where the pilot's advice *'shall not under any circumstance exonerate the Master and Owners from liability'*.

[163] Inter alia Bonny Clause 5.1 3rd subparagraph, Escravos Clause 3 and Qalhat Clause 1 (b)

Representatives',[164] who are defined as *'any director, officer, employee, contractor, servant, consultant, advisor, agent or representative of the Company in whatever capacity they may be acting'*.[165] Such disclaiming of vicarious liability on behalf of employees and contractors is not in accordance with Norwegian law. The starting point under the law of damages is that a legal person is directly liable in negligence as well as vicariously liable for the faults of its servants.[166]

6.3.2 The fault element

The majority of the terminals disclaim all and any liability regardless of fault on the part of themselves or their servants. Excluded faults are typically *'any act, neglect, omission or default'*.[167]

This must be understood to include ordinary negligence, gross negligence and intent.

The starting point under Norwegian law of damages is that a person can disclaim liability for the faults of others as well as for its own ordinary negligence, but not for its own intent. It is debatable whether liability for a person's own gross negligence can be disclaimed.[168]

All CoU expressly state that the terminal disclaims liability irrespective of fault or neglect.[169] This express statement may be a reac-

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164 Clauses 3 – 4

165 *'Conditions of Use'* 4th subsection

166 Torts Act § 2-1 and ordinary background law

167 Inter alia Kuwait, Kharg and Abu Dhabi Clause 2

168 *Hagstrøm:* Om grensene for ansvarsfraskrivelse, særlig i næringsforhold, TFR-1996-421, pp. 426 and 448 et seq., *Kaasen:* Petroleumskontrakter med kommentarer til NF 05 og NTK 05 (2006), pp. 601 et seq. and *Bull*, p. 394. Cf. also 6.4 below

169 Inter alia Kharg Clause 2: *'…whether or not it is due in whole or in part to any act, neglect omission or default…'*

tion to the fact that some jurisdictions have refused to accept disclaimers of negligence-based liability without an express statement to that effect.[170] In addition to personal fault, the Escravos Conditions also disclaim liability for fault in property, i.e. the *'fault or defect in any berth, premises, facilities, property, gear, craft, or equipment of any sort'*.[171]

However, the Port Rashid Conditions exempt an element of fault from the disclaimer on behalf of the tugs. The port specifically disclaims liability for unseaworthiness in relation to the tugs, provided that

> 'such liability […] is not caused by want of reasonable care on the part of the Port to make its tugs seaworthy for the navigation of the tugs during the towing or their services. The burden of proving any failure to exercise such reasonable care, shall lie on the Owner of the tow'.[172]

This implies firstly, that unseaworthiness as a starting point is disclaimed, secondly, that the port may be liable for damage caused by the tugs if it has not exercised reasonable case in ensuring seaworthiness, and thirdly, that the burden of proving such lack of reasonable care is reversed, i.e. it lies with the shipowner, thus creating a more stringent form of liability than the ordinary negligence-based one.[173]

The disclaiming of liability finds a parallel in the indemnity provisions, in the sense that all types of fault are to be indemnified. The three P&I-approved contracts state that indemnity shall be

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[170] *Bull*, p. 392. Cf. also 6.4 below

[171] Clause 3

[172] Clause 2 2nd subparagraph

[173] Cf. 6.2.3 above

negligence-based on the part of the vessel's personnel, but this includes all types of negligence, also ordinary negligence.[174]

6.3.3 Areas covered by the disclaimers

The disclaimers comprise several areas: navigational services, general safety of the port and safety and suitability of berth and terminal premises.

Disclaimers of liability for shipowner interests will typically be divided between navigational services, like pilots, tugs, buoys and markings on the one hand, and terminal services on the other hand.

Furthermore, the majority of the contracts contain separate disclaimers concerning port safety, whereby liability for the safety and suitability of the premises is disclaimed. These clauses are usually expressed to the effect that no *warranty* is given. No warranty means that there is no guarantee of performance or fulfilment, and thus 'no warranty' implies no liability.

The Escravos Conditions serve as a example:

> 'While The Company exercises due care to ensure that the berths […] are safe and suitable for vessels permitted or invited to use them, no guarantee, express or limited, of such safety and suitability is given'.[175]

Another version of the warranty exclusion is found in the Hazira Conditions: *'Company […] does not represent or warrant that the Port and Port Facilities are safe or suitable for any vessel.'*[176]

In relation to port safety, the Hazira Conditions also disclaim liability *'irrespective of whether or not the vessel is within the notified*

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[174] Inter alia Ras Laffan Clause 6: '*…which involves the fault, wholly or partially, of the Master, officers or crew, including negligent navigation*'

[175] Clause 3. Punta Europa, Abu Dhabi, Kharg and Kuwait are almost identical in their wording

[176] Clause 2.3. Altamira Clause 2 contains a similar wording.

limits of the Port'.[177] In contrast to the terminals' own warranty disclaimers, some contracts require a suitability warranty from the shipowner on behalf of the vessel.[178]

6.3.4 Disclaimed losses

The contracts stipulate a wide range of losses disclaimed by the terminal. The main types are loss, damage, delay, personal injury, loss of life and any actions by third parties.[179]

All CoU disclaim liability for *'any loss, damage or delay'* to vessel, cargo and crew.[180] Port Rashid's disclaimer clause is much more complex and verbose than the others, but does not appear to extend the scope.[181] Actions by third parties are disclaimed either in the form of disclaimers or indemnity clauses.[182]

The majority of the CoU also disclaim liability for losses directly or indirectly caused by labour disputes, strikes, etc.[183] Hazira's version is particularly wide, comprising

> 'the consequences of war, riots, civil commotions, acts of terrorism or sabotage, strikes, lockouts, disputes stoppages or labour disturbances […] or anything done in contemplation or furtherance thereof'.[184]

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177 Clause 2.2

178 Inter alia Qalhat Clause 1 1st subparagraph and Abu Dhabi Clause 1

179 Inter alia Escravos and Kuwait Clause 2

180 Inter alia Sharjah Clause 3 a) – c), Braefoot Bay Section A (a) Clause (i), Bonny Clause 5.1 4th subparagraph and Port Rashid's *'Port and Customs Dept.: Conditions of use of any premises…'*, *'Conditions binding upon all users of Port Rashid Dubai'* Clause a) and *'Conditions of tug hire'* Clause 2

181 *'Port and Customs Dept.: Conditions of use of any premises…'*

182 Cf. 6.1 above

183 Cf. inter alia Punta Europa page 4 6th subparagraph, Escravos Clause 4, Kharg Clause 3, Kuwait Clause 3 and Altamira Clause 4

184 Clause 2.7

The starting point under Norwegian law of damages is that all losses resulting from an injurious act are to be compensated without limitation if sufficiently foreseeable.[185] Thus, these disclaimers do not follow ordinary legal principles, since the shipowner does not recover its losses. On the other hand, if the loss is unforeseeable, the disclaimers are in line with background law, since the terminal is not liable for unforeseeable consequences in any case. However, the requirement for foreseeability in contract is less stringent towards the injured party than in tort.

Some special provisions are mentioned below:

The Braefoot Bay and Bonny Conditions contain separate clauses concerning claims related to delayed cargo operations. The former contract disclaims liability for

> 'any demurrage, loss claims or demands whatsoever' resulting from faults by the port,[186] and the latter disclaims liability for 'any costs incurred by a vessel, its Owners […] as a result of delay to or suspension of loading or discharging or a refusal to load or discharge all or part of a nominated shipment, or a requirement to vacate the jetty arising from Safety Regulations'.[187]

The Abu Dhabi Conditions contain a separate disclaimer concerning any damage claims *'for damage allegedly incurred by ships'* during anchoring and mooring operations.[188]

The necessity of these latter provisions is debatable, since the general disclaimers in any case comprise any loss, damage and delay.

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185 Cf. 6.2.4 above

186 Section A (a) Clause (v)

187 Clause 5.1 11th subsection

188 *'Damage Claims'* page 6

6.4 May the contractual provisions be set aside or adjusted?

As shown above, the CoU deviate from ordinary Norwegian legal principles in several areas by allocating all risk to one party. This section raises the question of whether such liability provisions could be set aside or adjusted by a Norwegian court.

Norwegian law distinguishes between absolute and relative invalidating factors. Absolute invalidating factors are inter alia violations of law or decency (as stipulated in NL 5-1-2[189]), insanity, duress, etc. Such factors will render the contract null and void.

However, the Formation of Contracts Act § 36 introduced the relative approach as a starting point for setting aside contracts, whereby the parties can choose to affirm. This provision gives Norwegian courts a considerable discretionary measure for setting aside contracts on a case-by-case basis, and these days the courts would probably base such a decision on § 36 rather than on NL 5-1-2, due to the flexibility of the former provision.[190]

Excerpt from § 36:

> 'An agreement may be overturned wholly or partly or altered insofar as it would be unreasonable or in breach of proper business conduct to invoke it. […]
>
> Such decision must emphasise not only on the contents of the agreement, the position of the parties and the circumstances surroundding the formation of the agreement, but also subsequently occurred conditions and the other circumstances…'.[191]

The effect of § 36 manifests itself on two levels; either directly, whereby the court relies on the provision to adjust a contract, or indirectly, in applying a test of *reasonableness* without direct refe-

[189] 'Kong Christian Den Femtis Norske Lov' of 15 April 1687

[190] *Bull*, p. 394

[191] Unofficial translation

rence.[192] Nevertheless, the courts tend to exercise considerable restraint in employing this provision. Moreover, since the provision was not introduced until 1983, jurisprudence from the other Scandinavian countries, which have parallel provisions, must be relied on for interpretation.[193]

Concerning commercial parties the starting point is that where the distribution of risk is clearly defined in the contract, the court will not interfere due to considerations of equality between negotiating parties and the need for predictability in professional intercourse.[194] Censorship in this area would undermine contractual freedom with its rewards and downfalls.

Although unreasonable risk allocation may in principle cause a provision to be set aside, this is mainly applied to consumer contracts. To date, the Norwegian Supreme Court has never relied on § 36 in a contractual claim between typical commercial parties.[195] However, there is an earlier obiter statement by the Supreme Court that when a liability disclaimer is very far-reaching, it *'is natural to interpret such a disclaimer restrictively'.*[196] Moreover, the Supreme Court has also stated that it is not doubtful that § 36 also applies to contracts between professional parties.[197] Furthermore, § 36 has

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192 *Hagstrøm:* Ansvarsfraskrivelse, p. 459

193 *Hagstrøm:* Ansvarsfraskrivelse, p. 461

194 Cf. ND 1990.204 NA *the Ula case*, where it was stated that commercial contracts are profit-based and will thus lead the parties to assume calculated risks

195 *Woxholth,* p. 367

196 Rt. 1961.1334, p. 1338 (unofficial translation). The case concerned a disclaimer as basis for the shipowner's recourse. Adjustment based on § 36 is also mentioned obiter in Rt. 1994.626, but the question was not decided on because the injurious party was not part of the company management (*Hagstrøm:* Ansvarsfraskrivelse, p. 422)

197 Rt. 1999.922 NSC, p. 943

been used by the court of arbitration to set aside provisions in shipping contracts on the basis that the provision would otherwise result in economic imbalance between the parties.[198]

This section will discuss whether the liability provisions of the CoU could be set aside or adjusted based on either i) monopoly or ii) disclaiming of liability for gross negligence/intent. The former is related to contract formation and the latter to contractual contents.

As regards i), monopoly is an example of inequality in the negotiating position between commercial parties. If only one person may provide services, it is considered monopoly. The precondition of choice among several contract partners fails if the party offering services is not competing in a free market but has monopoly and the other person is in a state of dependency.[199] Taking advantage of such dependency is a form of exploitation, which under § 36 is a deficiency in the *'circumstances surrounding the formation of the agreement'*.[200] Exploiting for personal profit the dependency of another may be sufficient grounds for setting aside a contract. Although this theory is originally related to emergency situations, it has been asserted that it also applies to economic interests.[201] The preparatory works of § 36 also state that conditions giving one party unreasonable means of pressuring the other may be subject to censorship.[202] Subsequently, if a person's opportunity to choose has been thwarted by monopoly, the contract may be open for adjustment under § 36.

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198 ND 1985.234 NA Mascot

199 *Wilhelmsen:* Avtaleloven § 36 og økonomisk effektivitet, TFR-1995-1, p. 103

200 *Wilhelmsen*, p. 102

201 Rt. 1994.833 NSC cf. *Wilhelmsen*, p. 104

202 *Woxholth,* p. 360

So far Norwegian courts have only set aside consumer cases on grounds of monopoly,[203] but there are examples of monopoly considerations involving professional parties in other Scandinavian courts. In U 1988.1042 DSC the Danish Supreme Court set aside a distribution contract with a 23 years termination period between professional parties on grounds of contractual unreasonableness and imbalance. Furthermore, in U 1986.602 DCA the seller of a property reserved the right to work for the buyers as a long-term future broker of the property, which prevented the buyers from choosing a broker freely. The Court of Appeal decided that the clause was against sound business practice without further grounds.[204] Both these decisions are based on a combined consideration of monopoly and unreasonableness.

In the case of the CoU, it may be argued that the terminal is exercising monopoly and thus is exploiting the shipowner's state of dependency since the vessel will be denied access unless the master signs the contract and even if signature is avoided, the contract applies regardless. Moreover, the fact that such conditions are customary in the trade[205] creates a monopoly situation.

Nevertheless, it is debatable whether the monopoly argument alone would hold in court. Firstly, the charterer nominates the port and freely enters into a contract of delivery with the terminal based on profit considerations. Secondly, due to the regularity of the gas trade the shipowner is often aware of what ports will be involved and freely enters into the charter party based on profit conside-

[203] Cf. inter alia RG 1991.546 NCA

[204] See also NJA 1989.346 SSC and U 1987.801 DSC, where the Danish Supreme Court set aside a contractual provision between two professional parties based on unreasonableness

[205] Cf. 7.3.1 below

rations and may thus choose to avoid charter parties involving certain trade areas.[206]

As regards ii), there are three degrees of fault, namely ordinary negligence, gross negligence and intent. There is no sharp borderline between ordinary and gross negligence, but the Norwegian Supreme Court has stated that gross negligence must represent

> 'a clear departure from conduct which is ordinarily justifiable' and the person must be 'substantially more to blame than in the case of ordinary negligence.'[207]

The traditional view under Norwegian law has been that all liability may be disclaimed, except for a person's own intent or gross negligence.[208] This indicates that vicarious liability for gross negligence and intent may be disclaimed.[209]

Case law has a strong tradition for setting aside disclaimers of gross negligence on the basis of NL 5-1-2, and it should be noted that when § 36 was introduced the legislators decided to keep NL 5-1-2.[210]

In the area of offshore construction contracts, which similarly to CoU are based on principles of risk allocation rather than compensation,[211] legal literature leans towards the opinion that if the contracts are agreed documents where both parties have influenced the agreement, the courts are not likely to set aside disclaimer

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[206] At the introduction of OPA 90 some Norwegian shipowners chose to avoid charter parties involving US ports due to the unlimited liability for oil pollution

[207] Rt. 1989.1318 NSC (unofficial translation)

[208] *Hagstrøm:* Ansvarsfraskrivelse, p. 421

[209] *Bull*, p. 394, cf. Rt. 1948.370 NSC. Compare *Hagstrøm:* Ansvarsfraskrivelse, p. 449 for a different position

[210] *Hagstrøm:* Ansvarsfraskrivelse, p. 464

[211] *Bull*, pp. 346 et seq.

clauses except where the loss is caused by the management's intent and perhaps also gross negligence,[212] since setting aside such contracts would adversely affect predictability. Thus, in the case of intent the court would most likely set the disclaimers aside.

The position of gross negligence, on the other hand, seems to be more open, and legal theory points in different directions.[213] The literature seems to favour the opinion that in the case of gross negligence, a complete evaluation must be made of the circumstances relating to the contract and the position of the parties rather than of traditional concepts like gross negligence and intent.[214]

Another important element is the court's attitude, and this varies from country to country.[215] Far-reaching disclaimer and indemnity provisions have been set aside on the basis of unreasonableness in other jurisdictions, e.g. in some American states.[216] On the other hand, as explained in 5.2 above, an English court would not set aside such onerous indemnity clauses inter alia due to the fact that they are customary in the trade. This *general practice* test also seems to be important in Norwegian jurisprudence, which states that *'well established and commonly employed contractual conditions'* within the trade will normally not be set aside under § 36.[217] This points against setting aside the provisions.

On the other hand, an important element of consideration for the court would be whether the contracts allocate liability fairly and reasonably.[218] The CoU are not agreed documents, and this may lead

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212 *Bull*, p. 394

213 *Hagstrøm:* Ansvarsfraskrivelse, pp. 462 et seq. and *Kaasen,* pp. 601 et seq.

214 *Kaasen,* p. 609 and *Hagstrøm:* Ansvarsfraskrivelse, pp. 463 and 473

215 *Bull*, p. 393

216 *Bull*, p. 393

217 *Hagstrøm:* Urimelige avtalevilkår (LoR 1994 No. 3/4), p. 156 (unofficial translation)

218 *Bull*, p. 393

the court to exercise a more restrictive interpretation. If one commercial party is inferior in the sense that it has had little opportunity to influence the contents of the contract, the court may intervene.[219] Other Scandinavian Supreme Courts have adjusted contracts in such instances and *'there is reason to believe that our Supreme Court may go the same way'*.[220]

The CoU are imbalanced contracts channelling all risk and unlimited liability to a party who may neither influence contents nor refuse to be bound. This creates a situation in which the effects of unreasonable contract terms and monopoly are combined. On this basis, I believe it is likely that a Norwegian court may adjust or set aside these liability provisions.

7 Insurance cover. Risk allocation between charterer and shipowner

7.1 Introduction

Norwegian shipowners normally effect insurance on Norwegian or English terms. The following discussion will be based on the Norwegian terms, more specifically the NMIP with respect to hull insurance, and Gard Statutes and Rules 2008 (GR) with respect to P&I insurance.

Generally speaking, shipowner insurances are divided into asset insurances (mainly hull and machinery), income insurances (mainly loss of hire) and liability insurances (mainly P&I).

Damage to and loss of the ship is the main area for ordinary hull insurance, whereas the chief function of P&I insurance is to protect the shipowner against third party liabilities, like personal injury,

[219] *Woxholth*, p. 368

[220] *Woxholth*, p. 369 (unofficial translation), cf. *Hagstrøm:* LoR 1994, p. 149

cargo damage, pollution, wreck removal, measures to avert or minimise loss and salvage. Moreover, the hull insurer and P&I insurer share the collision liability between them.

In relation to the CoU striking damage is particularly relevant, and due to the explosive nature of the cargo, it is possible to imagine rather costly losses in relation to cargo operations.

There are three means by which the shipowner may seek to limit such risks:

1) cover under P&I insurance
2) cover under hull insurance
3) charter party regulations of liabilities and costs

However, as shown below the risks arising from the CoU are not covered under the ordinary insurances, and thus the need for separate cover emerges. Another solution for the shipowner is to alleviate the risk by ensuring an acceptable distribution of risks and costs between shipowner and charterer in the charter party.

7.2 and 7.3 will examine the cover under P&I insurance and hull insurance, respectively, whereas 7.4 will look at risk allocation options under the terms of the charter parties.

7.2 Protection and indemnity insurance

7.2.1 The effect of onerous contract terms

A significant share of liabilities associated with a port call would normally be covered under the P&I insurance.[221]

[221] Inter alia GR 27 – 30 and 33 (personal injury and belongings), GR 34 – 35 (cargo liabilities), GR 36 – 37 (collision and striking), GR 38 (pollution), GR 40 (wreck removal), GR 42 (salvage), GR 43 (towage) and GR 46 (measures to avert or minimise loss)

However, the P&I insurers have rules which exclude liabilities in excess of what follows from ordinary background law, cf. GR 55 *'Terms of contract'* clause a):

> 'The Association shall not cover under a P&I entry liabilities, losses, costs or expenses:
>
> which would not have arisen but for the terms of the contract or indemnity entered into by the Member, or by some other person acting on his behalf, unless the terms have previously been approved by the Association, or cover for such liabilities, losses, costs or expenses has been agreed between the Member and the Association, or the Association decides, in its discretion, that the Member should be reimbursed;
>
> which result from, or would not have arisen but for the Member, or some other person acting on his behalf having used terms of contract which the Association has prohibited, or omitted to use terms of contract which are specified in Appendix VII or which the Association has otherwise prescribed.'

In particular, the following aspects of the CoU are not acceptable to the P&I insurers: the strict and unlimited liability and the absence of any requirement for causation.[222]

Gard's exclusion only applies to liabilities arising under a contract and not liabilities arising in tort or statute. Such contracts may be e.g. standard towage contracts and contracts and indemnities given to port authorities and harbour pilots.[223]

Notably, standard cover under P&I insurance is unlimited because the insurers may normally invoke the shipowner's statutory right of limitation.[224] Contracts imposing unlimited liability are therefore particularly onerous for the P&I insurers.

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[222] *Rygh:* Terminalvilkår

[223] Gard Handbook on P&I Insurance (1996), p. 487

[224] Cf. 6.2.5 above

Consequently, as a starting point contracts with these characteristics are not accepted by the insurers. Inter alia the Norwegian insurer Gard and the British insurer Britannia have refused cover for the CoU in their present form.[225]

As previously indicated, the oil trade partly solved the P&I insurance problem with side letters, whereby the terminals agreed not to rely on the indemnity clauses if the loss was resulting from negligence or default on their own part.[226] However, side letters do not seem to be as widespread in the gas trade.

7.2.2 Contract adjustment

Where the charterer has been in a position to make requirements, it has proven possible to adjust the CoU sufficiently through negotiations to obtain P&I approval. One option is to negotiate terminal-specific CoU with the most regular terminals. This is particularly relevant where the charterer is involved on the owner side of the terminal, which is not uncommon in the trade.

As previously mentioned, the Ras Laffan, Altamira and Hazira Conditions have obtained such approval after sufficient adjustment. What distinguishes these contracts from the others is primarily the indemnity provisions, which are negligence-based, the presence of causation and the limitation of liability.

With respect to the Altamira Conditions, the insurers have pointed out that wreck removal should be compulsory under local law and/or by local authorities in order for cover to apply. The starting point for P&I cover of wreck removal is cover of all liability imposed either by statute or authorities. Still, even if the shipowner has assumed a seemingly more far-reaching liability than what follows from background law, the risk of cancellation by the insurer

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[225] *Rygh:* Terminalvilkår

[226] Cf. 4.2 above

is not high, since the authorities in such a situation are likely to demand removal anyway.[227] In the case of Altamira, wreck removal will apparently be ordered by the authorities in any event, and thus there appears to be no excessive exposure in respect of cover.

As regards the Hazira Conditions, the wording is still considered to be onerous by the insurers, but is nevertheless acceptable in respect of cover for liabilities arising under the indemnity to the limit stipulated in the contract[228] for any one incident or occurrence.

These contracts nevertheless prove that it is possible to adjust the provisions to make them acceptable to the P&I insurers.

Notably, the Punta Europa Conditions require compulsory P&I cover,[229] but they are not acceptable as of yet. This contract also contains stipulations concerning limitation of liability and exception for sole negligence on the part of the terminal, but differs from the three approved ones inter alia with respect to lack of negligence-based liability and causation.

7.2.3 Separate additional insurance cover

Where negotiations do not prove successful, the alternative is to sign up for additional insurance cover. Both Gard and Britannia provide such additional insurances.

Gard offers a separate insurance to its members for this purpose, the cover of which costs approximately USD 17,000 per port call. The limitation amount is USD 100 million and the cover lasts for the duration of the call.

Britannia does not offer any separate insurance cover of its own, but is able to procure coverage in the London market. Still, this

[227] *Bull*, p. 378

[228] Clause 2.10

[229] Clause 2.4

solution is far more expensive, up to USD 70,000 per call. In any case, it may prove to be less practical, since Gard also offers its additional insurance to non-members for approximately USD 27,000 per call.

7.3 Hull insurance

7.3.1 The effect of unusual or prohibited terms

As already mentioned, in addition to ordinary hull cover, the hull insurer also bears a substantial portion of the collision liability.

In relation to hull cover, the terminal may cause damage to the vessel, inter alia in relation to navigational services by pilots and tugs, mooring and cargo operations or insufficient safety procedures. As regards damage caused to the ship by the terminal, the starting point is found in NMC § 12-1, which states that the ship is to be restored to the condition it was in prior to the occurrence of the damage.

In relation to collision cover, striking is particularly practical with respect to terminal damage, as already exemplified by *The Polyduke* case.

The starting point for collision cover under hull insurance is found in NMIP §13-1 first subparagraph:

> 'The insurer is liable for liability imposed on the assured for loss which is a result of collision or striking by the ship, its accessories, equipment or cargo, or by a tug used by the ship.'

However, hull cover may cease as a consequence of the CoU.

NMIP § 4-15 *'Unusual or prohibited terms of contract'* contains a provision similar to GR 55:

> 'The insurer is in no case liable for liability incurred because the assured or someone on his behalf:
>
> has entered into a contract that results in stricter liability than that which follows from the ordinary rules of maritime law, unless such terms

must be considered customary in the trade concerned,
has used or failed to use terms of contract which the insurer in accordance with § 3-28 has prohibited or described.'

Based on this, some hull insurers have stated that as long as the P&I insurers do not accept these contracts, neither do they.[230]

However, there is a vital difference between NMIP § 4-15 and GR 55: Whereas the decisive point for P&I coverage is whether such liability would not have arisen but for the contract terms *unless especially approved* by the insurer, the decisive point in hull insurance is whether *'such terms must be considered customary in the trade'*. The word *'customary'* implies no restrictions on grounds of reasonableness, since when the contracts are customary they are most likely known by the parties and may thus be provided for. Therefore, if the terms are considered to be customary, the hull insurer would have to issue cover even if the P&I insurers refuse.

The effect of such *general practice* on onerous terms has never been brought before a Norwegian court, but as mentioned above, *The Polyduke* decision contains statements to the effect that such indemnity clauses are in fact customary. The defendant shipowner was Norwegian, and the insurance was effected on the basis of the NMIP. The court made express reference to the wording *'unless such terms may be considered customary in the trade concerned,'* stating that this made the question of insurance cover depend on whether the onerous clause may be considered to be customary in the tanker trade.[231] It is evident from the decision that the court considered such conditions customary. In direct response to the shipowner's contention that the clause was especially wide, the judge referred to *'the background of similar conditions in force at*

[230] *Rygh:* Terminalvilkår

[231] p. 214

other oil terminals in many parts of the world'.[232] The court also stated that there is a general practice in the tanker trade of masters being required to sign such documents. It was held that the clause in question *"however harsh and one-sided [was] in line with many similar provisions'*[233] and in fact *'fairly common'*.[234]

The statements concerning general practice in the oil trade also have relevance for the gas trade, since it is often the same petroleum companies which own the terminals. Although CoU are mainly employed by export ports, they are quite commonly used by these terminals. It is thus doubtful whether the hull insurers' rejection of coverage would be upheld by court.

However, the hull insurer may also try to invoke NMIP § 3-28, which gives the insurer the right to exclude certain contract terms either from contracts in general or with respect to a specific port or trade. According to § 4-15 (b), see above, the *general practice* test does not apply to such terms prohibited by the insurer. Subsequently, it is possible for the insurer first to exclude onerous terms in accordance with § 3-28, and thereafter refuse insurance under § 4-15 (b).

7.3.2 The effect of recourse waiver

With respect to recourse claims, NMIP § 5-14 *'Waiver of claims'* opens the way for reduced liability for the insurer if the assured has waived its rights towards third parties, e.g. in connection with indemnification of the terminal:

> 'The insurer's liability shall be reduced by an amount equal to that which he is prevented from collecting because the assured has waived his right to claim damages from a third party, unless the waiver may be considered customary in the trade in question, or was

[232] p. 216

[233] p. 216

[234] p. 216

> given in accordance with directions issued by the insurer on the basis of § 3-28.'

Handbook in hull insurance[235] discusses recourse in relation to tug contracts:

> 'However, contracts for towage often contain more far-reaching liability provisions, whereby the towed ship will be held liable for damage suffered by the tug itself, whether or not the tug has collided with the tow or with an oncoming ship and regardless of whether or not the damage is a result of the tug's own negligence. Such contracts for towage may also prevent recourse actions from the insured ship against the tug in situations where the insured ship has incurred liability towards an oncoming ship. As long as such contract terms must be "considered customary in the trade concerned", cf. NMIP § 4-15 letter (a), or are not "prohibited" by the insurer according to NMIP § 3-28, cf. NMIP § 4-15 letter (b), the resulting liability for the insured ship will be fully recognised by the hull insurer and covered by him in his capacity as liability insurer under NMIP § 13-1.'

If we apply this text by analogy to terminal conditions, we are left with the following situation: While recourse from the terminal is highly unlikely in practice, once again the issue must be decided on whether the waiver can be considered customary in the trade or has been prohibited by the insurer. Reference is thus made to the discussion above.

7.4 Charter party cover

7.4.1 Cover under the ordinary charter party terms

In time chartering the operational costs are divided between shipowner and charterer. The shipowner undertakes to pay for the vessel's equipment, maintenance and crew, whereas the charterer covers costs related to voyage orders, i.e. bunkers and expenses

[235] *Wilhelmsen/Bull*, p. 288

associated with the port call.[236] Insurance costs normally fall on the shipowner under a time charter party[237] since insurance is often tied to the duty to repair and maintain.[238]

However, since the need for separate additional insurance cover is directly related to the port call and thus originates from the voyage orders, it is not automatically clear that the shipowner should assume these costs, and the same line of reasoning applies to possible uninsured liabilities arising from the CoU.

On the other hand, these are not direct expenses but potential indirect costs of additional insurance or alternatively an increased risk for the shipowner, and may thus not necessarily be transferred to the charterer without special regulation.[239] The shipowner can therefore not rely on automatic charter cover of increased liabilities and costs imposed by the terminal unless this has been specifically agreed from the outset.[240]

However, it has proven possible for some shipowners to obtain reimbursement by the charterer for such separate insurances under ordinary charter party terms without any prior agreement or specific regulation of the issue. Moreover, under some charter parties insurance costs are covered by the charterer on a so-called *'costs pass through'* basis, which in this context implies that the charterer is directly liable for incurred costs instead of reimbursing the shipowner. Such a system gives the charterer increased influence on expenditure.

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236 *Falkanger/Bull/Brautaset,* p. 408

237 *Michelet:* Håndbok i tidsbefraktning (1997), § 6.23. p. 144, cf. ShellLNGTime 1 Clause 40 (b) – (c)

238 *Falkanger/Bull/Brautaset,* p. 435

239 *Rygh:* Terminalvilkår

240 *Rygh:* Terminalvilkår

Nevertheless, since the shipowner may not automatically rely on ordinary charter party cover of such costs, Nordisk recommends implementing a special provision to ensure such cover. Furthermore, in addition to channelling extraordinary insurance expenses to the charterer, such a charter party provision should also contain an indemnification clause whereby the charterer assumes liability for potential uninsured losses or claims arising from the CoU.

7.4.2 Suggested charter party provision

To accommodate the above needs, Nordisk has drawn up the following suggested charter party provision.

The first part of the provision regulates cover of additional insurances:

> 'For the purpose of this clause, the words "Conditions of Use" shall mean any kind of agreement or terms that the Owners and/or the Vessel must enter into or accept with the operators of any port or terminal in order to be allowed access to or use of such port or terminal, whether or not such agreement or terms are entitled "Conditions of Use".
>
> If the context of such Conditions of Use are not acceptable to the Vessel's P&I club, the Owners shall be entitled to take out separate or additional insurance cover, and any additional premiums and/or calls and/or extra deductibles required by the Vessel's underwriters due to the Conditions of Use, shall be for the Charterers' account.'

The second part of the provision contains an indemnification of the shipowner whereby the charterer assumes liability for potential uninsured losses or claims arising from the CoU and also stipulates that the vessel shall remain on hire, unless the situation is caused by the sole negligence of shipowner or crew. The latter may become relevant if, for instance, the vessel is detained.

> 'Notwithstanding anything else contained in this Charter Party, and notwithstanding whether or not additional insurance cover has been taken out in accordance with the above provision, all liability, delay,

> costs or expenses whatsoever arising out of or related to Conditions of Use shall be for the Charterers' account and the Vessel shall always remain on hire, unless such liability, delay, costs or expenses result solely from the negligence of the Owners, Master or crew. The Charterers assume liability for and shall indemnify, defend and hold harmless the Owners against any loss and/or damage whatsoever (including consequential loss and/or damage) and all other claims of whatsoever nature, including but not limited to legal costs, arising from the Conditions of Use.'

8 Concluding remarks

The gas trade is dominated by large international petroleum companies with strong negotiating powers. Whereas the Conditions of Use are typically issued by export terminals, the charterers are typically involved on the import side. Amidst these two power players the shipowners have limited influence.

This discussion of the CoU has shown that the contracts are built on a principle of unilateral liability. The contractual provisions are characterised by unlimited and strict, or far-reaching, liability for the shipowner in the form of comprehensive indemnity and disclaimer clauses, which together produce the effect that the shipowner becomes liable for all damage to its own and the terminal's interests, as well as third party interests.

The liability provisions depart from ordinary legal principles inter alia with respect to the unlimited and strict liability for the shipowner, the lack of requirement for causation and the terminal's disclaiming of all fault on the part of itself and its servants.

P&I insurers do not cover liabilities in excess of what is imposed by ordinary background law. The cover under hull insurance is more uncertain, since the decisive point for this insurance is whether such terms may be considered customary in the trade.

Moreover, how these risks should be allocated between shipowner and charterer is not automatically clear, with the result that the charterer may refuse to cover expenses related to the CoU.

Nevertheless, shipowners and charterers have a united interest in seeking to reduce this risk exposure, and so far two solutions have been successful to a certain extent:

1) adjustment of the CoU through negotiations
2) separate P&I insurance cover.

Where the charterers have been in a position to make requirements, they have successfully negotiated sufficient adjustments of some CoU to obtain P&I approval. This proves that it is possible to negotiate balanced solutions. What distinguishes the approved contracts from the others is primarily the negligence-based liability on the part of the shipowner, the existence of causation and the limitation of liability.

Moreover, separate P&I insurances with an additional premium and limited liability cover are now available in the market.

Nevertheless, the shipowner is still exposed to increased risk, inter alia if the hull insurer rejects cover, or if P&I liabilities exceed the limited cover under the additional insurance. Such risks should, if possible, be provided for in the charter party.

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ND 1985.234 NA

ND 1990.204 NA

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U 1986.602 DCA

[1978] 1 Lloyd’s Rep 2-11 The “Polyduke” (Bahamas Oil Refining Co. vs. Kristiansands Tankrederi A/S and Others and Shell International Marine Ltd.)

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List of abbreviations

CoU – Conditions of Use

DCA – Danish Court of Appeal

DSC – Danish Supreme Court

GR - Gard Statutes and Rules 2008

IMO - the International Maritime Organization

LNG – liquefied natural gas

LPG – liquefied petroleum gas

LoR – Lov og Rett (law report containing Norwegian legal articles and literature reviews)

MARPOL - International Convention for the Prevention of Pollution from Ships of 1973, amended 1978

NA – Norwegian Arbitration

NCA – Norwegian Court of Appeal

NJA – Nytt juridiskt arkiv (law report containing inter alia all Swedish Supreme Court decisions)

NL – 'Kong Christian Den Femtis Norske Lov' of 15 April 1687

NMC – Norwegian Maritime Code of 24 June 1994 (No. 39)

NMIP – Norwegian Marine Insurance Plan of 1996 version 2007

Nordisk – Nordisk Defence Club

NSC – Norwegian Supreme Court

OPA 90 – the US Oil Pollution Act of 1990

P&I – Protection and Indemnity

RG – Rettens Gang (law report containing Norwegian Court of Appeal and First Instance decisions)

Rt – Norsk Retstidende (law report containing Norwegian Supreme Court decisions)

SIGTTO – Society of International Gas Terminal and Tanker Operators

SSC – Swedish Supreme Court

TRF – Tidsskrift for rettsvitenskap (law report containing Scandinavian legal articles and literature reviews)

Annex: Examined Conditions of Use

The following contracts, in alphabetical order, have been analysed in this thesis:

Abu Dhabi, United Arab Emirates (Annex 1)

Altamira, Mexico (Annex 2)

Bonny, Nigeria (Annex 3)

Braefoot Bay, United Kingdom (Annex 4)

Escravos, Nigeria (Annex 5)

Hazira, India (Annex 6)

Kharg Island, Iran (Annex 7)

Kuwait, Kuwait (Annex 8)

Port Rashid, Dubai (Annex 9)

Punta Europa, Equatorial Guinea (Annex 10)

Qalhat, Oman (Annex 11)

Ras Laffan, Qatar (Annex 12)

Sharjah, United Arab Emirates (Annex 13)

Part IV
A system for queuing in ports

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[1] Torgeir Hovden and Torgeir Willumsen Associate lawyers, Wikborg, Rein & Co, have been of invaluable help in developing the manuscript. The report forms part of the MARLEN and SYNCOPORT research projects. These projects were initiated by Det Norske Veritas and are funded by the Norwegian Research Council.

1 The problem

In some ports, there is a waiting line for ships to load or discharge.[2] Similar queues can be found before channels and straits. The organization of the waiting line – the system for queuing – varies quite a lot. This paper will discuss the organization of such queues with the aim to find a system for queuing that is:

- **efficient** in the sense that the processes are organized so that resources are not wasted for society,
- good for the **environment** in that energy is not wasted, e.g., by punishing ships on environmentally friendly slow steaming by placing them behind comparable fast steaming vessels in the queue, and
- **robust** in the sense that it does not allow much strategic positioning of the players.

Below in section 2, the weaknesses of the queuing systems currently in use will be pointed out. In section 3, a new approach to queuing that is will be introduced and discussed. It is submitted that the proposed approach is robust and more environmentally friendly than the current systems. Section 4 demonstrates that the system will work well with a system for trading queue priorities, so that it can be made at least as efficient as the current systems. A final

[2] The problem has diminished, but is far from eradicated, see Patrick M. Alderton: Port management and operations (London 2008) p. 163 et seq.

One of our informants has submitted that during the peek for the dry bulk segment an estimated 6-7 % of the world fleet was anchored at any time, and that Each percentage point cut in number of ships anchored will free 3.9 million DWT, or 70 Supramax vessels. In addition to the implication this will have on the emission of gren house gases related to the construction and operation of these vessels, this could have save the owners for $ 3.2 billion in construction cost alone.

remark in section 5 addresses the advantages and disadvantages for the ports in introducing the system proposed here.

Sometimes the operation of a port or a part of it is entrusted to a terminal operator. What is said about the port in the following, also applies to such terminal operators.

The basic contracts that influence port operations are:

- The contract of sale that causes the goods to be shipped in the first place, regularly within certain time frames
- The port agreement, which determines the conditions for the admission of and services to the vessel in the port. There may be several subcontractors for individual services. In public ports, the port agreement could be more like a statutory instrument, while in private ports, it is often difficult to distinguish between the port owner in that capacity and the port owner as shipper/receiver of the goods
- The charterparties, which are the contracts to carry the goods.

2 The current systems

In this section, some systems for queuing currently in use will be outlined. This with a view to highlight the problems each system evinces in relation to the three criteria listed in section 1.

The least sophisticated, and in shipping apparently the most used, way of arranging the queue is by the **arrival of the ships** (FCFS; "first come, first serve"). This is used e.g. in Newcastle, Australia[3]

[3] Newcastle Port Corporation: Vessel Priorities for the Port of Newcastle (9th December 2008)
<http://www.newportcorp.com/site/index.cfm?display=111679>. See also the remarks in Harilaos N. Psaraftis: When a port calls: ... an operations researcher answers In: Operations Research/Management Science Today, 1998.38-41 <http://www.lionhrtpub.com/orms/orms-4-98/psaraftis.html> on the use of this system in Piraeus.

and in the Turkish straits for vessels with hazardous cargo.[4] The method is simple and transparent (at least in smaller ports) and presumably also perceived as fair by the involved parties. Both from a commercial and environmental view, however, it does not make sense that ships should rush to get a place in the queue and then wait which at present often is the case. For the environment, rushing to join the queue causes extra bunker fuel oil to be used, compared to what would have been used if the ship had been slow steaming to reach the port just in time for an available berth. And commercially, the extra bunker fuel oil represents an unnecessary expense.[5]

Connected to these unfortunate effects are the contractual mechanisms in today's standardized charterparties. There are mainly two relevant types of clauses here, namely speed clauses and demurrage clauses. As further explained in Section 3.7, this will mostly apply to voyage charterparties and not time charterparties since the latter give the charterers full control over the commercial behavior of the vessel, whereas the parties to voyage charterparties to a larger extent have disparate interests.

Speed clauses impose an obligation on the owners to utilize a certain speed, often described as an obligation to utilize the “utmost despatch” or similar. This must be seen in connection with demurrage clauses where the charterers normally have the risk of congestion. In an FCFS-system, the charterers will have a high interest in early arrival of the vessel since this will determine how fast the

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[4] Maritime Traffic Regulations for the Turkish Straits and the Marmara Region, entered into force on 1 July 1994 <http://www.un.org/Depts/los/LEGISLATIONANDTREATIES/PDFFILES/TUR_1994_Regulations.pdf> articles 42 and 52.

[5] This is for the shipowner and charterer seen together. The individual commercial parties may have different interests depending on the contract, see below in 3.7.

vessel is served without (at least in principle) impacting on the demurrage rate. In addition, the owners pay the fuel costs under voyage charterparties, something which leaves the charterers without an incentive to agree to slow steaming.

However, it is submitted that speed and demurrage clauses are not a direct cause to the problems of high emissions and extra fuel costs, but to a much larger extent an effect of the underlying problem, namely the FCFS-system. The current clauses are only a commercial result of the circumstances surrounding the parties and thus not the root of the problem. Still, if the FCFS-system is replaced by the system set out below, these clauses may – because they have been drafted with different circumstances in mind – to some extent counter the intended effect of the new system as demonstrated in Section 3.7 below. Such clauses should therefore be amended, for instance in accordance with the draft clauses included in the Annex.

In aviation and in railway services, **slot systems** are used.[6] The infrastructure operator and the users agree on arrival times, and there are sanctions for not complying. This is the ultimate planning tool. But such systems cannot easily be used in shipping, because most shipping is tramp shipping where planning a new timetable of this kind every week would take a lot of resources. In addition, changes are more common in shipping, due to weather and rerouting, in particular for long distance sailings. It does usually not make sense to make a detailed plan only to rearrange it, or to impose sanctions for not arriving in time to use the slot so harsh that the ships have to add a safety margin of waiting time. The

[6] See IATA: Worldwide Scheduling Guidelines 16th ed., July 2008 <http://www.iata.org/NR/rdonlyres/2C1BAA18-6297-4984-A74E-4A6D1F945A55/0/WSG16thEdition.pdf > and, e.g., Bordörfer et al: An Auctioning Approach to Railway Slot Allocation. ZIB-Report 05-45 (2005) <http://www.zib.de/Publications/Reports/ZR-05-45.pdf>.

exceptions, triggered by necessity, are convoys, as in the Suez Canal,[7] and water locks, as in the Panama Canal.[8]

Quite similar to a slot system, one can also arrange the queue by order of **booking time**.[9] In this way one avoids wasteful speeding to get a place in the queue. This system is advantageous in enabling vessels to plan well in advance, such as transatlantic freighters, but disadvantageous for vessels sailing to a port to be nominated shortly before discharge. However, this could perhaps be adjusted by further sophistication of the system.

More important is the inefficiency of this type of system, in the sense that arranging the queue by booking time is unlikely to distribute the berths to the ships that should have them in order to preserve the maximum wealth in society. The system therefore needs to be supplemented by the possibility of trading berth times. However, if there is a possibility of trading berth times, then one will inevitably see bookings for strategic reasons. Solely by booking, one can obtain a priority that can be sold for a profit. It is questionable whether it is possible to add features to the system that will prevent this, or, alternatively, whether a booking system that

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7 See the information at Altlas Maritime Services: Suez Canal Guide <http://www.atlas.com.eg/scg.html>.

8 See OP´s Advisory to Shipping No. A-02-2008: Changes to the Panama Canal Transit Reservation (Booking) System <http://www.pancanal.com/common/maritime/advisories/2008/a-02-2008.pdf>, which is amended continuously. The rules are based on Regulation on Navigation in Panama Canal Waters (Agreement No. 13 of June 3, 1999 by The Board of Directors of the Panama Canal Authority <http://www.pancanal.com/eng/legal/reglamentos/navigation-compilation.pdf> Section Three.

9 An example from Rotterdam is Port of Rotterdam: Reservation procedure to request berth at 'Dolphins 80 - Caland Canal' <http://www.portofrotterdam.com/en/shipping/seashipping/buoys_dolphins/allocation_procedure.jsp>.

receives a large number of strategic bookings will work well for planning purposes.

In the relevant literature, different kinds of **auction systems** have been much discussed.[10] The great advantage of these systems is that it is likely that the berth times will be distributed efficiently in the sense that wealth is not lost for society. The disadvantages are three. Firstly, it may cause vessels to set up an environmentally undesirable high speed in order to reach an inexpensive berth time or the berth time won by an auction. Secondly, it requires quite a lot of organizing. And thirdly, it does not take into consideration that the various vessels going to a port do not know what their own needs are at the same time; some wish to know their berthing time before others even know they are going to that port, and that makes auctioning at one specific time difficult. In practice, therefore, auctioning is not much used. An exception is the auctioning of one single slot a day in the Panama Canal.[11]

3 The proposed queuing mechanism

3.1 Queuing by standardized ETA

The obvious disincentive for racing to get an early place in the queue in congested ports would, of course, be to find a criterion for obtaining a place in the queue other than on arrival. The criterion must be considered fair and objective.

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[10] See, i.a., Gershko/ Schweinzer: When Queueing is Better than Push and Shove (2008) <http://ssrn.com/abstract=1124076> and Strandenes/ Wolfstetter: Efficient (Re-)Scheduling: An Auction Approach (2003) <http://ssrn.com/abstract=560627>.

[11] Panama Canal Transit Reservation System. MR Notice to Shipping No. N-7-2007 <http://www.pancanal.com/eng/maritime/notices/2007/n07-2007.pdf>.

A queue arranged on the basis of when the ships left the previous port with a standardized adjustment for sailing time ("standardized ETA") would be fair and objective. In addition, in such a queuing system would not contain any incentives to race to the port.

As also the distance between the ports is a more or less objective fact, one is left with the issue as to which speed shall be used to calculate the ETA. Obviously, the sailing speed of a vessel, and hence the standardized ETA, cannot be based on what shipowners say about the speed of their vessels. Seeing that there is an advantage to gain from higher speed, owners of fast vessels would clearly oppose a common speed for all vessel types, and, under the alternative, many owners of slow vessels would presumably attempt at manipulating the speed recorded for producing their own vessel's ETA. One is thus in need of an objective and vessel specific speed.

The reference speed used for calculating the environmental index of a vessel would be almost ideal for these purposes when rules on environmental indices are adopted.[12] It will be recorded in the vessel's papers, and if it is set to high, the vessel will not meet the minimum requirements for its environmental index.[13]

This speed is not necessarily the speed of the vessel that is optimal from an environmental point of view. However, the calculation speed will in any event not determine the actual speed of the vessel, only its place in the queue.[14]

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[12] See IMO Document MEPC 58/23, Annex 11: Draft interim guidelines on the method of calculation of the energy efficiency design index for new ships and IMO Document MEPC 58/4/6: Comments on the draft Guidelines for the Method of calculation of new ship design CO2 Index – Proposal for definition of Vref, and corresponding draft.

[13] The reference speed is in the denominator of the proposed formula.

[14] See below in section 3.2.

Systems for calculating time of arrival that takes into account weather conditions etc. are being developed.[15] However, it is arguably more important to keep the system simple than to add such features. And as the use of such systems in any event will require some input on the desired speed of the vessel, one will not diminish the use for the reference speed in the environmental index formula through utilizing such complicating features in the calculations.

If an environmental index has not been calculated for a vessel, a default solution must be applied. The default reference speed could in such instances for example be the average of the calculation speed for similar vessels.

In addition to the calculated sailing time, one should add some standard extra time for vessels passing through the Suez Canal or other areas where vessels are generally slowed down.

In practice, when a vessel approaches a port one would have to ask when it left the previous port and which reference speed was used when calculating its environmental index. Based on the distance, it would then be easy to calculate the standardized ETA and rank the vessel in a queue, as in the table below.

[15] See SMHI: Improved calculations of ships' arrival times <http://www.smhi.se/cmp/jsp/polopoly.jsp?d=103&a=37577&l=en>.

An excerpt of a queue listing could accordingly look like the following in *Felixstowe*:

Ex. #	Ship name	Departure from	Departure time	Reference speed	Sailing distance, nm[16]	Standard-ized ETA	Queue #
1	Kasper	Rotterdam	19.08.08 12:30	20	121	19.08.08 18:33	5
2	Jesper	Bilbao	17.08.08 13:30	24	202	17.08.08 21:55	4
3	Jonathan	Rio de Janeiro	01.08.08 15:45	15	5174	16.08.08 0:41	2
4	Bastian	Hong Kong	30.07.08 23:30	25	9623	16.08.08 0:25	1
5	Sofie	Durban	07.08.08 9:00	23	5608	17.08.08 12:49	3

3.2 The standardized ETA's relation to the best time of arrival

When the rank in the queue is fixed in this way, the shipowners would wish to know their place in the queue and the time of arrival they should aim for. The standardized ETA is, of course, only used for ranking purposes and the port would not necessarily be able to berth the vessel at that time, or it may be able to berth it before that time. The in factual terms best arrival time would depend on, e.g., the number of ships in the queue, the speed of handling ships in the port and, perhaps, whether the port would like to have vessels

[16] Distance source: http://www.distances.com/ .

waiting in the port area in order to fill gaps caused by delayed vessels.[17]

Because of this inevitable discrepancy between the standardized ETA and the best time for arrival, it is important that vessels gain as much and up to date information as possible on its best time for arrival as this will help vessels adjust their speed to reach port at the best time possible. In terms of efficiency, this will serve to achieve a maximization of the utilization of both port and vessel capacity, and also enable vessels to in a timely manner make the necessary arrangements for their arrival.

It is submitted, that the proposed system with at all times up to date information on the length of the queue, on average, will help ports to provide vessels with a better projection as to the best time for arrival than what any of the other systems currently used in shipping does, at least when ports have had some time to tune in.

3.3 Late vessels

It may be that a vessel arrives later than the time a berth is available for it according to its place in the queue. There is no reason to impose sanctions in these cases. We are dealing with congested ports, and other vessels are likely to be waiting. The berth could be given to the vessel next in the queue, and when the slow or delayed vessel arrives, it could get the first available berth.

[17] Toll systems may be used to make ships adjust sailing time according to these ETAs, e.g., by setting a price on waiting in port, see Chen-Hsiu Laih et al: Effects of the optimal port queuing pricing on arrival decisions for container ships In: Applied Economics, 2007, 39, 1855–1865 and <http://www.informaworld.com/smpp/ftinterface~content=a780495368~fulltext=713240930>.

3.4 The vessels' foreseeability when approaching port

As already touched upon above, the proposed system would, like the FCFS system, not provide full foreseeability for the vessels in the sense that they would not necessarily know already at the time of departure when they can discharge their cargo. When the vessel Bastian (#4 in the example) leaves Hong Kong, it would be #1 in the queue. During the voyage, other vessels may get ahead of it, as the vessel Jesper (#2 in the example). Such foreseeability is in any event difficult to achieve.

If desirable, one can however perhaps provide a heightened foreseeability as vessels approaces the port. For instance one could set a deadline for rearranging the queue, e.g. so that a vessel is protectted against other vessels getting ahead of it, say during the last 12 hours before arrival. A vessel sailing a short distance, e.g. 6 hours sailing, would then get a corresponding disadvantage in the queue. Whether the advantages for the long distance vessels outweigh the disadvantages for the short distance vessels has to be determined as a matter of policy in each port. Obviously, vessels must have the foreseeability necessary to be able to arrange for stevedores etc pursuant to the customs in the particular port.

Foreseeability would also be reduced by vessels approaching the port without notifying it. The vessel is sailing from e.g. Hong Kong to a North European port "to be nominated". When the port is finally nominated and the port authorities are notified, the vessel will get a good priority despite short notice to the other vessels. This is, however, due to its standardized ETA and not to its late notice; the vessel does not get an advantage from late notice.

If desirable, this problem may be dealt with through the use of penalties for late notification of intended arrival, at least if the delay in notification is longer than strictly necessary. The need for

penalties depends on how important foreseeability for other vessels is considered in that particular port.

Under the current systems, there are no particular provisions in place to enable the vessel to at an early time foresee when it will be able to discharge its cargo. Quite on the contrary, under most current systems ports generally have reserved a right to provide new ETAs in their discretion,[18] and in the FCFS system they do not necessarily provide ETAs at all.

3.5 Several queues

Most ports with congestion problems have different queues for different ships. One can distinguish between small and large ships, liner ships and tramp ships, ships that need special equipment for discharging the cargo or not, etc.[19] The above principles can in that case be used for each queue separately. There would not be a problem to list a vessel in several queues, e.g., if one of the vessels in a queue can use more berths than the others due to its limited drafts. If the vessel is berthed due to its priority in one of the queues, it should simply be struck out of the other queues.

Some ports have policies affecting queues,[20] e.g. that

- ships where all hatches are worked 24 hours a day shall have priority before the weekend,
- vessels chartered by the port owner shall have priority,
- no more than one ship chartered by one and the same person shall be alongside at the same time.

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18 See e.g. Port of Rotterdam l.c.

19 On this point see Hugo Tiberg: The law of demurrage 4th ed. (London 1995) p. 303 et seq. and as an example, Vessel Priorities for the Port of Newcastle l.c.

20 Tiberg l.c. p. 303.

There is nothing in this queuing system that would prevent the implementation of such policies. The queue system is simply the starting point from which one can depart for policy reasons.

3.6 The robustness of the queue system

The beauty of generating queue priority on the basis of arrival is that it is not easy to manipulate. Either the ship is there or it is not, and if it is there, it can be observed by any interested person. In the following, it will be argued that the queue system proposed here has the same advantage – in addition to the fact that it allows economically sensible and environmentally friendly slow steaming.

In fact, departure from a port is today as observable as arrival, because this information can be collected and verified by such means as Lloyd's Maritime Intelligence Unit,[21] AIS observations[22] and reports by the authorities of the port of departure. The sailing distance is, of course, also more or less an objective fact. And the same is true for the sailing speed as long as objective criteria, as described above 3.1, are used.

The robustness of the system can, however, possibly be challenged by strategic positioning. I can think of only a few kinds of strategic behavior in this respect.

First, a vessel may claim queue priority on the basis of a port and then secretly call at an intermediate port. It is, however, likely that this will be discovered by, e.g., competitors or Lloyd's Intelligence, at least if one set up routine checks. If there are parts of the world that are not sufficiently transparent, one may choose to attach queue priority to, e.g., the passing of the Suez Canal or a defined line rather than the departure from a port beyond.

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[21] See http://www.lloydsmiu.com/lmiu/index.htm .

[22] See on AIS http://www.kystverket.no/?did=9140988#Hva%20er %20AIS

Second, a vessel running full speed on a long trip may wish to call at an intermediate port (that is not congested) to get a new basis for its priority. Due to the time and cost of such intermediate calls, it is unlikely that this will be common practice, and I am not sure that it would be considered unfair if vessels could get a new priority in this way. But if this should be a problem, one could decide that re-routing en route should not change queue priority, and that only ports of call where substantial amounts of goods were loaded or discharged should count. Also cargo data are available from vessel surveillance systems today, so rules of this kind should not be very difficult to enforce.

The system does not make it advantageous to supply false information. The ship supplying the information will not get a better position in the port it actually is destined for (port A) if it declares that it is on its way to port B. Furthermore, it is unlikely that other vessels will avoid port B because of the false report that another vessel is on its way to that port, as rerouting of a ship generally requires much stronger reasons than only one vessel getting ahead in the queue.

Thus, the system is fairly robust.

3.7 The effect of charterparties

In the text above, it has been assumed that the shipowner has no reason to go fast to a congested port unless it is necessary to get a place in the queue. In this section, it will be discussed whether charterparty clauses can cause the ship to go on full speed despite an environmentally friendly queuing system.

In a normal **time charterparty**, the charterer has the risk of delay, provides the bunker fuel oil (and thus gets the savings from reduced

speed) and he decides the speed of the vessel.[23] He has an interest in commercially sound behavior, and the shipowner cannot prevent it. Therefore, it is likely that a time charterer will respond to the proposed changes in the queuing system for congested ports by ordering slow steaming, as intended.

In **voyage charterparties** this is more complicated. Usually, the shipowner is entitled to compensation (demurrage) if the ship is delayed in port due to congestion,[24] and it is for the shipowner to determine the speed of the vessel (at his own bunker costs).[25] Therefore, rational behavior under the charterparty rules would be to proceed as fast as he can to the port in order to get the demurrage running, even if the ship would have to wait when it arrives.

This statement and the discussion below do not deal with prepaid laytime (when no demurrage is earned) and it does not take into account the expenses of the shipowner in port or at sea other than bunkers at sea. If the demurrage does not cover the shipowner's expenses or other losses, he will of course avoid demurrage regardless of the incentive structure of the contract.

The incentive to go full speed under the proposed rules would be even stronger than under the FCFS regime. If the ship arrives early

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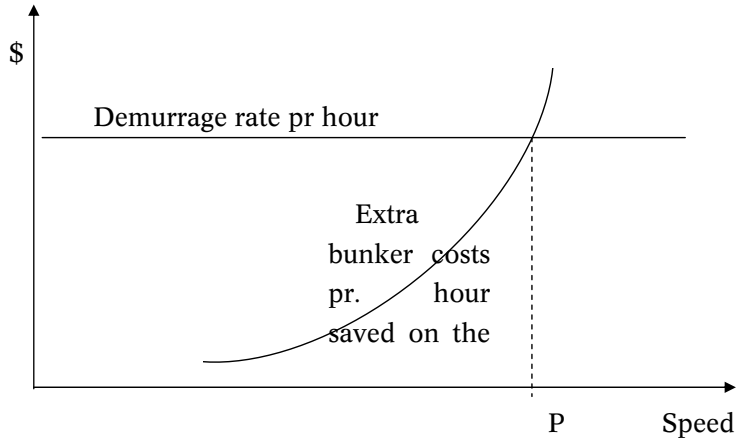
[23] The Norwegian Maritime Code (NMC), 1994 (Translated in MarIus No. 236, Oslo 1997) <http://folk.uio.no/erikro/WWW/NMC.pdf> reflects standard commercial practice, see s. 321 and s. 372 et seq.

[24] NMC s. 333, but see Tiberg l.c. p. 302 et seq. and Michael Brynmôr Summerskill: Laytime (5th ed., London 2005) para 3.509 et seq. and John Schofield: Laytime and demurrage (4th ed., London 2005) para 6-28 et seq. on "turn" clauses, which may be an exception to this principle. There exist, of course, other clauses that are also exceptions to the principle, such as "time waiting for berth not to count as laytime." If an exception applies, the situation in voyage chartering is similar to the situation in time chartering, in that the relevant risks and powers to make decisions are one-sided.

[25] NMC s. 339.

under an FCFS regime, it will get a berth faster. But under the proposed regime, it will not get a berth faster by arriving earlier, and the result will be prolonged time on demurrage with comparable congestion.

The only factor limiting this behavior is if the extra cost of bunker fuel oil burnt to speed up the vessel exceeds the extra demurrage payable upon early arrival. The following chart illustrates this:



The more the shipowner increases the speed, the higher the cost per hour saved on the total voyage time is likely to be. As long as the extra ("marginal") cost is less than the demurrage rate, the shipowner will get his money back, as the earlier arrival will cause more demurrage to be payable. However, if the speed is increased beyond P, the extra bunker cost will not be recovered from the increased demurrage. Therefore, the shipowner is likely to opt for (about) speed P.

The point of principle is clear: The incentive structure of voyage charterparties may influence the speed of the vessel more than the queuing system. The charterparty may cause the shipowner to go full speed under a voyage charterparty even if he would not have done so if he ran the vessel at his own expense.

Speed clauses in voyage charterparties are quite irrelevant in this context. Such charterparties are likely to provide that the shipowner shall use "due dispatch". Traditionally these clauses have been used to secure a certain minimum speed for the charterer. However, given the incentive structure, the charterer is likely to agree to a lower speed en route to a congested port if asked – if that will save demurrage.

Because of this incentive structure, one would need to alter some voyage charterparty clauses in order for the proposed queuing system to have effect. One way of doing so is to clarify that "due dispatch" shall not allow the shipowner to set a higher speed than necessary to reach the target arrival time.[26] Another way is to agree that the risk of delay does not pass to the charterer before the target arrival time (the ship is not an "arrived ship" before that time), so that no demurrage will incur before that time.[27]

The effect of either of these two changes would be a fairly radical shift of the risk of delay in port from the charterer to the carrier. Although the carrier would save some bunker costs on reduced speed, further adjustments may be necessary. One way of doing so is to agree on a price per knot per hour for speed lower than an agreed standard speed which the charterer must pay if the vessel is steaming slowly due to congestion in the destination port.

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[26] BIMCO's Documentary Committee will address slow steaming clauses in 2009.

[27] Draft clauses are included in the Annex.

It may be that some or all commercial parties choose not to amend their voyage charterparties as recommended here, even if changes make commercial sense for both parties when viewed together. The proposed queuing system in ports would then not have the desired effects for these vessels. However, the proposed system would not do any significant harm either, seen from society's point of view, and the system should therefore in any event be upheld for vessels under time charterparties – and for vessels under voyage charterparties that wish to take advantage of it. It is also submitted that, most likely, time will work in favor of the necessary changes in this respect as commercial parties usually are minded to adapt to altered circumstances.

4 Trading turns

4.1 The need for trading turns

One of the reasons why some vessels speed to port today is that there is a commercial need for it – it is for some reason important that the goods arrive as soon as possible. The proposed queuing system would in itself make it impossible to speed up the carriage of one particular cargo with the effect of it getting ahead of other cargoes in a congested port.

Mechanisms that would allow some cargoes to get ahead in the queue should be maintained, as there seems to be a need for them. These mechanisms should perhaps be more extensive than those existing today, provided there is no environmental downside. And they should neither be limited to transport situations in which there is a possibility of gaining time by speeding up.

There are many legitimate reasons why some vessels are in a greater hurry than others. Some of them are:

- Liner ships that are running behind schedule;

- Ships that need to meet LAYCAN (delivery deadline) under the next charterparty (as opposed, at the other extreme, to ships that do not yet have a new commitment);
- Ships carrying goods that are rapidly deteriorating;
- Ships to which a high demurrage rate and/or high lay time costs apply;
- Ships carrying goods that for various reasons are needed immediately.

In such situations, it makes sense that the vessels with the greater need should be allowed to skip the queue.

4.2 A system for trading turns

In this section, I will outline a system for commercial trading of turns in ports.

If at all possible, one should avoid port authorities being in a position to determine such matters in their discretion. The reason for this is that it is fairly easy to produce false reasons for skipping the queue and evaluating applications would include a lot of bureaucracy and facilitate bribery.

A better approach would therefore be to set up a system whereby turns may be traded between vessels.[28] Those who have the greatest need would then pay those who have a lesser need for speed, in order to get ahead in the queue. It is likely that this would lead to a more efficient use of the limited resources. Those who need it the most are the ones that are willing to pay the most for it, and they

[28] Such trading is not common today. However, there are a few cases that relate to rearranging of the queues, see, e.g., ND 1926.245 Swedish Supreme Court BERTA (=NJA 1926.329) and ND 1927.273 Swedish Supreme Court HANS.

will get it from those who are happier with the money than the queue priority.[29]

In commercial settings like the one here discussed, this is also likely to work fine. In some very special non-commercial cases, such as the discharge of a vessel carrying emergency relief after a catastrophe, one must, of course, let the vessel in first without paying.

If a trading system like this is set up, it is important that the payments mainly go to the ships that must wait for some extra time, and not to the port. Ships are likely to be more willing to offer their turns if they get compensation. And if the port authorities get the profit from the trading of turns, that would be a very undesirable incentive for them to keep the queues long.[30]

It is also important that turns that are traded are similar. A small vessel, which perhaps is expected to discharge in half a day, should not be allowed to switch turns with a large vessel which is behind in the queue. That would be a detriment to the vessels that are in between them in the queue. One must therefore only allow vessels of fairly similar needs for discharging time to switch turns. If needed, one could create a more advanced system that would be even more flexible, where time units at berth rather than turns are traded.

The set-up of a system for trading turns could be quite simple. When the queue for a given time period is established, shipbrokers could facilitate the trading of turns in a similar way to which they

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[29] Arguably, the establishment of a queue before the trading starts may still cause inefficiency, see Gershko/ Schweinzer l.c.

[30] See in relation to this Michael E Levine: Airport Congestion: When Theory Meets Reality. Yale Journal on Regulation, Vol. 26, No. 1, 2009; NYU Law and Economics Research Paper No. 08-55 <http://ssrn.com/abstract=1300983>.

facilitate the trading of vessels and cargoes. In these limited markets, the ships could even send offers directly to each other.

In cases where shipowners and charterers have disparate interests – typically in voyage charterparties[31] – trading turns could counter the charterers' risk of paying unnecessary demurrage, which in turn may reduce the owners' incentive to utilize full steam. Such a trading system would be greatly facilitated if both charterers and shipowners could be contacted directly. The queue information in a port should therefore ideally include contact details both for charterers and shipowners.[32]

4.3 The robustness of the trading system

Also a trading system must be robust in the sense that it does not allow much strategic positioning of the players.

If a place in the queue could be sold in a market, it is, of course, of paramount importance that the places in the queue are not created only for trading purposes. One must avoid the situation where a vessel sets up port A as its destination, sells the turn and then go to port B, which is perhaps not congested. One way of making such a practice meaningless would be to retain the payment from the ship that purchased the turn until the selling ship had actually discharged its cargo, and let the payment go to the port if the selling vessel never discharged that cargo in that port.

If brokers are utilized, they can, as they do in normal broking, easily accommodate payment and at the same time ensure both the sellers' interest in receiving the money, the buyers' interest in knowing that the place in the queue will be provided in return for

[31] See above in section 3.6.

[32] A draft charterparty clause that explicitly allows trading is included in the Annex.

the money, and the ports' interest in receiving the money in sellers' place should the latter attempt to manipulate the system.

With this modification, the system appears to be robust against manipulation.

5 What is in it for the ports?

The port administrations are pivotal in setting up systems such as those outlined above. If the ports do not change their queuing system, ships will continue to race to get a place in the queue. And if the ports do not publish queuing data and permit ships to trade turns, a market for trading turns would be impossible to establish. Even if this does not require very much effort, the job has to be done.

The proposals here would, on the other hand, also provide opportunities for ports. They would have fewer ships waiting in the port area, so that a lot of problems would be avoided, such as in-port collisions. And it would be possible to charge a commission on trading turns, so that revenue could be somewhat increased.[33] Furthermore, ports with a good infrastructure also in respect of queues would gain a competitive advantage. In many countries, governments would also look more favorably on ports which have implemented environmentally sound policies and perhaps even offer further stimuli to encourage ports to adopt such systems.

Ports could implement the proposed changes individually; they would not be dependent on cooperation with other ports or the approval of industry interests or other governments. However, it would perhaps be a good idea if IMO negotiated one or more sets of standardized port conditions in respect of queuing. In addition to

[33] As mentioned in section 4.2 above, the commission should be limited, so that the port does not get an incentive to uphold congestion.

the benefit of uniform rules, experience shows that the negotiation process itself is a good forum for developing and explaining ideas.

Annex: Draft charterparty clauses

A Clauses to reduce speed

The purpose of these clauses is to modify the general speed requirements i voyage charterparties, so that speed shall be reduced when possible without delaying the port operations. The clauses are alternative.

The two first clauses address the speed of the vessel, while the third addresses the earliest time of arrival. This is obviously two sides of the same coin.

The first clause has no special compensation scheme, even if the owners may lose demurrage on the reduced speed. If the carrier would like more compensation than what he gets from reduced bunkers costs, this will be a matter to be taken into account when the freight rates are negotiated. The other clauses include a special compensation scheme, and therefore also extended options for the charterer.

A1 Environmental speed rider without special compensation

The Owners are under no obligation to proceed faster than necessary to arrive at the port of destination as close as possible to the appropriate time of arrival, as from time to time reasonably advised by the port of destination.

A2 Environmental speed rider with special compensation

The Owners are under no obligation to proceed faster than necessary to arrive at the port of destination as close as possible to the appropriate time of arrival, as from time to time reasonably advised by the Charterers or the port of destination.

The Owners shall be compensated on demurrage rate for the time difference between (i) actual time of arrival and (ii) estimated time of arrival had the Vessel sailed with a speed of … knots, but with due consideration being given to the weather and other adverse conditions that actually occurred on the voyage. Saved bunkers costs shall be deducted from this compensation.

This clause does not deal with points of congestion, as demurrage usually is not payable if the vessel is delayed at such points.

As there is compensation for the owners, the charterer is free to set the target arrival time. However, there are limits to what the charterer can do, and to make this clear, it is stated that the charterers advice must be "reasonable."

The compensation clause is based on the difference between the actual arrival of the vessel and the hypothetical point of time it would have arrived had the vessel not slowed down. To make it easier to determine the hypothetical point of time, the parties agree on a calculating speed, and that the speed reducing events (e.g., fog and congestion) that occurred during the actual voyage, and not the events that could have happened during the hypothetical voyage at the calculating speed, shall be taken into consideration. The time lost is compensable at the demurrage rate, regardless of whether the vessel actually used or would have used its laytime in that port. (Demurrage will otherwise not be payable unless all the laytime is used.) The vessels savings on bunkers costs are deducted from the compensation.

See also the comments above.

A3 Environmental speed NOR clause with special compensation

Notice of Readiness not to be tendered before the appropriate time of arrival, as from time to time reasonably advised by the Charterers or the port of destination.

The Owners shall be compensated on demurrage rate for the time difference between (i) actual time Notice of Readiness at the earliest could have been tendered pursuant to this clause and (ii) estimated time Notice of Readiness had been tendered had the Vessel sailed with a speed of … knots, but with due consideration being given to the weather and other adverse conditions that actually occurred on the voyage. Saved bunkers costs shall be deducted from this compensation.

When Notice of Readiness cannot be tendered, demurrage will not be earned. Therefore, demurrage will not be an incentive for the owners not to reduce speed under this clause.

See also the comments above.

B Trading turns clause

The purpose of this clause is to expressly regulate the relationship between the parties in respect to alterations of the Vessel's queue priority. As touched upon above 4.2, sale and purchase of queue priorities will greatly facilitated if both the charterers and the owners may be contacted in this respect, and the rule is therefore opening this possibility. Any detrimental changes in the vessel's position in the queue may easily affect both parties and should thus only be allowed through mutual agreement.

If the port of destination [1] accepts [2] sale and purchase of queue places, the Owners shall immediately [3] notify the Charterers of any requests received from third parties in that respect. The Charterers shall in their sole discretion be entitled to purchase a queue place from a vessel holding a better [2] place in the queue. Neither the Charterers nor the Owners are entitled to sell the Vessel's place in the queue to a vessel holding an inferior place in the queue without the other party's prior written consent.

[1] The word "destination" is chosen to render the provision applicable for straits and canals as well as ports of loading and discharge. It will also encompass any bunkering stations en route.

[2] Whether such sale and purchase is allowed will follow from the port regulations.

[3] The word "immediately" is taken in to reflect that time may well be of the essence in this context, especially for attractive queue numbers.

[4] The charterers' right is expressly said to encompass "better place[s]". Read in conjunction with the express prohibition to sell the vessel's place in the queue without the owners' consent in the ultimate sentence of the clause makes it clear that this right does not apply to later queue priorities.

[5] The parties should be prohibited from selling the vessel's place in the queue to someone else without agreeing on it in advance. A sale will result in increased waiting time, something which normally will not be acceptable to any of the parties without some form of compensation. Depending on the distribution of risk, the owners may receive demurrage for additional waiting time, but he might also be more interested in timely delivery of the vessel under the next charterparty. In addition, there is no particular reason why any additional waiting time should not be a subject of negotiation between the parties.

Part V
The Athens Regulation is heading into harbour – The EU on the point of regulating liability for maritime passengers

Jens Karsten, LL.M[1]

1 A visit to the European Union's shipyard

Today (30 September 2008), almost six years after the adoption, on 1 November 2002, of the *London Protocol to the Athens Convention relating to the Carriage of Passengers and their Luggage by Sea* of 13 December 1974, the EU is close to adopting a Regulation on maritime passenger rights. This Regulation would incorporate the provisions of the renamed 'Athens Convention 2002' (hereinafter 'the Athens Convention' or 'the Convention') in the Community *acquis communautaire*. However, political bargaining over the ambit and content of the 'Regulation on the liability of carriers of passengers by sea and inland waterway in the event of accidents',[2] which was initially proposed in November 2005, ('the Athens Regulation') has been tough up to the last minute. The European Parliament's ('the EP') second-reading verdict of 24 September 2008[3] pits it against the Council of Ministers' ('the Council') common position of 6 June 2008 ('Common Position'[4]), with the European Commission ('the Commission') mediating in the co-decision conciliation procedure[5] which starts on 7 October 2008.

The law-making procedure will be over when this Yearbook is printed. It seems futile, therefore, to speculate at this stage on last-minute negotiations and to predict their outcome. This paper will instead be content with providing an abbreviated report of the *travaux préparatoires* undertaken for the implementation of the Athens liability regime and on summarising the legislative options being considered at present. It will be more ambitious, however, in looking ahead at the future Athens Regulation in the context of international law from which it is derived. An analysis of recent case law of the European Court of Justice ('ECJ' or 'the Court') reveals some significant doctrinal developments in the relationship between international law on civil liability in the transport area and

secondary Community law. This concerns both maritime transport law and air transport law, with the latter offering rich material for comparison as the far more developed branch of passenger law.[6] The issues that potentially arise from applying this transport case law on EC passenger law make the Athens Regulation a case study on the challenges of implementing an international liability convention into Community law.

The Regulation, vested with all the accoutrements of consumer protection, is also an example of the growth of European private law[7] and the expansion of consumer-law thinking across a whole range of Community policies. EC passenger law is constitutionally linked to the integration requirement of Article 153(2) EC[8] and to Article 38 of the Charter of Fundamental Rights of the European Union,[9] but it is based on Articles 70 to 80 EC[10] which define a *sui generis* concept of 'consumer protection' for transport users.[11] Further initiatives for sea passengers are under preparation,[12] such as a proposal announced for a 'Regulation on the rights of passengers with reduced mobility in the maritime sector'.[13] But it is with the Athens Regulation as a pioneering project that the EU is establishing itself as the main regional regulator for the passenger-carrier relationship in maritime transport. It will be interesting to observe how the Community performs in that new role.

This paper is divided into two parts. Part One first deals with the process of the Athens Regulation becoming part of the *acquis communautaire*. Part Two will look at the Regulation within the context of European law and the remit of international law.

PART ONE: The Athens Regulation becoming European Law

2 The Community's labours in endorsing the Athens Convention

The result of the IMO intergovernmental conference 2002[14] confronted the European Union with the task of accommodating the new Convention within its internal legal order, since parts of the London Protocol (those relating to jurisdiction and the recognition and enforcement of judgments[15]) belonged (because of 'Brussels I'[16]) to the exclusive competence of the European Community ('EC'). It was for this formal reason that the Commission originally received a negotiation mandate for the IMO conference by the Council[17] and it is private international law that obliges the EC to accede to the Athens Convention, before it can be duly ratified by its Member States.

The political motivations behind the EU initiative, with consideration for the objective of the Convention to protect passenger interests in maritime transport, are expressed by essentially three Commission policy papers: the 2001 Transport Policy White Paper,[18] the 2002 Maritime Passenger Safety Communication[19] and the 2005 Passenger Rights Communication.[20] In the White Paper the Commission formulated the general objective of developing and defining the rights of transport-users across transport modules (air, rail, sea and urban transport).[21] The Maritime Passenger Safety Communication, which was produced while the IMO Diplomatic Conference was still taking place, implemented this policy for sea transport. It outlined comprehensively and convincingly the Commission's views on the key elements which should go to make up a workable maritime passenger liability regime for Community legislation. The Passenger Rights Communication finally confirmed the objective of, among other things, legislating in favour of passengers travelling by ship.

Having prepared the ground by these policy papers, the legislative path chosen by the Commission for the pursuance of these objectives was two-tiered.

2.1 Accession

In 2003, the Commission proposed accession of the Community[22] – for the first time the EC was entitled to join an IMO convention as a "regional economic integration organisation"[23] – to the Athens Convention.[24] As stated, accession of the Community was to clear the way for national ratifications of the Convention. Its jurisdiction and enforcement clauses require the EC to become a Contracting Party to the Convention before Member States can do so,[25] making the Athens Convention a so-called 'mixed agreement' of Community law,[26] that is, an agreement which partly contains elements which belong to the exclusive competence of the Community (on private international law) and partly elements falling within the competence of Member States' liability for sea passengers (in the absence of Community legislation). The 2003 Commission initiative[27] has so far, however, not moved beyond the stage of a proposal.[28]

2.2 Incorporation

In 2005, embedded in the Third Maritime Package,[29] the Commission proposed the Athens Regulation as an instrument for the incorporation of the provisions of the Athens Convention into secondary Community law.[30] While incorporating international law was its main objective, it also proposed several adaptations of the Athens Convention and additional measures of Community law in favour of passengers. It aimed to extend the scope of application to both domestic sea transport and to inland waterway transport. The proposal aimed to remove the possibility of Member States under

the Convention fixing limits of liability higher than those provided for in international law. It included a provision according to which compensation for damage or loss of mobility equipment/medical equipment belonging to a person with reduced mobility ('PRM') would be equivalent, at the maximum, to the replacement value of the equipment. The proposal further provided for a clause requiring advance payments in case of the death of, or personal injury to a passenger. Finally, it requested pre-journey information to be provided to passengers similar to the air and rail transport sectors.[31]

2.3 State-of-play of the legislative procedure

The proposal for the Athens Regulation was based on Articles 71(1) and 80(2) of the EC Treaty (now only Article 80(2)).[32] It will be adopted in the Treaty's co-decision procedure (Article 251 EC Treaty). After the Commission proposal,[33] accompanied by an impact assessment[34] of November 2005, started the legislative procedure, the Committee of the Regions[35] and the Economic and Social Committee[36] adopted opinions in June and September 2006 respectively. Following the adoption of the complementary IMO Guidelines on terrorism-related damage in October 2006,[37] a Commission document was added in March 2007.[38] The European Parliament adopted its first-reading opinion in April 2007,[39] whereupon the Commission presented a revised proposal in October 2007.[40] The Council (which, according to a progress report,[41] also considered a presidency paper on the relationship between the Athens Convention and international conventions relating to the global limitation of liability[42] and a Commission non-paper *"Up to date factual information in support of the proposal for a Regulation on the liability of carriers of passengers by sea and inland waterway in the event of accidents"*[43]) reached a political agreement in November 2007,[44] adopting the revision (by qualified-majority voting – Italy abstained from voting) as its Common

Position in June 2008,[45] thereby concluding the first reading of the Regulation. The Commission responded shortly after.[46] The second-reading vote of the European Parliament of September 2008 disagreed with the Council.[47] This disagreement makes conciliation necessary, a process which needs to be concluded by the end of 2008.

While a comparison between the Legislative Resolution and the Common Position highlights the contentious issues which are certain to be debated in conciliation, discussion and amendment may also take place on other issues. In the co-decision procedure, the Conciliation Committee is convened if the Council does not accept the amendments proposed by the EP at second reading.[48] The basic text for conciliation is the Common Position and the amendments proposed by the EP. However, as the ECJ found in its *IATA* ruling,[49] the Conciliation Committee has above all the task "of reaching agreement on a joint text." In reaching a compromise the Committee is given a wide discretion and it will examine all the aspects of disagreement with a view to concluding a deal. This permits the Conciliation Committee to amend clauses that were not subject to disagreement in the second reading. Therefore, in principle, almost any solution is possible and changes could be made even on points of the Common Position which the EP did not criticise.

2.4 Disagreements

At this stage, the institutions of the European Union's power triangle (European Commission, European Parliament and Council of Ministers) agree on the overall objective of incorporation of the Athens Convention into Community law. They all wish to endorse the fundamental requirements of the Convention (strict liability, compulsory insurance, direct action) and to approve the IMO reservation and guidelines for implementation[50] (introducing a

special liability scheme concerning terrorist risks (Article 1(b), Article 3[51] and Annex II as well as recitals 4 to 6 of the Common Position)). The institutions, however, notably do not yet agree on:

- The inclusion in a Community law instrument of domestic coastal transport on smaller vessels
- The harmonisation of the level of compensation (national *per capita* limits and global limitation)
- Advance payments (for permanent invalidity and severe injury)
- Pre-journey information (as for package travel)

2.4.1 Domestic sea transport

While the liability regime of the Athens Convention is confined to international shipping,[52] the Commission proposed extending the scope of the Athens Regulation to cabotage (carriage of passengers by sea within a single Member State on board ships) on all seagoing vessels. Article 1 (subparagraph 2) and Article 2 of the Common Position limit this extension to larger vessels, qualified as 'Class A' passenger ships. According to Article 4(1) of Directive 98/18/EC on safety rules and standards for passenger ships[53] a 'Class A' vessel is "a passenger ship [*i.e. a ship which carries more than twelve passengers*[54]] engaged on domestic voyages [*voyages in sea areas from a port of a Member State to the same or another port within that Member State*[55]] other than voyages covered by Classes B,[56] C[57] and D,[58]" that is, sea transport within close range of the coast. As Article 1 (subparagraph 2) and Article 2 of the Common Position only refer to Article 4(1) of Directive 98/18/EC, domestic transport on high-speed passenger craft[59] seems to be equally excluded.[60] According to Article 2 (2nd subparagraph) of the Common Position it would be up to Member States to apply the Athens Regulation to all domestic seagoing voyages (opt-in).

Not accepting the Council's standpoint, the EP wishes to extend the scope of the Athens Convention's liability regime to all domestic carriage by sea and insists that there must not be any distinction between domestic and international carriage by sea as to the compulsory nature of the Regulation. The EP is of the opinion that this extension is feasible and that the insurance market will have the capacity to insure these types of risks with a reasonable extra cost for passengers. However, as operators of domestic traffic are not familiar with the schemes implemented at international level and the insurance market will need to be mobilised to organise the guarantee and direct actions on risks, Parliament suggests that those operators and actors in the insurance market be given a supplementary deadline for applying the Regulation.

2.4.2 National *per capita* limits

While Article 7(2) of the Athens Convention provides that a Contracting Party may individually adopt maximum compensation limits higher than those laid down in the Convention, the Commission proposed to make this clause inapplicable "except all Member States agree on such an application when amending [*the Athens*] Regulation." The clause, if introduced, would have promoted uniformity across the Community but not the most favourable regime for passengers, since national governments would have been precluded from requiring higher amounts of compensation. The Council has removed this clause from its Common Position. Instead, Article 3(1) of the Common Position includes Article 7(2) of the Convention which could duly be applied without amending the Regulation. The EP, reverting to the original Commission proposal, wishes to introduce a second subparagraph to Article 3(1) of the Regulation, saying that Article 7(2) of the Convention is inapplicable unless the Regulation is amended.

2.4.3 Global limitation of liability

Article 19 of the Athens Convention ('other conventions on limitation of liability') provides that the Convention "shall not modify the rights or duties […] provided for in international conventions relating to the limitation of liability of owners of seagoing ships," thus allowing Contracting Parties to apply rules on global limitation of liability on passenger claims derived from international law. Allowing for global limitation conventions to apply would put an upper ceiling on the *per capita* limitation amounts of the Athens Convention. Article 19 thus makes the Athens liability regime more palliable for carriers because individual passenger claims could be capped after a major shipping incident involving a large number of victims.

The Commission proposed to incorporate Article 19 of the Convention. In its first reading the EP wanted to make this clause inapplicable to the carriage of passengers. However, considering the ratification of the International Convention on Limitation of Liability for Maritime Claims of 19 November 1976, as amended by the Protocol of 2 May 1996 (LLMC 1996) by a number of Member States,[61] the Council insisted on Member States being able to apply this convention (but not the global limitation of liability of other conventions[62]). Article 5(1) of the Common Position ('Global limitation of liability') therefore says that the Athens Regulation "shall not modify the rights or duties of the carrier, or the performing carrier, under national legislation implementing the LLMC 1996, including any future amendment to that Convention." Member States would, however, not be obliged to adopt a global liability limitation regime and, as recital 13 specifies, such an obligation would not apply even to Member States that abide to the LLMC. Such Member States may "make use of the option provided by Article 15(3*bis*) of the LLMC 1996 to regulate, by specific

provisions of the Regulation, the system of limitation of liability to be applied to passengers."[63]

Nevertheless, the EP wishes to delete Article 5 of the Common Position. It says that the LLMC should not prevent victims having the amount of their claims limited on the basis of the Athens Convention. The EP's argument is that the global liability ceilings under the LLMC might prevent passengers from recovering a substantial part of their claims under the Convention.

2.4.4 Advance payments

While the Athens Convention (unlike the Montreal Convention[64]) is silent on the issue, the Commission proposed to oblige the carrier to make advance payments in case of death and personal injury.[65] The idea is that the carrier should grant interim relief to passengers waiting for the final settlement of their claims. The Council supported the idea that in the case of a shipping incident causing death of, or personal injury to, a passenger, an advance payment should be paid. According to Article 6 of the Common Position, however, this rule only applies if the shipping incident occurred within the territory of a Member State, or took place on board a ship that was flying the flag of a Member State or is registered in a Member State. Advance payment shall not constitute recognition of liability and may be offset against any subsequent sums paid. The Common Position further specifies in which cases the advanced payment might be returnable in accordance with the Athens Convention and the IMO Guidelines.

The EP requires, first, that the advance payment should, as a minimum, not only cover the event of death, but other cases, such as serious injury and permanent invalidity and, second, the abolition of the territorial limitations of the Common Position.

2.4.5 Pre-journey information

While the Athens Convention (unlike the Montreal Convention[66]) is silent on the issue, the Commission proposed obliging the carrier, the performing carrier and/or tour operator[67] to provide to passengers, prior to their departure, information regarding their rights under the Athens Regulation.[68] Article 7 of the Common Position duly requires appropriate and comprehensible "information to passengers" given "at the latest on departure." The Commission is asked to elaborate a summary of the provisions of the Athens Regulation.

The EP insists on "prior information of the passenger" and, for tour operators, in accordance with Article 4 of the Package Travel Directive.[69]

2.4.6 Abandoned: the inclusion of inland waterway transport

While the liability regime of the Athens Convention is confined to maritime shipping, the Commission proposed extending the scope of the Athens Regulation to inland waterway transport (carriage of passengers on rivers and lakes[70]). The Council disagreed and the Common Position provides for no such extension. Not accepting the Council's choice, the EP's *Rapporteur* considered, as a compromise, application of the Regulation to all ships providing international or national carriage by sea which have to operate a part of the journey by inland waterways and to all ships providing carriage by inland waterways which have to operate a part of the journey by sea. The *Rapporteur* argued that the guarantees of liability must be the same for ships covered by the Regulation when these latter operate on inland waterways. However, at its vote on the second reading, the EP did not endorse that point. It is therefore a near certainty that inland waterway transport will remain outside the scope of the Athens Regulation.

2.5 Options for conciliation

For conciliation essentially four options could be pursued:

A maximalist approach would aim for harmonised rules for all passengers. This approach would first include the fundamental requirements of the Convention (compulsory insurance, strict liability, direct action) and, second, an extension of the scope of application and the harmonisation of the level of compensation. The maximalist approach was the one originally proposed by the Commission. It is also the approach of the European Parliament with the difference that the EP would scale (or delay) the coming into force of the Regulation for short journeys by maritime transport.

A minimalist approach would only borrow the broad outline of the Convention and only take on board the minimum requirements of the Convention and apply them to Class A vessels. Liability ceilings remain capable of variation in the sense that the Regulation would not affect the application of global liability limits. The minimalist approach is the one preferred by the Council.

An intermediary approach allows for two further possibilities. The first would pursue the minimalist approach for all passengers with the possibility of delaying the coming into force of its rules. Liability ceilings would remain capable of variation. The second would pursue the maximalist approach but only for passengers of large vessels. Only those passengers would benefit from the rules of the Convention and the harmonisation of liability ceilings.

2.6 PRM-equipment

A topic which in all likelihood will not be discussed during the conciliation process is the Regulation's clause on PRM-equipment (Article 4 of the Common Position). While the Athens Convention only provides for rules on baggage, the Commission proposed, in

the event of total or partial destruction or loss of or damage to mobility equipment/medical equipment belonging to a passenger with reduced mobility, that the compensation should be equivalent, at maximum, to the replacement value of the equipment. Now Article 4 ('Compensation in respect of mobility equipment or other specific equipment') reads:

> "In the event of loss of, or damage to, mobility equipment or other specific equipment used by a passenger with reduced mobility [*the notion of PRM is not defined in the Athens Regulation*], the carrier's liability shall be governed by Article 3(3) of the Athens Convention [*on cabin luggage*]. The compensation shall correspond to the replacement value of the equipment concerned or, where applicable, the costs relating to repairs."

Similar clauses were adopted for EC law on air and railway transport[71] and they have already raised concern.[72] The specific issues raised by this clause, namely the concept of 'replacement value' and the omission of a definition of 'PRM' in the Regulation (while EC maritime law provides for an exceptionally broad concept[73] compared to air and railway transport[74]) have already been discussed.[75] Another issue arising from the maritime transport PRM-equipment clause is that it exceeds the liability limits of Article 8(1) of the Athens Convention, which imposes a limit of 2,250 SDR for damage to cabin luggage (defined in Article 1(6) of the Convention, for which the carrier is liable under its Article 3(3)), an issue discussed, among others, by *Lagoni*[76] and *Røsæg*.[77] A fundamental question is, therefore, whether this clause actually just adds to the standard of protection offered by the Convention outside the coordinated field of international law or whether it modifies it against binding international rules. It appears that payments for broken PRM equipment above the ceiling of Article 8(1) of the Convention would exceed internationally agreed ceilings. This is because, while Article 7(2) of the Convention allows State parties to be more generous for bodily harm suffered (making it possible to require

advance payments (Article 6 of the Common Position)), the PRM clause relates to material damage for which no such flexibility exists. Indeed, strict adherence to international law would require the Community to seek an international agreement on higher limits for PRM equipment, for which Article 23 of the Athens Convention institutes a special procedure.[78]

Adding to these problems is the definition of 'mobility equipment' in the preamble to the Regulation. Recital 9 explains:

> "For the purpose of this Regulation the expression 'mobility equipment' should be considered neither as luggage nor vehicles in the sense of Article 8 of the Athens Convention."

The wording of this recital would allow mobility equipment to be categorised as either a *sui generis* class of physical objects outside the liability regime established by the Athens Convention or as part of the passenger's body (after all, PRM-equipment serves to make good for physical deficiencies); both, however, with the specific liability ceiling of 'replacement value'. This audacious (re-)definition is not placed among the operative provisions of the Regulation but instead, somewhat hidden, in its preamble. *Røsæg* justifies excluding medical equipment from the notion of 'luggage', 'cabin luggage'[79] and 'vehicle' for political reasons[80] and he might be right. As the examples of aviation and railway law show, great dogmatic efforts are made to justify such clauses. A potential conflict with liability conventions, however, remains, which places the PRM-clauses of EC passenger law in a grey area between Community law and international law. This paper will return to this question in its second part.

3 Legislating after a compromise on the Athens Regulation

The outcome of the third reading will be known very soon. The result will be published in the Official Journal. The creation of new legislation on maritime passenger protection, however, is not going to come to an end with a deal on the Athens Regulation.

First of all, Member States governments will have to approve, in the Council, EC accession to the Athens Convention, thereby providing the indispensible prerequisite for the Convention to come into force for the Community (Article 12 of the Common Position). Because of the Convention's character as a 'mixed agreement', Member States are then asked to ratify the Athens Convention nationally.

Second, Member States have to decide on the various transition periods, as well as national opt-ins and opt-outs. Assuming that the Common Position prevails, it is the Member States' decision whether to opt-in and extend the application of the Athens Regulation to all domestic sea going voyages on Class B, C and D ships (Article 2, 2nd subparagraph). Conversely, Member States may decide to opt-out and defer the application of the Regulation on domestic transport for Class A ships until four years after the date of its application (Article 11). Member States may also consider ratifying the LLMC Convention, thereby deciding on the introduction of global liability limits (Article 5(1) and recital 13). Finally, they could make use of Article 7(2) of the Athens Convention (included by Article 3(1) of the Common Position) to provide for higher liability limits.[81]

Third, Article 5(2)(3rd subparagraph) of the Package Travel Directive[82] that refers to the Athens Conventions (see recital 19 of that Directive) may require, if not to be amended, at least to be reassessed in its national transposition.[83]

This is a lot of legislative activity after the coming into force of a directly applicable Regulation of Community law and, leaving many regulatory choices in the hands of national lawmakers, one that risks creating a still partly fragmented picture of maritime law in Europe, spoiling the Regulation's objective "to create a single set of rules governing the rights of carriers by sea and their passengers" (recital 14 of the preamble of the Common Position).

Moreover, should passenger law for inland waterways definitely remain outside the scope of the Athens Regulation (note the margin for manoeuvre of the Conciliation Committee), several options could be pursued. If European organisations remain inactive, passenger law for fluvial shipping will remain a matter for the national legislator, just as it is today. This could be done by reference to the maritime liability regime (as for instance in Germany: the *Binnenschiffahrtsgesetz*[84] (Inland Waterways Navigation Act of 1895) refers in § 77(1) to the transport of travellers and their luggage of § 664 *Handelsgesetzbuch* (Code of Commerce) on maritime passengers[85]) or by a stand-alone legislative act (national option). Provided there is a political stimulus, however, the Commission could begin working towards a 'Regulation on the liability of carriers of passengers by inland waterway in the event of accidents' – with liability limits acceptable to fluvial shipping – in further pursuance of its passenger rights agenda[86] (supranational option). It is also conceivable that another European (but intergovernmental) organisation, the Central Commission for Navigation on the Rhine (CCNR),[87] could take the initiative (international option). Related to passenger law, the CCNR is currently revising the *Strasbourg Convention on the Limitation of Liability of Owners of Inland Navigation Vessels* of 8 November 1988 (CLNI),[88] the inland waterway equivalent to the LLMC, with a view to possibly reaching an agreement on a new convention on global limitation of liability for fluvial shipping as

early as 2009.[89] Although this is pure speculation, it is not impossible that a successful modernised Strasbourg Convention on the limitation of liability could provide the momentum for the discussion of a twin convention on liability itself, as a part of the *acquis rhénan* and avoiding the flaws of its (unsuccessful) predecessor convention.[90]

PART TWO: The Athens Regulation in Community law and international law

4 Defining the fault-line between European and international passenger law

This paper has so far dealt with the Athens Regulation as a piece of Community law in-the-making, and in doing so has perhaps succumbed to the European habit of navel-gazing. However, limiting oneself to EU-lawmaking alone risks neglecting the essential character of the Regulation as legislation derived from an international transport convention. Transport conventions are global governance for global businesses like shipping (or aviation). They are international uniform law, replacing, within the remit of what they regulate, local (national and supranational) law related to the same subject-matter. Incompatible local law is, in principle, inapplicable.

Significantly, the Athens Regulation has been criticised even before being adopted because of an alleged incompatibility with the Athens Convention of some of its provisions. The critique relates to where the Regulation adds to carrier liabilities in the name of passenger protection. *Lagoni*[91] and *Røsæg*[92] controversially discussed the question of whether the Regulation's clause on advance payments (Article 6 of the Common Position) and on compensation for PRM-equipment (Article 4 of the Common Position) were in

conformity with the Convention. This debate is worth pursuing in this paper, not in order to actually decide whether these passenger rights clauses of Community law can prevail against the background of international law, but more generally to explore the possibility of testing passenger law as contained in EC-Regulations by applying higher-ranking law as contained in international conventions.

It is intriguing to consider whether some provisions of the Athens Regulation are incompatible with the Convention from which the Regulation is derived. That might be a paradoxical proposition. However, as the example of air transport law teaches, the issue of compatibility of secondary Community (passenger) law with international (transport) conventions is one that can cause considerable concern. The *IATA* ruling[93] dismayed air carriers because the ECJ defined the boundaries of the Montreal Convention more narrowly than they had assumed it would and found the Community competent to regulate a matter (damage due to late departure of a flight[94]) that carriers thought was exhaustively and bindingly regulated by international law (Article 19 of the Montreal Convention on damage due to delay). Indeed, in *IATA*, the Court saved Regulation 261/2004 by placing it outside the coordinated field of international law. It did so by distinguishing between two realms: that of the coordinated field of international law, which local legislators cannot change, and that of the un-coordinated field in which the local, in this case European, legislator maintains a margin of manoeuvre. In *IATA* the Court recognised the exclusivity of the Montreal Convention (Article 29) [and implicitly also of the Athens Convention (Article 14)], but it also established that for claims falling outside that scope the local regulator is not pre-empted from acting. This distinction – and the role of the Court in making such a distinction – is crucial for the whole concept of EC passenger law in the context of its international law origins. It shall be shown below how the ECJ

assumes the role of the arbiter and custodian defining the boundaries and regulatory competencies between these two regulatory complexes (N.B. always assuming that the EC accedes to the Athens Convention as foreseen).

4.1 The Athens Convention in Community law

Article 300(7) EC[95] stipulates that "agreements concluded under the conditions set out in this Article shall be binding on the institutions of the Community and on Member States." On the basis of this provision and its application by the ECJ, four questions must be answered to test the applicability and precedence of passenger conventions within the amalgam of European law. When is an agreement binding? Does it have direct effect? When does it have primacy over Community law? Eventually, and if the first three questions are answered in the affirmative: When can an international agreement overrule secondary Community law?

- a. Binding effect for the Community
- aa. The example of air transport law

As regards air transport law an interesting reference for a preliminary ruling from the *Cour de cassation* (Luxembourg) was lodged on 7 July 2008.[96] It essentially asks whether the Warsaw Convention of 12 October 1929[97] (with an array of amending protocols[98]) "forms part of the rules of the Community legal order" and thereby complements secondary Community law on air passenger rights. That is interesting to ponder but irrelevant for the present examination of the binding effect of the Athens Convention that, it is assumed, will be properly ratified in due course. The counterpart of the Athens Convention, as amended, is not the Warsaw Convention (which is not ratified by the EC), but the *Convention for the Unification of Certain Rules for International Carriage by Air* of 28 May 1999[99] ('the Montreal Convention'),

which aims to globally govern transport by air of passengers, baggage and cargo. Where applicable,[100] it succeeds and supersedes the 'Warsaw system', hitherto the most widely accepted unification of private law, as and between Signatory States.[101] The Montreal Convention entered into force on 4 November 2003.[102] It was signed and ratified by the EC as a "Regional Economic Integration Organisation"[103] and entered into force in its jurisdiction on 28 June 2004.[104] While the Community insisted on its exclusive competence in acceding to the Convention,[105] it was, as a 'mixed agreement', also ratified by Member States. On the Montreal Convention and Community law, the Court's Grand Chamber stated in its *IATA* judgment:[106]

> "(35) Article 300(7) EC provides that 'agreements concluded under the conditions set out in this Article shall be binding on the institutions of the Community and on Member States'. In accordance with the Court's case-law, those agreements prevail over provisions of secondary Community legislation.
>
> (36) The Montreal Convention, signed by the Community on 9 December 1999 on the basis of Article 300(2) EC, was approved by Council decision of 5 April 2001 and entered into force, so far as concerns the Community, on 28 June 2004. Therefore from that last date the provisions of that Convention have, in accordance with settled case-law, been an integral part of the Community legal order."[107]

Preparing the *IATA* ruling Advocate General Geelhoed explained:

> "The Community is party to the Montreal Convention and there is no doubt that the Community is bound by this Convention. The Convention was signed and concluded on the basis of Article 300 EC. Agreements concluded in accordance with Article 300 EC are binding on the institutions and the Member States and form an integral part of the Community legal order once they have entered into force [*quoting the* Haegeman[108] *and* Kupferberg[109] *cases*]. The fact that the Regulation was adopted before the entry into force, for the European Community, of the Montreal Convention does not change the obligations of the Community institutions under international

> law. The Montreal Convention is an international agreement and as such is binding on the parties thereto and must be performed in good faith. Therefore, even though the Community has not yet formally deposited its instrument of ratification, the Community institutions may not act against international agreements. The institutions were obliged, as from 9 December 1999, the date of signature, to refrain from acts which would defeat the object and purpose of the Convention. Thus, there was an obligation to refrain from adopting Community legislation which could be incompatible with the Montreal Convention."[110]

The *IATA* ruling thus firmly establishes that the Montreal Convention (1) has been validly concluded by the EC, (2) prevails over secondary EC law, and (3) is an integral part of the *acquis communautaire*. Henceforth, simple reassertion of this status should suffice. The ensuing *Schenkel* ruling[111] provides a condensed formula:

> "It is true that the Montreal Convention forms an integral part of the Community legal order. Moreover, it is clear from Article 300(7) EC that the Community institutions are bound by agreements concluded by the Community and, consequently, that those agreements have primacy over secondary Community legislation." [112]

Simply by replacing, in the quotes above, the term 'Montreal Convention' by 'Athens Convention' (N.B. a ratified Athens Convention), the binding effect of this convention of international maritime law could be established. However, the same cannot be said about other maritime conventions.

- bb. The example of maritime transport law

The solemn declarations of allegiance to international air transport law stand in contrast to maritime law whose conventions, according to the ECJ, do not, or not to the same level, have binding effect in the EC. Three ECJ judgements in particular inform us about the conditions necessary for international maritime agreements to be binding. These are (in chronological order): *Peralta*[113] (on the MARPOL Convention 73/78,[114] an instrument of environmental

law), *Intertanko*[115] (on the UNCLOS 82[116] and MARPOL) and *Commune de Mesquer*[117] (on the Liability Convention[118] and the Fund Convention[119] on oil pollution[120]).

In *Peralta*, despite the fact that the MARPOL Convention had been signed by almost all Member States in accordance with a Council Recommendation,[121] the Court relied on the fact that the Community was not a party to MARPOL to reject this convention's binding force for the EC. The ECJ further argued that the Community had not assumed powers previously exercised by the Member States in the field to which that convention applies (*i.e.*, environmental law).[122] As a consequence, MARPOL could not have the effect of binding the Community.[123]

In *Intertanko*, a Grand Chamber decision also on environmental law, the Court was asked to assess the validity of Directive 2005/35/EC on ship-source pollution and the introduction of penalties for infringements,[124] *i.e.* secondary Community law establishing a stricter liability regime for accidental discharges than provided for under international law. The Court found that the validity of the Directive could not be assessed in the light of the maritime conventions. It first noted that the EU institutions were bound by international agreements concluded by the Community. International treaties therefore had primacy over secondary Community legislation. The validity of, for instance, a Directive, could therefore be affected by a failure to comply with international rules. The ECJ then set out the conditions under which it is empowered to review the validity of a Community provision in the light of an international treaty. First, the Community would need to be bound by the treaty and, second, examination by the Court of the provision's validity could not have been precluded in particular by the treaty's nature and broad logic. Recalling these rules and analysing both international conventions in detail the Court observed that with regard to MARPOL the EC was not a party to

that convention. The mere fact that the Directive incorporated certain rules set out in it was not sufficient to enable the ECJ to review the Directive's legality in the light of that convention. With regard to UNCLOS, the Court observed that this convention had been signed by the Community and approved by a Community decision, thereby binding the Community. However, the Convention did not establish rules intended to apply directly and immediately to individuals. It did not confer upon them rights and freedoms capable of being relied upon against States, irrespective of the attitude of the ship's flag State. Consequently, the nature and broad logic of the UNCLOS prevent the Court from being able to assess the validity of a Community measure in the light of that convention.

In the third maritime case, *Commune de Mesquer*, the Court (also the Grand Chamber) had to rule on the relationship between secondary Community law (a Directive on the protection of the environment) and international law (on liability). On the effect of oil spill conventions the Court stated:

> "(85) [...] The Community is not bound by the Liability Convention or the Fund Convention. In the first place, the Community has not acceded to those international instruments and, in the second place, it cannot be regarded as having taken the place of its Member States, if only because not all of them are parties to those conventions, or as being indirectly bound by those conventions as a result of Article 235 of the UNCLOS, which entered into force on 16 November 1994 and was approved by Council Decision 98/392/EC,[125] paragraph 3 of which confines itself [...] to establishing a general obligation of cooperation between the parties to the convention.
>
> (86) Furthermore, as regards Decision 2004/246 authorising the Member States to sign, ratify or accede to, in the interest of the Community, the Protocol of 2003 to the Fund Convention, it suffices to state that that decision and the Protocol of 1993 cannot apply to the facts at issue in the main proceedings."[126]

- cc. Result

The conclusion that can be drawn from this case law is that formal accession to a convention (Article 300 EC Treaty) is the all-important issue to make an international agreement binding for the Community. Lacking ratification by the EC, a convention is denied to have binding effect in the Community whatever the standing or recognition the agreement might otherwise enjoy.

- b. Primacy over secondary Community law

The Montreal Convention, the Court says, enjoys "primacy over secondary Community legislation"[127] and so will the Athens Convention when the EC has acceded to it. The implications of the primacy of international transport conventions for the Community legislator have been explained by the Court in *Intertanko*. In *Intertanko* the crucial factor that excluded the UNCLOS from binding the Community was that this convention did not regulate the subject-matter "directly and immediately to individuals."[128] The ECJ came to this conclusion by developing a test, wherein it set out the conditions under which it may review the validity of a Community provision in the light of an international treaty:

> "(42) It is clear from Article 300(7) EC that the Community institutions are bound by agreements concluded by the Community and, consequently, that those agreements have primacy over secondary Community legislation.
>
> (43) It follows that the validity of a measure of secondary Community legislation may be affected by the fact that it is incompatible with such rules of international law. Where that invalidity is pleaded before a national court, the Court of Justice thus reviews, pursuant to Article 234 EC, the validity of the Community measure concerned in the light of all the rules of international law, subject to two conditions.
>
> (44) First, the Community must be bound by those rules.
>
> (45) Second, the Court can examine the validity of Community legislation in the light of an international treaty only where the nature and the broad logic of the latter do not preclude this and, in addition, the treaty's provisions appear, as regards their content, to

> be unconditional and sufficiently precise" [*quoting the* IATA *ruling, paragraph 39*]."[129]

The Court's ruling, relying on preceding case law,[130] is highly signifycant in that it sets the parameters for ascertaining the compatibility of secondary Community law with binding international law. In such a judicial review, for which the ECJ claims sole competence[131] (examining the alleged infringement of higher-ranking law by an act of Community law), a convention may indeed overrule a Regulation or a Directive. This on three conditions:

First, the international law in question must be binding, that is, the convention must be properly ratified by the EC. Whether this criterion is fulfilled can be determined, first, by applying public international law (has the passenger convention been acceded to by the EC?) and, second, by asking whether the Community has taken the place of the Member States (has the Treaty transferred to the EC the competence on the basis of which the Member States signed that passenger convention?).[132] The Athens Convention duly concluded by the EC would fulfil this criterion.

Second, "the nature and the broad logic" of the convention must not exclude the examination of the validity of the Community act.[133] Framework legislation addressed to States and not conferring rights to individuals can therefore not provide the background for a validity check. UNCLOS failed that test given its generality. However, passenger conventions such as the Athens Convention do precisely that: giving rights to individuals.

Third and last, the convention's provisions must appear, "as regards their content, to be unconditional and sufficiently precise" in establishing rules intended to apply directly and immediately to individuals. This third criterion deserves a closer examination.

- c. Direct effect for passengers and carriers

There is a striking similarity between the *Intertanko* method of assessing the compatibility of EC law with international law and the

ECJ's doctrine on the direct effect of Community law in national law regarding the third criterion. On the direct effect of EC law the Court has determined that a provision of Community law that is unconditional and sufficiently precise can produce direct effects.[134] A measure is unconditional, "where it is not subject, in its implementation or effects, to the taking of any measure either by the institutions of the Community or the Member States."[135] Further, a measure is sufficiently precise when its provisions are set out in "unequivocal terms"[136] or furnish "workable indications for the national court."[137] Applied to passenger conventions it is easy to see how both requirements are fulfilled, *i.e.*, how they apply directly and immediately to individuals.[138] In the case of the Athens Convention its provisions, once endorsed, do not need the national or supranational legislator or executive to become effective; they operate without the aid of legislative provision and will be applied by courts as they stand. The Athens Convention's provisions are also sufficiently precise to be applied by courts without further guidelines or executive decrees. Read in conjunction, the *Intertanko* ruling therefore arguably establishes a variation of the 'direct effect' doctrine for passenger conventions.

Exactly what variety of the 'direct effect' doctrine, however, is not established. In EC law, one can make a distinction between "direct applicability" mandated by the Treaty (Article 249 EC provides that Regulations "are directly applicable in Member States") and the doctrinal creation of "direct effect" (mostly used to argue in favour of applying Treaty provisions and Directives). On international trade agreements the ECJ upholds case law that is essentially based on an analysis of the obligations flowing from such agreements. In the *International Fruit* case[139] it accordingly held that the General Agreement on Tariffs and Trade (GATT) was not directly effective because the enforcement of the obligations left room for executive negotiation. In other words an act of the executive was required to

make the agreement judicable. The same analysis was adopted more recently in *Portugal v. Council*[140] denying the direct effect of the WTO Agreement. The case law on trade agreements, however, does not explain why passenger conventions should be immediately enforceable in national courts by individual applicants. The effect of passenger conventions may therefore *mutatis mutandis* be better conceived as that of Regulations.[141] Interpreting the effect of international agreements that way would allow international law endorsed by the EC to impose directly applicable legislation on the EU and its citizens, just as the EU imposes directly applicable Regulations on its Member States and those under their jurisdiction. Above all it has the advantage of taking due account of the fact that passenger conventions confer rights and duties on individuals.

4.2 The Athens Regulation subject to the *Intertanko*-test

From the date of its entry into force for the Community the Athens Convention will be binding for the EU and its Member States. The Convention will enjoy primacy over secondary Community law. It will have direct effect as between passengers and carriers. What remains to be answered is whether and under which conditions provisions of the Athens Regulation could be overruled should they prove to be incompatible with international law.

This paper has already referred to the discussion on the legitimacy of the Regulation's clauses on advance payments and PRM-equipment compensation payments. These are operational provisions that arguably could conflict with the Convention (because the Athens Convention, unlike the Montreal Convention, does not provide for the possibility of introducing advance payments and because the Athens Convention's liability limits for luggage are inflexible). This discussion is worth pursuing.

However, it is also worth looking at the recitals of the preamble of the Athens Regulation where guidelines for the interpretation of the Athens Convention are established. Article 253 EC Treaty[142] requires that the recitals of the preambles to Regulations and Directives "state the reasons on which they are based" and thereby enlighten the background to legal acts of the Community.[143] The ancillary character that is thus given to recitals should, however, not diminish or disguise the impact they can have on the reading of the law. Recital 9 on the notion of 'mobility equipment' has already been mentioned as a problematic case. It has been stated that, by saying how the law should be read, recital 9 is actually modifying the notion of 'luggage', 'cabin luggage' and 'vehicle' of the Convention and therefore possibly violating the exclusivity of the Athens Convention as expressed in its Article 14. Another such rule for interpretation is recital 6. This clause states:

> "The provisions of the Athens Convention (Annex I) and of the IMO Guidelines (Annex II) should be understood, *mutatis mutandis*, in the context of Community legislation."

The idea behind this clause might simply be to make it clear that the Convention and Guidelines form part of the Community legal order and to advise that these instruments should be construed so that they harmonise with concepts of European law. Relevant Community law in which international law is so embedded will be the *acquis communautaire* on maritime transport, of course, but also, in particular when considering the private law nature of the Convention's provisions, the body of EC passenger law (the Regulations on air and rail transport) as well as EC consumer law, namely the Package Travel Directive.[144] From the point of view of EC passenger law such a holistic approach is a welcomed development. The private and consumer law nature of the provisions of international passenger conventions and the similarity of issues addressed by these conventions make it a useful endeavour to seek

common legal notions across the law on different transport modules.[145]

However, there is a balance to be struck between the desire for comprehensive Community passenger law and the allegiance to international law imperative according to Article 300(7) of the EC Treaty. This balance is that, if the Community accedes to the Convention and thereby helps it to enter into force globally, the Community must then respect the supremacy of international law. A balance, finally, that ultimately the ECJ has to guarantee.

It is submitted that the *Intertanko*-test provides the tools for overruling secondary Community law that conflicts with binding international law, especially in the transport area. These tools would be applied by the judiciary. By developing the test the ECJ not only appointed itself as gatekeeper of international law in European law.[146] It also provided for the possibility for national judges to refer cases where there is doubt about the legality of a provision of Community law.

Such cases will most certainly come up. Recital 6 is in particular vulnerable to challenge, since it is in quite obvious contradiction to the rules on the interpretation of treaties of Articles 31 to 33 of the Vienna Convention on the Law of Treaties of 23 May 1969.[147] As a general principle Article 31(1) of the Vienna Convention requires:

> "A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose."

As it becomes clear from further reading of Articles 31(2) to 33 of the Vienna Convention, the 'context' within which treaty provisions shall be interpreted is that of international law. International context, uniformity and observance of good faith must be regarded; no role is given to national or supranational law.

An example illustrates the point. Applying the Vienna Convention on concepts of the Athens Convention, the notion of 'loss' and also

of 'personal injury' of Article 3 of the Athens Convention become autonomous concepts. 'Loss' is consequently not to be confused with the notion of 'damage' enshrined in Article 5 of the Package Travel Directive. However, here lies a potential for conflict. A tendency can be observed in European legal doctrine towards seeking an all-encompassing private law approach towards this key terminology of the law on civil liability in transport and tourism. Evidence for this trend is Advocate General Tizzano's opinion on the *Leitner* case.[148] In his search for arguments in support of compensation for non-material damage under the Package Travel Directive, he interpreted the notion of 'damage' by looking across the *acquis*, including the Product Liability Directive 85/374/EEC[149] as well as "the Community's own case-law, by certain relevant international conventions on the subject, and by current developments in the legislation and case-law of the Member States."[150] On international conventions he explained:

> "As regards indications provided by international treaties, I note that, although they are mainly concerned with issues related to transport or material objects and thus are not of direct relevance for the purpose of compensation for damage arising out of a ruined holiday, the Warsaw Convention of 1929 on International Carriage by Air, the Berne Convention of 1961 on Carriage by Rail, the Athens Convention of 1974 on Carriage by Sea and the Paris Convention of 1962 on the Liability of Hotel-keepers for items brought by clients into hotels – all referred to in the eighteenth recital of Directive 90/314/EEC – refer to a general concept of damage and therefore do not preclude non-material damage. Further, of even more specific interest is the International Convention on Travel Contracts,[151] Article 13(1) of which states that the organiser's contractual liability for the travel covers *tout préjudice causé au voyageur*, (all damage occasioned to the traveller) at the same time establishing, in subsequent Article 2, the ceilings for compensation in respect of non-material damage, material damage and all other types of damage."[152]

Although still theoretical at this stage, it is quite possible that in future cases on the Athens Regulation, similar opinions will be

developed to underpin passenger claims for non-material damage. Loss of enjoyment of a holiday (but also mental suffering after a shipping incident that may be sought to be qualified as 'personal injury') may so become qualified as 'loss' under the Convention, especially if recital 6 of the Athens Regulation is employed to cross-reference to the *Leitner* ruling wherein the ECJ gave consumers a right to compensation for non-material damage. A doctrinal methodology espousing indiscriminately concepts of consumer law, should it be employed, could amount to an infringement of international law. Fortunately however, one can take reassurance from the fact that such interpretations could be challenged by applying the *Intertanko*-test. If referred to the ECJ, such a case is amendable to review and may thereby become the litmus test for defining the fault-line between international and European passenger law.

5 Access to justice

Compliance of European maritime passenger law with international law is not only a question of complying with the liability regime of the Athens Convention and the rules on the interpretation of international law. Procedural questions also matter. Therefore, the judicial system of Member States needs to be checked to see whether it allows for the enforcement of passenger rights in courts.

At times, when dealt with by a Member State's ordinary judiciary, the enforcement of passenger rights encounters obstacles whereby what is essentially the claim of a client of a transport service intrinsic to the modern age clashes with the surviving privileges of carriers who are sheltered by customary dispensations. Maritime law in particular is prone to time-honoured exemptions in legal coverage intended to protect what is (or was) thought to be the interests of a nation's fleet. The European Court of Human Rights (ECHR)[153] in a case brought by relatives of 55 people who perished

in the *Jan Heweliusz* disaster, the sinking of a Polish vessel in 1993,[154] had to deal with the applicants' claim that their case had not been heard by impartial and independent tribunals, in violation of Article 6(1) of the European Convention on Human Rights[155] guaranteeing the right to a fair hearing. As it happened, according to a Polish law dating back to the 1920s in its original version, the benches of the maritime dispute chambers exclusively competent to deal with assessing liability for the incident were staffed with government appointees. Due to this appointment practice, Polish legal doctrine was divided over whether to classify these maritime chambers as administrative or judicial bodies. The ECHR found that Article 6(1) of the Convention was violated, noting that "the decisions delivered by the maritime disputes chambers were final and not amenable to any form of judicial review. Since their presidents and vice presidents were appointed and removed from office by the Minister of Justice with the agreement of the Minister for Maritime Affairs, they could not be considered irremovable and the relationship between them and the ministers was one of hierarchical subordination. The Court accordingly found that a maritime disputes chamber as constituted under Polish law could not be regarded as an impartial court capable of ensuring compliance with the principles of fairness set out in Article 6 of the Convention, and that, accordingly, the applicants could have had objectively founded concerns about its independence and impartiality."[156]

The context of the *Heweliusz* case might be unique, but a more general meaning would be to signal that State parties (EU Member States in this context) have to ensure that passenger complaints obtain a fair hearing, which can require a revision of national law and customs on civil and administrative procedure. In the law of this area, it has still taken some time to comprehend fully that transport is a service rendered to passengers as customers who, if

not satisfied, tend to complain. This notion challenges old privileges stemming from times when railways where built and owned by governments and when ships and planes, apart from being means of transport, were also ambassadors of national pride.

6 Conclusion

With the Athens Regulation, the European Union has affirmed and extended its role as the main executor of international passenger law in Europe. The Community, and not its Member States, takes the main responsibility for the implementation of the Montreal Convention for air passengers, the COTIF/CIV (where it legislates for railway passengers[157]) and now also for the Athens Convention for maritime passengers. In doing so the European legislator shows a welcome propensity to promote consumer interests, but also, at times, an insensitivity in disregarding international law applicable in the area, which risks bringing passenger Regulations into conflict with transport conventions. However, if international governance is to be taken seriously, it is ultimately necessary to respect the exclusivity of the conventions' international uniform law.[158] Where the European legislator aims for a higher level of passenger protection, its ambition has to be strictly limited to areas not bindingly regulated by international law. It is the task of the ECJ to disentangle overlapping rules and to overrule where EC law conflicts with higher-ranking international law. Fortunately, its case law already provides the tools needed by the Court to cast its authoritative vote in favour of transport conventions and international governance. It appears that the ratification of transport conventions and adoption of passenger Regulations have been only the beginning of the 'consumerisation' of transport law. Litigation, and ECJ case law in particular, will define the emerging shape of

European passenger law on the crossroads between international law, EC transport law and Community consumer policy.

Addendum

By securing an agreement on 8 December 2008, the European Parliament and the Council concluded negotiations on the Third Maritime Safety Package, which had gone to conciliation after two readings.[159] The agreement will now have to be voted in plenary by the European Parliament and confirmed by the Council.[160]

The principal questions to be resolved in conciliation were the entry into force of the Regulation and its application to domestic transport (ship classes as defined in Article 4 of Directive 98/18/EC). It was agreed that:

- the Regulation will apply as of the date of the entry into force of the Athens Convention for the Community, but at the latest on 31 December 2012.
- Member States may postpone the application of the Regulation on Class A passenger ships until 31 December 2016 and on Class B passenger ships until 31 December 2018.
- for extending the scope of application to Class C and Class D passenger ships the Commission will present a legislative proposal by 30 June 2013 at the latest.

The Athens Regulation is thus really moving closer to its berth.

'Athens II'

A proposal for a Regulation concerning the rights of passengers when travelling by sea and inland waterway[161] was published on 4 December 2008[162] (together with a proposal for the protection of bus and coach travellers[163]). It aims to establish rules regarding

- non-discrimination between passengers with regard to transport conditions offered by carriers,
- non-discrimination and mandatory assistance for disabled persons and persons with reduced mobility,
- the obligations of carriers towards passengers in cases of

cancellation or delay,

- minimum information to be provided to passengers,
- the handling of complaints, and
- the enforcement of passengers' rights.

The 'Athens II'-Regulation is thus just starting its journey through the EU legislative machinery.

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[1] LL.B. (Frankfurt am Main 1994), LL.M. in European Law (University of Nottingham 1996), German Bar Exam (Wiesbaden 1999)

[2] COM(2005) 592 final of 23 November 2005

[3] European Parliament legislative resolution of 24 September 2008 (http://www.europarl.europa.eu)

[4] Common Position (EC) No. 19/2008 of 6 June 2008 (OJ C 190E, 29.7.2008, p. 17)

[5] Article 251(4)-(6) EC Treaty.

[6] This paper also refers to railway passenger law where appropriate (see: Karsten, J. (2008), *EC passenger law running on track - The Regulation on rail passengers' rights and obligations*, Yearbook of Consumer Law 2009, vol. 3, pp. 331-341)

[7] Cf. Cambridge Companion to European Union Private Law (Cambridge University Press) (forthcoming)

[8] To become Article 12 of the Treaty on the Functioning of the European Union (OJ C 115, 9.5.2008)

[9] OJ C 303, 14.12.2007, p. 1

[10] To become Articles 90 to 100 of the Treaty on the Functioning of the European Union

[11] Karsten, J. (2007), *Passengers, Consumers and Travellers – The Rise of Passenger Rights in EC Transport Law and its Repercussions for Community Consumer Law and Policy*, Journal of Consumer Policy, vol. 30, pp. 117-136

[12] On the consultation launched by the Commission Staff Working Paper "Strengthening the protection of the rights of passengers travelling by sea or inland waterway in the European Union" see: (http://ec.europa.eu/transport/maritime/consultation/2006_03_30_passenger_rights/index_en.htm ; visited 30.9.2008).

[13] Working Document on the Council Directive 90/314/EEC of 26 July 2007 (available on-line: http://ec.europa.eu/consumers/rights/timeshare_en.htm (visited 30.9.2008)). Before, the Commission, in its EU Consumer Policy Strategy 2007-2013 (Commission Communication COM(2007) 99 final of 13 February 2007, p. 12), said that "the Commission will build on passenger rights developed in the aviation sector in other transport modes, in particular for passengers with reduced mobility." Further: Council Resolution of 31 May 2007 (OJ C 166, 20.7.2007, p. 1), Written Question E-6480/07 by MEP Graham Watson "EU disability travel cards" and answer given by Commissioner Špidla of 14.2.2008 and Written Question E-683/07 by MEP Proinsias De Rossa "Rights of disabled persons or persons with reduced mobility when using maritime transport" and answer given by Commissioner Barrot of 30.4.2007. *Cf.*: Regulation (EC) No. 1107/2006 concerning the rights of disabled persons and persons with reduced mobility when travelling by air (OJ L 204, 26.7.2006, p. 1) and Articles 19 to 24 of Regulation (EC) No. 1371/2007 on rail passengers' rights and obligations (OJ L 315, 3.12.2007, p. 14).

[14] IMO Briefing 34/2002 of 1 November 2002 "Liability limits for ship passengers raised with new Athens Convention, compulsory insurance introduced"

[15] Articles 17 and 17*bis* of the Athens Convention (not reproduced in the Common Position)

[16] Regulation (EC) No. 44/2001 on jurisdiction and the recognition and enforcement of judgements in civil and commercial matters (OJ L 12, 16.1.2001, p. 1), as last amended by Regulation (EC) No. 1791/2006 (OJ L 363, 20.12.2006, p. 1)

[17] Council Decision of 8 October 2001 (Council doc. 12484/01). Henrik Ringbom (2004), *EU Regulation 44/2001 and its Implications for the International Maritime Liability Conventions*, Journal of Maritime Law & Commerce, vol. 35, No. 1, pp. 24/5

[18] White Paper "European Transport Policy for 2010: Time to Decide" (COM(2001) 370 final of 12 September 2001, pp. 82/3). Also see: "Keep Europe moving - Sustainable mobility for our continent - Mid-term review of the European Commission's 2001 Transport White Paper" (COM(2006) 314 final of 22 June 2006, paragraph 4.2 on passenger rights).

[19] Commission Communication on the enhanced safety of passenger ships in the Community (COM(2002) 158 final of 25 March 2002), pp. 8-15. Commission press release IP/02/502 of 4 April 2002 "European Commission fights to improve passenger protection on ships."

[20] Commission Communication "Strengthening passenger rights within the European Union" (COM(2005) 46 final of 16 February 2005). See also Commission press release IP/05/182 of 16 February 2005 "Transport with a human face: new rights for passengers" and website (http://europa.eu/scadplus/leg/en/lvb/l24124.htm (visited 30.9.2008)).

[21] Karsten (op.cit. n. 11 above)

[22] Ratification of ten States is necessary for the Athens Convention to enter into force (Article 20 of the London Protocol).

[23] Article 19 of the London Protocol

[24] Proposal for a Council Decision concerning the conclusion by the European Community of the Protocol of 2002 to the Athens Convention relating to the carriage of passengers and their luggage by sea (COM(2003) 375 of 24 June 2003). Commission press release IP/03/884 of 24 June 2003 "Commission proposes to accept IMO's passenger liability rules." For other transport modules compare COM(2000) 446 final of 14 July 2000 (on accession of the EC to the Montreal Convention) and COM(2002) 24 final of 23 January 2002 (on negotiating accession of the EC to the COTIF/CIV).

[25] Amongst EU Member States, Finland, Germany, Spain, Sweden and the United Kingdom have signed until September 2006. According to the *Comité Maritime International* (http://www.comitemaritime.org), Latvia has already acceded to the Protocol.

[26] For the most part, external powers of the Community are shared with the Member States, rather than being exclusive. Where competence is shared, the international agreements entered in that field are known as 'mixed agreements' and both the EC and the Member States may be parties. On external powers also see Case C-22/70, Commission v. Council [1971] ECR 263 ('ERTA judgment').

[27] Based on Articles 65 and 80(2) in conjunction with Article 300(2)(first sentence) and Article 300(3)(first subparagraph) EC Treaty

[28] Also still pending is the EC's accession to COTIF/CIV (Appendix A 'Uniform Rules concerning the Contract for International Carriage of Passengers and Luggage by Rail' to the COTIF or Convention concerning International Carriage by Rail of 9 May 1980, amended by the Vilnius Protocol of 3 June 1999). The Montreal Convention has, however, been concluded by the Community (see below).

[29] Commission Communication "Third package of legislative measures on maritime safety in the European Union" (COM(2005) 585 final of 23 November 2005)

[30] Note 2 above

[31] The original proposal was discussed in Karsten, J. (2007), *European Passenger Law for Sea and Inland Waterway Transport*, Yearbook of Consumer Law 2008, vol. 2, pp. 201-232.

[32] To become Article 100 of the Treaty on the Functioning of the European Union (OJ C 115, 9.5.2008)

[33] Note 2 above

[34] SEC(2005) 1516 of 23 November 2005 (French only)

[35] OJ C 229, 22.9.2006, p. 38

[36] OJ C 318, 23.12.2006, p. 195

[37] Adopted by the IMO Legal Committee at its 92nd session in Paris of 19 October 2006 (IMO Circular Letter No. 2758 of 20 November 2006)

[38] Commission Staff Working Document on the compensation for terrorism-related damage (SEC(2007) 377 of 16 March 2007)

[39] EP Legislative Resolution of 25 April 2007

[40] COM(2007) 645 final of 22 October 2007

[41] Council document 9548/07 of 15 May 2007

[42] Working document 2007/18 TRANS SHIPPING of 13 March 2007

[43] Working document 2007/27 TRANS SHIPPING. The paper supplements the Impact Assessment presenting statistics on the volume of passenger transport and information on insurance costs.

[44] Political Agreement of 30 November 2007 (Council document 16097/07 of 7 December 2007)

[45] Note 4 above

[46] COM(2008) 375 final of 13 June 2008

[47] Note 3 above. Also see: European Parliament press release "Transport Committee still at odds with Council on third maritime package" of 4 September 2008 and European Parliament press release of 24 September 2008 "Maritime package: Parliament still at odds with Council"

[48] See: "Co-decision 'step-by-step'" (http://ec.europa.eu/codecision/stepbystep/text/index5_en.htm; visited 30.9.2008)

[49] Case C-344/04, The Queen on the application of International Air Transport Association (IATA) & European Low Fares Airline Association (ELFAA) v. Department for Transport, [2006] ECR I-403, paragraphs 49 to 63

[50] Note 37 above

[51] Article 3(1) of the Common Position is a general reference similar to Article 3(1) of Regulation (EC) No. 2027/97 on air carrier liability in the event of accidents (OJ L 285, 17.10.1997, p. 1), as amended by Regulation (EC) No. 889/2002 (OJ L 140, 30.5.2002, p. 2) and Article 11 of Regulation (EC) No. 1371/2007 on rail passengers' rights and obligations (OJ L 315, 3.12.2007, p. 14).

[52] 'International carriage' is defined in Article 1(9) of the Athens Convention.

[53] OJ L 144, 15.5.1998, p. 1, as last amended by Directive 2003/75/EC (OJ L 190, 30.7.2003, p. 6)

[54] Article 2(e) of Directive 98/18/EC

[55] Article 2(n) of Directive 98/18/EC

[56] 'Class B' means a passenger ship engaged on domestic voyages in the course of which it is at no time more than 20 miles from the line of coast, where shipwrecked persons can land, corresponding to the medium tide height.

[57] 'Class C' means a passenger ship engaged on domestic voyages in sea areas where the probability of exceeding 2,5 m significant wave height is smaller than 10 % over a one-year period for all-year-round operation, or over a specific restricted period of the year for operation exclusively in such period (e.g. summer period operation), in the course of which it is at no time more than 15 miles from a place of refuge, nor more than 5 miles

from the line of coast, where shipwrecked persons can land, corresponding to the medium tide height.

[58] 'Class D' means a passenger ship engaged on domestic voyages in sea areas where the probability of exceeding 1,5 m significant wave height is smaller than 10 % over a one-year period for all-year-round operation, or over a specific restricted period of the year for operation exclusively in such period (e.g. summer period operation), in the course of which it is at no time more than 6 miles from a place of refuge, nor more than 3 miles from the line of coast, where shipwrecked persons can land, corresponding to the medium tide height.

[59] Article 2(f) of Directive 98/18/EC (n. 53 above)

[60] Generally excluded from the Athens liability regime are air-cushion vehicles. Those are exempted from the notion of 'ship' in Article 1(3) of the Athens Convention 2002.

[61] Bulgaria, Cyprus, Denmark, Finland, Germany, Luxembourg, Malta, Spain, Sweden and the United Kingdom have ratified the Protocol of 1996

[62] Article 3(1) of the Common Position does not refer to Article 19 of the Athens Convention.

[63] Article 15(3bis) of the LLMC 1996 reads: "Notwithstanding the limit of liability prescribed in Article 7(1), a State Party may regulate by specific provisions of national law the system of liability to be applied to claims for loss of life or personal injury to passengers of a ship, provided that the limit of liability is not lower than that prescribed Article 7(1)."

[64] Article 28 of the Montreal Convention

[65] Compare Article 5 of Regulation (EC) No. 2027/97 on air carrier liability in the event of accidents (OJ L 285, 17.10.1997, p. 1), as amended by Regulation (EC) No. 889/2002 (OJ L 140, 30.5.2002, p. 2) and Article 13 of Regulation (EC) No. 1371/2007 on rail passengers' rights and obligations (OJ L 315, 3.12.2007, p. 14)

[66] Article 3(4) of the Montreal Convention

[67] The notion of 'tour operator' is defined in Article 2 No. 2 of Directive 90/314/EEC on package travel, package holidays and package tours (OJ L 158, 23.6.1990, p. 59)

[68] Compare Article 6 of Regulation (EC) No. 2027/97 on air carrier liability in the event of accidents (OJ L 285, 17.10.1997, p. 1), as amended by Regulation (EC) No. 889/2002 (OJ L 140, 30.5.2002, p. 2) and Article 29 of Regulation (EC) No. 1371/2007 on rail passengers' rights and obligations (OJ L 315, 3.12.2007, p. 14)

[69] OJ L 158, 23.6.1990, p. 59

[70] *Cf.* Karsten (op.cit. n. 31 above)

[71] Compare Article 12 of Regulation (EC) No. 1107/2006 concerning the rights of disabled persons and persons with reduced mobility when travelling by air (OJ L 204, 26.7.2006, p. 1) and Article 25 of Regulation (EC) No. 1371/2007 on rail passengers' rights and obligations (OJ L 315, 3.12.2007, p. 14)

[72] Commission Communication on the scope of the liability of air carriers and airports in the event of destroyed, damaged or lost mobility equipment of passengers with reduced mobility when travelling by air (COM(2008) 510 final of 7 August 2008) summarises the problems perceived and the solutions envisaged.

[73] Article 2(w) of Directive 98/18/EC on safety rules and standards for passenger ships (n. 53 above)

[74] Article 2(a) of Regulation (EC) No. 1107/2006 concerning the rights of disabled persons and persons with reduced mobility when travelling by air (OJ L 204, 26.7.2006, p. 1) and Article 3 No. 15 of Regulation (EC) No. 1371/2007 on rail passengers' rights and obligations (OJ L 315, 3.12.2007, p. 14)

[75] Karsten (op.cit n. 31 above), pp. 217-219

[76] Nicolai Lagoni, Die Haftung des Beförderers von Reisenden auf See und im Binnenschiffsverkehr und das Gemeinschaftsrecht – Die EG auf Konfrontationskurs mit

dem Völkerrecht, Zeitschrift für Europäisches Privatrecht (vol. 4/2007), pp. 1079-1096 (pp. 1086-1088)

77 Erik Røsæg (2008), *The Athens Regulation and international law*, Zeitschrift für Europäisches Privatrecht (vol. 3/2008), pp. 599-604

78 Compare the "review of limits" procedure of Article 24 of the Montreal Convention.

79 Defined in Article 1(5) and (6) of the Athens Convention

80 Røsæg (op.cit. n. 77 above), p. 601

81 Article 23 of the Athens Convention ('amendments of limits') and the IMO Guidelines (Annex II of the Common Position) provide for amendment procedures internationally.

82 Note 69 above

83 On the regulatory challenges for an eventual reform of the Package Travel Directive see: Working Document on the Council Directive 90/314/EEC of 26 July 2007 (available on-line: http://ec.europa.eu/consumers/rights/ timeshare_en.htm (visited 30.9.2008)

84 Gesetz betreffend die privatrechtlichen Verhältnisse der Binnenschiffahrt vom 15. Juni 1895

85 Karsten (op.cit. n. 31 above), p. 224

86 The idea was already expressed in *Karsten* (op. cit. n. 31 above), pp. 225/6 ('Loreley Regulation')

87 http://www.ccr-zkr.org. On the "modernisation and reinforcement of the organisational framework for inland waterway transport in Europe," *i.e.* the cooperation between the river commissions and the EU, see Commission Staff Working Documents SEC(2008) 23 and SEC(2008) 24 of 10 January 2008.

88 Authentic in French, German and Dutch, but not in English. The Strasbourg Convention entered into force on 1 September 1997.

89 Cécile Tournaye (2009), Revision of the CLNI, TranspR 4-2009, pp. 156-162. Also see Council Working document 2007/18 TRANS SHIPPING of 13 March 2007 (n. 42 above).

90 UN-ECE Convention on the Contract for the International Carriage of Passengers and Luggage by Inland Waterway of 6 February 1976 (CVN), with protocol of 5 July 1978 (not in force)

91 Note 76 above

92 Note 77 above

93 Note 49 above, paragraphs 34 to 48

94 Article 6 ('delay') of Regulation (EC) No. 261/2004 establishing common rules on the compensation and assistance to passengers in the event of denied boarding and of cancellation or long delay of flights, and repealing Regulation (EEC) No. 295/91 (OJ L 46, 17.2.2004, p. 1)

95 Article 300(7) was to become Article II-323(2) of the - abortive - Constitutional Treaty. It is now to become Article 351 of the Treaty on the Functioning of the European Union (OJ C 115 of 9.5.2008).

96 Case C-301/08, Irène Bogiatzi, married name Ventouras v. Deutscher Luftpool, Luxair SA, European Communities, State of the Grand Duchy of Luxembourg, Foyer Assurances SA (pending)

97 Convention for the unification of certain rules relating to international carriage by air signed at Warsaw on 12 October 1929. The convention attracted adherence in more than 150 States.

98 Such as the Hague Protocol (1955), the Guadalajara Convention (1961), the Guatemala City Protocol (1971), the 1975 Additional (Montreal) Protocols, numbers 1-3, and Montreal Protocol Number 4.

99 OJ L 194, 18.7.2001, p. 39

100 The Montreal Convention currently has 86 parties (Source: ICAO (http://www.icao.org)).

[101] However, the Warsaw scheme still governs cases where a controversy involves States that are signatories to the Warsaw Convention, but not to the Montreal Convention.

[102] Article 53(6) of the Montreal Convention. The USA was the 30th country to ratify the convention which thereby became, as a ratified Federal Treaty, the "the supreme law of the land" and as such pre-empts all State and Federal law to the contrary.

[103] Article 53(2) of the Montreal Convention

[104] Council Decision of 5 April 2001 on the conclusion by the European Community of the Convention for the Unification of Certain Rules for International Carriage by Air (OJ L 194, 18.7.2001, p. 38)

[105] The instrument of approval by the EC contains the following declaration (referring to Regulation 2027/97): "4. In respect of matters covered by the Convention, the Member States of the EC have transferred competence to the Community for liability for damage sustained in case of death or injury of passenger. The Member States have also transferred competence for liability for damage caused by delay and in the case of destruction, loss, damage or delay in the carriage of baggage. This includes requirements on passenger information and a minimum insurance requirement. Hence, in this field, it is for the Community to adopt the relevant rules and regulations (which the Member States enforce) and within its competence to enter into external undertakings with third States or competent organisations."

[106] Case C-344/04, The Queen on the application of International Air Transport Association (IATA) & European Low Fares Airline Association (ELFAA) v. Department for Transport, [2006] ECR I-403, paragraphs 35 and 36. See also paragraph 32 of the Opinion of Advocate General Geelhoed of 8 September 2005.

[107] *IATA* judgment, paragraphs 35/6

[108] Case C-181/73, Haegeman v. Belgium [1974] ECR 449

[109] Case C-104/81, Hauptzollamt Mainz v. Kupferberg [1982] ECR 3641

[110] Opinion of Advocate General L.A. Geelhoed of 8 September 2005, paragraph 32

[111] Case C-173/07, Emirate Airlines Direktion für Deutschland v Diether Schenkel (OJ C 155, 7.7.2007, p. 9). Opinion of Advocate General Eleanor Sharpston of 6 March 2008. Judgment of 10 July 2008 (not yet published in the ECR).

[112] Previous note, paragraph 43. Now also Case C-549/07, Friederike Wallentin-Hermann v. Alitalia – Linee Aeree Italiane SpA, judgment of 22 December 2008 (not yet published in the ECR), paragraph 28.

[113] Case C-379/92 Criminal proceedings against Matteo Peralta [1994] ECR I-3453. Opinion of Advocate-General Lenz of 11 May 1994.

[114] International Convention for the Prevention of Pollution From Ships of 1973 as modified by the Protocol of 1978 (http://www.marpol.com)

[115] Case C-308/06, The Queen on the application of the International Association of Independent Tanker Owners (Intertanko), the International Association of Dry Cargo Shipowners (Intercargo), the Greek Shipping Co-operation Committee, Lloyd's Register, and International Salvage Union v. Secretary of State for Transport, Judgment of 3 June 2008 (not yet published in the ECR). Opinion of Advocate-General Juliane Kokott of 20 November 2007.

[116] United Nations Convention on the Law of the Sea of 10 December 1982

[117] Case C-188/07, Commune de Mesquer v. Total France & Total International Ltd., judgment of 24 June 2008 (not yet published in the ECR)

[118] International Convention on Civil Liability for Oil Pollution Damage adopted at Brussels on 29 November 1969, as amended by the Protocol signed in London on 27 November 1992 (OJ L 78, 16.3.2004, p. 32)

[119] International Convention on the Establishment of an International Fund for Compensation for Oil Pollution Damage adopted at Brussels on 18 December 1971, as

amended by the Protocol signed in London on 27 November 1992 (OJ L 78, 16.3.2004, p. 40)

120 http://en.iopcfund.org

121 Council Recommendation 78/584/EEC on the ratification of conventions on safety in shipping (OJ 1978 L 194, p. 17)

122 This point has been explained by Advocate General Lenz in his Opinion of 11 May 1994 (paragraphs 29 and 30). He stated that "the [MARPOL] Convention could form part of Community law only if the Treaty had transferred to the Community the competence on the basis of which the Member States signed that convention. However, it is clear from Article 130r EC Treaty in the version resulting from the Single European Act (and the Maastricht Treaty) [now Article 174] that the Member States remain competent in the field of the environment, in any case so long and in so far as the Community does not act itself under the combined provisions of Article 130r and Article 130s EC Treaty [now Article 175]. Consequently, the MARPOL Convention does not form part of Community law and is not, as such, capable of constituting a criterion for reviewing national provisions."

123 The full quote (paragraphs 15/6 of the judgment) reads "[...] the national court is asking this Court about the compatibility of the Italian legislation with [the MARPOL Convention]. It appears to consider that this convention produces effects in the Community legal order." "In so far as the Italian court raises the question of the compatibility of the Italian legislation with the MARPOL Convention, it is sufficient to find that the Community is not a party to that convention. Moreover, it does not appear that the Community has assumed, under the EEC Treaty, the powers previously exercised by the Member States in the field to which that convention applies, nor, consequently, that its provisions have the effect of binding the Community."

124 OJ L 255, 30.9.2005, p. 11

125 OJ L 179, 23.6.1998, p. 1

126 *Commune de Mesquer*, paragraphs 85/6 of the judgment

127 *Schenkel*, paragraph 43 of the judgment

128 *Intertanko*, paragraphs 59 and 64 of the judgment

129 *Intertanko*, paragraphs 42 to 45 of the judgment

130 This case law was summarised by Advocate-General Kokott in her Opinion on Intertanko of 20 November 2007 where she stated that "under Article 300(7) EC, agreements concluded under the conditions set out in that Article are binding on the institutions of the Community and on Member States. [...] It follows, according to settled case-law, that the provisions of [signed and approved conventions] form an integral part of the Community legal order." Further she said that "international agreements concluded by the Community prevail over provisions of secondary Community legislation. [...] Where individuals seek to rely thereon, the provision in question must, as regards their content, be unconditional and sufficiently precise."

131 "Where that invalidity is pleaded before a national court, *the Court of Justice* thus reviews, pursuant to Article 234 EC, the validity of the Community measure concerned in the light of all the rules of international law" (*Intertanko*, paragraph 43 of the judgment; emphasis added)

132 *Intertanko*, paragraphs 48 to 50 of the judgment

133 *Intertanko*, paragraphs 53 to 65 of the judgment

134 Provisions will have direct effect when (1) they have a clear and binding aim, (2) they do not involve the exercise of broad discretionary powers, and (3) they are 'legally complete' (Craig & De Búrca, EU Law (2nd edition 1998), p. 180).

135 Case C-236/92, Comitato di Coordinamento per la Difesa della Cava and others v. Regione Lombardia and others [1994] ECR I-483, paragraph 9

136 *Ibd*., paragraph 10

[137] Pierre Pescatore (1983), *The doctrine of 'direct effect': An infant disease of Community law*, 8 ELRev 155

[138] *Intertanko*, paragraph 64 of the judgment

[139] Cases C-21-24/72, International Fruit [1972] ECR 1219

[140] Case C-149/96, Portugal v. Council [1999] ECR I-8395

[141] On the direct effect of Regulations see: Case C-39/72, Commission v. Italy [1973] ECR 101 and Case C-50/76, Amsterdam Bulb BV v. Produktschap voor Siergewassen [1977] ECR 137

[142] Article 253 EC was to become Article I-38(2) of the – abortive – Constitutional Treaty. It is now, reworded, to become Article 296 of the Treaty on the Functioning of the European Union (n. 8 above).

[143] Case C-380/03, Germany v. European Parliament and Council, ECR [2006] I-11573, paragraph 107: "Although the statement of reasons required by Article 253 EC must show clearly and unequivocally the reasoning of the Community authority which adopted the contested measure, so as to enable the persons concerned to ascertain the reasons for the measure and to enable the Court to exercise its power of review, it is not required to go into every relevant point of fact and law" [with further references to case law].

[144] Note 69 above

[145] Karsten (op.cit n. 11 above), pp. 135/6

[146] "Where that invalidity is pleaded before a national court, *the Court of Justice* thus reviews, pursuant to Article 234 EC Treaty, the validity of the Community measure concerned in the light of all the rules of international law" (*Intertanko*, paragraph 43 of the judgment; emphasis added)

[147] Note that the *IATA* case (n. 49 above), paragraph 40 expressly refers to the Vienna Convention of 23 May 1969 on the Law of Treaties and the Vienna Convention of 21 March 1986 on the Law of the Treaties between States and International Organisations or between International Organisations.

[148] Case C-168/00, Simone Leitner v. TUI Deutschland [2002] ECR I-2631, Opinion of Advocate General Tizzano of 20 September 2001

[149] OJ L 210, 7.8.1985, p. 29, as amended by Directive 1999/34/EC (OJ L 141, 4.6.1999, p. 20). Corrigendum (OJ L 283, 6.11.1999, p. 20). Third application report COM(2006) 496 final of 14 September 2006.

[150] Note 148 above; paragraph 37

[151] *Convention internationale relative au contrat de voyage* (CCV), signed in Brussels on 23 April 1970. It was adopted within the framework of UNIDROIT and entered into force on 24 February 1976, but has a limited number of signatories.

[152] Note 148 above, paragraph 39

[153] http://www.echr.coe.int

[154] Brudnicka and others v. Poland, No. 54723/00, Judgement of 3 March 2005 (French only). For an English summary of the issues raised in the case, compare the press release issued by the registrar of 16 January 2003: "Chamber hearing on the admissibility and merits in the case of Brudnicka and others v. Poland."

[155] Convention for the Protection of Human Rights and Fundamental Freedoms of 4 November 1950 (ETS No. 5), with protocols. Other cases on Article 6 of the Convention in relation to proceedings in maritime affairs are: Leray and others v. France, No. 44617/98, Judgment of 20 December 2001; Stone Court Shipping Company S.A. v. Spain, No. 55524/00, Judgment of 28 October 2003; and SCP Huglo, Lepage & Associes, Conseil v. France, No. 59477/00, Judgment of 1 February 2005.

[156] Press release issued by the ECHR Registrar of 3 March 2005

[157] Appendix A 'Uniform Rules concerning the Contract for International Carriage of Passengers and Luggage by Rail' to the COTIF or Convention concerning International Carriage by Rail of 9 May 1980, amended by the Vilnius Protocol of 3 June 1999

[158] In consumer contract law, this exclusivity is enshrined in Article 5(2)(3rd subparagraph) of the Package Travel Directive (n. 69 above) and Article 1(2) of Directive 93/13/EEC on unfair terms in consumer contracts (OJ L 95, 21.4.1993, p. 29). The latter provision is now about to be reviewed. Article 30(3) of the proposed 'Directive on consumer rights' (COM(2008) 614 final of 8 October 2008) reads: "This Chapter [*on consumer rights concerning contract terms*] shall not apply to contract terms reflecting mandatory statutory or regulatory provisions, which comply with Community law and the provisions or principles of international conventions to which the Community or the Member States are party." The reference "particularly in the transport area" of Article 1(2) of the Unfair Terms Directive is now contained in recital 46 of the proposal.

[159] Also see: Commission Opinion (COM(2008) 831 final of 26 November 2008)

[160] European Parliament press release "EP and Council agree on Third Maritime Package" of 9 December 2008

[161] Proposal for a Regulation concerning the rights of passengers when travelling by sea and inland waterway (COM(2008) 816 final of 4 December 2008)

[162] Commission press release IP/08/1886 of 4 December 2008 "Commission proposes new rights for bus and maritime passengers"

[163] Proposal for a Regulation on the rights of passengers in bus and coach transport (COM(2008) 817 final of 4 December 2008)

Part VI
Annulment of framework decision 2005/667/JHA

The EC`s Scope of Action in Preventing Ship-Source Pollution by the Introduction of Penalties

Dipl. Jur. Caroline Rusniok, LL.M

1 Introduction: European Measures Promoting Maritime Safety

Ship-source pollution is one of the major challenges of today`s shipping community. Both accidental spills and illegal voluntary discharge of polluting substances into the seas lead to considerable damage of the marine environment. Following the major accidental oil-spills of 1999 and 2002 in the "ERIKA" and "PRESTIGE" accidents off the French and Spanish coastlines, the European Union adopted a series of legislative measures to improve safety at sea. These were outlined in the so-called Erika 1, Erika 2 and Erika 3 packages, which contained inter alia a ban on single-hull oil tankers transporting heavy-fuel oil in European ports, the establishment of the European Maritime Safety Agency and a strengthening of the legislation relating to the inspection of ships by port states and classification societies.

In the course of this process, a sanctions regime for ship-source pollution offences was also developed, and on 12 July 2005 the European Parliament and the EU Council adopted Directive 2005/35/EC[1] "on ship-source pollution and on the introduction of sanctions, including criminal sanctions for polluting offences", based on Article 80(2) EC Treaty. To supplement the Directive, Framework Decision 2005/667/JHA[2] "to strengthen the criminal law framework for the enforcement of the law against ship-source pollution" was adopted in September 2005 on the basis of Title VI of the Treaty on European Union.

According to Article 1 of the said Directive, its purpose is "to incorporate international standards for ship-source pollution into

1 OJ 2005 L 255, Page 11.

2 OJ 2005 L 255, Page 164.

Community law and to ensure that persons responsible for discharges are subject to adequate penalties." It establishes that Member States are required to regard ship-source pollution committed with intent or serious negligence as infringements, which must "be subject to effective, proportionate and dissuasive penalties, which may include criminal or administrative penalties."

The Framework Decision was adopted to supplement the Directive as the instrument by which the European Union intended to approximate criminal-law legislation of the Member States.[3] It provided that the Member States, in order to attain the objective pursued by the Directive, should regard certain offences specified in the Directive as criminal offences and provide for criminal penalties. Furthermore, it contained detailed provisions on the nature, type or levels of the criminal penalties that should be applied by the Member States in case of ship-source pollution caused with intent or by serious negligence.

Both the Directive and the Framework Decision were recently challenged before the European Court of Justice (hereinafter: the Court).

The Directive was challenged by a broad coalition of the maritime shipping industry led by INTERTANKO and representing substantial proportions of that industry. The applicants were supported by the Member States Greece, Cyprus and Malta. They argued that the Directive was invalid because of a conflict with the international regime for criminal liability for ship-source pollution, which binds the Member States by MARPOL 73/78 and UNCLOS 1982. While MARPOL 73/78 only imposes liability for polluting offences in case of "intent" or "recklessness", the Directive requires the Member States to introduce penalties in cases of "serious negligence." On 3 June 2008 the Court delivered its judgment in this

[3] See also: Commission v Council (C-440/05) [2007] ECR I-09097, para 3.

case. It ruled that the validity of the Directive cannot be assessed by reference to MARPOL or UNCLOS and that conesquently the Directive is valid.[4]

In contrast to this case, the Framework Decision was not challenged by opponents to a strict pollution regime inside the European Union, but by the Commission itself. The Commission based its appeal on competence issues, stating that the Framework Decision was adopted on the wrong legal basis. The Court on 23 October 2007[5] followed the Commission`s appeal and annulled the Framework Decision. It held that some provisions of the Framework Decision could have been validly adopted by the Community, and that consequently the adoption of the Framework Decision by the Council under the third pillar infringed on Community competences.

The annulment of Framework Decision 2005/667/JHA in Case C-440/05[6] (*Marine Pollution)* constituted a new "milestone" in the complex process of "Europeanization" of criminal law and received a lot of attention. Concerning the EU`s combat against ship-source pollution, several questions arise out of the annulment.

First, it has to be asked how this judgment affected the sanctions regime for ship-source pollution offences. There has been some dissension between commentators as to whether the decision rather weakened or strengthened the EU`s legal framework on maritime safety. While the shipping industry viewed the decision as a blow against the EC`s overhasty legislative responses to the ERIKA and PRESTIGE disasters, legal scholars rather interpreted it as possibly

4 Intertanko v The Secretary of State for Transport (C-308/06) [2008] ECR 000.

5 Commission v Council (C-440/05) [2007] ECR I-09097, para 3.

6 Commission v Council (C-440/05) [2007] ECR I-09097.

strengthening the fight against ship-source pollution since more competences were conferred on the supranational first pillar.

The next question is which possible actions are available to the EC as responses to the judgment, in order to fill the legal vacuum that was created by the annulment of the Framework Decision. Considering the legislative competences of the Community, what would be the most effective means to achieve the aims pursued by the Framework Decision? Should the Community really stick to criminal law related measures or could other means, such as administrative sanctions, be equally effective to protect the maritime environment?

To answer these questions, it will be necessary to look at the scope of the Community`s competences in criminal law - how did things develop in this field before the judgment in *Marine Pollution*, what where the grounds for the annulment of the Framework Decision and most important, what are the implications to be drawn for the future from the decision?

Furthermore, this paper will consider administrative sanctions as a possible alternative to criminal law in the Community`s efforts to promote maritime safety. The Community has for a long time utilized administrative sanctions as a remedy to enforce compliance with Community law. The most prominent sectors are hereby competition law[7] and agriculture,[8] which will be considered in more detail below. However, concerning ship-source pollution, the Commission sticks to criminal law as a "necessary instrument in the fight for an effective enforcement of the rules on maritime safety."[9] The

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7 See: 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, OJ 2003 L 1, page 1.

8 Confer: Germany v Commission (C-240/90) [1992]ECR I-5383.

9 EUROPA – Rapid – Press Releases: "Questions and Answers on criminal law measures against maritime pollution", MEMO/08/156, 11 March 2008.

accuracy of this assumption will be questioned, especially in respect of the necessity to introduce criminal sanctions in the field of maritime safety.

Chapter two of the thesis starts by touching briefly on the legal basis of Community acts in the maritime safety sector. Then, an analysis of the status of criminal law in the European Community follows. First, the standing of criminal law in legal systems is examined in general. Second, the competences of the Community in the field of criminal law are illustrated. Emphasis is put on the recent developments in the Europeanization of criminal law, especially on a landmark case of the Court in environmental matters of 1995 and on the recent annulment of Framework Decision 2005/667/JHA. Through this, the limits of the Community concerning the adoption of criminal provisions in the field of maritime safety will be illustrated.

Chapter three goes on to analyse what effect the annulment of Framework Decision 2005/667/JHA has had on the European fight against ship-source pollution. The annulled provisions are examined in detail. Further the presently pending legislative response of the Commission to the annulment is illustrated. The chapter moreover contains a discussion of some possible future implications of the annulment.

Chapter four examines whether, administrative sanctions could be an appropriate alternative to criminal penalties in the fight against ship-source pollution. To this end, administrative sanctions are first generally classified. Following this, there is an overview of administrative sanctions in the legal system of the Community, with an emphasis on competition law and the agricultural sector. Thereafter, the possibility of imposing administrative sanctions in the field of maritime safety is examined by analogy to the sanction systems in competition law and the agricultural sector. Finally, the introduction of administrative sanctions in maritime safety is

discussed in respect of aspects such as effectiveness, the culpability of legal persons and the international character of the shipping industry.

Finally, in the concluding fifth chapter, some arguments are set out as to why the introduction of administrative sanctions on Community level seems to be an appropriate alternative to criminal penalties in the field of maritime safety.

2 The Union`s Legislative Scope of Action

2.1 The Union`s Legislative Scope of Action Regarding Maritime Safety

According to Article 1 EU, the European Union marks a new stage in the process of creating an ever closer union among the peoples of Europe and is based on the Communities, supplemented by the policies and forms of cooperation established by the EU Treaty itself.

There are accordingly three different pillars[10] under the "roof" of the Union: The first or "Community pillar", the second, which covers common foreign and security policy (Title V) and the third, which concerns police and judicial cooperation in criminal matters (Title VI). While the Community pillar is "supranational",[11] the second and third pillars are classified as "more governmental."[12]

[10] Note that the „pillars" of the EU will be abolished if the Treaty of Lisbon comes into force.

[11] See the judgments in: Van Gend&Loos (C-26/62) [1963] ECR 1; Costa/ENEL (C-6/64) [1964] ECR 585.

[12] Opinion of AG Mazak in Commission v Council (C-440/05) [2007] ECR I-09097, paras 45, 46.

Accordingly, the measures adopted under the latter are more of an international law nature and lack direct effect.[13]

The founding Treaties of the European Communities conferred a range of competences on the Communities` institutions. As a starting point, the Community institutions have to take into consideration both the contents and the limitations of their competences under the EC Treaty every time they act. According to what is generally known as the "principle of attributed powers" or the principle of positive legality, the Community may only exercise as much power as is conferred on it by the founding Treaties.[14] This principle is explicitly laid down in Art. 5(1) EC.[15] The Community thus has no general legislative competence, but can only act if a particular competence is conferred on it by an enabling provision. These competences of the Community as such are called "vertical competences", whereas the distribution of competences among the institutions is labelled "horizontal competences."[16]

Regarding the field of maritime safety, Article 80(2) EC Treaty empowers the Council to decide "whether, to what extent and by what procedure, appropriate provisions may be laid down for sea and air transport." The Court has interpreted this provision as conferring broad legislative powers upon the Community and ruled that the Community is competent to lay down, inter alia, "measures

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13 Ibid.

14 Von Bogdandy, Armin and Bast, Jürgen, "The European Union`s Vertical Order of Competences: The Current Law and Proposals for Reform", *Common Market Law Review* (2002), No 39, page 232.

15 Article 5 EC states: „The Community shall act within the limits of the powers conferred upon it by this Treaty and of the objectives assigned to it therein."

16 Von Bogdandy, Armin and Bast, Jürgen, *supra*, note 14, page 235.

to improve transport safety" and "any other appropriate provisions" in the field of maritime transport.[17]

Consequently, Directive 2005/35/EC was adopted on the legal basis of Article 80(2) EC as the adequate enabling norm. Since Article 80(2) EC was accepted by the Court as the legal basis for the Directive, the question of whether the Directive could also have been based on the Community`s competence in environmental policy according to Art.175 EC does not need any further examination.[18]

In contrast to the Directive, Framework Decision 2005/667/JHA was adopted on the basis of the Union`s third pillar, in particular Articles 31(1)(e) and 34(2)(b) EU. Title VI of the EU Treaty aims at providing citizens with a high level of safety within an area of freedom, security and justice, by means of common action among the Member States in the fields in question, in order to prevent combat and crime. This is to be achieved, inter alia, through the approximation of national rules on criminal matters.[19] One of the tools created for these purposes is the framework decision, which promotes the approximation of national statutory and regulatory provisions.[20] Like directives under the first pillar, framework decisions are, according to Article 34 EU, binding as to the result to be achieved, leaving to the national authorities the choice of form and methods. But, unlike directives, they never have direct effect.

According to the foregoing, the Directive 2005/35/EC to combat ship-source pollution via the introduction of sanctions was adopted under the "supranational" first pillar, but the framework decision

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17 Commission v Council (C-440/05) [2007] ECR I-9097, para 58.

18 Regarding this question see: AG Mazak, *supra*, note 12, paras 126-129.

19 Article 29 EU.

20 Opinion of AG Colomer in Commission v Council (C-176/03) [2005] ECR I-7879.

designed to supplement this Directive was adopted under the "more intergovernmental" third pillar only. This splitting between Community and intergovernmental competence via a so – called "double-text" mechanism was in the past applied several times, due to the limits of the legislative competences of the Community.[21]

2.2 Criminal Law in the European Community

2.2.1 Classification of Criminal Sanctions in Legal Systems

Criminal law as such is supposed to sustain peaceful coexistence by ensuring law and order in legal systems and to protect both the society and the individual against substantive breaches. In doing so, criminal law avails itself of the authority`s fiercest means, namely the public imposition of penalties. Criminal penalties constitute the authority`s strongest interference with the individual`s rights and are therefore often classified as the "ultima ratio" in the range of legal instruments.[22] As a result, being the "last resort" of public force, criminal sanctions shall only be imposed, if the sanctioned behaviour is not only prohibited, but especially harmful to society and its prevention therefore deemed particularly important.[23]

The means that are available to criminal law to achieve its aims are the official disapproval of certain acts and the imposition of penalties.[24] Criminal sanctions can be imprisonment, the imposition of fines or the infliction of other disadvantages on the wrongdoer.

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21 Communication from the Commission to the European Parliament and the Council on the implications of the Court's judgment of 13 September 2005 (Case C 176/03 Commission v Council), COM (2005) 583 final.

22 Jescheck, Hans-Heinrich, *"Lehrbuch des Strafrechts – Allgemeiner Teil"*, page 3.

23 Appel, Ivo, *"Verfassung und Strafe"*, page 23.

24 Ibid., at page 20.

It is widely acknowledged that criminal sanctions are distinguished from other punitive measures of the authority by a distinct "ethical dimension" of criminal law. This ethical dimension is said to be embodied in a moral disapproval by society of the wrongdoer`s acts.[25] Criminal sanctions implicate this moral disapproval, thereby stigmatizing the wrongdoer in public, which is supposed to constitute a distinct evil for him.

As to the aims of criminal law, it is widely agreed, that the primary purpose of criminal sanctions is to re-establish law and order and to avoid future breaches. According to the European Court of Human Rights "the aims of prevention and reparation are consistent with a punitive purpose."[26]

Reparation hereby means that a breach is compensated by the imposition of a proportionate punishment, which expresses public disapproval of the sanctioned behaviour and thereby reinforces the existing legal order.[27]

Prevention is above all supposed to be achieved by the dissuasive or deterrent nature[28] of criminal law. First, the sanctioned wrongdoer is kept from committing further breaches by the memory of the disadvantages he suffered. Second, every member of the legal system is deterred from committing criminal offences by the fear of sanctions.

In addition, it is often stated that criminal law as a legal system`s "last resort" embodies the social standards underlying that system,

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25 Heitzer, Anne, *"Punitive Sanktionen im Europäischen Gemeinschaftsrecht"*, 1997, page 10.

26 Cf. Welch v United Kingdom (1995) ECHR A307-A.

27 Jescheck, Hans-Heinrich, *supra,* note 22, page 11.

28 Cf. AG Mazak, *supra,* note 12, para 71.

and is therefore closely related to the identity of that particular community.[29]

2.2.2 Community Competence in Criminal Law

The law of the European Community and the criminal law of the Member States have for a long period existed alongside each other, without material points of contact. This is due to the fact that there was no conferment of powers on the Community in this field when the founding Treaties were signed.[30] In fact, the EC Treaty only expressly refers to criminal law to preclude a Community criminal competence in certain areas, such as e.g. customs cooperation.[31] Criminal law has traditionally been considered to be at the core of national State sovereignty[32] and it is consequently widely acknowledged that the Community has no competence in criminal law. Accordingly, the ECJ has several times set out in its case law, that "as a general rule, neither criminal law nor the rules of criminal procedure fall within the Community`s competence."[33]

The lack of a Community competence in criminal law relates to both the "jurisdiction to prescribe" and the "jurisdiction to enforce".[34] This means that the Community can in principle neither

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29 Ibid.

30 Tiedemann, Klaus, „Europäisches Gemeinschaftsrecht und Strafrecht", *Neue Juristische Wochenschrift* (1993), No 1, page 23.

31 Article 135 EC.

32 Miettinen, Samuli, "Constitutional limits of European Community criminal law", Montreal 2007, http://www.edgehill.ac.uk/law/Profiles/SMiettinenPro.htm [Visited 10 August 2008], page 2.

33 See: Casati (C-203/80) [1981]ECR 2595, para 27; Lemmens (C-226/97)[1998]ECR I-03711, para 19; Commission v Council (C- 176/03) [2005]ECR I-7879, para 47; Commission v Council (C-440/05) [2007] ECR I-9097, para 66.

34 Tiedemann, Klaus, *supra,* note 30, page 24.

adopt provisions on criminal offences, nor can its organs impose criminal sanctions.

However, this does not mean that criminal matters are "the exclusive preserve" or "domaine réservé" of State sovereignty.

First, Community law requires that the Member States protect Community interests in the same way as national interests. In the so-called Greek Maize – scandal, the Court held that infringements of Community law must be penalized under conditions, both procedural and substantive, analogous to those applicable to infringements of national law of a similar nature and importance and which, in any event, make the penalty effective, proportionate and dissuasive. Moreover, the national authorities must proceed with respect to infringements of Community law with the same diligence as that which they bring to bear in implementing corresponding national laws.[35]

Second, Community law affects national criminal law in a negative dimension: The Member States must not create criminal offences that contradict Community law, such as e.g. the principle of proportionality or the fundamental freedoms.[36] In this case, convictions on the grounds of such provisions are themselves incompatible with Community law, and Community law can require the repeal of these national laws.

Third, the Community has over the past years adopted several directives, containing a duty on the Member States to ensure compliance with the Community rules by the imposition of sanctions. These directives concerned mostly white-collar criminality, such as

35 Commission v Greece (C-68/88) [1989]ECR 2965, paras 24, 25.

36 Tiedemann, Klaus, *supra,* note 30, page 25.

money laundering, insider-trading or import/export of dangerous waste materials.[37]

However, due to the Community`s lack of criminal competence, these Directives could not contain the order to impose criminal sanctions. The decision as to whether the sanctions regime should be of a civil, administrative or criminal law nature therefore rested with the Member States.[38] A duty to impose criminal penalties could only arise out of the reasoning in *Greek-Maize*, if the Member States had decided to introduce criminal penalties for protection of a comparable national law. Moreover, regarding the effect of these directives, it should be borne in mind that Community rules can generally only be enforced against Member States, not individuals. When a Member State fails to implement a directive, the Commission can initiate an infringement procedure according to Art. 226 EC against this State. As neither infringement proceedings nor any other remedies for non-compliance with Community directives can be applied to individuals, the individuals can only be affected by the punitive aspects of Community criminal law, if Member States fulfil their duty to implement directives into their national legal systems.[39]

Thus, while the Community has no competence to adopt criminal law provisions on its own, it is widely acknowledged that the EC can restrict the Member States in their criminal law legislation and also instruct them to sanction certain acts in their legal systems.[40]

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37 Dannecker, Gerhard, „Strafrecht in der Europäischen Gemeinschaft", *Juristenzeitung* (1996) No 18, page 870.

38 Pohl, Tobias, „Verfassungsvertrag durch Richterspruch – Die Entscheidung des EuGH zu Kompetenzen der Gemeinschaft im Umweltstrafrecht", *Zeitschrift für Internationale Strafrechtsdogmatik,* (2006) No 5, page 213.

39 Miettinen, Samuli, *supra,* note 32, page 14.

40 Dannecker, Gerhard, *supra,* note 37, page 873.

Criminal law is thereby clearly a part of the European integration process, even if a restricted one.

2.2.3 Recent Developments Regarding the "Europeanization in Criminal Law"

The status of Community competences in criminal law as described above was notably affected by two recent judgments of the ECJ, which received a considerable amount of attention both from legal scholars and from the European institutions themselves. In Commission v Council (C-176/03)[41](*Environmental Legislation)*, the Court ruled that although criminal law as such is no Community policy, the Community has the implied power to harmonise criminal laws of the Member States in relation to the protection of the environment. Following this judgment, the Court in *Marine Pollution*[42] regarding the annulment of the Framework Decision on ship-source pollution, affirmed its ruling in *Environmental Legislation*, thereby showing that it would stick to the new course. Moreover, it extended the Community`s power to harmonise criminal laws to legal acts which were not based on the Community`s competences in environmental policy according to Art.174, 175 EC.

In both cases, the Court annulled Framework Decisions regulating criminal law related measures on grounds of an infringement of the Community`s competences. In the eyes of the Court Article 47 EU, according to which none of the provisions of the EC Treaty is to be affected by a provision of the EU Treaty, establishes the primacy of EC law over EU law. According to its case law it is therefore "the task of the Court to ensure that acts which, according to the Council, fall within the scope of Title VI of the Treaty on European Union, do not encroach upon the powers conferred by

41 Commission v Council (C-176/03)[2005] ECR I-7879.

42 Commission v Council (C-440/05) [2007]ECR I-9097.

the EC Treaty on the Community."[43] In other words, if the EC Treaty confers a competence on the Community, the Union`s institutions are in this area banned from acting under the second or third pillar. Both cases did consequently not address the question of whether the Union as such had the competence to regulate, but instead addressed the delimitation of competences between the first and third pillar.

For this reason, commentators also advance the view that the issue of a Community criminal competence primarily concerns the horizontal division of competences in the Union, rather than the criminal liability of individuals.[44]

The Judgment in Environmental Legislation (C-176/03)

The proceedings in *Environmental Legislation* dealt with the validity of Framework Decision 2003/80/JHA "on the protection of the environment through criminal law". The Framework Decision required the Member States to prescribe criminal penalties in respect of certain environmental offences. The Commission argued that both the purpose and content of the Framework Decision were within the scope of the Community`s powers on environmental policy. The Court followed this opinion and found that provisions of the Framework Decision could have been validly adopted under the Community`s competence in environmental matters, as laid down in Art. 175 EC.

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43 Commission v Council (C-170/96) [1998]ECR I-7879, para 39; however, it was criticized by commentators that the Court failed to give a reason for the primacy of EC law, confer e.g. Emmans, Anna-Maria, "Die strafrechtliche Annexkompetenz der EG umfasst nicht Art und Mass der einzuführenden Kriminalstrafen – sie besteht aber auch jenseits des Umweltrechts, *European Law Reporter* (2008) No 3, page 103; Pohl, Tobias, *supra,* note 38, page 217.

44 Confer e.g. Miettinen, Samuli, *supra,* note 32, page 1.

The Court recalled its former case law by stating that "as a general rule, neither criminal law nor the rules of criminal procedure fall within the Community`s competence."[45]

However, this should not prevent "the Community legislature, when the application of effective, proportionate and dissuasive criminal penalties by the competent national authorities is an essential measure for combating serious environmental offences from taking measures which relate to the criminal law of the Member States which it considers necessary in order to ensure that the rules which it lays down on environmental protection are fully effective."[46]

According to this ruling there is only one requirement to be met for the Community to require the Member States to introduce criminal sanctions: the imposition of criminal penalties must prove itself "necessary", to ensure full effectiveness of the Community rules. The judgment however fails to give further criteria on how to establish this "necessity" of criminal sanctions and the Opinion of AG Colomer is not helpful on this issue. He only points to the importance and fragility of environmental interests and states that criminal law is the only "effective, proportionate and dissuasive" response to environmental offences.[47]

The statements which the Court made in *Environmental Legislation* were interpreted in different ways, as follows.

The Commission issued a communication[48] and the European Parliament issued a resolution[49] in response to the judgment, in

45 Confer, *supra,* note 33.

46 Commission v Council (C-176/03) [2005] ECR I-7879, para 48.

47 Opinion of AG Colomer in Commission v Council (C-176/03)[2005]ECR I-7879, paras 75, 86.

48 Communication from the Commission, *supra,* note 21.

which both institutions elaborate on the effects of the judgment. Both institutions interpret the judgment broadly and think that the Court`s reasoning is not limited to the protection of the environment. Instead, it shall be applicable to any sector under the first pillar, where the Community deems it necessary to ensure effectiveness of Community law provisions by criminal law measures.[50]

In contrast to this understanding of the judgment, the Council and the Member States have interpreted the judgment more narrowly, meaning that it should be understood as relating only to the field of environmental policies.[51] Following this opinion, the Community`s competence to require the Member States to impose "effective, proportionate and dissuasive criminal penalties" would be restricted to the protection of the environment alone.

It should moreover be noted, that Advocate General Colomer, in his opinion delivered in *Environmental Legislation,* touched upon the question of the extent of the penalties that are to be applied by the Member States.

In this regard, he stated that "no one is in a better position to assess the feasibility, appropriateness and effectiveness of a punitive response than the national legislating authorities."[52] However, the Court`s judgment did not address the issue of whose responsibility it should be to determine the type and level of penalties.

Though it is without any legal effect, it should be mentioned that the judgment was widely criticized by legal scholars and practitioners. The first point of criticism was that the criterion of "necessity"

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49 European Parliament resolution on the follow-up to Parlaiment`s opinion on environmental protection: combating crime, criminal offences and penalties, B6-0544/2006.

50 Communication from the Commission, *supra,* note 21, para 8.

51 AG Mazak, *supra,* note 12, paras 7, 37.

52 AG Colomer, *supra,* note 20, para 48.

is no real requirement, but only a pseudo-requirement.[53] According to the Court`s ruling, criminal sanctions are necessary when the Community considers them necessary. The necessity of a measure is consequently entirely dependent on the Community`s discretion, which makes a review on ground of objective criteria impossible. Moreover, the decision was criticized for anticipating the Treaty of Lisbon.[54] Article 83(2) of the Treaty of Lisbon establishes a legislative competence of the Community in criminal law as the Court founded by its judgement.

The Judgment in Marine Pollution

Following the judgment in *Environmental Legislation*, the Commission issued a list of the acts adopted and pending proposals which it deemed to be affected by the judgment and which it deemed to require amendment.[55] The only case where the Commission had the possibility of introducing an appeal for annulment within the procedural deadlines was the appeal to the Court for annulment of the Council Framework Decision 2005/667/JHA. The appeal led to proceedings that were relatively parallel to those in *Environmental Legislation* and as seen above, the Court annulled Framework Decision 2005/667/JHA because some of its provisions could have been validly adopted under the first instead of the third pillar.

With the ruling in *Marine Pollution* the Court affirmed its judgment in *Environmental Legislation* and moreover it at least partly addressed and cleared the issues that were raised by this former judgment. Framework Decision 2005/667/JHA contained provisions that requested the Member States to regard certain

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53 Hefendehl, Roland, „Europäischer Umweltschutz: Demokratiespritze für Europa oder Brüsseler Putsch?“ *Zeitschrift für Internationale Strafrechtsdogmatik* (2006) No 4, page 164.

54 See e.g. Emmans, Anna-Maria, *supra,* note 43, page 106.

55 See: Communication from Commission, *supra,* note 21.

offences relating to ship-source pollution as criminal offences. Moreover, it contained detailed provisions on the type and level of the penalties that should be adopted by the Member States in case of an infringement. These provisions should provide for an approximation of sanction levels for the same kind of offences in the different Member States.

The Court found that the provisions of the Framework Decision which requested the Member States to impose criminal sanctions for certain offences could have been validly adopted by the Community. However, what distinguishes *Marine Pollution* from *Environmental Legislation,* is that the legal basis in the EC Treaty to adopt those provisions was not held to be Art. 175 EC but instead Art. 80(2) EC. Directive 2005/35/EC is based on Art. 80(2) EC, which gives the Community the power to regulate air and sea transport.

The Court in this regard stated that the Community legislature has broad legislative powers under Article 80(2), inter alia regarding "measures to improve transport safety" and "any other appropriate provisions"[56] in the field of maritime transport. It found that the main purpose of the Framework Decision was the promotion of maritime safety and that it therefore belonged to the range of legislative measures that could be validly adopted under Art.80(2) EC.

The Court then went on to renew its central statement in *Environmental Legislation*, namely that "when the application of effective, proportionate and dissuasive criminal penalties by the competent national authorities is an essential measure for combating serious environmental offences, the Community legislature may require the Member States to introduce such penalties in order

[56] Commission v Council (C-440/05) [2007]ECR I-9097, para 58.

to ensure that the rules which it lays down in that field are fully effective."[57]

By this ruling, the Court regrettably failed to give clear guidance on the question of whether the Community is only competent to provide for criminal provisions in environmental policies or if this competence also exists in other sectors, if "necessary" to ensure effectiveness of the Community rules.

Advocate General Mazak addressed the issue in his opinion on the case. He stated that the reason for the existence of the Community`s power to require the Member States to use the tool of criminal enforcement was the "general principle of effectiveness underlying Community law". He concluded that this power therefore "must in principle also exist in relation to any other Community policy area, such as transport."[58]

The judgment however did not give a clear response to his opinions. On the one hand, it was held that regarding ship-source pollution the provisions providing for criminal penalties could be based on the Community`s competence in the transport sector. On the other hand, the Court referred to the protection of the environment several times, pointed to the "horizontal character" of this Community objective and stressed the fact that the Framework Decision aimed at improving protection of the marine environment.

What can be said, is that the Court in any case did not affirm a general transferability of the judgment in *Environmental Legislation* to other Community competences, on ground of effectiveness.[59] However, the judgment at least widened the Community`s criminal competences in so far as the power to require the Member States to

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57 Ibid., at para 66.

58 AG Mazak, *supra,* note 12, para 99.

59 See also regarding this question: Fromm, Ingo, "Urteilsanmerkung EuGH Urteil vom 23.10.2007 – C-440/05", *Zeitschrift für Internationale Strafrechtsdogmatik* (2008) No 3, page 174.

impose criminal sanctions can be transferred to other sectors than the environmental sector, if the measures in question also aim at the "horizontal" matter of protection of the environment, which according to Art. 6 EC has to be integrated into all Community policies.

Accordingly, most commentators do not believe that the Court in future is going to restrict the Community`s power to harmonise criminal laws to the protection of the environment, but that it will be extended to other Treaty objectives such as e.g. the fundamental freedoms.[60]

The other important aspect of the judgment in *Marine Pollution* regards the specification of sanctions that should be imposed by the Member States to penalize the infringements laid down in the Directive. Whereas the Court widened the Community`s power to provide criminal law provisions, it drew a clear line under the Community`s competences regarding the sanctions.

In the judgment it simply states without further reasoning, that "the determination of the type and level of the criminal penalties to be applied does not fall within the Community`s sphere of competence."[61]

The Court thereby follows the line that was already set out by AG Colomer in his opinion in *Environmental Legislation*, which was neither affirmed nor rejected by the Court, since it did not address this issue in the former decision. AG Mazak[62] agreed with AG Colomer and provided some further reasoning as to why the specification of penalties should lie with the Member States. He pointed out that each Member State`s criminal code reflects a

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60 See e.g.: Emmans, Anna-Maria, *supra,* note 43, page 106 ; Fromm, Ingo, *supra,* note 59, page 174.

61 Commission v Council (C-440/05) [2007]ECR I-9097, para 70.

62 AG Mazak, *supra,* note 12, paras 103-108.

particular ranking of the legal interests which it seeks to protect. Further he followed the UK government`s argument, that a given level of fine can send out very different messages in different Member States regarding the seriousness of the offence in question.

The Framework Decision was annulled in its entirety, since the Court regarded it to be indivisible.

3 Effects of the Judgment in *Marine Pollution*

3.1 Provisions of Framework Decision 2005/667/JHA – Content and Grounds for Annulment

The provisions of the annulled Framework Decision can be largely divided into three groups.

Articles 2, 3 and 5 required the Member States to apply criminal penalties to certain forms of conduct. According to Article 2, the infringements laid down in Articles 4 and 5 of Directive 2005/35/EC should be regarded as criminal offences by the Member States. Article 3 established that aiding, abetting or inciting such an offence should also be criminally punishable. And Article 5 concerned the liability of legal persons for those offences. The Court held that these Articles could have been validly adopted by the Community on the basis of Article 80(2) EC.

Articles 4 and 6 contained detailed provisions as to the type and level of penalties that should be applied by the Member States for those offences. Article 4 dealt with penalties for natural persons and established time frames for the length of custodial penalties. For example, an intentionally committed offence, as referred to in Article 2, that caused significant damage to the marine environment and the death or serious injury of persons should be punished by a "maximum of at least between five and ten years of imprisonment."

Article 6 concerned penalties against legal persons and contained specifications as to the amounts of fines that should be applied, e.g. in the most serious cases a maximum of at least between 750 000 and 1 500 000 Euro. Regarding these provisions, the Court held that the determination of the type and level of criminal penalties does not fall within the Community`s competence, so that they could not have been validly adopted under the first pillar. However, since these Articles make references to Articles 2, 3 and 5 they were considered to be inextricably linked to those provisions. Being indivisible from those provisions, Articles 4 and 6 also had to be annulled.

Articles 7, 8 and 9 concerned the establishment and co-ordination of jurisdiction, a mechanism for the exchange of information on the commission of criminal offences and the establishment of contact points to that end. Articles 10, 11 and 12 respectively concerned territorial scope of application of the Framework Decision, the implementation obligation on Member States and the date of entry into force of the Framework Decision. The Court did not elaborate on the question of whether these provisions could have been validly adopted under the first pillar, since it established that they were in any case inextricably linked with the other provisions of the Framework Decision. However, it is possible to find more guidance on this in AG Mazak`s opinion, who concluded that at least Articles 7, 8 and 9 were outside the Community`s competence to criminalise certain conduct.

After the annulment of the Framework Decision in *Marine Pollution*, the contents of these provisions were naturally lost as a part of the EU`s legislative package to promote marine safety. To fill this "legal vacuum", the Commission in March 2008 released a proposal for an amending Directive 2005/35/EC. According to recital one of the proposal`s preamble, it is the purpose of the amending Directive to "approximate the definition of ship-source

pollution offences committed by natural or legal persons, the scope of their liability and the criminal nature of penalties that can be imposed for such criminal offences by natural persons".

The new proposal amends Directive 2005/35/EC without changing its substance, by incorporating in the directive those provisions of the annulled Framework Decision, which prescribed that ship-source pollution committed with intent, recklessly or with serious negligence should be considered a criminal offence.[63] There are thus no substantial amendments to the offences originally created by the "double-text mechanism" or to the levels of culpability necessary to commit an offence under the Directive.

Articles 4, 6 and 7 to 12 however, due to the limits of the Community`s legislative powers as confined by the Court in its judgment, did not find their way into the amending Directive. There were also no efforts from the Council to re-establish these provisions in a new, separate Framework provision. Consequently, regarding the content of these provisions, the Commission did not manage to fill the legal vacuum.

3.2 Possible and Actual Effects of Amending Directive 2005/35/EC on the Combat against Ship-Source Pollution

In the event of adoption of the proposal for the amending directive, those provisions of the Framework Decision which required the Member States to impose criminal penalties, will be removed from the more governmental third pillar to the supranational first pillar.

We are here not dealing with a purely technical matter concerning only the horizontal division of competences in the Union; in

[63] Proposal for a Directive of the European Parliament and of the Council amending Directive 2005/35/EC on ship source pollution and on the introduction of penalties for infringements, COM (2008) 134 final.

fact this deferral would entail some far-reaching consequences. In contrast to Community provisions, Framework Decisions have no direct effect,[64] a failure to transpose them cannot be overcome by an action for infringement as provided for in Art. 226 EC, and the Court`s jurisdiction to give rulings on the validity and interpretation of Union legal instruments according to Art. 35 EU is not compulsory, since this jurisdiction is subject to acceptance by the Member States.[65] Hence, the means to ensure compliance with acts adopted under the first pillar are much more effective than under the third pillar. These limits to the effects of Framework Decisions result in a weaker independent legal standing of acts adopted under the third pillar, compared to acts adopted under the first pillar.

Consequently, the annulment of the Framework Decision will, in case of the adoption of the amending Directive, bring about a strengthening of the Union`s legal framework to promote maritime safety with regard to the criminalization of ship-source pollution.

However, it should be remembered that the adoption of the amending Directive requires a qualified majority of the Member States represented in the Council according to its legal basis, Article 80(2) EC. Although the provisions were adopted unanimously by the Council in the Framework Decision, this does not automatically mean that there will be a qualified majority voting for the same provisions in the Directive. The Member States are traditionally suspicious when it comes to transferring competences in criminal law as a "core area" of national sovereignty to the Community.[66] This assumption was just recently affirmed by the fact that Member States such as Greece, Cyprus and Malta supported the applicants in "Intertanko" in their fierce resistance against Directive

64 Article 34(2)(b) EU.

65 AG Colomer, *supra,* note 20, para 4.

66 Confer: Miettinen, Samuli, *supra,* note 32, page 4.

2005/35/EC. It is therefore hardly imaginable that these Member States would agree to the stipulation of criminal liability under the Directive itself. Therefore, even if the Commission had succeeded in widening the Community`s competences, regarding the fight against ship-source pollution, this might have been a Pyrrhic victory.[67]

3.3 Possible and Actual Effects of the Waiver of an Approximation of Sanction Levels on the Combat against Ship-Source Pollution

Articles 4 and 6 of Framework Decision 2005/667/JHA contained detailed provisions as to type and level of penalties and were aiming at the approximation of sanction levels regarding ship-source pollution in the Member States. Due to the Court denying a Community competence to rule on "type and level" of penalties, these provisions cannot be included in the amending directive. And since there was also no new legislative action at Union level, the legal vacuum created here will persist for an indefinite period of time.

The Commission acknowledges that different sanction levels in the Member States bring about the risk of providing safe havens for offenders. However, it considers its hands bound by the Court`s judgment. Concerning its future actions in this area, the Commission therefore only states that it "continues to believe that the approximation of sanction levels is an important issue and [that it] will reconsider the possibility and need for a legislative proposal in due course."[68]

Taking into consideration the international character of the shipping industry, it is quite difficult to understand this laid-back attitude of the Commission. Considerably differing sanction levels in

67 Hefendehl, Roland, *supra,* note 53, page 166.

68 EUROPA Press Releases, *supra,* note 9.

the Member States undoubtedly contravene the Directive`s aim of protection of the environment.

When considering illegal voluntary discharges, polluters have the possibility of choosing to discharge oil or other harmful substances in the waters of Member States which have lower sanction levels than neighbouring Member States. However, discharges do of course not only affect the State in whose waters the discharge occurs. Polluting substances in the seas spread and consequently also affect States who want to protect their seas by the dissuasive effect of higher sanction levels. Their efforts could be "sabotaged" by the laxer attitude of other States. Yet, if a polluting act that affects several Member States is substantial enough to be discovered quickly and can be traced back to the producer, several States could claim criminal jurisdiction, respectively applying a different system of sanctions. Situations like these are likely to cause legal uncertainty as to the criminal consequences of the very same actions.

These effects become even more severe in the case of accidents caused by serious negligence. As seen above, Directive 2005/35/EC requires the Member States to regard polluting offences caused by "serious negligence" as criminal offences, in contrast to the standard of "recklessness" as laid down in MARPOL 73/78. Major shipping nations like Greece, Cyprus and Malta supported the applicants in Intertanko and strongly contradicted the "serious negligence" approach because they fear it will lead to a criminalizing of innocent mistakes.[69] Greek commentators even perceive the "sword of Damocles hanging over the oceans" for private persons involved

[69] http://www.intertanko.com/upload/ECJ%20judgment%20-%20briefing%20note%20FINAL.pdf [visited on August 13, 2008].

in the shipping industry.[70] In opposition to this, several other Member States, such as Spain or Sweden, are opposed to the application of the industry coalition in Intertanko. With this background, it is easy to foresee that a free choice of penal sanctions will lead to considerably differing sanction levels when it comes to offences committed with serious negligence. One does not need visionary abilities to foresee that sanction levels in Greece, Cyprus and Malta will probably be considerably lower than in other Member States. These Member States of course make their ports more attractive for the shipping industry, which in turn could have a negative effect on the establishment of an internal market.

Hence, the waiver of an approximation of sanction levels will probably have considerable practical effects on the European combat against ship-source pollution.

3.4 Preliminary Conclusions to be Drawn from the Annulment of Framework Decision 2005/667/JHA

The Community is, according to the Commission, turning to the criminal law in the field of maritime safety as a "necessary instrument for an effective enforcement of the rules."[71] The International Convention for the Prevention of Pollution from Ships (MARPOL), to which all EU Member States are parties and thereby bound to adhere to its provisions, stipulates in Article 4(4) that penalties must be "adequate in severity to discourage" potential polluters. Referring to this provision, the Commission holds the opinion that "the deterrent effect of the system of sanctions must be reinforced,

[70] Christodoulou-Varotsi, Illiana, "Recent Developments in the EC Legal Framework on Ship-Source Pollution: The Ambivalence of the EC`s Penal Approach", *Transportation Law Journal* (2007) No 6, page 381.

[71] EUROPA Press Releases, *supra,* note 9.

sending a strong signal, with a much greater dissuasive effect, to potential offenders."[72] This view is also set out in the explanatory memorandum to the amending directive, which moreover states that "criminal investigation and prosecution and judicial cooperation between Member States can be essential and more powerful than administrative action."[73] The Commission thereby follows the reasoning that was already set out by Advocate Colomer in his opinion in *Environmental Legislation*, who stated that criminal law would constitute the only effective, proportionate and dissuasive response to conduct adversely affecting the environment.[74] However, neither the Commission nor AG Colomer give distinct reasons as to why they consider criminal law the only effective means to protect the environment.

Hence, with this starting point, the Community restricts itself in the protection of the maritime environment to the narrow and quite unclear limits of its competences in criminal matters.

Even if one theoretically agrees with the Commission that criminal law is the most effective means to avoid undesirable behaviour, one must still take into consideration the factual circumstances in each case.

As could be seen above, it is still not really clear as to whether the necessary qualified majority of Member States represented in the Council will consent to the amending directive. Moreover, the approximation of sanction levels is by no means a negligible matter and should not be left disregarded for a longer period.

If the Commission considers itself bound by the ECJ's judgment concerning the types and levels of criminal penalties, it should start to think about alternative means to achieve an effective protection

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72 Ibid.

73 Proposal for an amending Directive 2005/35/EC, *supra,* note 63.

74 AG Colomer, *supra,* note 20, para 86.

of the environment. Article 8 of Directive 2005/35/EC states that Member States shall take the necessary measures to ensure that infringements are subject to effective, proportionate and dissuasive penalties, which may include criminal or administrative penalties. Thus, in the present situation it virtually itself suggests turning to the means of administrative sanctions. Sadly, the Commission simply condemned this possibility as "less powerful" than criminal investigation and prosecution.[75] However, it can be strongly doubted whether the imposition of criminal penalties as such is automatically more powerful, as long as the decision on sanction levels is left to the single Member States.

The following therefore examines whether administrative sanctions could be as effective or even more effective to protect the environment than criminal penalties and how they could be legally construed.

4 Administrative Sanctions in the Combat against Ship-Source Pollution

4.1 Classification of Administrative Sanctions in Legal Systems

Legal systems use sanctions in situations in which individuals do not adhere to their public duties, although these are laid down in laws or have been stipulated bindingly in the course of application of the law.[76] The term "sanction" is in legal theory defined as every

[75] EUROPA Press Releases, *supra,* note 9.

[76] Ogg, Marcel, *Die verwaltungsrechtlichen Sanktionen und ihre Rechtsgrundlagen*, 2002, page 1.

legal disadvantage, which is imposed on a person who has infringed a legal provision.[77]

However, this definition does not give any guidance as to whether a sanction belongs to the civil, criminal or public law sphere. Formally, administrative sanctions are sanctions which are prosecuted and imposed by administrative authorities and which contain all consequences that are inflicted on individuals if they disregard administrative duties.[78] The Member States of the European Union have shaped their systems of administrative sanctions in different ways.[79] Some States[80] have special codifications for administrative sanctions, which regulate the imposition of such sanctions in detail; others simply know the concept of sanctions which are imposed by administrative authorities.[81]

The distinctive criteria of administrative sanctions can be shown best by a comparison to criminal sanctions, even if it is not always easy to draw the demarcation line between these legal instruments.

Generally, sanctions can fulfil three different functions: prevention, reparation and suppression.[82] Prevention aims at the hindrance

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77 Heitzer, Anne, *supra,* note 25, page 6; Kadelbach, Stefan „Verwaltungsrechtliche Sanktionen bei Verstößen einzelner gegen das Gemeinschaftsrecht", page 81, in: Van Gerven & Zuleeg (eds.) *Sanktionen als Mittel zur Durchsetzung des Gemeinschaftsrechts,*1996.

78 Ogg, Marcel, *supra,* note 76, page 7; Kadelbach, Stefan, *supra,* note 77, page 82.

79 See: National Reports – Volume I, *The system of administrative and penal sanctions in the Member States of the European communities*, Luxembourg, 1994.

80 E.g. Germany, Austria, Italy and Portugal.

81 E.g. France, the Netherlands, Greece and Belgium.

82 Schwarze, Jürgen, „Rechtsstaatliche Grenzen der gesetzlichen und richterlichen Qualifikation von Verwaltungssanktionen im europäischen Gemeinschaftsrecht", *Europäische Zeitschrift für Wirtschaftsrecht* (2003) No 9, page 265.

of further breaches through deterrence. Reparation seeks to undo the harm inflicted on the legally protected interest. Suppression aims at avengement of the wrong done by the infliction of a personal legal or economic disadvantage.[83]

Administrative sanctions are applied by authorities of the Member States to fulfil all of these functions.[84] However, while criminal law places emphasis on the repressive function, the primary function of administrative sanctions is said to be preventive; this means they are above all applied to maintain the functioning of administrative action, to terminate a current unlawful state or to prevent certain events in the future.[85]

Apart from the slightly different functions, it is commonly stated that the most important difference between criminal and administrative law is the "ethical dimension".[86] While criminal sanctions contain a social disapproval and stigmatise the wrongdoer, administrative sanctions do not aim at labelling the wrongdoer as a "criminal".[87] It is therefore often stated that administrative sanctions are to be considered as morally neutral measures.[88]

However, not all administrative sanctions can be regarded the same, in fact, measures adopted under this label can be of a considerably different character. Broadly speaking, administrative sanctions can be divided into two categories: sanctions with a purely

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83 Ibid.

84 Heitzer, Anne, *supra*, note 25, page 17.

85 Kadelbach, Stefan, *supra,* note 77, page 82.

86 AG Colomer, *supra,* note 20, para 74.

87 Opinion of Advocate General Jacobs in C-240/90 [1992] ECR I-05383, para 11.

88 Eg. Heitzer, Anne, *supra,* note 25, page 15.

remedial or compensatory character and sanctions with a punitive character.[89]

Sanctions with a purely compensatory character consist e.g. in the reclaiming of benefits which were wrongly obtained, the subsequent invoicing of duties not paid or the charging of interest on duties, which have to be paid.[90] The addressee of such measures does not suffer from a disadvantage that goes beyond his original legal duties, as these kinds of sanctions are to be assessed exactly according to the loss to be recovered. There is no infliction of a personal legal or economic disadvantage, which means that the authorities do not pursue any suppressive aim by applying such measures.

Punitive sanctions however go beyond these measures. They consist mostly in the imposition of fines,[91] but can also consist of the enhancement of a due amount, the withdrawal of a licence, the ban from a profession[92] or the forfeiture of deposits.[93] As a conesquence to the loss which the wrongdoer has caused to others or the public a personal disadvantage is inflicted on him. Consequently, what distinguishes punitive from compensatory sanctions is that they contain a suppressive and deterrent function:[94] they are in fact penalties.

This essay will not touch upon the much discussed question, if it is at all admissible to impose penalties in the form of administrative

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89 Ligeti, Katalin, „European Criminal Law: Administrative and Criminal Sanctions as Means of Enforcing Community Law", *Acta Juridica Hungarica* (2000), Nos 3-4, page 207.

90 Kadelbach, Stefan, *supra,* note 77, page 81.

91 Ligeti, Katalin, *supra,* note 89, page 205.

92 Heitzer, Anne, *supra,* note 25, page 16.

93 See: Commission Regulation No 2220/85 of 22 July 1985, OJ 1985 L 205, page 5.

94 Confer the statements of the ECJ in ACF Chemiefarma (C-41/69) [1970] ECR 661, paras 172-174.

sanctions and if, or to what extent, administrative sanctions are consciously used to enhance a decriminalisation in certain areas. For the purpose of this essay it is sufficient to assert that even if sanctions have a penal character, they can still be classified as administrative penalties. The decisive point is that they are imposed by administrative authorities, in contrast to criminal penalties, which can only be imposed by a judge.

However, due to the penal character of these sanctions, the question arises of whether, and to what extent fundamental criminal law guarantees have to be applied. The constitutional courts of Germany, France and Spain have all acknowledged that administrative authorities have to adhere to classical criminal law guarantees such as e.g. the principle of legality (nulla poena sine lege) when imposing sanctions with a penal character.[95] Accordingly, under the codifications for administrative sanctions in Germany, Italy and Portugal, criminal law guarantees are for the most part applicable as in criminal law itself.[96]

Even more important, from a more international perspective, this position has also been confirmed by the case-law of the European Court of Human Rights (ECHR). Article 6 of the European Rights Convention provides for additional and more extensive procedural and substantive guarantees with regard to criminal cases, as compared with civil cases. In its widely known cases Engel v Netherlands[97] and Öztürk v Germany,[98] the ECHR held that for protection under the Convention, the formal classification made by national law is not decisive. Instead, the applicability of the guarantees under Article 6 should depend on the nature of the

95 Tiedemann, Klaus, *supra,* note 30, pages 27, 28.

96 Ibid., at page 28.

97 Engel v Netherlands [1979-1980] EHRR 706.

98 Öztürk v Germany [1984] EHRR 409.

offence itself and on the nature and severity of the sanction which can be imposed.

When it comes to the relevance of administrative sanctions in a legal system, one must not forget that they are in some countries the only possibility for sanctioning legal persons. While corporate criminal liability is well developed in countries such as the Netherlands, Denmark, the UK and Ireland, countries like Luxemburg, Portugal, Spain, Austria and Germany still lack criminal liability for corporations.[99] The adherence to the maxim "societas delinquere non potest" is for example justified by the fact that legal entities cannot be morally blameworthy and cannot be imprisonned.[100]

Furthermore, it is worth mentioning, that imprisonment is generally excluded from the range of measures that can be imposed as administrative sanctions.[101]

4.2 Administrative Sanctions in the Community`s Legal System

4.2.1 General Remarks on Sanctions in the Community

As seen above, neither criminal law nor criminal procedure fall within the Community`s competence. However, this does not mean that the Community has to do without the application of sanctions

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99 See: Results of the study concerning the sanctions applicable on the non-observance of European Directives by Faure, Michael and Heine Günther, "Criminal Penalties in EU Member States environmental law", in: Eser, Albin (ed.), *Beiträge und Materialien aus dem Max-Planck-Institut für ausländisches und internationales Strafrecht in Freiburg i. Br.*, Freiburg, 2000, page 334.

100 Confer: National Reports, *supra,* note 79.

101 An exception to this rule is Austria where imprisonment up to six weeks is possible, see: Faure, Michael and Heine, Günther, *supra,* note 99, page 333.

in the case of breaches of Community rules. In fact, the Community is, like any other legal system, dependent on the possibility of imposing sanctions to enforce its legal order.[102]

Accordingly, administrative sanctions have been established in various fields of the Community legal order, for example in competition law, merger control, transport, agriculture and fisheries. Administrative sanctions are by now a well developed means of enforcement of Community law, but there has been a lot of debate about the Community`s power to establish these sanctions. Since the legal basis differs according to the Community policy in question, a closer look at the exact legal basis for Community sanctions will be taken when dealing with the different sanctions in the respective area. This essay will examine in greater detail the Community sanctions in the fields of competition law and agriculture.

Administrative proceedings in the Community can be structured in different ways. In certain areas, such as competition law and state subsidies, the administration is handled exclusively by the Community itself. For example, in competition law the Community has the power to carry out inspections by its own agents. This type of administration is within the Community legal order known as "direct administration."[103] In other areas, for example agriculture, the Community institutions act as supervisors only, while the implementation of measures is the task of national authorities. This form of administration is what is known as "indirect administration."[104] In between these two models, there are various forms of administrative cooperation between Community institutions and

[102] Int. Handelsgesellschaft (C- 11/70) [1970] ECR 1125, para 25.

[103] Cassese, Sabino, „European Administrative Proceedings", in: *The Administrative Law of the European Union*, 2004, page 21.

[104] Ibid.

national authorities; however, further examination of these would go beyond the scope of this paper.

With regard to administrative sanctions, direct administration means that Community institutions impose a sanction themselves, after having examined the individual case in an administrative procedure. [105] In this procedure, the right to be heard must be granted,[106] and it is up to the courts of the Community[107] to review the decision of the Community institution in question. The national courts are not at all involved in the whole process.

In areas where the Community cannot act directly, it can instead include provisions in its legal acts providing for specific sanctions in case of breaches against these acts. These sanctions are then imposed by national authorities or courts,[108] via indirect administration, without the involvement of any Community authority. Hence, the actors in the system of indirect administration are the Community legislator and the national administrations.[109] Judicial review lies with the national courts, which cooperate with the ECJ through the instrument of preliminary rulings. The implementation of Community law by the Member States is the general rule, direct administration is only applied if Community provisions expressly provide for it.[110]

The application of Community sanctions, exactly like the application of national sanctions, raises the question if, and to

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105 E.g: Fines in Competition Law.

106 See: Fiskano v Commission (C-135/92) [1994] ECR I-02885.

107 Court of First Instance and, in a procedure limited to the review of legal questions, the European Court of Justice, Article 225 EC, Articles 58, 59 Statute of the Court of Justice.

108 E.g.: The forfeiture of deposits in the field of agriculture.

109 Koen von, Lenaerts, „Sanktionen der Gemeinschaftsorgane gegenüber natürlichen und juristischen Personen“, *Europarecht* (1997) No 1, page 17.

110 Heitzer, Anne, *supra,* note 25, page 28.

which extent fundamental principles and criminal law guarantees have to be considered. As seen above, the ECHR ruled that the application of fundamental freedoms and rights, as laid down in Article 6 of the European Convention of Human Rights, cannot depend on the formal classifications of a measure. However, the Community has not ratified the Convention, which means that it is not directly applicable to Community law.[111] Still, Article 6 of the EU Treaty states that the Union "shall respect fundamental rights as guaranteed by the European Convention for the Protection of Human Rights" and consequently the provisions of the Convention are seen as a special tool for the interpretation and as leading principles for the rights and guarantees under Community law.[112]

In 1995, the Council adopted a regulation on the protection of the European Communities` financial interests,[113] which serves as a general framework for investigating and repressing acts and omissions that, by violating Community rules, cause financial harm to the Community, or could do so.[114] The regulation provides for fundamental criminal law guarantees to be applied to Community sanctions with a punitive character. Inter alia, the regulation states that the rule of law ("nulla poena sine lege") has to be applied and it stipulates the requirement of guilt ("nulla poena sine culpa"). The ECJ has for quite a long period been rather reluctant to apply

[111] According to Article 59 of the European Convention of Human Rights, the Convention can be ratified by members of the Council of Europe. According to Article 4 of the Statute of the Council of Europe, any "European State" can become a member of the Council of Europe. This formulation leaves the Community outside, it can not become a member.

[112] Schwarze, Jürgen, *supra,* note 82, page 264.

[113] Council Regulation (EC, Euratom) No 2988/95 of 18 December 1995 on the protection of the European Communities financial interests, OJ 1995 L 312, pages 1-4.

[114] Ligeti, Katalin, *supra,* note 89, page 204.

criminal law guarantees to Community sanctions,[115] but in its recent case law it affirmed the applicability of the aforementioned principles, as well as the acknowledgment of reasons for justification and exculpation.[116]

The establishment of Community sanctions is seen as beneficial, because they are governed by one legal order, which is of course Community law, and they are of the same legal nature in all Member States. This is assumed to promote an equal and effective protection of EC law everywhere in the Community.[117]

4.2.2 Community Sanctions in Competition Law

The most prominent sanction system in the Community was established in the area of competition law. The competition law in the Community is built on two substantive provisions of the EC Treaty: Article 81 EC prohibits agreements, decisions and concerted practices which may distort competition in the Community and declares any such agreement or decision as automatically void. Article 82 EC prohibits any abuse of a dominant position within the common market. Both provisions imply that the distortion may affect trade between Member States.

Article 83 EC expressly enables the Community to adopt provisions designed "to ensure compliance with the prohibitions laid down in Article 81(1) and in Article 82 by making provision for fines and periodic penalty payments."

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[115] Tiedemann, Klaus, *supra,* note 30, page 28; see also: Declaration of a Community sanction as not punitive and consequently no application of criminal law guarantees in case "Käserei Champignon" (C-210/00) [2002] ECR I-6453.

[116] Tiedemann, Klaus, „Gegenwart und Zukunft des Europäischen Strafrechts", *Zeitschrift für die gesamte Strafrechtswissenschaft* (2004), No 4, page 947.

[117] Winkler, Rolf, „*Die Rechtsnatur der Geldbuße im Wettbewerbsrecht der Europäischen Wirtschaftsgemeinschaft*", 1971, page 16.

In order to achieve the EC Treaty`s aim of a common market,[118] it was already, from the early years of the Community, considered essential to "establish a system ensuring that competition shall not be distorted in the common market."[119] Based on the authority in Article 83 EC (former Article 87), Article 15 of the (by now disestablished) Regulation 17/62[120] empowered the Commission, in case of a breach against Art. 81 or Art. 82 EC, to impose sanctions in the range of 1000 to 1 million Euro[121], or up to 10% of the undertaking`s total turnover. Moreover, it was expressly stated in Article 15 of Regulation 17/62, that sanctions imposed under this article should "not be of a criminal law nature." The subsequent and presently valid Regulation 1/2003[122] did not bring any substantive changes to these provisions. In Article 23 of Regulation 1/2003, the range of fines in Regulation 17 for infringements of Articles 81 and 82 EC was adopted, as well as the express legal qualification of sanctions under this article as "not criminal."

According to this designation of the legal nature of these sanctions, the early case law of the Court insinuated that the sanctions provided for by Article 15 of Regulation 17 did not have a punitive character.[123] Correspondingly, the fines imposed in these

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118 Article 2 EC.

119 Preamble of EEC Council Regulation No 17: First Regulation implementing Articles 85 and 86 of the Treaty, OJ 1962 013, Pages 204-211.

120 EEC Council: Regulation No 17: First Regulation implementing Articles 85 and 86 of the Treaty, OJ 1962 013, Pages 204-211.

121 Of course, the original wording of Article 15 did not say Euro, but „units of account"; later, from 1979 to 1998, the ECU was used as the unit of account in the EC, until it was replaced by the Euro on Jan 1st, 1999.

122 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, OJ 2003 L 1, page 1.

123 E.g. Boehringer Mannheim GmbH v Commission (C-45/69) [1970] ECR 769, paras 52 ff.

early years of the Community were rather low.[124] This practice changed considerably with the Pioneer case[125] in 1979, which saw a substantial increase in the level of fines. The Commission imposed what was described as an "exemplary fine" on one of the undertakings involved and the decision was said to "startle the business world."[126] The ECJ expressly permitted that the Commission raised the fines for the reason of deterrence.[127] From that time on, a clear Commission policy to impose high fines to deter serious violations of Articles 81 and 82 has emerged.[128] A recent decision of the Commission[129] to fine Microsoft for not complying with an anti-trust decision constitutes a new peak in this development. Microsoft was ordered to pay 899 million Euro, which makes it the largest fine the EC has ever imposed on a single company.

In determining the level of the fines, the Commission first has to consider the basic criteria stated by Regulation 1/2003: intent or negligence, and the nature and gravity of the infringement.[130] In addition, the Commission has developed a system of aggravation and mitigation of fines related to its policy of deterrence through

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124 Schwarze, Jürgen, *supra,* note 82, page 263.

125 Pioneer (C-100-103/80)[1983] ECR 1825.

126 Palmer, Fiona, „European Sanctions and Enforcement: European Law Meets the Individual", *Cambrien Law Review* (1997) No 45, page 49.

127 Musique diffusion francaise (Pioneer) (C-100-103/80) [1983]ECR 1825, para 106.

128 Faull, Jonathan, „The Enforcement of Comeptition Policy in the European Community: A Mature System", *Fordham International Law Journal* (1991-1992), No 15, page 244.

129 Decision of the European Commission C(2008) 764 final of 27 February 2008.

130 Regulation 1/2003, Article 23.

the imposition of fines.[131] It should be mentioned that the fines are not intended to compensate for the damage done by the infringing party or parties.[132]

In the light of the case law of the European Court of Human Rights, the amount of the fines imposed by the Commission in competition law procedures and the deterrent purpose of these fines, raise the question of to which extent the legal classification of the sanctions as "not criminal" in Article 23 of Regulation 1/2003 can be decisive. This question is widely discussed by legal scholars and commentators in the Community; however this discussion has to date no factual influence on the legal nature of these sanctions. For the purpose of this essay it is therefore sufficient to establish that the fines imposed under the competition law sanctions regime are in fact administrative sanctions.

Another important aspect of the sanctions system in EC competition law, is that it is the model example for the concept of "direct administration" as described above. The Commission acts as the executive authority and is in charge both of the administrative procedure and of the imposition of fines. Legal review of its decisions lies with the Court of Justice.[133] In the course of establishment, if an infringement of Articles 81 or 82 EC has occurred, the Commission has fairly wide powers of investigation and inspection, such as their famous "dawn raids."[134]

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131 Confer: Guidelines on the method of setting fines imposed pursuant to Article 23(2)(a) of Regulation No 1/2003 (OJ 2006 C210, pages 2-5).

132 Faull, Jonathan, *supra,* note 128, page 244.

133 Article 31 of Regulation 1/2003 states: "The Court of Justice shall have unlimited jurisdiction to review decisions whereby the Commission has fixed a fine or periodic penalty payment. It may cancel, reduce or increase the fine or periodic penalty payment imposed."

134 See Article 20 of Regulation 1/2003.

4.2.3 Community Sanctions in the Field of Agriculture

Since the eighties, regulations of the Community in the field of agriculture contain sanctioning provisions.[135] The sanctions comprise measures such as the forfeiture of deposits, the withdrawal of a licence, the exclusion from subsidies for the future or surcharges up to 40% on amounts wrongly received and having to be repaid.[136] By and by, the regulatory activity in this field increased; while the Commission e.g. in 1989 adopted 18 acts providing for sanctions in the field of agriculture, this figure already in 1990 rose to 42 acts.

The introduction of sanctions in this area was regarded as necessary to prevent fraud and other infringements to the detriment of the financial interests of the Community.[137] The Commission moreover complained about insufficiency of national enforcement measures, and groundless differences between implementing provisions in the Member States.[138]

Due to the absence of Community provisions stating otherwise, the administrative procedures and imposition of sanctions in this area lie with national authorities in the Member States (see above: indirect administration).

In the first years after these sanctions were adopted, the Community`s competence to actually adopt sanctions in the agricultural sector, as well as their legal basis and the principles applicable to them, were unclear and controversial. For some time, the Court only ruled on the legitimacy of such sanctions in individual cases, without making a general statement.[139] However, in 1992 the Court

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135 Heitzer, Anne, *supra,* note 25, page 27.

136 Tiedemann, Klaus, *supra,* note 116, page 948.

137 Pache, Eckhard, „Zur Sanktionskompetenz der Europäischen Wirtschaftsgemeinschaft“, *Europarecht* (1993) No 2, page 176.

138 Palmer, Fiona, *supra,* note 126, page 60.

139 Heitzer, Anne, *supra,* note 25, page 136.

issued a landmark decision on these questions in the case of Germany v Commission (*Sheep Meat)*.[140] The judgment recognizes the "Community`s power to impose penalties necessary for the effective application of the rules in the sphere of the common agricultural policy."[141]

When it comes to the legal basis of sanctions in the field of agriculture, there is no provision in the EC Treaty itself providing for such sanctions.

Yet, Article 229 EC (former Art. 172 EC) states: "Regulations adopted jointly by the European Parliament and the Council, and by the Council, pursuant to the provisions of this Treaty, may give the Court of Justice unlimited jurisdiction *with regard to the penalties provided for in such regulations*." This formulation has caused a controversy in legal theory: according to the strict doctrine, it is supposed to refer exclusively to competition law, as the only field where the possibility of imposing sanctions is expressly mentioned in the EC Treaty.[142] In contrast to this opinion, the supporters of a broader interpretation assume that Art. 229 EC implies a general competence to impose sanctions.[143]

However, this discussion has no effect on the legal basis for sanctions in the field of agriculture, since the Court found in *Sheep Meat* that "Article 172 (now Art. 229 EC) concerns only penalties fixed and imposed directly by the Community institutions"[144] and

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[140] Germany v Commission (C-240/90)[1992] ECR I-5383.

[141] Ibid., at para 11.

[142] Sevenster, Hannah, " Criminal Law and EC Law", *Common Market Law Review* (1992) No 29, page 33.

[143] They point out, that Art. 229 EC would be redundant, if it only referred to Competition law, see e.g: Opinion of Adcocate General Jacobs in Germany v Commission (C-240/90) [1992] ECR I-5383, para 13.

[144] Germany v Commission (C-240/90)[1992] ECR I-5383, para 34.

consequently denied applicability of this provision to the agricultural sector.

Yet, even in the absence of express provisions in the EC Treaty, the Court`s case-law seems to be based on the assumption of a general competence of the Community to impose sanctions, as Advocate General Jacobs showed in his opinion in *Sheep Meat.*[145] The Court consequently found in its judgment in *Sheep Meat*, that the Community has the "power to impose penalties necessary for the effective application of the rules in the sphere of the common agricultural policy" and that this power "is based on [the former] Article 40(3) and Article 43(2) EC."[146] (The former) Articles 40(3) and 43(2) EC enabled the Community to adopt "all measures required" for the implementation of a common agricultural policy. By this formulation, the Court made clear that the competence of the Community to provide for sanctions in the agricultural sector comes as an annex to the competences in this field.[147]

The Court further stated that the "sole condition" imposed by Articles 40(3) and 43(2) EC, in order for a measure to come within the powers of the Community, is that "the measures contemplated

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145 See: Advocate General Jacobs refers in his opinion in *Sheep Meat* to former judgments of the ECJ: Amsterdam Bulb (C-50/76)[1977] ECR 137: "in the absence of any provision in the Community rules for the punishment of individuals [...] the national legislatures can adopt such sanctions as appear to them to be appropriate"; Commission v Greece (C-68/88)[1989] ECR 2965: "where Community legislation does not specifically provide any penalty for an infringement[...] Article 5 of the Treaty requires the Member States to take all measures necessary".

146 Germany v Commission (C-240/90)[1992] ECR I-5383, para 11.

147 According to the principle of "effet utile", provisions in the EC Treaty are to be interpreted in a way to give them full effect. If a competence in the EC Treaty is regarded as not enforceable without the imposition of sanctions, the competence to provide for sanctions comes as an annex to the original competence, see: Heitzer, Anne, *supra,* note 25, page 140.

should be necessary to attain the objectives of the common agricultural policy."[148] This formulation leaves a considerable discretion with the Community legislator as to the question of whether a measure is necessary for an effective application of the Community rules.

Furthermore, as regards content of the power to impose sanctions, the ECJ did not provide any clear guidelines. The Community legislator was therefore also awarded a wide discretion regarding the choice of the applicable sanctions. In addition, the Court affirmed the possibility of adopting sanctions, which are to be imposed by authorities of the Member States.[149]

When it comes to the application of criminal law guarantees to sanctions in the agricultural sector, the 1995 Regulation to protect the European Communities financial interests[150] gives some guidance. The preamble of the regulation classifies Community measures in this sector as punitive sanctions, and the regulation stipulates the applicability of general principles, like the principle of legality and the "nulla poena sine culpa"-principle.

4.3 Analogy to the Introduction of Administrative Penalties in the Combat against Ship-Source Pollution

4.3.1 Analogy to Administrative Sanctions in Competition Law

When considering the introduction of administrative penalties in a policy of the Community, it seems itself to suggest drawing on the sanction system in competition law as comparison. This is first of all

[148] Germany v Commission (C-240/90) [1992] ECR I-5383, para 18.

[149] Ibid., at paras 20, 32.

[150] See, *supra,* note 113.

due to the fact that the sanction system in competition law is well established and very well known in the Community. The procedures are observed by the public and receive a lot of attention in the media.

Unfortunately, there is one big obstacle to a direct comparison of the sanction system in competition law to other policies in the Community: competition law is the only field in the EC Treaty where the possibility of imposing sanctions is expressly mentioned. Apart from Article 83 EC in competition law, the only article mentioning sanctions in the EC Treaty is Article 229 EC. Irrespective of the question of whether Article 229 EC implies a general Community competence to impose sanctions,[151] it is in any case not conferring a competence to impose sanctions linked to a special policy like Article 83 EC. Hence, the conferment of the Community competence to impose sanctions in competition law is singular in its form.

However, apart from the legal basis, several features of the sanction system in competition law can be drawn on, when thinking about the possibility of administrative sanctions in the combat against ship-source pollution.

As seen above, infringement procedures in Community competition law are characterized by the imposition of high fines. The Court has, in its case law on competition matters, clearly shown that the capacity of an administrative penalty to constitute a valid deterrent against infringements justifies the existence of particularly high penalties.[152] Moreover, the deterrent nature of fines imposed in competition matters is increased by the high publicity of such

[151] See above.

[152] Opinion of Advocate General Saggio in Molkereigenossenschaft Wiedergeltingen v Hauptzollamt Lindau (C-356/97)[2000] ECR I-5461, para 50.

procedures.[153] On the whole, the accused in such procedures are big undertakings, which can be heavily affected by damage to their "good reputation" in the business world.

There is no reason why an analogical deterrent effect should not be created in the field of maritime transport through the imposition of high administrative fines. As in competition matters, in maritime safety it is also mainly corporations that profit from infringements.[154] Therefore, even the range of fines applied in competition matters could give some guidance as to appropriate fines in maritime transport. Moreover, in maritime transport, the systematic use of publicity could even be more effective: Being publicly accused as a "reckless" polluter of the seas probably has an even stronger negative effect on an undertaking`s reputation, than "only" being accused of a breach of competition rules.[155]

As explained above, competition law constitutes one of the areas in Community law where the exception of direct administration is applied. The sole competence of Community institutions brings about advantages in the implementation of Community rules. There is no risk that Member States fail to implement Community provisions or that there are differences in enforcement and sanc-

153 Appel, Ivo, *supra,* note 23, page 37.

154 Faure, Michael and Heine, Günther, *supra,* note 99, page 335.

155 See in this regard for example statements of Intertanko in connection with the proceedings in Intertanko v The Secretary of State for Transport (C-308/06) [2008] ECR 000: "It is important to emphasise that the coalition claimants are not attempting to obstruct the development of the law with respect to combating marine pollution, still less to ensure any kind of `freedom to pollute`. They are responsible bodies in a major industry, which are committed to the maintenance of proper standards for the prevention of marine pollution.", Intertanko Press releases Year 2007, http://www.intertanko.com/templates/Page.aspx?id=43069 [visited August 14, 2008].

tions actually imposed in the Member States.[156] However, the application of direct administration in the field of maritime safety would bring about a heavy workload for the Commission. Considering the fact that the notification system in Competition law was changed in 2004 to reduce the Commission`s workload, the introduction of direct administration in maritime transport does not seem likely.

4.3.2 Analogy to Administrative Sanctions in the Field of Agriculture

As seen above, administrative sanctions in the field of agriculture exist in the Community legal order since the eighties, although there is no express legal basis for them in the EC Treaty. However, the Court, in its landmark decision in *Sheep Meat,* based the Community`s competence to provide for sanctions in this field on (the former) Articles 40(3) and 43(2) EC. Articles 40(3) and 43(2) empowered the Community to take actions which "may include all measures required to attain the objectives" of the common agricultural policy.

Measures dealing with maritime safety can be described as having a twofold objective: They aim at the regulation of maritime transport as well as at the protection of the environment. They can therefore be said to be located at an interface between Title V EC, regulating the common transport policy of the Communities, and Title XIX EC on the environment. Therefore, measures in maritime safety could theoretically have their legal basis in both Community policies.

Concerning the combat against ship-source pollution, Directive 2005/35/EC "on ship-source pollution and on the introduction of sanctions, including criminal sanctions for polluting offences", was

[156] See: Sevenster, Hanna, *supra,* note 142, page 69.

based on the Community policy in transport, more precisely on Article 80(2) EC. In addition, the Proposal for an amending Directive 2005/35/EC[157] is based on Art. 80(2) EC. The Commission explains this choice of a legal basis by simply stating that "The provisions of this Directive relate to maritime transport. Consequently, the legal base chosen is Article 80(2) of the EC Treaty."[158] However, the Preamble of Directive 2005/35/EC starts with the words: "The Community's maritime safety policy is aimed at a high level of safety and environmental protection[...]."[159] This formulation shows that the Directive first of all aims at the protection of the environment. Advocate General Mazak pointed out in this regard, that "the fact that a Community measure pursues aims of environmental protection does not automatically mean that it has to be adopted on the basis of Art.175 EC."[160] In reverse, it could in theory also have been based on Art. 175 EC.

It therefore makes sense to take a closer look at the enabling norms in both fields: The enabling norm concerning maritime transport is Article 80(2) EC, which reads: "The Council may,[...], decide whether, to what extent and by what procedure appropriate provisions may be laid down for sea and air transport."

In environmental matters, the relevant norm is Art. 175 EC, which states: "The Council, […] shall decide what action is to be taken by the Community in order to achieve the objectives referred to in Article 174."

Both provisions give a wide discretion to the Council in deciding, which measures should be adopted to achieve the aims of the Treaty. There is no instruction as to the content of the measures

157 COM(2008) 134 final.

158 Ibid.

159 OJ 2005 L 255, page 11.

160 AG Mazak, *supra,* note 12, para 128.

that should be adopted. The Council is therefore only limited by the general principles of Community law, e.g. the subsidiarity and proportionality principles. The structure of these norms corresponds to (the former) Art. 40(3) and 43 (2) EC, on which the Court based the Community`s sanctioning competence in the agricultural sector as an annex to the competences in this field. Based on the wording of Articles 80(2) and 175 EC and the "effet utile" principle, there appears to be no reason why the Court`s reasoning in the agricultural sector should not be conferrable to the Community policies of transport and environment.

Another aspect of Community sanctions in the agricultural sector is their diversity. As set out above, the Community regulations in this field provide for quite a wide variety of different penalties. Again in relation to environmental infringements, sanctions other than fines or imprisonment seem to be effective. At minimum, various Member States of the Community increasingly make use of so-called complementary sanctions in environmental matters.[161] These measures contain e.g. restoration following of harm done to the environment, the removal of illegal gains, the "black-listing" of offenders or the future refusal of a licence.[162] As these complementary sanctions seem to prove effective both on Member State and Community levels, it seems advisable to also introduce them on a Community level in order to protect the environment. The enabling norms in the Community policies of transport and environment do not prevent this, as there are no limitations as to the content of measures adopted under these norms.

Community sanctions in the agricultural sector are imposed by national authorities in the Member States. Also in environmental matters, many norms were adopted at Community level, but

[161] Faure, Micheal and Heine, Günther, *supra,* note 99, page 334.

[162] Ibid.

enforcement mechanisms were traditionally left with the Member States.[163] Considering the expertise of national administrative authorities and the workload which the Commission would have to handle in the case of a change to the system, indirect administration seems most appropriate for sanctions in the fields of transport and environment.

4.4 Discussion of the Introduction of Administrative Sanctions in the Field of Maritime Safety Instead of Criminal Sanctions

4.4.1 The Question of Effectiveness

In the proposal for an amending Directive 2005/35/EC, the Commission states that criminal law related measures "are necessary to ensure that the Community`s rules on maritime safety will be fully effective."[164] To justify this assumption, the Commission gives the following reasoning:

> "[...] the deterrent effect of the [present] system of sanctions must be reinforced, sending a strong signal, with a much greater dissuasive effect, to potential offenders. Common rules on criminal offences make it possible to use effective methods of judicial cooperation between Member States. Criminal investigation and prosecution can be more powerful than administrative action."[165]

This reasoning largely corresponds to former statements of the Commission, as e.g. given in a proposal for a directive "on the

[163] Faure, Michael, "European Environmental Criminal Law: Do we really need it?", *European Environmental Law Review* (2004), page 20.

[164] COM (2008) 134 final.

[165] EUROPA Press Releases, *supra,* note 9.

Protection of the Environment through Criminal Law"[166] presented by the Commission on 13 March 2001. The Commission held:

> In many cases, only criminal penalties will provide a sufficiently dissuasive effect. First, the imposition of criminal sanctions demonstrates a social disapproval of a qualitatively different nature compared to administrative sanctions or a compensation mechanism under civil law. It sends a strong signal, with a much greater dissuasive effect, to offenders. [...]
>
> Second, the means of criminal prosecution and investigation (and assistance between Member States) are more powerful than tools of administrative or civil law and can enhance effectiveness of investigations. Furthermore, there is an additional guarantee of impartiality of investigating authorities, because other authorities than those administrative authorities that have granted exploitation licences or authorisations to pollute will be involved in a criminal investigation.

In both statements, the Commission basically gives two arguments justifying the introduction of criminal penalties.

First, it attributes "a much greater dissuasive effect" to criminal sanctions than to other types of sanctions. While this "greater dissuasive effect" is not explained any further in the present proposal, the 2001 proposal at least points to "a social disapproval of a qualitatively different nature compared to administrative sanctions." It is of course true, that the "ethical dimension"[167] of criminal law distinguishes criminal sanctions from other types of sanctions. However, it seems doubtful if this can be enough to make criminal law per se effective. At least, this "symbolic" character of criminal law cannot serve as an objective criterion upon which the principle of effectiveness can be based.[168]

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166 COM (2001) 139 final.

167 AG Colomer, *supra,* note 20, para 74.

168 Herlin-Karnell, Esther, "Commission v Council: Some reflections on Criminal Law in the First Pillar", *European Public Law* (2007) No 13, page 77.

Besides that, the dissuasive effect which is created by the high publicity and high fines in competition law procedures should not be overlooked. In light of the fines and public attention seen as in the recent Microsoft case[169], it is doubtable whether the mere fact that a sanction is criminal really creates such a "greater dissuasive effect."

The second argument of the Commission for the introduction of criminal penalties is that it considers criminal investigation and prosecution to be more powerful than administrative action. In addition, it considers criminal procedures as a guarantee for impartiality of investigating authorities, because other authorities than those administrative authorities that have granted exploitation licences or authorisations to pollute will be involved in a criminal investigation. Regarding the latter, the Commission ignores the fact, that in most Member States it is not the administrative authorities granting a licence or giving an authorisation which will be involved in subsequent investigation procedures, but different authorities.[170] As to the assumption that criminal investigation is per se more powerful than administrative action, it should be noted that environmental law enforcement requires a great deal of expertise. In this area, administrative authorities often have more technical knowledge and information than traditional law enforcement authorities.[171] So, in addition to the limited capacity of police forces in most Member States, they mostly also lack this expertise. Moreover, the introduction of criminal sanctions in implementing legislation does not guarantee the effective application of these sanctions in question. In most Member States, the so-called

[169] Decision of the European Commission C(2008) 764 final of 27 February 2008.

[170] Faure, Michael, *supra,* note 163, page 22.

[171] Ibid.

opportunity principle is still valid and there is no duty to actually prosecute.[172]

Furthermore, administrative sanctions can be more differentiated than criminal penalties - the widespread use of complementary sanctions in the Member States is a sign that these sanctions are suitable in the protection of the environment. The introduction of criminal penalties could therefore deprive legal systems of their flexibility in environmental matters.

4.4.2 Culpability of Legal Persons

Against the background of the Commission`s view that criminal law is a "necessary instrument in the fight for an effective enforcement of the rules on maritime safety", the status of legal persons becomes quite an interesting question. The proposal for an amending Directive 2005/35/EC[173] stipulates that offences under the Directive should be punishable by "effective proportionate and dissuasive penalties, which have to be of a criminal nature for legal persons. Effective, proportionate and dissuasive penalties should also be applied to legal persons if they are considered liable [...]". However, the proposed Directive "leaves the Member States the choice of whether criminal penalties should also apply to legal persons." This is due to the fact that not all Member States know the concept of corporate criminal liability.[174] In order to prevent, these States having to make changes in their national criminal law systems, the Directive leaves the criminal liability of legal persons to the Member States.[175]

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172 Ibid.

173 COM (2008) 134 final.

174 See above under 4.1.

175 Confer the reasoning in COM (2001) 139 final.

There is a remarkable ambivalence in the Commission`s reasoning when it comes to the role of legal persons in the area of maritime safety. On one side, the Commission states that "only criminal penalties will provide a sufficiently dissuasive effect."[176] On the other side, it considers non-criminal sanctions for legal persons sufficient, as long as they are effective, proportionate and dissuasive.[177]

This shows that the Commission at least recognizes the possibility of effective non-criminal sanctions in maritime safety, even if it would prefer criminal sanctions. Most environmental crimes are committed by natural persons for the benefit of corporations.[178] The shipping industry is of course no exception to this. It is therefore obvious, that if sanction rules in maritime safety are supposed to be effective, one must put emphasis on the role of legal persons.

Unfortunately, the Commission with its focus on criminal law ignores the possibility of itself creating an effective sanction system for legal persons in maritime safety. In the current situation it is left with the Member States as to whether they want to sanction legal persons by criminal or non-criminal sanctions. Moreover, if they choose to apply non-criminal sanctions, they are completely free regarding the type and level of these sanctions. This can lead to considerable differences in the sanctioning of legal persons for infringements under the Directive 2005/35/EC. There is no guarantee at all that no "safe heavens" for legal persons committing offences under the Directive will be provided. If the Community instead introduced the same administrative measures or a certain level of fines for infringements in all Member States, it would send a

176 Ibid.

177 Faure, Michael, *supra,* note 163, page 23.

178 Faure, Michael and Heine Günther, *supra,* note 99, page 335.

much stronger signal to legal persons involved in the shipping industry.

4.4.3 The International Character of the Shipping Industry – Distortion of Competition

As seen above, the competition rules of the Community aim at avoiding distortion of competition as much as possible, in order to create a common market. The rationale is that if equal conditions of competition are achieved in the Member States, the market will do the rest to establish the common market.[179] Disparities in sanction levels constitute an objective difference in the conditions of competition between Member States. However, regarding sanction rules, it is very unlikely that the free play of market forces will lead to desirable results. As Member States normally do not want to place their own companies at disadvantage, they rather prefer to be too lenient than being too strict.[180]

The shipping industry is like no other industry, being characterised by its cross-border dimension. Different conditions regarding the shipping industry`s activities in the Member States are therefore very likely to have an immediate impact on competition. Especially in such an international industry, uneven enforcement of Community rules can easily lead to tensions and erosion of public confidence in the system.[181] Moreover, Member States could consciously keep their sanction levels low to profit from the so-called "Delaware Effect." The "Delaware effect" describes a situation in which sanction levels in different states vary to such an extent that it influences the decision of companies on where to establish

[179] Sevenster, Hannah, *supra,* note 142, page 54.

[180] Ibid.

[181] Palmer, Fiona, *supra,* note 126, page 66.

business or whether to transfer certain activities to another State.[182] By the adoption of a Community legal act providing for the same administrative sanctions throughout the Community, distortion of competition could be avoided.

4.4.4 Choice of Instruments

The proposal for an amending Directive 2005/35/EC states that the existing Directive 2005/35/EC must be brought in line with the Court ruling in Case C-440/05 (*the Marine Pollution case)*.[183] According to the proposal, a directive can only be amended by an amending directive.

Independent from this rule regarding amendments, there is no reason why a directive should not be supplemented by a regulation. Articles 80(2) and 175 EC enable the Community to adopt regulations both in the field of maritime transport and environment. Even if environmental law in the Community has traditionnally been in the form of Directives, there is no rule restricting Community environmental law to one legal instrument only. In theory, both a directive and a regulation providing for administrative sanctions in the field of maritime safety could be based on either Art. 80(2) or Art. 175 EC.

5 Conclusion

By adopting Directive 2005/35/EC and Framework Decision 2005/667/JHA, the Community first and foremost aimed at the protection of the seas against pollution by irresponsible actors of the shipping industry. Moreover, the Community aimed at implementing the International Convention for the Prevention of

[182] Ibid.

[183] COM (2008) 134 final.

Pollution from Ships (MARPOL), which stipulates in Article 4(4) that penalties have to be "adequate in severity to discourage" potential polluters.

The Community decided that criminal penalties constitute a necessary tool to ensure an effective enforcement of the rules on maritime safety. The annulment of Framework Decision 2005/667/JHA tore a hole in the European legislative package designed to achieve an equal protection of the marine environment all over the Community.

Concerning the question of whether the judgment in *Marine Pollution* rather weakened or strengthened the fight against pollution of the seas, no definite answer can be provided at this point of time. On one hand, the Community was awarded the authority to instruct the Member States to introduce criminal penalties for polluting acts, which means that it can also enforce this instruction with its full powers under the supranational first pillar. On the other hand, it is by no means certain that the Community will reach the qualified majority in the Council to adopt such a legislative act. And even more important, the judgment led to a loss of the provisions providing for an approximation of sanction levels for polluting acts in the Member States.

In the course of its efforts to fill this "legal vacuum created concerning a harmonised approach regarding possible penalties in the fight against maritime pollution"[184] the Commission decided in favour of a partial solution: it adopted a proposal for an amending Directive 2005/35/EC based on Article 80(2) EC, which contains an obligation of the Member States to regard infringements under the Directive as criminal offences. However, the types and levels of penalties to be adopted in order to sanction these offences are left with the Member States.

[184] Proposal for amending Directive 2005/35/EC, *supra,* note 63.

This approach is logical from the Commission`s viewpoint. As it is determined to adhere to the use of the criminal law in order to combat pollution, it fully utilises the Community`s competences in this sphere as set out by the Court in *Marine Pollution.* And since the Court ruled that the Community is not competent to decide on type and level of criminal sanctions, the Commission intends to leave the decision on sanctions with the Member States.

Moreover, the requirement to sanction infringements under Directive 2005/35/EC by criminal penalties does not include legal persons. So, regarding the most important actors in the shipping industry, there are no clear instructions at all regarding sanctions, apart from the rather abstract stipulation that they be "effective, proportionate and dissuasive." Considering the different attitudes of the Member States on maritime safety rules, it is very likely that sanction levels, and concerning legal persons even the legal nature of sanctions, will differ considerably within the Community. As a result of this, the Community`s aim of prevention of "safe heavens" for offenders can not be guaranteed, and due to the international character of the shipping industry, differences in sanction levels are very likely to distort competition.

However, the Court`s ruling that the Community must not decide on type and level of sanctions, only refers to criminal sanctions. When it comes to administrative sanctions on the contrary, the Community is free to regulate on both of these aspects.

Administrative penalties have proved to be an effective means of enforcement of Community law, especially in the field of competition law and in the agricultural sector. By the imposition of high fines and the use of publicity, administrative sanctions in competition law have achieved a strong deterrent effect. Community sanctions in the agricultural sector stand out by a broad diversity of sanctions, which allows for an appropriate answer to the respective breach of Community law. As could be seen, many of

the features of these sanction systems could be transferred to the field of maritime safety. The Community could utilise its experience with administrative penalties in competition law and the agricultural sector to promote the enforcement of Community rules on maritime safety.

It may be true, that criminal law generally constitutes the fiercest method of a legal system to prevent certain forms of behaviour. However, this does not mean that criminal law has to be the most effective means in any situation. Concerning ship-source pollution, a consistent system of administrative sanctions at Community level would certainly send a much stronger signal to potential offenders. All actors in the shipping industry would know that polluting offences result in the same consequences all over the Community. In addition, no Member State would be able to make itself more attractive to the shipping industry by applying more lenient rules than others.

If the Community really wants to ensure that penalties are "adequate in severity to discourage" potential polluters as stipulated by MARPOL, it should abandon its approach that only criminal law can be truly effective to prevent ship-source pollution. It should rather adopt a legislative act providing for administrative sanctions on Community level, entailing penalties of sufficient severity to have a deterrent effect on the shipping industry.

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Part VII
The Bunker Convention

International Convention on Civil Liability for Bunker Oil Pollution Damage

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1 Introduction

1.1 The subject and the objective of the paper

This thesis will primarily examine the International Convention on Civil Liability for Bunker Oil Damage – the Bunker Convention – that implements a liability and compensation regime for pollution damage caused by spills of oil carried as fuel in the ship's bunkers. Since the scope of this paper does not allow for an exhaustive presentation of the Convention, the following discussion will be limited to a three-fold objective.

Firstly, a presentation of the situation in place before the Bunker Convention comes into play is a necessary starting point to the understanding of the Convention itself. It will be thus important to recall the relevant legal instruments in place dealing with ship-source marine pollution, and to present the way national legislations have been dealing with bunker oil spills up until the entry into force of the Convention.

Secondly, the key characteristics of the Bunker Convention will be discussed and its practical consequences critically analysed.

Thirdly, the author will seek to determine whether the States Parties to the Bunker Convention can, in the implementation legislation, provide for additional measures other than those set out in the Convention itself. In other words, this paper intends to ascertain whether the Bunker Convention brings about minimum or maximum standards to be followed, allowing or not, depending on the case, the States Parties to create tougher rules at national level.

The Bunker Convention entered into force on 21 November 2008, more than six years after its adoption by the International Maritime Organization (IMO) in 23 March 2001.

To date, twenty six[1] countries have ratified the Convention, but it was Sierra Leone's accession on 21 November 2007 that guaranteed the meeting of the entry-into-force criteria,[2] at which point the combined gross tonnage of the ratifying states amounted 114,484,743 (15.86 % of the world's merchant shipping tonnage).[3]

1.2 Legal Sources

1.2.1 Conventions

The obvious primary source of law used for the preparation of this paper is the Bunker Convention as adopted by IMO in 2001.

Furthermore, because the Bunker Convention was modelled both on the Civil Liability Convention 1969/1992 (CLC Convention) and on the Convention on Liability and Compensation for Damage in connection with the Carriage of Hazardous and Noxious Substances by sea of 1996 (HNS Convention), these will also be important sources of law as their similarities and differences will be identified and analysed below.

Regarding the question of limitation of liability, the author will make use of the International Convention on Limitation of Liability

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1 As of 15 December 2008, Bahamas, Bulgaria, Cook Islands, Croatia, Cyprus, Denmark, Estonia, Germany, Greece, Hungary, Jamaica, Latvia, Liberia, Lithuania, Luxemburg, Marshall Islands, Norway, Poland, Samoa, Sierra Leone, Singapore, Slovenia, Spain, Tonga, United Kingdom, Vanatu.

The information is available at: http://www.imo.org/includes/blastDataOnly.asp/data_id%3D22499/status-x.xls (visited 15 December 2008).

2 Bunker Convention, Article 14(1). See also Griggs, Patrick, *"Obstacles to Uniformity of Maritime Law"* (2002), at 172, for the reason why the Bunker Convention's threshold was set so high.

3 As of 31 October 2008, the combined gross tonnage of the 22 Contracting States corresponded to 28.83% of the world's tonnage. The information is available at: <http://www.imo.org/> (visited 15 December 2008).

for Maritime Claims, 1976, and the Protocol of 1996 amending such convention.

1.2.2 National legislation

In Norway, domestic implementation of international conventions related to maritime law and shipping are included in the Norwegian Maritime Code. For that reason, this is an important source of law not only when it comes to understanding the national rules in place preceding the entry into force of the Bunker Convention, but also when it comes to ascertaining the national implementation of the Convention itself.

English law will be analysed in three situations. First, the rules applicable to bunker oil pollution from non-tankers preceding the entry into force of the Bunker Convention, which can be found in the Merchant Shipping Act of 1995, will be presented. Second, the rules on direct action will be discussed on the basis of the provisions of the Third Party (Rights against Insurers) Act of 1930. Third, the English implementation of the Bunker Convention will be ascertained on the basis of the Merchant Shipping (Oil Pollution) (Bunker Convention) Regulations 2006.

Regarding the U.S. legislation, the focus will be on the Oil Pollution Act of 1990 (OPA '90), in that a comparative analysis will be drawn between the provisions of this act and the provisions of the international liability and compensation conventions. Besides that, the OPA '90 regulates pollution damage caused by bunker oil spill in the U.S. territory, the reason for which it is indispensable for the elaboration of this paper.

1.2.3 Preparatory works

The Bunker Convention was adopted by the International Maritime Organization (IMO). It is thus not only appropriate but also necessary to consult and analyse the discussions undertaken at the

IMO's headquarters in London leading to the passing of the Convention. This will be ascertained through the reading of the reports of the 77th, 78th, 79th, 80th, 81st, 82nd, and 83rd sessions of the IMO's Legal Committee.

The Norwegian implementation of the Bunker Convention will be ascertained through a look at the preparatory works (Ot.prp nr. 77 (2006-2007)), which explain the background and propose changes to domestic law, in order to comply with the obligations undertaken with the ratification of the Convention.

1.2.4 Literature

The author consulted a number of books for the preparation of this paper, among which two deserve special mention: (a) "Compulsory Insurance and Compensation for Bunker Oil Pollution Damage" by Ling Zhu, dealing specifically with the Bunker Convention; and (b) "Shipping and the Environment" by Colin De la Rue and Charles Anderson, dealing with the various aspects of oil pollution as such.

Among the legal articles used, three have particularly been important sources of information since they specifically deal with the Bunker Convention: (a) "Liability and Compensation for Bunker Pollution" by Chao Wu; (b) "International Convention on Civil Liability for Bunker Oil Pollution Damage" by Patrick Griggs; and (c) "The Bunker Pollution Convention 2001: completing and harmonizing the liability regime for oil pollution from ships?" by Michael Tsimplis.

1.2.5 Courts decisions

Since the Bunker Convention has only recently come into force, it is obvious that no specific court decision on the subject can be found. However, since the Bunker Convention was modelled on the CLC Convention – and because court decisions help with the understanding of how the provisions of the Convention have been

interpreted by national courts – the author will discuss one court decision related to tanker oil pollution: the Swedish Supreme Court's ND 1983.1 SSC TSESIS.

In addition, two English cases will be discussed: the *"Aegean Sea case"* regarding the admissibility of limitation of liability for oil pollution claims under the International Convention on Limitation of Liability for Maritime Claims (LLMC 1976); and the *"Fanti case"* regarding the validity of the "pay-to-be-paid" clause in the light of The Third-Party (Rights against Insurers) Act of 1930.

1.3 The structure of the paper

In order to achieve the three-fold objective of this paper, it is worth starting with a overview of the legal framework in place, developed as a response to oil pollution incidents that have taken place over the years (Chapter 2). Additionally, the situation in place before the entry into force of the Bunker Convention will be discussed and three practical examples will be given (Chapter 3). Following this, the key features of the Bunker Convention will be critically analysed, which will also involve a comparison with the current liability regime applicable to oil pollution from tankers (Chapter 4). Further, closer attention will be drawn to possible additional measures to be taken by the ratifying States Parties when implementing the legislation at national level, namely: (a) whether or not the concept of strict liability can be extended to a wider range of persons than those charged with liability under the Convention (item 5.1); (b) whether or not compulsory insurance can be required of persons not originally required to take out insurance under the Convention (item 5.2); and (c) whether or not direct action can be permitted for any insurance that exists beyond the LLMC 1976 limits (item 5.3). Finally, the author will try to balance the advantages and disadvantages of the Bunker Convention in order to

ascertain whether this piece of legislation is destined for success or failure (Chapter 6).

2 Ship-Source Marine Pollution: Liability and Compensation Systems

2.1 Introduction

Before explaining the different national regimes dealing with bunker oil pollution prior to the adoption of the Bunker Convention, it seems useful to recall how the development of responses undertaken in order to prevent, minimise, or compensate for damage caused by oil pollution has progressed in the international scenario. This discussion is helpful for a better understanding of the context in which the Bunker Convention was conceived.

The development of responses undertaken in order to tackle the effects of ship-source marine pollution has invariably followed the occurrence of major marine disasters involving the spill of large quantities of oil in the marine environment – most of the time associated with tankers carrying oil as cargo - which explains why the Bunker Convention discussions were put aside until 1996.

It is worth noting that two different liability and compensation regimes for oil pollution damage were triggered following the occurrence of two marine disasters involving the spill of crude oil from tankers: the United States v. the Rest.[4]

[4] Gold, Edgar, *Liability and Compensation for Ship-Source Marine Pollution: The International System* (1999/2000), at 32.

In March 1967, the *Torrey Canyon*[5] ran aground off England spilling 120,000 tons of crude oil into the sea, that turned out to be the worst oil spill in history up to that time. This incident culminated in the adoption of the CLC Convention in 1969 and the Fund Convention in 1971 by the International Maritime Organization (IMO). In March 1989, a new oil pollution disaster took place when the oil tanker *Exxon Valdez*[6] ran aground in Alaska (U.S.) spilling approximately 40,000 tons of crude oil into the sea, causing serious environmental damage. The U.S.' response to the *Exxon Valdez* incident was the establishment of the Oil Pollution Act of 1990 (OPA '90).

Accordingly, in the present Chapter, the author will set out the liability and compensation systems conceived in order to cope with damages occurred in connection with the carriage of pollutant cargo substances. First, a short presentation of the IMO's fundamental role in addressing marine pollution problems will be given. In this context, of all the instruments put in place by the IMO, three deserve special attention: the already mentioned CLC Convention, which leads us to a discussion on the Fund Convention, and the HNS Convention. This presentation is a necessary starting point to the discussion that will be carried out under Chapter 4, not only because the Bunker Convention was modelled[7] on the CLC and the HNS Conventions, but also because

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5 Liberian registered tanker owned by a subsidiary of Union Oil Company, built in the U.S. in 1959 with a cargo capacity for 60,000 tons but later enlarged to 120,000 tons capacity.

6 American registered tanker owned by the Exxon Corporation, built in the U.S. and delivered in 1986, with a cargo capacity for 150,000 tons.

7 Two alternatives for an instrument on liability for damage caused by bunker oil spills were contemplated during the discussions leading to the adoption of the Bunker Convention: one alternative involved a free-standing convention and the second alternative involved a protocol to the CLC

all of them together complete the IMO's legal framework addressing ship-source marine pollution. And, second, the U.S.' Oil Pollution Act of 1990 and its main features will be analysed.

2.2 The International Maritime Organization and its Conventions

The International Maritime Organization (IMO), formerly known as Inter-Governmental Maritime Consultative Organization (IMCO), was established by the Convention on the Intergovernmental Maritime Consultative Organization adopted in 1948 and entered into force in 1958. The IMO is one of United Nations' specialized agencies, being responsible for improving maritime safety and preventing pollution from ships.

The *Torrey Canyon* incident in 1967 delineated once and for all the IMO's role as an active participant in the prevention, control and reduction of marine pollution. After an extraordinary session of the IMCO Council, requested by the Government of the United Kingdom, a plan was developed to tackle the disastrous conesquences of the *Torrey Canyon* incident.[8] Among other measures, in 1969, the IMO adopted two conventions as an immediate response to the accident: the International Convention Relating to Intervention on the High Seas in Cases of Oil Pollution Casualties (delimiting the coastal states' entitlement to take measures of intervention in cases of maritime accidents) and the International Convention on Civil Liability for Oil Pollution Damage (governing the strict liability of shipowners for oil pollution damage). Two

Convention. See IMO LEG 77/6/2, for advantages and disadvantages of each one of these alternatives.

[8] Mensah, Thomas, *Prevention of Marine Pollution: The Contribution of IMO* (2007), at 44.

years later, the Fund Convention was adopted, creating a second tier of compensation to the CLC Convention.

Gradually, the IMO developed a comprehensive set of measures, set out not only in the form of conventions, but also comprising resolutions, recommendations, guidelines, non-binding codes, all of which create the framework enabling oil pollution issues to be promptly addressed.

The nature of the measures designed by the IMO in order to address marine pollution issues is threefold: first, preventive measures (rules designed to avoid accidents causing pollution); second, measures to control or minimise the effects of oil pollution; and, third, measures dealing with liability and compensation for damage as a result of pollution.[9]

2.2.1 The International Convention on Civil Liability for Oil Pollution Damage (CLC Convention)

As already mentioned, the CLC Convention was designed as an immediate response to the *Torrey Canyon* disaster, and for that reason it deals with pollution caused by a certain type of oil carried on a certain type of vessel, as will be explained below. Up until then, liability schemes were, when in existence, regulated at national level. It became evident then that the national regulations available were not sufficient to enable the granting of adequate compensation to parties suffering damage caused by oil pollution. That, associated with the urge to adopt uniform regulations and procedures defining new standards of responsibility, led to the adoption of the CLC Convention in 1969 (which entered into force in June 1975).

[9] See Falkanger, T., Bull, H.J. & Brautaset, L., *Scandinavian maritime law: the Norwegian perspective* (2004), at 195, referring to rules both at national and international level, thus also applicable to the IMO's rules.

The occurrence of a new disaster in March 1978[10] caused the CLC Convention to be revised and modified through a Protocol of 1984. The limits of liability set out in the CLC Convention 1969 proved to be too low to provide adequate compensation for victims of major oil spills. For that reason, the 1984 Protocol established higher limitation amounts. Moreover, the adoption of the 1984 Protocol was an attempt to get the U.S. to ratify the Convention. The U.S. never ratified the 1984 Protocol, the main reason why its entry-into-force criteria could not be met.

In 1992, a new Protocol was adopted, this time not only changing the entry into force criteria,[11] but also widening both the functional and the geographical scope of application of the Convention. The 1992 Protocol came into force in May 1996.

Later, in October 2000, the limitation amounts were again increased by a decision of the IMO Legal Committee which came into force on 1 November 2003.

The CLC Convention has its functional scope of application restricted to damage caused by a certain type of oil carried by a certain type of vessel. The type of oil is defined to be any persistent hydrocarbon mineral oil, which includes crude oil, fuel oil, heavy diesel oil, lubricating oil,[12] whereas the type of ship is defined to be any vessel constructed or adapted to carry oil in bulk as cargo, provided that it is actually carrying oil in bulk as cargo and during any voyage following such carriage, unless it is proved that it has no

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10 The Liberian-registered tanker *Amoco Cadiz* ran aground off the coast of Brittany (France) releasing its entire cargo of 223,000 tons of crude oil and 4,000 tons of bunker fuel, and resulting in one of the largest oil spills ever recorded.

11 The entry-into-force requirement was changed by reducing from six to four the number of large tanker-owing countries needed for the Protocol to come into force.

12 CLC 1992, Article I (5).

residues of such carriage of oil in bulk aboard.[13] That basically means that the CLC Convention is directed to pollution from tankers, irrespective of whether the oil spilled was being carried in bulk as cargo or in the bunkers as fuel.

Concerning the geographical scope of application,[14] the CLC Convention shall be applied to pollution damage caused on the territory of a State Party, including its territorial sea and its exclusive economic zone, and to preventive measures[15] taken in order to prevent or minimise such damage. In other words, the CLC Convention will be applicable in so far as pollution damage has been suffered within these jurisdiction zones.

The key characteristics of the CLC Convention are: strict liability imposed on the registered owner of the ship coupled with limitation of liability, channelling of liability, compulsory insurance, and direct action against the insurer. Further details on these features will be elaborated below when a comparison will be drawn with the provisions of the Bunker Convention.

2.2.2 The International Convention on the Establishment of an International Fund for Compensation for Oil Pollution Damage (Fund Convention)

It is not possible to discuss the CLC Convention without referring to its supplementary Convention adopted in 1971 – the Fund Convention – which entered into force in 1978. The Fund Convention created a compensation, rather than a liability, regime, and represented a second tier of compensation.

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13 CLC 1992, Article I (1).

14 CLC 1992, Article II.

15 CLC 1992, Article I (7)

The Fund was established based on two main reasons. First, it was a common understanding that liability should not be borne exclusively by the shipowners alone but that it should also be spread to the cargo interest i.e. oil companies. In fact, payments of compensation under the Fund Convention are financed by contributions levied from entities in the Member States which receive more than 150,000 tons of crude or heavy fuel oil in a year after sea transport.[16] Second, it was necessary to secure compensation to those suffering from damage from oil pollution in cases where the CLC coverage was insufficient or even unobtainable.[17]

Following the CLC Convention revisions, the Fund Convention 1971 was also revised through protocols in 1984 (which never entered into force), and in 1992 (which entered into force in 1996). Additionally, as already mentioned above in relation to the CLC Convention, in October 2000 a decision by the IMO Legal Committee increased even more the limitation amounts in comparison to the amounts available under the 1992 Protocol.

The third tier of compensation was established in May 2003 (entered into force in March 2005) by the Supplementary Fund Protocol 2003, which increased significantly the amounts of compensation available in the States who opt to ratify it.

2.2.3 The International Convention on Liability and Compensation for Damage in connection with the Carriage of Hazardous and Noxious Substances by Sea, 1996 (HNS Convention)

The discussions pointing to the need for an international liability regime regulating damage resulting from carriage by sea of hazard-

[16] The International Oil Pollution Compensation Fund (IOPC) was established in 1978 to manage the compensation regime under the Fund Convention.

[17] Fund Convention 1971, Article 4.

ous substances emerged in parallel to the discussions leading to the CLC and Fund Conventions, but were not carried on at that instance. A first draft Convention returned to the IMO's agenda only in 1984, but it again did not succeed.[18] It was only on 3 May 1996 that the HNS Convention, one of IMO's liability and compensation conventions, was adopted with the intent to secure compensation to victims of incidents occurred in connection with the carriage by sea of hazardous and noxious substances. Twelve years after its adoption,[19] the entry-into-force criteria[20] have not yet been met, since only 11 states[21] representing 3.76% of the world's tonnage have so far ratified it.

It is important to mention that the HNS Convention, like the Bunker Convention, was modelled on the CLC Convention. However, as opposed to the Bunker Convention, the HNS Convention does depend upon a second tier compensation system, that being the reason why it was also modelled on the Fund Convention. This second tier of compensation is financed by contributions from the cargo interest, i.e. receivers of hazardous and noxious substances in

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18 Göransson, Magnus, *The HNS Convention* (1997), pp. 1-2.

19 It is outside the scope of this paper to discuss the reasons why, even after twelve years from its adoption, the HNS Convention has still not come into force. The subject was brought back into IMO's Legal Committee work programme, at its 80th session, when it was agreed that a Corresponding Group would prepare the ground for discussions regarding monitoring the implementation of the HNS Convention. See IMO LEG 80/10/2 and LEG 80/10/3.

20 HNS Convention, Article 46.

21 Angola, Cyprus, Lithuania, Morocco, Russia, Saint Kitts and Nevis, Samoa, Sierra Leone, Slovenia, Syrian Arab Republic, and Tonga. The information is available at: http://www.imo.org/includes/blastDataOnly.asp/data_id%3D22499/status-x.xls> (visited 11 August 2008).

the States Parties. The Fund will be liable when the compensation provided under the first tier is inadequate or unobtainable.[22]

The key characteristics of the HNS Convention follow the main features of the CLC Convention. The author will revert to these elements below, to the extent necessary, when drawing a comparison between the Bunker Convention, the CLC Convention and the HNS Convention.

2.3 The United States' regime: the Oil Pollution Act of 1990

Despite the efforts of the marine community to have the U.S. adher to the international liability and compensation regime created by the IMO, especially with the passing of the 1984 Protocols, the U.S. opted to take a unilateral approach by enacting the Oil Pollution Act on 18 August 1990 (OPA '90).[23]

Before the enactment of the OPA '90, the U.S., like some other countries, relied on its national legislation to regulate oil spill liability and compensation.[24] Limitation of liability related to oil pollution damage was also regulated by national law.[25] However, the regime in place was far from being adequate. For example, although the liability regime in place before the OPA '90 was to a great extent equivalent to the CLC requirements, it was only applicable to damages caused to the U.S. Government, but did not

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22 HNS Convention, Article 14(1).

23 See Kim, Inho, *A comparison between the international and US regimes regulating oil pollution liability and compensation* (2003), at 269-271, for the reasons behind the U.S.' decision to choose a different approach.

24 Consisted of 4 federal statutes: the Federal Water Pollution Act, the Outer Continental Shelf Lands Act, the Deepwater Port Act, and the Trans-Alaska Pipeline Authorization Act.

25 The Limitation of Shipowners' Liability Act of 1851.

cover liability to others damaged by pollution.[26] Ordinary claimants would still be required to prove the existence of fault on the part of the owner of the ship. Such a regime called for modifications which only came about following the *Exxon Valdez* incident.

The main differences between the international regime and the OPA '90 can be found in the two following subjects: first, the scope of the definition of pollution damage; and, second, the liability limits.[27] A further distinction is found in the subjects upon whom liability is imposed.

First, the scope of recoverable damages under the OPA '90 includes damage to natural resources and damage to real or personal property. It also includes economic losses associated with loss of natural resources, real property, or personal property, loss of subsistence use, loss of revenues which are recoverable by the federal or state governments, and damages for net costs of providing increased and additional public services connected to the spill.[28] It is necessary to bear in mind, however, that although the scope of recoverable damages under OPA '90 may be more far-reaching than the one provided by the CLC Convention, this does not mean that the final outcome will be necessarily different. As the definition of "pollution damage" provided by the CLC Convention gives only limited guidance on the types of claims that are recoverable,[29] the interpretation will be to a great extent left to the national courts applying the Convention, which will invariably lead to the same results intended to be achieved by the OPA '90.[30]

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26 Gold, Edgar, *supra*, note 4, at 34.

27 Kim, Inho, *supra,* note 23, at 266.

28 U.S. OPA '90, Section 1002(b).

29 De la Rue, Colin & Anderson, Charles, *Shipping and the Environment* (1998), at 84.

30 For example, the IOPC Fund policy admits claims for pure economic loss: loss of earnings caused by oil pollution suffered by persons whose property

Second, the OPA ’90 establishes considerably higher liability limits for the responsible parties, when compared to the limits provided by the CLC and Fund Conventions. In addition, these limits are relatively easily breachable.[31] In this context, it should be noted that the OPA ’90 does not preempt state legislation, allowing thus the individual states to implement their own liability laws,[32] which can provide for higher limitation amounts, or even provide for unlimited liability.

Third, another characteristic of the OPA ’90 is that it imposes strict liability not only on the shipowner but also on the operator and the demise charterer of the ship.[33] This characteristic is particularly interesting because, as we will see below, the Bunker Convention, following the U.S. example, also provides for strict liability for other parties than the registered owner of the ship.

Last but not least, it is necessary to point out that the liability and compensation regime established by the OPA ’90 regulates not only damage caused by oil pollution from tankers, as it is the case of the CLC Convention, but also covers damage caused by bunker oil pollution from any kind of sea going vessel.[34]

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has not been polluted, even though this has not been expressly mentioned in the definition of damage. This information is available at:

http://www.iopcfund.org/npdf/claimsman-en.pdf (visited 25 August 2008).

31 U.S. OPA ’90, Section 1004(c): liability is unlimited, for example, when the spill occurs due to gross negligence, wilful misconduct, or violation of any federal safety, construction, or operating or safety regulation.

32 Zimmermann, Jaclyn, *Inadequacies of the Oil Pollution Act of 1990: Why the United States should adopt the Convention on Civil Liability* (1999), at 1521.

33 U.S. OPA ’90, Section 1001(26).

34 See OPA ’90, Section 1001: “Definitions. […] (23) ‘‘oil’’ means oil of any kind or in any form, including petroleum, fuel oil, sludge, oil refuse, and oil mixed with wastes other than dredged spoil, but does not include any substance which is specifically listed or designated as a hazardous

3 The national systems dealing with bunker oil pollution

Prior to the discussion on the key characteristics of the Bunker Convention, which will be carried out under Chapter 4 below, one important question arises: how has liability and compensation for pollution caused by bunker oil spills been regulated before the adoption and entry into force of the Bunker Convention? The answer to that question is: such liability and compensation has been regulated, when regulated at all, on a non-uniform basis by different regimes in existence in the national legislation of different countries.

These regimes can be categorised as three different types: (a) the traditional jurisprudence; (b) the legislation extending some aspects of the CLC Convention to bunker spills; and (c) the legislation actually differing from the CLC Convention liability system.[35]

In the first situation, where traditional jurisprudence regulates liability and compensation in the event of damage caused by fuel oil spill in the absence of a legal provision doing so, liability is normally established on the basis of negligence. Liability can be established based on a blameful conduct of the shipowner, who may also be vicariously liable for the torts of his or her servants. Liability can also be established based on the fault of any other person whose acts or omissions caused the bunker oil spill.

Such a solution is obviously not satisfactory since it would not be reasonable to expect that victims with limited resources would have to prove that the spill of fuel oil resulted from someone's faulty

substance under subparagraphs (A) through (F) of section; 101(14) of the Comprehensive Environmental Response, Compensation, and Liability Act (42 U.S.C. 9601) and which is subject to the provisions of that Act; […] and; (37) "vessel" means every description of watercraft or other artificial contrivance used, or capable of being used, as a means of transportation on water, other than a public vessel."

35 De la Rue, Colin & Anderson, Charles, *supra,* note 29, pp. 267-268.

conduct. Besides that, questions like limitation of liability and jurisdiction are not properly regulated, leading to uncertainty as to the application of the law.

A sub-division of this first approach would include countries which have in fact enacted relevant legislation to regulate liability for bunker oil pollution damage but such liability is dependent on the existence of a negligent conduct by the shipowner. That is the situation in place in Australia: no compensation is to be paid if the shipowner is not at fault. Additionally, Australia has ratified the International Convention on Limitation of Liability for Maritime Claims 1976 (LLMC) and the 1996 Protocol,[36] and, in the event of fault, the shipowner will be able to limit his or her liability to the amounts prescribed in that convention. It is noteworthy that although Australia took a proactive position during the discussions leading to the adoption of the Bunker Convention, it has not to date ratified it. Nevertheless, works are in progress in order to establish the necessary regime to implement the Convention.[37]

Some countries decided to address bunker oil pollution matters by making use of the second approach mentioned above, i.e. extending the liability regime applicable to oil pollution from tankers, in accordance with the CLC Convention, to bunker oil pollution with the necessary adjustments. Such a solution was adopted by the Nordic countries, and it seems appropriate to analyse how this system works in practice. Norway is taken as the example.

Liability for damage from oil pollution is regulated under Chapter 10 of the Norwegian Maritime Code of 1994 (NMC) which

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[36] Australia's Limitation of Liability Act of 1989.

[37] See http://www.aph.gov.au/library/Pubs/bd/2007-08/08bd100.htm#Passage (visited on 14 July 2008) concerning the status of the Protection of the Sea (Civil Liability for Bunker Oil Pollution Damage) Bill 2008.

implements at national level the CLC and Fund Conventions rules, including provisions for i.a. strict liability of the registered owner of the ship and exemptions from liability,[38] limitation of liability,[39] insurance obligation,[40] and direct action against the insurer.[41] Such rules are initially intended to address liability for damage from oil pollution from tankers. However, tucked away in the second last section of Chapter 10 is a provision (Section 208) addressing pollution caused by oil escaping or being discharged from other ships than the ones mentioned in Section 191,[42] in that it extends the imposition of strict liability to damage caused by oil used or intended to be used for the operation or propulsion of the ship. It is important to point out though that the convention-based rules (channelling of liability, compulsory insurance and direct action) are not applicable to bunker oil pollution from non-tankers. In addition, the limits of liability are the ones provided in Chapter 9 of the NMC, commonly known as "global limitation", calculated in accordance to the LLMC 1976, as amended. The Norwegian implementation of the Bunker Convention will be carried out through an amendment to the Norwegian Maritime Code with the introduction of Sections 183 to 190.[43]

The solution is similar in the U.K., where the Merchant Shipping Act of 1995 imposes on the shipowner strict liability for damages

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38 NMC, Section 191 and 192.

39 NMC, Section 193.

40 NMC, Section 197.

41 NMC, Section 200.

42 NMC, Section 191, third paragraph: ''A ship which can carry oil and other cargo shall nevertheless in this context be regarded as a ship when it is in fact carrying oil as cargo in bulk, and during subsequent voyages unless it is shown that no residues of such oil remain on board".

43 See Ot.prp. nr. 77 (2006-2007)

caused by oil pollution from ships other than tankers,[44] which corresponds to the situations involving bunker oil pollution. Whereas the channelling provisions applicable to oil pollution from tankers are also extended to oil pollution from other vessels,[45] the limitation amounts,[46] the requirement for insurance,[47] and the right of direct action[48] are not. The English implementation[49] of the Bunker Convention will be carried out through an amendment to the Merchant Shipping Act 1995 by the Merchant Shipping (Oil Pollution) (Bunkers Convention) Regulations 2006 with the introduction of Section 153A.[50]

Finally, following the third category mentioned above, some countries opted to tackle bunker oil pollution issues by deviating from the rules adopted in the CLC Convention, creating a tougher liability and compensation regime than the one introduced by the international regime. The classic example of a country falling under this category is the United States which enacted the OPA '90, as discussed at length above.

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44 U.K.'s M.S.A. 1995, Section 154.

45 U.K.'s M.S.A. 1995, Section 156.

46 U.K.'s M.S.A. 1995, Section 157.

47 U.K.'s M.S.A. 1995, Section 163.

48 U.K.'s M.S.A. 1995, Section 165.

49 Following the European Union Council Decision 2002/726/EC which authorised the member States to sign, ratify or accede to the Bunker Convention.

50 See Tsimplis, Michael, *Marine pollution from shipping activities* (2008), at 123.

4 The Bunker Convention: Main elements

4.1 Legislative background

The CLC and the Fund Conventions have, for the past 30 years, been the core of the international system of liability and compensation for oil pollution from ships. However, their scope of application is restricted, not covering all types of pollution arising out of ships, such as spills of hazardous and noxious substances and bunker oil spills from vessels other than tankers. International regulation for pollution damage caused by incidents connected with the carriage of hazardous and noxious substances came about in 1996 with the adoption of the HNS Convention, although it has not yet come into force, as discussed above. In relation to pollution damage caused by fuel spill from ships other than tankers, the last gap is now being filled with the adoption and entry into force of the Bunker Convention.

The understanding that there was a need for a liability regime for bunker oil pollution dates back to 1969 at the time when the CLC Convention itself was being discussed.[51] During the discussions on the 1992 Protocol to the CLC Convention 1969, the idea was again debated. However, in order not to delay the good progress of the liability regime necessary to address the *Torrent Canyon* incident, bunker oil spills were intentionally left outside the scope of the CLC Convention.[52]

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[51] See Griggs, Patrick, *International Convention on Civil Liability for Bunker Oil Pollution Damage; 2001* (2001), at 1. See also Wu, Chao, *Liability and Compensation for Bunker Pollution* (2002), at 554, making reference to the IMO LEG/CONF/C.2/WP7.

[52] This information is available at: < http://www.imo.org/Newsroom/contents.asp?topic_id=67&doc_id=457> (visited 10 August 2008).

In contrast to what most might think, and although oil spills originating from tankers invariably catch media attention, it is a common misconception that most oil spills actually originate from tankers. Statistics and studies, in fact, indicate otherwise.[53] Besides that, many non-tankers have bunkers capacity in excess of some tankers, and bunker fuels are deemed to be more costly to deal with than many crude oil cargo.[54]

For example, in November 1997, the wood chip carrier *M/V Kure* had its fuel oil tank ruptured after colliding with a loading dock in Humboldt Bay, California, spilling several thousand gallons of bunker fuel. At the time, it was recorded as the most expensive oil spill in terms of dollars per barrel.[55]

The issue was thus brought back to the table by Australia in 1994 at the 38th session of the IMO's Marine Environment Protection Committee, which referred the question to the IMO Legal Committee. Following this, both during the 73rd and 74th sessions of the Legal Committee, the need for a system regulating compensation to those suffering damage from a pollution incident involving oil from the ship's bunkers was not only confirmed, but also given high priority. However, it was only on 23 March 2001 that the final text of the Bunker Convention was agreed, adopted and opened for signature.

4.2 Scope of application

Oil pollution is defined in the Bunker Convention as "loss or damage caused outside the ship by contamination resulting from the

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53 UK P&I Club Analysis of Major Claims, 1993, at 33: "It is also significant, however, that half the total number of pollution claims arose from incidents involving ships not carrying oil cargo."

54 See IMO LEG 78/5/1.

55 De la Rue, Colin & Anderson, Charles, *supra,* note 29, pp. 263-264.

escape or discharge of bunker oil from the ship" and "the costs of preventive measures and further loss or damage caused by preventive measures".[56]

Following this definition, it is in relation to their functional scope of application that the Bunker Convention and the CLC Convention notably differ. The Bunker Convention is designed to provide compensation for damage caused by incidents in connection with escape or discharge of bunker[57] oil from ships. As ship is defined[58] to be any seagoing vessel and seaborne craft, of any type whatsoever, it is the Bunker Convention itself that provides for the exclusions[59] to the definition, among which is the exclusion that the Bunker Convention shall not apply to pollution damage as defined in the CLC Convention. In other words, these two conventions are mutually exclusive. Other exclusions relate to warships, naval auxiliary or other ships owned or operated by the State, provided they are being used on non-commercial service.

The geographical scope of application[60] of the Bunker Convention covers pollution damage caused in the territory (including territorial sea) of a State Party, the exclusive economic zone of a State Party, and includes preventive measures, wherever taken, to prevent or minimise such damage. It follows from a comparison with the correspondent provision of the CLC Convention that their geographical scope of application is identical, although it should be noted that the introduction of the exclusive economic zone in the

56 Bunker Convention, Article 1(9).

57 Bunker Convention, Article 1(5).

58 Bunker Convention, Article 1(1).

59 Bunker Convention, Article 4.

60 Bunker Convention, Article 2.

scope of application of the CLC Convention was only achieved by the 1992 Protocol.[61]

A closer look at the functional and geographical scopes of application of the Bunker Convention in combination with the functional and geographical scopes of application of the CLC Convention leads us to the following conclusion: if bunker oil is spilled either from a laden tanker in a State that is not a party to any of the CLC Conventions or from an unladen tanker in a State that is party only to the CLC 1969 (and not to the 1992 Protocol), neither the CLC Convention nor the Bunker Convention will apply.

In relation to the first situation, where a laden tanker spills bunker oil in a State that has not ratified any of the CLC Conventions, but has ratified the Bunker Convention, none of the conventions will be applicable for two reasons. Obviously, the CLC Convention is not applicable because such State is not a Party to it. However, the Bunker Convention is not applicable, even though such State is a party to it, because the Bunker Convention itself excludes pollution damage as defined in the CLC Convention, whether or not compensation is payable under the CLC Convention.

In relation to the second situation, where an unladen tanker spills bunker oil in a State that has only ratified the CLC Convention 1969 (but not the 1992 Protocol), and has also ratified the Bunker Convention, none of the conventions will be applicable for the following reasons. The Bunker Convention is not applicable for the

[61] See also HNS Convention, Article 3(c): The geographical scope of application of the HNS Convention differs from the one provided by the CLC Convention and the Bunker Convention in that it also includes damage caused outside the territory of any State, including its territorial sea, whenever such damage has been caused by a substance carried on board a ship registered in a State Party or, in the case of an unregistered ship, on board a ship entitled to fly the flag of a State Party.

same reason explained in the previous paragraph. The CLC Convention 1969 is not applicable because the definition of ship thereof only comprises vessels actually carrying oil in bulk as cargo, which is the opposite situation of an unladen tanker.

Consequently, there is a gap that could have been left deliberately in order to encourage the States Parties to the CLC 1969 to become parties to the CLC 1992. [62]

But does that mean that the Bunker Convention will never apply to tankers, defined in the CLC Convention as a ship that is "constructed or adapted for the carriage of oil in bulk as cargo"? As seen above, the definition of ship was widened by the 1992 Protocol in order to include spills from tankers during "any voyage following such carriage unless it is proved that it has no residues of such carriage of oil in bulk aboard", i.e. tankers in ballast. This definition could be better illustrated with the following example: an oil-tanker departs from Norway to the U.S. carrying oil in bulk, it discharges the oil in the U.S., and returns to Norway in ballast. Up to that moment, if oil had been spilled on the voyage back to Norway, the CLC Convention 1992 would apply, unless it could be proved that there was no oil residue from the previous transport. But one could envisage a situation where this same tanker, after returning to Norway, is laid-up for a period of six months. After these six months, it starts on a new voyage to a port in order to load crude oil again, but before reaching that port, it runs aground, and bunker oil is spilled in the ocean. In this case, it appears that the CLC Convention will not be applicable because this new voyage cannot be considered a subsequent voyage following the carriage of oil from a previous transport. Consequently, the Bunker Convention

[62] Wu, Chao, *Liability and Compensation for Bunker Pollution* (2002), at 557.

can come into play, regulating thus liability and compensation for bunker oil spilled from a tanker.

Finally, it is important to draw attention to oil spills taking place during bunkering operations when there are two vessels involved: one supplying the bunkers and one receiving them. It is necessary thus to investigate from which vessel the spill originated. The vessel supplying the bunkers is usually a vessel falling under the definition provided by the CLC Convention (1969 or 1992). Consequently, if the spill originates from this type of vessel, and the damage was caused in a CLC state, then the CLC and the Fund Conventions will be applicable. On the other hand, if the spill originates from the vessel receiving the bunkers, which can be a cargo vessel or a fishing vessel for example, and the damage was caused in a State Party to the Bunker Convention, this Convention will apply. Lastly, it should be pointed out that irrespective of which of the parties will be subject to strict liability, depending on the two situations above, his or her right of recourse will not be prejudiced in relation to the other party whose blameful act resulted in the spill.[63]

One could envisage, for example, a hypothetical situation where the spill does not originate from either of these two vessels, but resulted from a rupture of the hose used for the bunker transfer. Which party should then be subject to strict liability? As pollution damage is defined as the loss or damage resulting from the escape or discharge *from the ship,*[64] one would have to investigate whether such hose would fall into the definition of ship provided by the Conventions. The definitions of ship under both Conventions have been provided above, and, strictly speaking, they do not seem to encompass such structures designed to convey liquid, in this case

[63] Zhu, Ling, *Compulsory Insurance and Compensation for Bunker Oil Pollution Damage* (2007), at 23.

[64] CLC Convention 1992, Article I (6), and Bunker Convention, Article 1(9).

fuel oil. Obviously, such a solution is far from satisfactory, and it seems that the hose conveying bunker oil from one ship to another should be considered an inextricable part of the ship: part of the ship's equipment. As discussed above, strict liability will be imposed on the owner of the vessel from which the spill originated. Following this same line of thinking, and because the hose should be considered as part of the ship's equipment, strict liability should be imposed on the owner of the hose. This will then determine which one of the Conventions will be applicable.

4.3 Key features

4.3.1 Strict liability

The general rule under tort law is that liability is based on the presence of fault. The main purpose of tort law is to provide compensation for harm, and such compensation can be obtained as long as a blameworthy conduct can be attributed to the tortfeasor, whose act or omission violates a duty of care, inflicting harm on the injured party. Strict liability is, as a starting point, an exception to the rule. The development of the strict liability concept is usually associated with the understanding that those engaged in dangerous activities should bear the risks arising out of such activities, simply because these are the persons economically benefiting from them.

In this context, strict liability was one of the novelties introduced to the shipping industry in 1969 with the advent of a new international liability and compensation regime, the CLC and Fund Conventions. It became obvious then that a liability and compensation system relying on the presence of fault was far from satisfactory to guarantee prompt and effective compensation to oil pollution victims. Strict liability has, since then, become the rule, and not an exception to the rule, when it comes to oil pollution

liability, and was equally maintained by the drafters of the Bunker Convention.[65]

Hence, tracking the corresponding concept in the CLC Convention, the Bunker Convention also provides that the shipowner is strictly liable for pollution damage caused by bunker oil spill from his or her ship. Here again, the shipowner will be liable regardless of fault, except when the incident is connected to certain exonerating circumstances:[66] (a) damage resulted from an act of war, hostilities, civil war, insurrection or natural phenomenon of an exceptional, inevitable and irresistible character; or (b) damage wholly caused by an act or omission done with the intent to cause damage by a third party; or (c) damage wholly caused by the negligence or other wrongful act of any government or other authority responsible for the maintenance of lights or other navigational aids in the exercise of that function.[67]

Although these exonerating circumstances were also modelled on the CLC Convention, one practical difference exists between the two systems. Under the international liability and compensation regime, the International Compensation Fund (IOPCF) will provide compensation when the injured party has been unable to obtain it "because no liability for damages arises under the 1992 Liability Convention".[68] This applies to all the defences mentioned above, with the exception of pollution damage resulting from an act of war,

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[65] Gauci, Gotthard, *Protection of the Marine Environment through the International Ship-Source Oil Pollution Compensation Regimes* (1999), at 30.

[66] Bunker Convention, Article 3(3).

[67] The HNS Convention, Article 7(2), provides the shipowner with an additional defence in case of failure of the shipper or any other person to furnish information concerning the hazardous and noxious nature of the substances shipped.

[68] Fund Convention 1992, Article 4(1)(a).

hostilities, civil war or insurrection.[69] In contrast, since the Bunker Convention does not rely on a second tier of compensation, the injured parties will have to seek compensation from other liable parties than the shipowner.

It is also important to draw attention to the fact that the second and the third exceptions to liability are accompanied by the word "wholly", while the first exception is not. This seems to indicate that the scope of applicability of the war exception is broader, it being enough that this is the dominant or closest cause of the damage.[70]

Moreover, it has been suggested that the war exception is rather undesirable, in that requiring the shipowner to subscribe for the relevant insurance cover would be more effective than requiring the injured party to recover damages from an entity engaged in belligerent actions.[71]

One contemporary question is whether "acts of terrorism" could be deemed to be an exonerating circumstance falling under one of the exceptions above. First of all, it should be investigated whether it could fall under the war exception. Because such exception is consistent with the exclusion clause from insurance covers against marine risks,[72] assistance can be sought in the relevant Marine Insurance legal theory, so an interpretation by analogy can be achieved. Accordingly, taking the Norwegian legislation as an example, it is noted that even before the expression "acts of terrorism" was included in the Norwegian Marine Insurance Plan

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69 Fund Convention 1992, Article 4(2)(a).

70 See Hoftvedt, Jannecke, *Bunkersoljekonvensjonen: En sammenligning med sjøloven § 208* (2002), pp. 30-31, for the possible interpretations of the expression "wholly caused".

71 Gauci, Gotthard, *supra*, note 65, at 32.

72 De la Rue, Colin & Anderson, Charles, *supra,* note 29, at 88, referring to the same exception but in relation to the CLC Convention.

(NMIP),[73] it has been considered either as part of the expression "war or war-like conditions", or as part of the term "sabotage", or as part of the expression "and the like".[74] Following that, and strictly speaking, it appears that the expression "act of war" provided by the Bunker Convention is not as far-reaching as the related expressions provided by the NMIP. However, the second exonerating circumstance (b) mentioned above seems to encompass damages resulting from terrorism, in that under an "act of terrorism" the damage can be deemed to have been caused by an act of a third party done with the intent to cause damage.[75]

Determining whether damage caused by terrorism would fall under the first or the second exonerating circumstance is only useful within the scope of the CLC Convention to the extent that the IOPF will provide compensation for claims connected to the second defence, but not to claims connected to the first. In the Bunker Convention, the discussion is merely academic.

The practical application of such exceptions can be better understood through a look at court decisions borrowed from tanker oil pollution cases within the scope of application of the CLC Convention, among which one specific decision of the Swedish Supreme Court can be mentioned. In ND 1983.1 SSC TSESIS, the Russian tanker *Tsesis* struck a rock which was incorrectly marked on the chart. In fact, the dangerous area had been discovered years before but the chart was never amended accordingly. The Swedish Supreme Court held that the chart as a "navigational aid" and such "navigational aid" was defective, allowing the owner to rely on the

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73 NMIP, Sections 2-8 and 2-9.

74 Wilhelmsen, Trine-Lise & Bull, Hans Jacob, *Handbook in Hull Insurance* (2007), pp. 96- 97.

75 See Tsimplis, Michael, *The Bunker Pollution Convention 2001: completing and harmonizing the liability regime for oil pollution from ships?* (2005), at 89, in relation to sabotage, which can be by analogy applied to terrorism.

third exception to liability in any claim for the cleanup costs of the spillage and any pollution claims.

4.3.2 Who is liable?

While the CLC Convention and the HNS Convention define shipowner solely as the "persons registered as the owner of the ship", the definition of shipowner under the Bunker Convention[76] is broader, also including the bareboat charterer, the manager and the operator of the ship.[77] Their liability is joint and several.[78]

A preliminary description of roles played by these liability subjects is advisable in order to introduce the discussion that will be carried out under 5.1 below.

The meaning of registered owner needs no further explanation since it is expressly given by the Bunker Convention.[79] The bareboat charterer is the person or persons hiring the vessel under a bareboat charter party, who takes possession of the vessel through the master and crew, taking over the functions of the shipowner in that he assumes not only the commercial but also the nautical management of the ship.[80]

The definitions of operator and manager are not provided in the Bunker Convention and are somewhat imprecise. It has been pointed out that reference to "manager or operator" already

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[76] Bunker Convention, Article 1(3).

[77] See IMO LEG 79/6/1: One of the reasons that such definition was favoured during the discussions leading to the adoption of the Bunker Convention is that it rests on a stronger precedent, in that it is based on Article 1(2) of the LLMC 1976. As we will see below, the LLMC is the recommended limitation regime to be followed by the States Parties to the Bunker Convention.

[78] Bunker Convention, Article 3(2).

[79] Bunker Convention, Article 1(4).

[80] See Falkanger, T., Bull, H.J. & Brautaset, L., *supra,* note 9, at 246.

appeared in the U.K. legislation[81] qualified by the expression "any person interested or in possession of a ship", although the 1976 Convention may not have intended to restrict the concept of "manager or operator" only to those who are either interested in or in possession of the ship.[82] One author[83] points out that the definition of operator can be found in the discussions leading to the CLC Convention 1969. As a result, the operator, who is presumably but not necessarily the shipowner, is the person who uses the ship in his own name and mans, equips and supplies it.

The imposition of liability on as many as four different parties may also lead to practical problems, such as: whether or not liability has to be shared by all the parties included in the definition of shipowner; in which way liability among the parties and their insurers is to be apportioned; and in which way the limits of liability and the test for the right of limitation are to be applied.[84]

There is no clear and definitive answer to any of these questions. It appears though that the question of apportionment of liability will only come into play on eventual recourse claims among the parties, since their liabilities are joint and several, which means that the claimants will be able to choose which one of the parties to sue.

One scholar[85] has drawn attention to another inconvenience related to the high number of persons that may be liable, and refers

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81 The U.K.'s Merchant Shipping (Liability of Ship Owners and Others) of 1958.

82 Gaskell, Nicholas, *Limitation of Shipowners' Liability: The New Law* (1986), at 29: "One can perhaps envisage a case where there are a group of companies one of which is the operator of the ship but does not charter her or own her, but otherwise arranges all matters connected with the management and operation of the ship."

83 Zhu, Ling, *supra,* note 63, at 139.

84 Wu, Chao, *supra* note 62, at 559.

85 Tsimplis, Michael, *supra,* note 75, at 89.

to an example: in situations where the damage is done partly by bunker oil and partly by hazardous and noxious (hns) substances, the other parties falling into the definition of shipowner, other than the registered owner of the ship, run the risk of paying compensation for damages caused by the hns substances.

4.3.3 Channelling of liability

The other novelty introduced by the CLC Conventions 69/92 – together with the imposition of strict liability on the registered owner of the ship – lies in the channelling of liability provision, according to which claims for compensation founded upon convention-based liability for oil pollution can only be made against a predetermined person, being the registered owner of the ship. Since then, such provision has been customarily found in oil pollution liability conventions, like the HNS Convention.

As a result, both the CLC Convention 1992 and the HNS Convention regulate that no claim for compensation for pollution damage may be made against certain persons[86] unless the damage resulted from their personal act or omission, committed with the intent to cause such damage, or recklessly and with knowledge that such damage would probably result.

[86] CLC 1992, Article 4 (4): "(a) the servants or agents of the owner or the members of the crew, (b) the pilot or any other person who, without being a member of the crew, performs services for the ship; (c) any charterer (howsoever described, including a bareboat charterer), manager or operator of the ship; (d) any person performing salvage operations with the consent of the owner or on the instructions of a competent public authority; (e) any person taking preventive measures; (f) all servants or agents of persons mentioned in subparagraphs (c), (d) and (e)".

The fact is that since the *Erika* incident[87] the channelling provisions have been "under attack".[88] The result is that the channelling of liability was not regulated under the Bunker Convention.[89]

The reason why the channelling mechanism was left outside the scope of the Bunker Convention lies in the fact that the Bunker Convention does not rely on a second-tier compensation system.[90] The Bunker Convention, as opposed to the CLC and to the HNS Conventions, is not supplemented by any international fund, meaning that compensation can only be obtained either from the liability subjects or from their insurers. The intention was thus to increase the claimants' possibilities of recovery.

But is it really so that imposing liability on as many as four parties, and at the same time not protecting certain persons from potential claims, will improve the situation of the claimants? The answer appears to be negative for two reasons. The first reason relates to the requirement for insurance from the registered owner of the ship coupled with the right of direct action against the insurer, which will be further developed below. Although it will be up to the claimant to decide against which of the liability subjects the claim is going to be directed, it appears correct to foresee that

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87 Maltese registered oil tanker that sank off the coast of France on 8th December 1999, after breaking in two in a heavy storm when entering the Bay of Biscay, causing 22,000 tons of oil to leak from its cargo tanks.

88 See Chao, Wu, *Liability and Compensation for Oil Pollution Damage: Some Current Threats to the International Convention System* (2003), at 105.

89 See IMO LEG 77/4/3. It comprises a submission by the U.S. to the IMO's Legal Committee and describes the U.S.' experience with channelling pollution liability to a small group, rather than channeling to a single party. The terminology adopted when referring to the imposition of strict liability to a small group of persons as a "channelling" provision does not seem helpful.

90 Zhu, Ling, *supra*, note 63, at 29.

most of the claims will be directed against the registered owner's insurer. The second reason relates to the limitation of liability regime applicable. Briefly, and provided that the LLMC 1976/1996 is the legal instrument in place regulating limitation of liability, it appears that the claimants will not be able to recover up to the prescribed limits from each one of the liability subjects. This will also be further explained below.

4.3.4 Limitation of liability

The right of the shipowner to limit his or her liability is a traditional principle of maritime law. Such a right was recognised long before the advent of the CLC Convention in 1969. Hence, the CLC Convention essentially confirmed the right of the shipowner to limit his or her liability to a pre-determined amount,[91] except when the incident resulted from his or her personal act or omission, committed with the intent to cause damage, or recklessly and with knowledge that such damage would probably result.[92] The novelty introduced by the CLC Convention was that pollution damage was no longer part of the ordinary system of limitation, but of a new one which provided for higher amounts.

Not surprisingly, following the CLC and the HNS Conventions, the commonly recognised principle was also embraced under the Bunker Convention, in that the shipowner (including the registered owner, the bareboat charterer, the manager and the operator) and his or her insurers, are all entitled to limit their liabilities.[93] However, while the CLC and the HNS Conventions introduce their own compensation limitation amounts,[94] the Bunker Convention

[91] CLC 1992, Article V (1).

[92] CLC 1992, Article V (2).

[93] Bunker Convention, Article 6.

[94] CLC 1992, Article V, and HNS Convention, Article 9.

makes express reference to existing law on limitation of liability, applicable either under national or international regimes.

During the discussions leading to the adoption of the Bunker Convention, the provision regulating limitation of liability gave rise to extensive debate over the alternatives available.[95] Some delegations were of the opinion that the Convention should contain its own limitations figures instead of referring to other instruments. Another option then contemplated would be to tie the limitation amounts to the CLC 1992, by reproducing its limitation of liability provision. However, the majority preferred linking the limitation amount to an instrument already in existence. At last, a consensus was achieved in that the shipowner would be entitled to limit his or her liability under any applicable regime, and this might involve referring to international conventions already regulating the relevant limitation, among which the LLMC 1976, and its 1996 Protocol, are examples.[96]

The result is that the limitation of liability was regulated in a fairly imprecise manner, leaving significant discretion to the States Parties as regards the amounts to be applicable to bunker oil pollution related claims. In any event, as an attempt to harmonise the application of the limitation amounts, the Bunker Convention was accompanied by a resolution which urges the States who have not yet ratified or acceded to the Protocol of 1996 to the International Convention on Limitation of Liability for Maritime Claims, 1976 (LLMC), to do so. The Protocol of 1996 increases the limits of liability in relation to the LLMC 1976.[97]

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[95] See IMO LEG 77/6/1 and LEG 78/11.

[96] Other international conventions regulating limitation of liability are the 1924 Limitation Convention and the 1957 International Convention Relating to the Limitation of Liability of Owners of Sea-Going Ships.

[97] As of 31 July 2008, 15 of the 22 States Parties to the Bunker Convention have already ratified or acceded to the Protocol of 1996 and they are:

Another problem arising out of the imprecise limitation of liability provision is that claims in connection to damage from bunker oil pollution are not specifically listed in the LLMC 1976 as one of the claims subject to limitation. This means that they will have to fall within one of the listed categories thereof. However, one could think of cases of bunker oil pollution falling outside the scope of the LLMC 1976, creating the very unsatisfactory consequence that the shipowner is left without the protection of the limitation of liability.

Before carrying on with a more detailed analysis of each one of the categories listed in the LLMC 1976,[98] it is important to make reference to the *Aegean Sea* case[99], in which the question as to what extent liabilities resulting from an oil spill would fall under the categories listed in the LLMC 1976 was considered by the English High Court. In this case, the court decided that the three types of claims arising from the oil spill incident would fall into the first category, since they were either in respect of "damage to property" or "consequential losses" resulting from the loss of the cargo.[100] However, the court made no specific distinction between other claims that could unfold and those three types of claims initially considered, and for that reason a closer look at the relevant provision of the LLMC 1976 is needed.

Bulgaria, Croatia, Cyprus, Germany, Jamaica, Latvia, Lithuania, Luxemburg, Marshall Islands, Norway, Samoa, Sierra Leone, Spain, Tonga and United Kingdom. Five of them (Bahamas, Estonia, Greece, Poland and Singapore) are parties to the LLMC 1976. Two of them (Iceland and Slovenia) have neither ratified the LLMC 1976 nor the 1996 Protocol.

The information is available at: <http://www.imo.org/includes/blastDataOnly.asp/data_id%3D22499/status-x.xls> (visited 11 August 2008).

98 LLMC 1976, Article 2(1).

99 *Aegean Sea Traders Corporation v. Respsol Petroleo S.A. and Another (The "Aegean Sea")* [1998] 2 Lloyd's Rep. 39.

100 De la Rue, Colin & Anderson, Charles, *supra,* note 29, at 271.

According to one author,[101] the claims usually arising in connection with a bunker oil spill incident are: clean up costs and other removal measures; property damage and consequential loss; pure economic loss; and restoration of damaged environment. Having that in mind, special attention should particularly be paid to the first, the fourth and the fifth categories explained below.

The first category of claims that are subject to limitation of liability includes "(a) claims in respect of loss of life or personal injury or loss of or damage to property (including damage to harbour works, basins and waterways and aids to navigation), occurring on board or in direct connection with the operation of the ship or with salvage operations, and consequential losses resulting therefrom". Considering that loss of life and personal injury are not relevant for claims connected to bunker oil spills, this category (a) covers all the claims in connection with property damage and financial loss as a consequence of damage to the property. It is noteworthy that pure economic loss[102] does not fall under this category and would have to be tested under the third category (c) explained below.

The second category of claims includes "(b) claims in respect of loss resulting from delay in the carriage by sea of cargo, passengers or their luggage". Considering that the definition of pollution damage under the Bunker Convention is restricted to loss (or damage) caused outside the ship by contamination, it appears that this category relating to loss from delay will not have significant impact on claims for bunker oil spills.

The third category of claims includes "(c) claims in respect of other loss resulting from infringement of rights other than

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[101] Wu, Chao, *supra,* note 62, at 563.

[102] For example, earnings lost by operators of hotels and restaurants when tourists avoid the polluted beaches.

contractual rights, occurring in direct connection with the operation of the ship or salvage operations". As mentioned above, claims for pure economic loss could fall under this category, since there is no requirement for the loss to be connected with damage to the property of the claimant. However, since the interpretation of the meaning of the expression "infringement of rights other than contractual rights" is somewhat vague - and the answer will have to be found in national legislation[103] - it may be the case that such claims are not subject to limitation under the LLMC 1976.[104]

The fourth category of claims includes "d) claims in respect of the raising, removal, destruction or the rendering harmless of a ship which is sunk, wrecked, stranded or abandoned, including anything that is or has been on board such ship". This category of claims covers clean-up costs and removal measures, provided the pollution arises from a ship that is sunk, wrecked, stranded, or abandoned. Attention should be drawn to the fact that the States Parties to the LLMC 1976 were conferred the right to make a reservation in order to exclude, at national level, such claims from the limitation amounts set out in the Convention.[105]

The fifth category of claims includes "(e) claims in respect of the removal, destruction or the rendering harmless of the cargo of the ship". First, it is not certain whether bunker oil under these circumstances could be defined as "cargo of the ship". The fact is

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[103] Zhu, Ling, *supra,* note 63, at 156.

[104] See De la Rue, Colin, & Anderson, Charles, *supra,* note 29, at 272: "Some countries with a civil law tradition allow recovery of pure economic loss only where the basis of liability is that the claimant's rights have been infringed. In these jurisdictions the effect of Art. 2.1(c) may be reasonably clear, but in common law jurisdictions a different approach to pure economic loss has been taken and the concept of "rights" being "infringed" is relatively unusual."

[105] LLMC 1976, Article 18.

that the Bunker Convention covers oil used, or intended to be used, for the operation and propulsion of the ship as fuel or lubrication. It has been pointed out that the distinction between cargo and bunkers lies in the demonstration of intention of use.[106] Following that, it appears to be correct to conclude that bunker fuel does not fall within the definition of "cargo of the ship". According to this understanding, claims relating to the removal of bunker oil from a vessel would not fall under this category (e). Second, even if one considers that bunker oil would fall within the definition of "cargo of the ship", another question arises. There may be an overlap between the expressions "cargo of the ship" and "anything that is or has been on board such ship" found in the previous category.[107] Considering that the same right of reservation mentioned in the previous paragraph was conferred to the States Parties in relation to claims falling under this category (e), a conflict may be created[108] in those States that incorporated one category, and excluded the other.[109]

The last category of claims listed in the LLMC 1976 that are subject to the limitation amounts includes "(f) claims of a person other than the person liable in respect of measures taken in order to avert or minimize loss for which the person liable may limit his liability in accordance with this Convention, and further loss caused by such measures". Similarly to the claims falling under the fourth

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106 Tsimplis, Michael, *supra,* note 75, at 86.

107 Griggs, P.J.S., Williams, R., & Farr, J., *Limitation of Liability for Maritime Claims* (2005), at 24.

108 See Chen, Xia, *Limitation of Liability for Maritime Claims* (1998), at 47.

109 Griggs, P.J.S., Williams, R., & Farr, J., *supra,* note 107: "But limitation is not available under (2)(1)(d) in the United Kingdom. It may therefore be that in the United Kingdom, claims in respect of cargo removal, qualify for limitation before the ship is sunk, wrecked, stranded or abandoned but not after that event has occurred."

category (d) above, clean-up costs and removal measures can also fall under this last category (f), provided that the measures were taken to avert or minimise losses for which the liable person may limit his liability, in accordance with the categories (a), (b) and (c). But because the claimants, in this situation, can only be "a person other than the person liable", the result is that the shipowner will not be able to submit his response costs for payment from the limitation fund. Clearly, this reduces the incentive to the shipowner to take prompt action as a response to an oil pollution incident.[110]

It is worth drawing attention to the fact that claims falling under the three last categories mentioned above ((d), (e) and (f)) are not subject to limitation when they relate to remuneration under a contract with the person liable.[111]

Furthermore, the Bunker Convention does not regulate in which way the limits of liability are to be applied, i.e. if the rights of the registered owner of the ship, the bareboat charterer, the manager and the operator are independent or joint. As briefly mentioned above, to the extent that the LLMC 1976/1996 is applicable, even if the claimants decided to sue all the parties, they would only be able to recover from all of them up to the prescribed limits. The explanation for that can be found in the LLMC 1976/1996 itself,[112] when it establishes that a fund constituted by one person shall be deemed constituted by all persons.[113]

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[110] Wu, Chao, *supra,* note 62, at 563: "Both the CLCs and the HNS Convention encourage the shipowner to take prompt action following a spill, by making clear that the costs and sacrifices incurred by the shipowner in preventing or minimising damage can be ranked as other admissible claims against the shipowner's own limitation fund."

[111] LLMC 1976, Article 2(2).

[112] LLMC 1976/1996, Article 11(3).

[113] Tsimplis, Michael, *supra,* note 75, at 93.

It should be also pointed out that the lack of a dedicated limitation regime equals the lack of a dedicated fund to exclusively cover bunker oil pollution claims. From the point of view of the victims, the absence of a dedicated fund is unsatisfactory since oil pollution claimants will have to compete with other claimants to see their demand satisfied. From the point of view of the shipowners, such a system is positive since they will not have to establish two different funds in the occurrence of an accident.

Finally, for the sake of completeness, if the limits provided by the 1996 Protocol are to be applied, the ceiling amount for claims other than loss of life or personal injury for ships with a tonnage not exceeding 2,000 tons is 1 million SDR.[114] For ships with a tonnage in excess of 2,000 tons, the following amounts are added: (a) 400 SDR, for each ton from 2,001 to 30,000; (b) 300 SDR, for each ton from 30,001 to 70,000; (c) 200 SDR, for each ton in excess of 70,000 tons.[115]

4.3.5 Compulsory insurance cover

The requirement for compulsory insurance was first introduced in the context of international conventions by the CLC Convention. Back in 1969, the CLC Convention imposed on the owner of a ship carrying more than 2,000 tons of oil in bulk as cargo an obligation to obtain insurance or other financial security to cover his or her liability for pollution damage under the Convention.[116] Years later, in 1996, the same concept was also adopted in the HNS Convention and has been of great importance in the development of

[114] Special Drawing Rights. Further information is available at: <http://www.imf.org/external/np/exr/facts/sdr.htm> (visited 11 August 2008).

[115] 1996 Protocol, Article 3(b).

[116] CLC 1969, Article VII (1).

liability conventions in the IMO.[117] The Bunker Convention, following its model Convention, establishes the same requirement for the owner of a ship with a gross tonnage of more than 1,000 tons.

First, it is important to point out that the need for insurance goes hand-in-hand with the imposition of strict liability, since strict liability would not serve its purpose if the shipowner was not financially able to satisfy the amounts of compensation claims resulting from damage caused by oil pollution.

Second, despite the fact that other persons than the registered owner are subject to strict liability, namely the bareboat charterer, the manager and operator of the ship, the requirement for subscribing for compulsory insurance is only imposed on the registered owner of the ship.

Third, attention should be drawn to the threshold figure of 1,000 gross tons, below which no obligation for compulsory insurance or financial security is imposed. In spite of efforts from countries such as the U.K., Australia and Canada to see vessels of 300 gross tons and above included in the compulsory insurance requirement, a compromise had to be made to guarantee the passing of the convention, leading thus to a relatively high threshold.[118]

Four, the insurance or financial security required to cover the owner's liability shall be subscribed to an amount equal to the limits of liability under the applicable limitation regime of the flag state or international regime, but not exceeding the limits provided by the LLMC, 1976, as amended.[119] The conclusion is that even if national legislation establishes higher amounts for limitation of liability than

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[117] Røsæg, Erik, *Compulsory Maritime Insurance* (2000), at 1.

[118] Fowler, Rodriguez, Kingmill, Flint, Gray, & Chalos, L.L.P., *The International Convention on Civil Liability for Bunker Oil Pollution Damage, 2001* (2005), at 5.

[119] Bunker Convention, Article 7(1).

the ones provided by the 1996 Protocol, the owner will only have to subscribe for insurance up to the amounts calculated in accordance with the 1996 Protocol.

Fifth, it should be noted that although the compulsory insurance is taken out for the benefit of bunker oil pollution claimants, the fact is that it will serve to protect other claimants as well, considering that such insurance cover will be arranged, in most of the cases, by the Protection and Indemnity insurers (P&I Clubs) which, in short, provide the shipowners with marine insurance against third party liability. The P&I Clubs' Rules will establish not only the scope of coverage for claims for oil pollution,[120] but also the limitation amounts applicable to such claims.[121]

Finally, the requirement for compulsory insurance leads to the requirement that a certificate attesting that insurance or financial security is in force is issued by the competent authority[122] and always carried on board.[123] The result is the creation of administrative burdens on the States Parties to the Convention, both as flag states and port states, related to the issuing and monitoring of such certificates.[124]

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120 See e.g. Gard's Rules and Statutes, Rules for ships, Part II, Rule 38.

121 See e.g. Gard's Rules and Statutes, Rules for ships, Part II, Rule 53, and Apendix III.

122 Bunker Convention, Article 7(2).

123 Bunker Convention, Article 7(5).

124 See Gard Circular No. 4/2008: Ships registered on a State Party need to obtain a certificate from that State only, and such certificate will be regarded as evidence of insurance when calling ports in the other States Parties. Ships registered in a State that is not party to the Bunker Convention must obtain a State issued certificate from a State Party to the Convention in order to be able to call any of its ports or terminals.

4.3.6 Direct action

In direct connection with the requirement for compulsory insurance is the right of the claimants to address any claim for compensation for pollution damage directly against the insurer or other person providing financial security for the registered owner's liability for pollution damage.[125] The right for direct action was inspired in the corresponding provision of the CLC Convention,[126] and it also includes the right of the defendant (insurer) to invoke the defences which the shipowner would be entitled to invoke (other than bankruptcy and winding up), including availing of the same limits of liability. Furthermore, the defendant will be able to avoid liability when pollution damage has resulted from the wilful misconduct of the shipowner.[127]

It is important to stress that even if the shipowner is not entitled to limit his or her liability, the insurer will be entitled to limit his liability to an amount equal to the amount of the insurance or other financial security required to be maintained. In practice, this means that direct action claims will be dependent on the amounts set out in national legislation, but never higher than the amounts provided by the LLMC 1976, as amended by the 1996 Protocol.

As seen above, before the adoption and entry into force of the Bunker Convention, liability and compensation for bunker oil spills were regulated under national law. Similarly, the right of direct action against the insurer for such claims would also be dependent on the regulation by domestic legislation. For the sake of illustration, two examples will be provided below.

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[125] Bunker Convention, Article 7(10).

[126] CLC 1969, Article VII (8).

[127] See Ot.prp. nr. 77 (2006-2007): The Norwegian *Justisdepartmentet* understands that although the Bunker Convention refers to the term shipowner, such exception is only applicable when related to the registered owner's willful misconduct.

In Norway, the right of direct action is regulated under the Norwegian Insurance Contract Act (ICA) 1989. The starting point is that third parties have the right to seek compensation directly from the insurer, and this rule applies to both voluntary and mandatory insurances.[128] However, in certain situations,[129] among which marine insurance is included, the injured party is entitled to take direct action against the insurer only if the carrier is insolvent, and also provided jurisdiction is established before a Norwegian court.[130] The relevant provisions are mandatory, i.e. cannot be derogated by the parties, meaning that the "pay-to-be-paid" clause,[131] in such circumstances, would not be upheld under Norwegian Law.[132]

Under English common law, the right of direct action is not well developed and is limited to the privity rule, according to which no person may enforce a contract to which he or she is not a party.[133] The Third-Party (Rights against Insurers) Act of 1930 addresses such a question and provides for the transfer of the insured's rights against the insurer to third-parties in the event of the insured becoming insolvent or in the event of winding up of the insured[134]. Third parties are thus conferred a "statutory subrogation".[135]

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128 ICA 1989, Sections 7-6 and 7-7.

129 ICA 1989, Section 1-3.

130 ICA 1989, Section 7-8.

131 Commonly found in the P&I Clubs' insurance contracts (See Gard Rules, 87), the "pay to be paid" clause establishes that in order for the insurer to be liable under the insurance contract, the insured has to first discharge his liability to the third parties.

132 Falkanger, T., Bull, H.J. & Brautaset, L., *supra,* note 9, at 537.

133 Merkin, Robert & Hjalmarsson, Johanna, *Compendium of Insurance Law* (2007), Chapter 5.

134 The 1930 Act, Article 1(1).

135 Zhu, Ling, *supra*, note 63, at 175.

However, in *the Fanti case*[136] the House of the Lords confirmed the understanding that the "pay to be paid" clause is not contrary to the 1930 Act and it must be obeyed to the letter. The result is that the 1930 Act cannot apply to P&I Clubs, which are not liable until the assured has made payment.

Hence, the provision of the Bunker Convention establishing the right of direct action against the shipowner's liability insurer is now broadening the scope of admissibility of bunker oil pollution claims in comparison to national regulations in place before the adoption of the Convention.

Lastly, it has been discussed above that although the compulsory insurance is taken out for the benefit of bunker oil pollution claimants, it will also serve to protect other claimants. It has also been mentioned that the lack of a dedicated fund to cover bunker oil pollution claims means that bunker oil pollution claimants and non-pollution claimants suffering damage from the same incident will have to compete in order to see their claims satisfied. A number of questions arise in this regard in connection with the right of direct action. Will non-pollution claimants have the right of direct action against the insurer? How are the different claims and the right of the insurer to limit his liability organised in practice?

Regarding the right of non-pollution claimants to address their claims directly against the insurer, the answer will have to be found under the relevant applicable national legislation. In the two examples above, under Norwegian and English laws, non-pollution claimants would not, as a starting point, benefit from the same rights conferred on bunker pollution claimants. A conflict is thus created, in that some of the claimants will be able to obtain compensation directly from the insurer, whereas others will have to

[136] *Firma C-Trade v. Newcastle Protection and Indemnity Association* [1990] 2 Lloyd' Rep 191, per Lord Goff of Chieveley.

seek compensation first from the shipowner, in accordance with the "pay-to-be-paid" clause. Considering that in many instances it may not be possible to determine in advance whether the limitation fund will be exceeded by the value of claims, another question arises: will the bunker pollution claimants have to wait until all the other claims are settled? The answer to this question can only be negative, and following the CLC and Fund Conventions examples, it would be reasonable to expect that the insurer would authorise limited payments on a provisional basis.[137]

4.3.7 Responder immunity

It is worth finalising this chapter by mentioning one provision that was not actually included in the Bunker Convention: the legal protection for persons taking measures to prevent or minimise pollution, such as salvors and clean up contractors, the so-called responder immunity. Such protection would serve to encourage prompt and effective response to oil pollution incidents, but was not agreed upon prior to the adoption of the Bunker Convention.

Despite that, the Bunker Convention was accompanied by a Resolution which urges the States to consider introducing, in their implementing legislation, a provision providing for the exemption of liability for those persons responding to a casualty and taking reasonable measures to prevent or minimize the effects of the oil pollution, except when this resulted from their personal act or omission, committed with the intent to cause damage, or recklessly and with knowledge that such damage would probably result. To the States that have already adapted their legislation providing for such protection in the cases of oil pollution from tankers under the

[137] See Gaskell, Nicholas, *Pollution, Limitation and Carriage in The Aegean Sea* (2000): In the Aegean Sea case, admissible claims have been paid on a 40% basis, in case the overall claims exceeded the Fund's limits.

CLC Convention, it will just be a matter of extending such protection to the cases of pollution falling under the scope of application of the Bunker Convention. That was exactly what has been done by Norway and the U.K., as we will see under 5.1. below.

It has been suggested that such a compromise is rather unsatisfactory, since the States Parties will in fact be fulfilling their commitments under the Bunker Convention even if they do not comply with the Resolution.[138]

5 Additional measures that could be added in the implementing legislation

The focus of the discussion below will be on the national implementation of the Bunker Convention, on the basis that the author will try to ascertain whether additional measures can be added when national law is adopted or modified by the States Parties, in order to ensure the compliance of the obligations undertaken with the ratification of the Convention.

6 Strict liability for a wider range of persons

The first question that arises is whether or not the Bunker Convention restricts the freedom of the States Parties to implement domestic rules extending the imposition of strict liability to others than the registered owner, the bareboat charterer, the manager and the operator.

Two main arguments are available in order to provide an answer to the proposed question.

On one hand, the Bunker Convention, by comparison with the CLC and HNS Conventions, took a step further, in that it adopted

[138] Tsimplis, Michael, *supra,* note 75, at 90.

the same approach embodied under the OPA '90, imposing strict liability not only on the registered owner of the vessel, but also on the bareboat charterer, the manager and the operator of the ship. As a brief explanation about the roles of these persons was already provided under 4.3.2 supra, it is now time to point out that the common denominator among these four subjects is the fact that their activities are closely connected with the operation of the ship, in the same way as bunker pollution is directly linked to the operation of the ship.[139] In fact, during the discussions leading to the adoption of the Bunker Convention, it has been pointed out that "both options in respect of the definition of "shipowner" have been drafted so that the person *having effective control of the vessel* will be responsible for ensuring that the appropriate obligations of the Convention are met" (emphasis added).[140] It goes without saying that those are the individuals in the best position to guard against bunker oil spills.

On the other hand, the Bunker Convention, as opposed to the CLC and HNS Conventions, does not include a provision preventing claims for bunker oil pollution to be brought against certain specified persons. In other words, compensation can be obtained from other potentially liable parties, which means that third parties are in principle not exempted from liability in case their actions or activities have led to bunker oil spill.

The answer to the proposed question may not seem clear. However, taking these two arguments into consideration, it appears that the States Parties are free to extend strict liability to other persons than the ones mentioned in Article 1(3) of the Bunker Convention, and here is why. Although the drafters of the Bunker Convention might have intended to impose strict liability only on

[139] See IMO LEG 77/6/1.

[140] *Ibid.*

those parties who are really able to control and prevent bunker oil spills, the lack of a provision protecting other parties from liability should be understood as a silence, and as such it does not prevent national legislators either excluding liability of some parties or deciding that others can be made liable.

A question of a different nature relates to whether it is fair and reasonable to legislate differently, and, in this context, it appears to be correct to state that the imposition of strict liability on parties that are not closely involved in the operation of the ship cannot be considered reasonable. As an example, we can mention the particular condition of the cargo owners, who, although not made strictly liable under the CLC Convention, bear part of the costs related to compensation for oil pollution, to the extent that they contribute to the formation of the international compensation funds. The CLC and the Fund Convention relate, as seen, to oil pollution caused by ships carrying oil in bulk, meaning that, under these conventions, the nature of the cargo justifies the cargo owners bearing part of the burdens caused by oil pollution. In addition, such cargo owners also benefit from the "dangerous" activity carried out by the shipowner. The same reasoning is not valid for cargo owners when it comes to fuel oil pollution under the Bunker Convention.

The Norwegian implementation of the Bunker Convention seems to be in consonance with the conclusion above. First, it includes in the already known definition of shipowner as provided by the Bunker Convention *all other parties engaged on key activities connected to the operation of the ship.*[141] Additionally, it extends the

[141] See Ot.prp. nr. 77 (2006-2007) which refers to a submission from *Den Norske Advokatforening,* pointing out that the definition of manager is somewhat unclear under Norwegian law, even though such term is referred to in Section 171 of the NMC, which is based on the relevant provision of the LLMC 76/96. Accordingly, more important than the literal

channelling of liability provision contained in Section 193 of the Norwegian Maritime Code to the situations involving bunker oil pollution, so as to avoid claims being brought against the persons named under that section, with the exception of the bareboat charterer, the manager and the operator of the ship.[142]

Apparently, Norway has gone further than it was allowed to under the Bunker Convention, as it exempted from liability exposure other parties than the so-called "responders", as recommended in the Resolution on protection for persons taking measures to prevent or minimise the effect of oil pollution. Hence, the channelling of liability not originally provided for under the Bunker Convention will be operative in Norway, and claims for bunker oil pollution shall not be directed against the parties listed in NMC §193, with the exception of the bareboat charterer, the manager and the operator of the ship.[143]

7 Compulsory liability insurance for persons not required to take out insurance

The second question that arises is whether or not the Bunker Convention restricts the freedom of the States Parties to implement domestic rules extending the insurance requirement to other

interpretation of the definitions of the persons who fall under the definition of shipowner, is the fact that their activities are closely connected with the operation of the ship.

142 See Ot.prp. nr. 77 (2006-2007), NMC, new Section 185.

143 See Tsimplis, Michael, *supra,* note 50, at 125: The U.K. implementation of the Bunker Convention also excludes from liability a number of parties (see new Section 156(2B) introduced by the Merchant Shipping (Oil Pollution) (Bunkers Convention) Regulations 2006), and according to Tsimplis: "This is arguably an improvement on the 2001 BOPC and, strictly speaking, is not against the implementation on the 2001 BOPC as the Convention is silent on the liability of these parties".

persons than the registered owner of the ship, taking into consideration that the relevant provision of the Convention does not extend such requirement to anyone else, not even to those who have been charged with strict liability, namely the bareboat charterer, the manager and the operator.

Introductorily, an understanding of the rationale for compulsory insurance is advisable. First, the requirement for insurance is intended to guarantee that victims of oil pollution will be able to obtain compensation even if the shipowner becomes insolvent. Second, the right for direct action, associated with the requirement for compulsory insurance, facilitates the accessibility problem, in that claimants will not have to seek compensation in remote jurisdictions, running the subsequent risk of not finding there assets to cover the claim. Third, the requirement for insurance is believed to improve the insurance industry's regulation with respect to safety standards on board, as a way of minimising risks. Finally, competition aspects will be regulated to the extent that irresponsible shipowners will not be able to escape the costs for subscribing for insurance.[144]

During the discussions leading to the adoption of the Bunker Convention, the Japanese delegation proposed an alternative text to the relevant draft provision regulating compulsory insurance, according to which the insurance requirement would be extended to the other parties falling into the definition of shipowner. In response, some delegations argued that the situation of the claimants would not be improved by requiring separate insurance cover for other parties, while other delegations expressed their concern about the practical difficulties[145] that would arise out of

[144] Røsæg, Erik, *supra*, note 117, pp. 3-4.

[145] See Zhu, Ling, *supra,* note 63, at 139, *in fine*: One of the practical difficulties related to broadening the insurance requirement seems to be the

such proposal. The proposal was thus rejected and the original draft provision, which required insurance only for the registered owner, was maintained.[146]

It seems that the Bunker Convention had the categorical intention to make a distinction between the term "shipowner" applied in the rule providing for strict liability, and the term "registered owner of the ship" applied in the rule providing for compulsory insurance.[147]

Following that, it appears to be correct to conclude that the Bunker Convention did not intend to leave the question of compulsory insurance to the discretion of the States Parties. Hence, the answer to the proposed question is that the States Parties are not free to legislate differently, and to extend the insurance requirement to other parties than the shipowner.

A question of another nature (rather than whether it is allowed or not) is whether requiring separate insurance cover from other parties than the registered owner would be advisable, or even necessary, from a practical point of view.

First of all, as one author rightly emphasised: "The reason why still only one person has to maintain insurance is simply that nothing is added if the same liability is insured several times".[148] Second, it has been already signalled by the insurance market (P&I Clubs) the difficulties of extending the same coverage for parties

fact that imposing compulsory insurance on a plurality of parties would increase even more the administrative burdens associated with the issuing and monitoring of certificates placed on the State Parties.

146 See IMO LEG 81/4.

147 See IMO LEG 81/4: "It was suggested that the provisions in these articles might be viewed as a package which could provide a practical and workable way forward, given that the Committee had accepted the present definition of "shipowner" contained in article 1(3)".

148 Røsæg, Erik, *supra*, note 117, at 12.

which are not members of the Clubs.[149] That is due to the key characteristic of P&I Clubs, the mutuality, which can be defined as the sharing of liability between the members of the Club on a non-profit basis, meaning that they all share the interests and risks with one another in the Club.[150] Lastly, another inconvenience that could stem from the requirement for insurance for a plurality of parties would be the practical difficulty of apportioning liability between the parties' insurers, what would possibly lead not only to delays in taking response measures, but also to delays in the final settlement of claims.[151]

In any event, the fact that the bareboat charterer, the manager and the operator are not obliged to take up insurance does not necessarily mean that they are not going to do so, especially considering that they can be held jointly and severally liable together with the registered owner. If they do it, it will be on a voluntarily basis. In this context, mention should be made of the relevant provision of the Bunker Convention relating to the right of recourse of the shipowner against other liable parties.[152] The mentioned provision regulating the right of recourse and the provision regulating the parties' several and joint liability are inextricably linked.[153] Accordingly, the right to seek recovery among the parties listed in the definition of "shipowner" is maintained independently of the Bunker Convention.

Both the Norwegian and the English implementation of the Bunker Convention fall into line with the conclusion reached

149 *Ibid.*

150 Zhu, Ling, *supra*, note 63, at 128.

151 See IMO LEG 81/4/2.

152 Bunker Convention, Article 3(6).

153 See IMO LEG 81/11.

above, in that the requirement of compulsory insurance was only imposed on the registered owner of the ship.[154]

8 Direct action for insurance beyond the LLMC 1976 limits

The third question that arises is whether or not the Bunker Convention restricts the freedom of the States Parties to implement domestic rules extending the right of direct action for claims connected to insurance that exists beyond the LLMC 1996 limits.

The proposed question could be illustrated by way of the following example: Country A ratifies the Bunker Convention but is neither a party to the LLMC 1976 nor to the 1996 Protocol, applying thus to claims for bunker oil pollution the limits of liability set out in its own national legislation, which comprises higher amounts than the ones established in the mentioned international instruments. Could country A then implement the Bunker Convention modifying its original text, and conferring the right of direct action also for insurances existing beyond the LLMC 1976 (as amended) limits?

The starting point to the discussion should be the interpretation of the Bunker Convention's provisions *per se*, i.e. as to whether the text of the Convention leaves some discretionary power to the States Parties in respect of providing for such "extra" direct action. Or, in contrast, as to whether it restricts the freedom of national law to provide for it, by establishing a maximum limit for the

[154] See Norwegian Ot.prp. nr. 77(2006-2007), Norwegian Maritime Code, new Section 186. See also English Statutory Instrument 2006 no. 1244, The Merchant Shipping (Oil Pollution) (Bunker Convention) Regulations 2006, Regulation 17 which inserts new Section 163A to the Merchant Shipping Act 1995.

admissibility of direct action claims, upon which the States Parties are not free to regulate.

It follows from the Bunker Convention that the right for direct action is available whenever the shipowner has taken out liability insurance, whether it is compulsory or not. And although the limits of the compulsory insurance shall not exceed the amounts calculated in accordance with the 1996 Protocol, the shipowner can in theory still be found liable for larger amounts, for example in countries with unlimited liability or in countries where the national law regulating limitation of liability sets out higher limits than the 1996 Protocol. The result in these cases is that the insurer, in its internal relationship with the shipowner, will not be relieved from its obligation to indemnify the shipowner who has paid out compensation for larger amounts. However, with respect to the insurer's relationship with third parties suffering damage from bunker oil pollution, the situation appears to be different.

It seems clear that the Bunker Convention categorically intended to limit the right of direct action to the amounts of the compulsory insurance. "The insurer has the unequivocal right to cap the exposure in relation to direct action claims to the applicable LLMC limits…"[155] However, in two instances, the insurer's exposure to direct action may be subject to higher limitation amounts.

Because the ceiling for both the right of direct action and for the requirement for compulsory insurance is found in the provisions of the LLMC 1976/1996, a closer look at this convention is advisable. It follows from article 6 of the 1996 Protocol that the States Parties can reserve the right to exclude the application of the limits of liability set out in article 6 of the LLMC 1976 (as amended by article 3 of the 1996 Protocol) in three different cases, among which

[155] Røsæg, Erik & Ringbom, Henrik, *Liability and compensation with regard to places of refuge* (2004), at 22.

are: "claims in respect of the raising, removal, destruction or the rendering harmless of a ship which sunk, wrecked, stranded or abandoned, including anything that is or has been on board such ships"[156] and "claims in respect of removal, destruction or rendering harmless of the cargo of the ship".[157] These two situations can well be applicable to bunker-fuel pollution, for example, removal of bunker-fuel from a grounded vessel and the cleaning-up of oil spills on beaches after a ship has sunk.

On the basis of a combined analysis of the above provisions of the LLMC 1976/1996 with the provisions of the Bunker Convention relating to direct action and to compulsory insurance, the following conclusion appears to be valid: a State Party to the Bunker Convention is free to implement domestic legislation extending the right of direct action for insurances existing beyond the LLMC 1979/1996 limits, but only in relation to those claims for which the LLMC 1976/1996 itself establishes the right of the States Parties to exclude limitation of liability, and only if such right of reservation has been exercised.

As an example, Norway, as a State Party to the 1996 Protocol, has taken such reservation and has established, for such claims, higher limitations amounts.[158] According to the reasoning above, Norway would thus be free to extend direct action for these types of claim to amounts beyond the LLMC 1976/1996 limits, and that was actually done in the implementation of the Bunker Convention under the Norwegian Maritime Code.[159]

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156 LLMC 1976, Article 1(d).

157 LLMC 1976, Article 1(e).

158 Norwegian Maritime Code, Sections 172 and 175a.

159 Ot.prp. nr. 77 (2006-2007): Norwegian Maritime Code, new Section 188, 3rd paragraph.

9 Conclusion

The adoption of the Bunker Convention under the auspices of the IMO represents the latest gap-filling international measure addressing ship-source marine pollution. The Convention's entry into force in November 2008 undoubtedly indicates that a continually increasingly environment-conscious world is taking the necessary steps towards the protection of the marine environment. Despite such efforts, the fact cannot be ignored that some aspects of the Convention fail to address relevant issues (or rather address them in a non-comprehensive way), raising a number of questions regarding its practical interpretation and application.

First, although the imposition of strict liability on as many as four parties (combined with the lack of a corresponding channelling provision exempting other potentially liable parties from liability) arguably increases the possibilities of recovery of compensation for victims, it may also lead to practical problems relating to the sharing and apportionment of liability among the parties and their insurers.

Second, the imprecision of the provision establishing the applicable limitation of liability regime to bunker oil pollution claims will inevitably cause uncertainty as to which limitation amounts are actually going to be followed, to the extent that the States Parties are somehow free to set out their own national legislation regulating the subject. In addition, even if we assume that the States Parties will follow the recommendation to accede to the 1996 Protocol, it is uncertain whether all types of claims for bunker oil pollution will be subject to the limits set out thereof.

Moreover, still with regard to the provision regulating limitation of liability, it is noted that the lack of a dedicated fund will mean that bunker pollution claims will compete with other claims subject to limitation of liability under the relevant limitation regime. As a result, there is a greater chance that the limits provided in the

relevant legislation are not sufficient to meet the totality of all claims.

Four, the conclusions drawn in Chapter 5 of this thesis, i.e. that additional measures can be included in the national law implementing the Bunker Convention, conflict with the ideal of reaching uniformity in international private maritime law.

Shipping is an international industry, most of its quests rapidly assume a global dimension, and for that reason it should ideally be regulated not only on an international but mainly on a uniform basis. Uniformity is desirable in order to promote certainty regarding the application of law in the multiple States that interact in the maritime law environment. Uniformity is achieved not only by ensuring that the conventions are implemented at national level without any changes to the text, but also by seeing to it that their interpretation will not vary from country to country.

Hence, it is arguably the case that the compromises undertaken in order to achieve a consensus during the drafting and adoption of the Bunker Convention will put in jeopardy the Convention's stated desire to "adopt uniform international rules and procedures for determining questions of liability and providing adequate compensation"[160] for damage caused by pollution resulting from the escape or discharge of bunker oil from ships.

Lastly, despite the fact that the author opted to highlight the downsides of the Bunker Convention in the present conclusion, it is important to set the records straight: it is better to have a rather incomplete system regulating liability and compensation for bunker oil spills, based on strict liability coupled with compulsory insurance and direct action, than being unable to rely on any at all. It remains to be seen how the individual states – and their Courts – will fill in the blanks left by the Bunker Convention. And these blanks will

[160] Bunker Convention, Preamble.

certainly have to be filled in, in order to enable the Bunker Convention to achieve its main purpose, which is to "ensure the payment of adequate, prompt and effective compensation for damage caused by pollution resulting from the escape or discharge of bunker oil from ships".[161]

[161] Bunker Convention, Preamble.

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Part VIII
Local content requirements in the Brazilian upstream oil industry[1]

With focus on Concession Agreements

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[1] This article is based on the thesis the author wrote in connection with the fulfillment of the Master of Laws in Maritime Law at the Scandinavian Institute of Maritime Law. The thesis was written under the supervision of Ola Mestad.

1 Introduction

1.1 The recent debate

As oil related companies operate throughout the world, they are consistently exposed to the policies of foreign governments. One such policy that directly affects their operations and that has become a vital aspect of doing business in a number of oil producing countries is the Local Content Rule, which requires oil companies to procure certain amounts of labour, goods and services from suppliers in the host country.

Interest in local content is being driven by a number of converging factors. With more attention being paid to issues such as sustainability and transparency in the oil and gas sector, host countries are now taking seriously the need to adjust their relationship with international companies so as to transfer the benefits of those resources to their citizens.[2]

Over the last years, Brazil[3] and a number of other countries have taken a proactive approach in this respect. Some states have required oil companies to give greater preference to national suppliers who can compete internationally in terms of costs, quality and schedule. This policy is commonly delivered through the negotiated terms of host country agreements between oil companies and government, and manifests as, *inter alia,* requirements for joint ventures between foreign and national sub-contractors and lower

[2] Menas Associate - British Consulting Company with focus on Local Content. See: www.menas.co.uk

[3] Brazil, an oil producer since the beginning of the 1930s, reached self-sufficiency in 2006 but is still not a member of the Organization of Petroleum Exporting Countries (OPEC).

pre-qualification and tender appraisal criteria than applied otherwise.

Obligations to acquire minimum amounts of labour, goods and services locally have also been used by some host governments. Such a policy is often set out in the country's Petroleum Law and implemented in the Concession/Production Sharing Agreements entered into between governments and oil companies.

In short, some countries require that local content be "maximised" or "optimized" without specifying any concrete levels of local content, while others require a specific percentage of the work to be performed by local firms. [4]

Canada, Nigeria, Angola and Norway are examples of nations which either make or have made use of local content policies in order to develop their local supply industry.[5] To illustrate, article 54 of the Norwegian Royal Decree of 1972 directed the government to ensure that Norwegian goods and services should have preference, provided they were competitive in terms of price, quality, schedule and service.[6] Subsequent to the entry into force of the European Economic Area Agreement in 1994, however, all regulations that

[4] For an overview of the measures taken different nations, see: Locke, Wade and Strategic Concepts Inc (2004): "Exploring Issues Related to Local Benefit Capture in Atlantic Canada's Oil and Gas Industry", Petroleum Research Atlantic Canada. Available at: http://www.acoa.ca/e/ library/ policy.shtml. Last visited on July 19, 2008.

[5] Klueh, Ulrich, P. G., A. S and Zarate, Walter (2007): "Inter-sectoral Linkages and Local Content in Extractive Industries and Beyond – The Case of São Tomé and Príncipe", International Monetary Fund Working Paper 07/213

[6] For an overview of the Norwegian preference rule, see: Skirbekk, Gaute (1988): "Leveransereguleringen i Petroleumsvirksomheten": MARIUS, No. 147, 1/1988

affected the free flow of goods and services were curtailed and article 54 was rendered invalid.[7]

In addition to the European Union rules, the World Trade Organization (hereinafter WTO) also has rules which forbid limitations on free trade. Such prohibition, however, does not apply to all WTO Member States, but only to those who have signed the Plurilateral[8] Agreement on Government Procurement (hereinafter GPA).[9] Although a founding member of the WTO, Brazil is not a signatory to the WTO Government Procurement Agreement and is therefore not bound by it.[10]

Since Brazil has not undertaken to implement rules that forbid restrictions to free trade, the country is free to adopt provisions which give preference to national companies. As a consequence, law 8.666 of 1993 - which covers most government procurement other than informatics and telecommunications - allows consideration of non-price factors, giving preferences to certain goods produced in Brazil and stipulating local content requirements for

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7 OECD (2003): "Regulatory Reform in Norway: Enhancing Market Openness through Regulatory Reforms". Available at: www.oecd.org. Last visited on June, 01, 2008.

8 As opposed to multilateral agreements, which are binding on all WTO members, plurilateral agreements are only binding on those WTO members who have expressly accepted them.

9 The use of offsets, i.e. measures to encourage local development by means of domestic content, investment requirements, counter-trade, etc. are explicitly prohibited in the Agreement. Notwithstanding this, developing countries may negotiate conditions for the use of offsets, provided these are used only for the qualification to participate in the procurement process and not as criteria for awarding contracts. For more information, see: http://www.wto.org/english/tratop_e/gproc_e/gpa_overview_e.htm. Last visited on July 20, 2008

10 The WTO Agreements were incorporated into national law in December 1994, following the ratification of Presidential Decree No. 1.355 of December 30th, 1994.

eligibility for fiscal benefits. Decree 1.070 of 1994, which regulates the procurement of information technology goods and services, also requires federal agencies and government-controlled entities to give preferences to locally produced computer products.

Generally speaking, new firms have little chance of competing head-to-head with the established firms located in the developed countries. Many foreign suppliers have been in business longer and over time have been able to improve their efficiency in production. They have better information and knowledge about the production process, about market characteristics, about their own labour market, etc. As a result, they are able to offer their product at a lower price or with guaranteed quality in international markets and still remain profitable.

A new supplier producing a similar product, on the other hand, would not have the same production technology available to it. Its workers and management will normally lack the experience and knowledge of its rivals and thus would most likely produce the product less efficiently. If forced to compete directly with international suppliers, the local firms would be unable to produce as profitably and thus would not be able to remain in business.

Protection of these firms in the form of local content requirements would thus increase the amount of contracts awarded to them. Over time, local suppliers would, in theory, gain production and management experience that would lower their costs of production and allow them to compete globally. Essentially, the firms would follow the same path that the developed country firms have followed to realize their own production efficiency improve-

ments. The protection, thus, would allow the infant industry time to "grow-up".[11]

Although beneficial to local companies, local content requirements represent a great challenge to the international oil firms for a number of reasons. Upon being forced to use Brazilian goods and services in their projects, oil companies lose the opportunity to select the supplier they see as the most qualified. They are forced to purchase goods and services from local suppliers who may lack the professional qualifications and management skills necessary to deliver the goods or service within the established deadline.[12] As a result, they may have to add longer time on execution schedules and increase their budgets in order to comply with local content regulations. Overall quality may also suffer.

As we shall see in this paper, the Brazilian government has implemented the preference rule in the terms of the Concession Agreements. In order to minimize the negative aspects of implementing very strong preference rules, the Agreement established that only those Brazilian suppliers who were competitive in terms of price, quality and delivery time should be given preference. Notwithstanding this, the Concession Agreement also contains minimum local content obligations, whereby oil companies are required to procure a minimum amount of goods and services locally. The adoption of these two competing sets of rules creates confusion with regard to the true scope of the Concessionaire's obligation in relation to local content.

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[11] Suranovic, Steven M. (2002): "The Infant Industry Argument and Dynamic Comparative Advantage" In: International Trade Theory and Policy, Chapter 100-4

[12] Munson, Charles L. and Meier J. Rosenblatt (1997): "The Impact of Local Content Rules on Global Sourcing Decisions" in: Production and Operations Management, Vol.6, No.3, Fall 1997, pp. 277 - 290

The implementation of minimum obligatory local content obligations also creates doubts as to the true objectives of the government's policy. Due to the strong signs of nationalism present in the regulation, it might be argued that the only role of the local content obligations is to increase local purchase in the short term rather than to foster the development of the local industry on a competitive basis.

This paper seeks to analyze from a legal perspective the two main local content implementation vehicles used in the Brazilian upstream oil industry, namely: (i) the requirements set by the National Petroleum Agency (hereinafter ANP) in the bid for exploration and production licenses, (ii) and the requirements set by Petrobras - the Brazilian dominating oil company – in the bids for the construction of platforms.

Amongst the different development policies used by the ANP in the Concession Agreements, only: (i) the obligations to provide equal opportunity to local suppliers; (ii) the obligation to give preference to the latter whenever they are competitive; and (iii) the obligation to procure minimum levels of local goods and services will be examined in this paper. Related obligations on training of Brazilian personnel and payment of a special contribution to the funding of Research and Development in the event of discoveries are, thus, outside the scope of this paper.

1.2 The Regulatory reform

From 1953 onwards, the monopoly of the Brazilian government over all oil related activities was exercised exclusively through Petrobras and its subsidiaries as bodies entrusted with the accomp-

lishment of the policies established by the National Council of Petroleum (CNP).[13]

Forty two years later, however, the scenario changed dramatically. In order to enable the Federal Government to hire companies other than Petrobras to carry out oil and gas activities, the Federal Constitution was amended in November 1995.[14] As a consequence, although the monopoly over the oil exploration and production activities was retained by the government, the same was then allowed to hire foreign and national private companies to undertake such activities. Following this constitutional amendment, an Act providing for the terms and conditions under which Petrobras or other companies would be hired was created.

This Act, known as the Petroleum Act,[15] revoked the 1953 Act and provided for the creation of the National Council for Energy Policy (CNPE) and the National Agency for Petroleum, Natural Gas and Biofuels (ANP).[16] The former sets forth the policy for the energy sector, while the latter is in charge of enforcing such policies, setting rules and promoting regulatory measures in the oil industry.

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[13] Buscheb, José Alberto (2007): "Direito do Petróleo: A Regulação das Atividades de Exploração e Produção de Petróleo e Gás Natural no Brasil", Rio de Janeiro: Ed. Lumen Juris

[14] Constitutional Amendment No. 09 of November 1995 redefined paragraph 1 of Art. 177 of the Constitution, which thereafter red as follows: "The Union will be able to contract the accomplishment of the activities referred to in clauses I to IV of this article with public or private companies, respecting the conditions established by law". (Free translation)

[15] Following the Constitutional Amendment, on August 06, 1997 the Brazilian Congress approved Federal Law 9.478, named the Petroleum Law.

[16] *"ANP has the responsibility for the rational exploitation of the nation's petroleum resources and maintaining a fertile and responsive business climate which protects and balances the interests of both the private and public sectors"*. David Zylbersztajn, ANP Director General. Press release at Rio de Janeiro, December 18, 1998.

The Petroleum Law establishes that exploration, development and production of oil and gas are to be carried out through Concession Agreements, necessarily preceded by a bidding process.[17] These agreements are awarded by the ANP on behalf of the government to the winners of the bidding contests and require the Concessionaire to explore the designated area on its own and at its sole risk, and also to produce the hydrocarbons that it may find.

Among a number of powers granted to the ANP, those with more relevance are: (i) the capacity to delimitate the areas with regard to the concessions; (ii) the elaboration of the terms and rules for the tenders regarding these concessions; (iii) the power of being the body drafting and closing the corresponding agreements and managing their enforcement; and (iv) the power to stipulate the government's share of the oil and natural gas production in this area.

The Brazilian Concession Agreement is based on the royalty/tax model. In brief, following a public bid and being awarded a Concession Agreement, the Concessionaire undertakes the risk of the exploration. If successful, the Concessionaire is the sole owner of the production, subject to the payment of the relevant fiscal burdens, such as the corporate income tax, and legal or contractual participations. The Brazilian government has no rights over the production but only over the payment of the relevant taxes and the fees established under the Petroleum Law (government take).[18]

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[17] The economic efficiency and the transparency benefits from a competitive leasing system were chosen over the earlier model used e.g. in Norway, where individual leases were negotiated directly with the International Oil Companies.

[18] Four different forms of governmental economic participation have been established in the concession contracts, namely: (1) *signature bonus:* amount bid by the tender winner subject to minimum amounts; (2) *royalties:* percentage interest ranging from 5 to 10 per cent on the

Understanding that the country should benefit not only from the payment of taxes but also from the development of its local industry, the ANP introduced in the Concession Agreement three different policies aiming at ensuring that Brazilian suppliers would be awarded a considerable amount of contracts for the supply of goods and services. These rules, which will be studied in chapter 2, have a direct impact on the procurement strategies of oil companies, especially Petrobras, which is still the main player in the country.

1.3 The new role of the industry's main player – Petrobras

Since the Petroleum Law opened up the market for exploration and production activities in 1998, the structure of Petrobras and of the Brazilian oil industry has changed significantly.

As previously mentioned, the "oil reform" removed from Petrobras the exclusivity with regard to the monopolized activities which the company had enjoyed since 1953 and enabled private companies to bid for the realization of such activities. The performance of these activities may now be implemented through consortiums between Petrobras, either as the lead company or not, and domestic or foreign companies, provided the latter has incorporated a Brazilian subsidiary with head office and administration in Brazil.[19] That is, the company operates now through subsidiaries or in

production of each field, as financial compensation to the Government for the concession; (3) *special participation:* a surcharge ranging from 0 to 40 per cent, owed by the concessionaire only when the field achieves unusually high levels of productivity and/or profitability, certain deduction considered; and (4) *payment for the occupation or retention of the area:* an annual payment owed by the concessionaire in connection to the occupied area.

19 Section 5 of the Petroleum Act.

association with third parties, in competition with other companies on a free market basis.

Additionally, the Petroleum Act allowed the sale of up to 49.9 percent of Petrobras voting shares.[20] As a result, the company was partially privatized with its shares being listed in the São Paulo and New York Stock exchange markets.

Despite these changes, the national oil company remains the predominant player in the Brazilian industry, controlling over 95%[21] of the crude oil production in the country, and is today regarded as one of the most experienced deepwater operators in the world.[22]

Petrobras' leading position in the Brazilian oil industry also means that the company is the main tool for implementing the local content initiatives. In addition to being under a contractual obligation to comply with the local content provisions established in the Concession Agreements signed with the ANP, as the controlling shareholder of Petrobras, the Brazilian government often pursues certain of its economic and social objectives through the oil company.[23] Petrobras has thus engaged in activities that give

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[20] Although the Federal government owns 55,7% of Petrobras' voting shares, it holds only 32,2% of the company's total capital stock with private shareholders holding the rest. For more information, see Petrobras' website: http://www2.petrobras.com.br/ingles/ads/ads_Negocios.html. Last visited on June 02, 2008

[21] Energy Information Administration (EIA): http://www.eia.doe.gov/emeu/cabs/Brazil/pdf.pdf. Last visited on July 25, 2008.

[22] Nordås, Hildegunn Kyvik, Eirik Vatne and Per Heum (2003): "The upstream Petroleum Industry and Local Industrial Development: A Comparative Study", Institute for Research in Economics and Business Administration, Bergen: SNF Report No. 08/03, page 14.

[23] So long as the Brazilian government owns a majority of Petrobras' voting stock, it will have the power to elect a majority of the members of the board of directors and, through them, a majority of the executive officers who are responsible for the company's day-to-day management.

preference to the objectives of the Brazilian government rather than to its own economic and business objectives.[24]

A typical example of the influence the government has over Petrobras' decisions was the reform of the bidding procedure for the construction of platforms P-51 (Marline Sul field) and P-52 (Roncador field) in 2003 – the same year President Lula took office.[25] The bids were first delayed while checks were made to see whether Brazilian shipyards had the technical capability to engineer such platforms. Once it "became clear" that they did, minimum local content stipulations were made to ensure that local firms would be benefited.

1.4 Local content levels throughout the time

A key point of departure for the Brazilian oil industry was its nationalisation in the 1950s and the creation of Petrobras, which was, until the beginning of the last decade, the only major developer of the country's oil and gas assets, although a number of local suppliers and companies were also involved. A long tradition of protectionism has ensured that local content has always been very high.[26]

In the 1980s, in order to accelerate the development of offshore resources, the government signed a number of licensing agreements with international operators.[27] Doing so facilitated the development

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[24] Annual Report of a Foreign Private Issuer, available at: http://www.secinfo.com/d19YC9.t2Pg.htm

[25] Menas Associates - British Consulting Company with focus on Local Content. See: www.menas.co.uk

[26] See the National Organization of the Petroleum Industry (ONIP) website: www.onip.org.br

[27] In late 1975, the government decided to authorise Petrobras to seek service contracts with foreign companies. Seven bidding rounds were offered to domestic and foreign private companies for Risk Service Contracts between

of domestic technology by enabling access to state of the art technology which could be adapted to domestic requirements. Typically, local content volumes in such joint ventures varied from 80% to well over 90% at times.[28]

This structure was once again modified in 1997. At the same time as the opening of the Brazilian oil sector created new opportunities for local suppliers, a concern also grew among politicians that oil companies would purchase goods and services abroad. Such a concern was based not only on the oil companies' tradition of using their long-established suppliers in the international market, but also on Petrobras' orientation to act in a more competitive way, placing its orders exclusively in markets where the price, schedule and quality conditions were more favourable.[29] Such uncertainties created the basis for the local content regulations in force today.

1.5 Legal sources and presentation of the paper

Before the analysis of the material part of this paper can take place, a few comments regarding the paper' legal sources must be made. Such remarks will be significant in terms of how a reader should relate to this paper's presentation, discussions and conclusions.

Most of the theoretical work found on local content has appeared in economics literature. These studies tend to concentrate on macroeconomic production and welfare effects of local content

April 1976 and October 1988. Under these contracts, the companies were allowed to explore fields at their own risk, and, if successful, they had to sell the reserves to Petrobras.

[28] Heum, Per, Christian Quale, Jan Erik Karlsen, Moses Kragha and George Osahon (2003): "Enhancement of Local Content in the Upstream Oil and Gas Industry in Nigeria", Bergen, Stavanger and Lagos: SNF Report No. 25/03

[29] ONIP's Technical Note 02/2005. Available at www.onip.org.br. Last visited on June 08, 2008

policies, talking little about relevant legal issues. Despite a comprehensive search of legal libraries and databases, the amount of legal work found on local content was not significant when compared to the time spent. The almost complete absence of previous relevant legal work on local content rules can be noted not only in Brazil, but also in other countries which make use of the rule.

Articles and information found on websites of the main agencies responsible for the Brazilian oil regulation provided the main legal source for the writing of this paper.

In the next chapter, an overview of the legal framework for the implementation of local content rules in the Concession Agreements will be provided. Also, the most central elements of the Concessionaires' obligation to provide equal opportunities to local suppliers and to give preference to those whenever they are competitive will be examined.

In chapter 3, an analysis of the Concessionaires' obligation to reach minimum levels of local investment percentages will be made. During this chapter, a number of problems relating to the scope of this contractual obligation will be analyzed. The use of local content as evaluation criterion of the bids will also be dealt with.

Chapter 4 will provide an overview of the relation between the local content obligation imposed by the Concession Agreements and the requirements that Petrobras has introduced in the bidding for construction of platforms. Finally, chapter 5 will provide an account of the local content calculation system. The second part of this chapter, which deals with the Local Content Manual, applies to local content requirements both under the Concession Agreement and under Petrobras bidding rules.

The system of fines set forth in the Concession Agreement for the case of non-compliance is outside the scope of this paper. It can be mentioned, however, that local content is looked upon as a firm commitment entered into at the Concessionaire's initiative and is

part of the criteria used to determine the winning bid. Therefore, non-compliance constitutes a breach of the agreement and may lead to penalties including fines and, in the case of reoccurrence, termination of the Concession Agreement.[30]

2 Local Content Requirements in the Concession Agreements

2.1 Legal Background

Pursuant to Article 177 of the Federal Constitution and Articles 5 and 23 of the Petroleum Law, the Federal Government may authorize the State and private companies incorporated under Brazilian Law and with their head offices in the country to perform activities of exploration and production of oil and gas through Concession Agreements preceded by a bidding process.

The Petroleum Act also establishes that, as a representative of the Federal Government, the ANP shall be responsible for the execution of Concession Agreements and the supervision of the oil related activities, aiming at looking after the Federal Government's patrimony based on certain principles. These include, inter alia: (i) *"the preservation of the national interest";* (ii) *"the development and expansion of the labour market"*; (iii) *"the promotion of free competition";* and (iv) *"the growth of the country's competitiveness in the international market"*.[31]

As opposed to a number of oil producing countries, which included local content provisions in their basic Petroleum Law, the Brazilian oil legislation does not contain any specific provision in this

[30] The fine varies from 60 to 100% of the value of the non-realized local content percentage, c.f. section 20.7 of the concession agreement.

[31] Section 1 of the Petroleum Act.

regard. The Act merely states the basic principles to be followed and leaves the implementation of the national energy policy to the ANP. Thus, when preparing the First Bidding Round in 1999, which effectively marked the end of the monopoly of the exploration and development activities in the country, an intense debate took place within the ANP. The outcome of the discussion was one institutional solution and one set of rules on local content.

The institutional solution was the creation of The National Organization of the Petroleum Industry, known as ONIP, in 1999.[32] This private and non-profit institution is composed of organizations representing the main players involved in the oil and gas industry in Brazil, governmental agencies, and technical-scientific organizations. The organization has the role of contributing to the development of a favourable environment for new investments and operations in the Brazilian petroleum sector and of promoting the increase of local content on a competitive basis.

The second outcome of the debate was the implementation of local content rules in the Concession Agreements. Although the Petroleum Act did not direct the ANP to do so, the agency understood that the principles on which the Act was based allowed them to make use of such requirements in the Concession Agreements. Local content rules were then introduced in the Final Tender Protocol33 ("Edital de Licitação") or "Request for Proposals" of the First Bidding Round held in 1999, which is the

[32] The organization was created after the Norwegian INTSOK model

[33] The protocol is named Final after the corrections and improvements that arise from a public hearings process have been implemented into it. The Concession Agreements are annexes to the Final Tender Protocol of each licensing round. Among other details, the Tender Protocol indicates: (i) the object of the bidding; (ii) the terms and conditions for execution and performance of the contract; and (iii) the criteria for the evaluation of proposals.

instrument by which the conditions of the Concession Agreement are made public.

The most recent version of the Concession Agreement[34], which sets out in detail the rights and obligations of the parties already sketched out in the Final Tender Protocol, contained three different set of rules on local content, namely: (i) the obligation to provide equal treatment between local and foreign suppliers; (ii) the obligation to give preference to the former; and (iii) the obligation to fulfil minimum percentages of local investments in the exploration and development phases.

The Agreement also sets out the obligation to pay a special contribution to the funding of Research and Development in the event of Discoveries and Development of Fields with a view to enhancing the participation of national suppliers in the Brazilian oil sector.[35] The discussion of such clause is, however, outside the scope of this paper and will therefore receive no further attention here.

As we shall see in this chapter, a number of legal questions arise in connection with the contracting of local suppliers by oil companies in light of equal opportunity rules, preferential treatment obligations and minimum local content requirements. This chapter will provide a general analysis of the first two of these rules, whilst

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[34] The Concession Agreement of Round 9 - the last Round held so far - is available at:

http://www.brasil-rounds.gov.br/round9/edital/Conc_agreement_11_10.pdf. Last visited on August 18, 2008.

[35] The special contribution shall be equivalent to 1% of the gross revenue from the respective fields. Up to 50% of this amount may be used in the company's own R&D activities within Brazil. The remaining amount must be invested in collaboration with university and/or national R&D institutions registered in the ANP, c.f. section 8.11 of the Final Tender Protocol.

the examination of minimum local content requirements will be made on the next chapter due to its greater complexity.

2.2 Equal opportunity

The upstream oil and gas sector typically outsources many non-core activities. This leaves a primary core function of concessionaires essentially as project management with up to 90% of work contracted out.[36] Local suppliers from the countries where projects are situated have increasing opportunities to work on international projects. In Brazil, such opportunities are "guaranteed" to local suppliers by clauses introduced in the Concession Agreements.

As a starting point, sections 18.1 and 19.5 of the Concession Agreement provides that the Concessionaire is free to purchase the goods and hire the services required for the execution of its operations from any supplier, being able to do so in Brazil or abroad. Notwithstanding this freedom, section 20.1 lays down procedural requirements to be followed by the Concessionaire when purchasing goods and services, in order to assure that the

> "contract's objective to guarantee Brazilian suppliers equal opportunities in relation to other companies invited to submit proposals"

will be respected. These procedural requirements read as follow:

> "(a) Include Brazilian suppliers in the companies invited to submit proposals;
>
> (b) Grant access to a Portuguese or English version of the same technical specifications for all companies invited to submit proposals, being disposed to accept equivalent specifications where in

[36] For example, BP spends about USD 35 billion a year on suppliers which represents 80% of the company's total spend; and interfaces with over 100.000 suppliers globally across its upstream and downstream businesses. This includes office supplies, catering and retail divisions, as well as exploration and production, refining and marketing. See: www.bp.com. Last visited on July 02, 2008.

accordance with the Best Practice of the Oil Industry, in such a way that does not restrict, inhibit or impair the participation of Brazilian Suppliers. All of the non-technical documents and correspondence shall be sent to Brazilian suppliers in Portuguese;

(c) Ensure that all invited companies shall have equal and adequate time consistent with the requirements of the Concessionaire, both in the preparation of proposals and in the delivery of goods and services, in accordance with the Best Practice of the Oil Industry, so as not to exclude potential Brazilian suppliers;

(d) Require no technical qualifications or certifications of Brazilian suppliers besides those required from foreign suppliers;

(e) The acquisition of goods and services supplied by Affiliates is equally subject to the other items in this clause, except in case of services that, in accordance with the Best Practices of the Oil Industry, are usually carried out by Affiliates; and

(f) Keep track of the Brazilian Suppliers which are able to offer supplying services and seek, whenever applicable, updated information on the universe of suppliers at the trade associations and entities with renowned knowledge on the subject". (my underlining)

2.2.1 The term *"equal"*

Upon the opening up of the Brazilian oil sector, traditions in the form of well-established business relationships and Petrobras' search for more competitive prices were perceived as the main challenges to the development of the local industry. Fearing that the widely/globally recognised solutions and systems offered by foreign suppliers would be preferred at the expense of unknown suppliers and alternative methods, the ANP introduced the obligation to give Brazilian Suppliers an *"equal opportunity"* to compete for contracts into the terms of the Concession Agreement. Nevertheless, what is encompassed by this term?

The word *"equal"* implies that neither person shall have any advantage over the other. That is to say, all suppliers should have the same rights and opportunities to compete for contracts. Hence, *"equal opportunity"* can be taken to mean that both the tendering procedure and the procurement decision should be made in a way

that does not restrict the participation of Brazilian suppliers in the competition for a particular contract. However, does this obligation prevent the Concessionaire from limiting the participation of competitors to "qualified firms" or from setting stringent standards with respect to the quality of the goods and services to be procured?

The complexity and specialized nature of a contract may entail only offers from firms with known and proven qualifications being accepted. Moreover, although the Concessionaire undertakes to "facilitate" the participation of Brazilian suppliers, the final decision on the award of the contract remains with the oil companies themselves. Accordingly, although the Concession Agreement attempts to place the local supplier in the exactly same position as the foreign suppliers, the Concessionaire's obligation under this section is limited to checking whether there are suppliers in the local market capable of delivering the particular good or service, and if so, to invite them to compete with foreign suppliers under the same conditions. In other words, the Concessionaire will still be free to set stringent quality standards for the goods and services required, being merely required to set the same standards for foreign suppliers invited to submit proposals. Since these are normally capable of providing goods with known and proven technologies, they will normally not have problems meeting such requirements.

2.2.2 General remarks regarding the procedural requirements set forth in Section 20.1

Section 20.1 lays down different procedural requirements which aim at facilitating the participation of the local industry in the competition for contracts. Amongst them, the obligation to give all companies "adequate" time for submission deserves some special considerations.

Since local suppliers are normally small firms, they require more time to prepare proposals than experienced international com-

panies. However, given the high costs inherent in oil and gas activities and the great importance assigned to timely delivery, technical specifications and deadlines are only required to be adjusted for local suppliers if they respect the limits set by economy and efficiency criteria. That is to say, the Concessionaire must not be required to modify its specifications and schedules in a way that adversely affects the safety and profitability of its operations. In this respect, the obligation to provide adequate time for submission of proposals, as well as the other requirements laid down in section 20.1, can be said to have a limited application.

Secondly, it can be argued that foreign suppliers will also benefit from the obligation to provide adequate time for submission of proposals. Unquestionably, any simplification of tendering procedures may benefit not only local, but also foreign suppliers. However, since Brazilian suppliers generally have fewer resources, any action that renders the procurement process easier and less costly has a relatively larger beneficial effect on them. More accessible deadlines for submission of proposals and delivery of goods are thus more beneficial for local firms, even though foreign suppliers might also benefit from this rule.

Lastly, it must be noted that the procedural requirements set forth in section 20.1 are not exhaustive. Accordingly, the Concessionaire must be free to use other mechanisms in order to ensure that "equal opportunity" is being given. One alternative would be the communication of future demands to national suppliers. Local communication channels could thus be used to ensure local suppliers are aware of opportunities for involvement over the short and medium term. Communicating upcoming demands allows local suppliers to target work for which they have existing capacity and to make investments to build the required capability to deliver work in

the near future.[37] Also, longer contracting periods may be desirable in some instances in order to enable emerging business to justify the acquisition of capital equipment or to train their welders.

2.2.3 The Concessionaire's freedom to select the contracting method with suppliers

In contrast to the tender requirements for government purchase found in most countries, there are few countries with obligatory rules on tender bidding for private industries. In Brazil, there are no statutory provisions regarding ordinary commercial tender bidding. Accordingly, with exception of Petrobras[38], all companies entering

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[37] Engineers Against Poverty Briefing Note: "Maximising the contributions of local enterprises to the

supply chain of oil, gas & mining projects in low income countries". Available at: http://www.engineersagainstpoverty.org/docs/Enterprise%20development%20briefing%20note.pdf. Last visited on August 22, 2008.

[38] Article 37 of the Constitution provides that, in general, public works, purchases and services should be contracted through a public tender process. The relevant regulations are established in Law No. 8666 of 21 June 1993. However, with regard to Petrobras, section 67 of the Petroleum Law expressly establishes that all acquisitions of goods and services made by the company must be preceded by the simplified bidding procedure defined by Decree No. 2745 of 1998.

Although expressly stated by law, the application of such a Decree by Petrobras has been challenged on a number of occasions by companies which implied that the oil company should also follow the government procurement act, which is more complex and does not allow for the use of Invitation letters. These claims were based on the argument that the Petroleum Act does not deal with bidding rules, the reason why the law could not mandate the application of a simplified procedure by Petrobras. Nevertheless, the Federal Supreme Court has ruled that the application of a simplified procedure by Petrobras is in accordance with the constitutional principle of efficiency and allows the company to act in a more competitive way, being therefore valid. The Court understood that, with the end of Petrobras'

into Concession Agreements with the ANP are free to choose the contracting procedure towards their suppliers/subcontractors.

Although the Concession Agreement does not impose any specific obligation upon the Concessionaire to hold competitive bids, the terms *"invited to submit proposals"* and *"preparation of proposals"* used in sub-paragraphs a) and b) of section 20.1 indicate that some sort of competition is expected. However, how far should this competition go?

Although not stated in the contract, it is clear that bidding arrangements are not required when competition is unfeasible, e.g. when only one supplier is capable of meeting the specifications established by the Concessionaire in the invitation for proposals. In such cases, the Concessionaire will naturally be free to contract abroad without being required to invite any local company to submit proposals. Nevertheless, is the Concessionaire forced to hold competitive bids whenever competition is feasible?

Due to the high costs involved in the exploration and development activities and the need to ensure that the most competitive supplier is selected, bidding procedures are widely used in the procurement of goods and services in the oil and gas industry. However, the organization of bidding procedures is costly and time consuming. Thus, below certain specified contract amounts, simplified methods are normally preferred, e.g. a request for quotations. Since neither the Brazilian Petroleum Act nor the Concession Agreement contains any provision regarding contract sizes,

monopoly in 1997, the company must now perform oil related activities in free competition with foreign companies, which are not subjected to the provisions of the Government Procurement Act. Therefore, if Petrobras was forced to comply with the bureaucratic rules set forth in this act, the company would be at a clear disadvantage when compared to its foreign competitors. (decision made in "Mandado de Segurança" No. 25.888 by Minister Gilmar Mendes). See: www.stf.gov.br

Concessionaires must be free to use more simplified procurement methods even where the purchase involves large amounts. That is to say, they are in principle free to select the contract method they see as the most appropriate, regardless of the price of the goods or service to be contracted.

However, although the contract price does not appear to affect the Concessionaire's freedom to select the contracting method, the nationality of the suppliers requested to present proposals seems to have a bigger effect on this freedom. In this respect, the wording *"include Brazilian suppliers in the companies invited to submit proposals"* used in sub-paragraph a) indicates that the Concessionaire is required to invite Brazilian suppliers to submit proposals whenever foreign suppliers have been invited as well. Accordingly, as soon as a foreign firm is requested to submit a proposal, Brazilian suppliers should also be given the opportunity to do the same under "equal" conditions, which means that the Concessionaire is not free to contract directly with foreign firms where there are firms in the local market capable of delivering the same good/service.

As a consequence, foreign suppliers will always have to compete with local firms when these are capable of delivering the particular goods, while Brazilian suppliers may be contracted directly by the Concessionaire without having to face competition with foreign firms. It must be observed, however, that even though this rule aims at protecting the local industry, it may also lead to unfair competition among local suppliers, as only one firm may be awarded the majority of contracts without having to face any competition from other local firms.

2.3 Preference to national suppliers

Preferring particular companies or groups, generally local firms, in the award of contracts is by far the most common means of implementing local content policies and can consistently be found in

public procurement legislation of a number of countries.[39] Pursuant to the terms of the Brazilian Concession Agreement, the national industry should not only be given equal opportunity to submit proposals, but should also be awarded contracts whenever their proposals are *equal* to the other suppliers in terms of price, delivery time and quality. This requirement is set forth in section 20.8, which reads as follow:

> "The Concessionaire shall ensure the preference to hiring Brazilian Suppliers whenever their proposals present price, delivery time and quality conditions equal to the other suppliers invited to present the proposals".

Two main questions arise in connection with this rule. Firstly, how does this rule benefit local suppliers? Secondly, what should be understood as *equal* price, quality and delivery time conditions?

The first question relates to the type of suppliers that will be ensured preference by this rule. As previously demonstrated, due to their existing experience, foreign suppliers tend to be more price competitive or to offer technologies and quality already "approved" by oil companies. On the other hand, due to their inexperience, local suppliers are often unable to supply goods/services with the same technology and quality offered by foreign competitors. If they manage to meet quality standards, they will normally require a longer deadline to delivery the respective goods or service. In other words, they are rarely capable of submitting a proposal that is equal to the foreign supplier in all three relevant aspects. Accordingly, only those local suppliers who are already globally competitive in all three respects will benefit from this rule.

Therefore, unless combined with the other rule that guarantees local suppliers the opportunity to compete for contracts, this

[39] Norway, Trinidad & Tobago and Angola are just some few examples of countries who adopted such policy.

section, on its own, is of little assistance to those suppliers who are trying to obtain the necessary experience to compete internationnally. Essentially, without the opportunity to do, learn and improve, the local industry will never have the opportunity to become competitive.[40] Therefore, the Contract must be read as a whole, i.e. this section must be read in conjunction with the obligation to provide equal opportunity to local suppliers treated above.

The second question is when the proposals of local suppliers shall be deemed as equal to the foreign suppliers. Preferences for local suppliers and contractors are in some countries set at 7.5 per cent, 10 per cent or even 15 per cent of the contract price. In Angola, for instance, local suppliers should be awarded contracts whenever their bid is no more than 10% higher than the bids submitted by foreign competitors.[41] Although arbitrary, the election of the preference levels provides guidance as to when local suppliers should be preferred.

The wording of section 20.8 states that local suppliers shall be given preference whenever their proposals are equal in terms of price, quality and delivery time. The section makes no reference as to levels of preference. Thus, it appears that local suppliers must be preferred only when their proposals are identical to the foreign suppliers. This raises a number of other questions. For example, how is the price difference detected between two proposals where one supplier offers a lower price than the other, but also makes a

[40] In this respect, the government of Trinidad & Tobago has stated that the traditional approach to give preference to local suppliers when these are competitive in terms of price, quality and delivery time has not helped the country to build local capability, since only those who are already globally competitive would succeed. See: www.energy.gov.tt. Last visited on August 08, 2008

[41] Order 127/03 issued by the Angolan Ministry of Petroleum.

reservation to the acceptance of the invitation to bid? Likewise, what will rank highest, lower price, earlier delivery or quality?

These doubts illustrate the importance of clear and transparent rules. The terms of invitations to bid set out by oil companies when they subcontract activities will normally answer the above-mentioned questions. However, without further guidance from the ANP as to how this issue must be dealt with, oil companies cannot really know when local companies are to be preferred. It seems reasonable to assume, however, that there has to be at least some significant difference before the contract is permitted to go to a foreign contractor where preferential rules are used.[42] Since the ANP used the word "equal" rather than "higher", it appears that the difference before the contract is to be awarded to a foreign supplier is very small. Over time, it is expected that case law will answer this question.

3 Minimum local content requirements

3.1 Relation with the preferential rule

In addition to the obligation to provide equal opportunity to local suppliers and to give preference to them whenever their proposals are competitive, oil companies entering into Concession Agreements with the ANP must also comply with minimum amounts of local content, i.e. they must purchase a given amount of goods and services locally.

This rule, which is by far the most significant means of implementing local content policies in Brazil, certainly has the strongest impact on the way projects are developed and contractors are selected in the country. As we shall see, minimum local content

[42] Arvid Frihagen, Offshore Tender Bidding page 77.

obligations can lead to higher costs if the local industry does not have sufficient capacity available. Failure to fulfil the percentages required can also lead to fines, as provided for in the sanction system of the Concession Agreement.

However, before we begin discussion of the material aspects of the rule, some consideration must be given as to how this provision relates with the obligation to give preference to Brazilian suppliers.

The question that must be answered is how these minimum local content obligations relate to the obligation to give preference to local suppliers, described under section 2.3 above. As already noted, local suppliers shall only be preferred if the goods or services they offer are equivalent to the ones offered by foreign suppliers in terms of quality, price, and delivery time. National goods and services shall thus only be preferred where all aspects of the goods or services are as good as of the ones offered by foreign suppliers. The question here is how this "quality analysis" relates to the obligation to fulfil minimum *"Local Investment Percentages"*.

This provision can be understood in two different ways. Either the preference rule interferes with the minimum local content obligations so that the minimum limit of 37% of local content (for deep water blocks in the exploration phase) shall only be fulfilled insofar as Brazilian goods and services are of the same quality as foreign goods. Alternatively, minimum local content obligation can be seen as a lower or higher threshold, which must be fulfilled unconditionally.

This issue does not seem to have been thought through by the ANP and the Concession Agreement does not contain a clear answer to this question. According to the wording of the Concession Agreement, local content requirements are mandatory and sanctions are applicable in case of non-compliance. In addition, the Agreement foresees specific situations where the Concessionaire will be exempted from performing the local content amount

required. So, unless the Concessionaire falls under one of the three situations set forth in the Agreement (in case he receives an excessively high price proposal; high term of delivery; or he needs to use technology not yet available in Brazil)[43], it appears that he has an unconditional obligation to comply with the minimum local content levels set forth in section 20.2 (a) and (b). In other words, minimum obligatory local content must be fulfilled irrespective of whether the goods provided by the local suppliers are of the same quality as foreign goods, with the Concessionaire only exempted from this obligation if the price or delivery term of the local supplier is *"excessively high"*, or if he needs to use technology not yet available in the country.

Hence, local suppliers must be "preferred" even where the goods they offer do not meet the quality, price or delivery time offered by their foreign competitors.

3.2 Local content as evaluation criterion of the bids

As previously noted, the Petroleum Act did not foresee the use of local content in the Concession Agreements. Nevertheless, section 41 allowed the ANP to use, beyond the signature bonus, other objective criteria in the evaluations of the bidding process.[44] As a result, during the first bidding round held in 1999, the ANP

[43] See section 3.6 below (Authorization to hire overseas).

[44] As opposed to Norway, where the legislative history of a statute is publicly available and plays an important role in the understanding of such statute, in Brazil the work done before an act is passed is not available to the public and therefore does not assist the reader in the interpretation of a given law. Nevertheless, articles published by ONIP and available at the organization's website have stated that the ANP used section 41 of the Petroleum Law as basis for the introduction of local content requirements as evaluation criterion.

introduced the bidder's commitment to local content as an evaluation criterion of the bids and this has developed further into firmer requirements.

The rule was introduced in the Final Tender Protocol of Round 1, and the percentage of *"spontaneous commitment"* to purchase local goods and services was attributed 15% weight in the awarding decision, while the remaining 85% weight was attributed to the signature bonus offered for each concession (value in money offered for the block).[45] Companies entering the Brazilian market were thereby encouraged to offer high levels of local content in their bids in order to obtain concessions for exploration and production of blocks.

Until Round 4 (in 2002), the values of goods and services to be acquired from Brazilian companies for the carrying out of exploration and development activities could be freely offered by the bidders. Nevertheless, so as to adjust its practice to the policy priorities of the socialist government which took office in 2003, the ANP significantly modified the rule in Round 5. The bidder had now to comply with a minimum obligatory percentage of total local investments. The minimum national content requirement started at 30% for deepwater offshore blocks in both exploration and production phases, and increased to 70% for onshore blocks in both phases.[46] Additionally, greater weighting was given to local content in the evaluation of bids. This aspect of the bids became a major factor, accounting for a 40% weighting, as opposed to the 15% weighting it had on the previous rounds.[47]

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[45] For more information, see http://www.anp.gov.br/brasil-rounds/round1/index.htm. Last visited on August, 14, 2008

[46] Item 4.8 of he Initial Tender Protocol describes in detail the local goods and services plans to be presented by the bidder.

[47] Resolution No. 8 was passed on 21 July 2003 and specifically established that the ANP should set minimum percentages of local content, which

Changes continued through rounds 7 and 8, in 2005 and 2006.[48] Essentially, the rules now establish a greater distinction between different fields according to on/offshore and the depth of water involved. Another innovation to make the system work was the introduction of the "Local Content Manual" as a tool of measurement of contractual local content. A spreadsheet containing items and sub-items for both the exploration and development phases was also created, whereby bidding companies are allowed to allocate weights and percentages of local content to each one of the items. Such allocation has to comply with minimum levels previously established by the ANP in the Tender Protocol. For example, the list used in Round 9 required the local content of a deep-water christmas tree to reach a minimum of 85%, while the minimum local content required for lease of eco-sounders was only 10%.

The most material change, however, was the stipulation of maximum local content amounts to be offered by the bidder (local content ceiling). Now, only the percentages of Local Content that are included between the minimum and maximum amounts defined by the ANP are taken into consideration in the evaluation of the bids, i.e. the bidder does not gain further points if the local content share is above the percentage established in the Tender Protocol. So, e.g., if a bidder offers the respective maximum local content required in a given block and another bidder offers an even higher amount, both will receive the same amount of points. This change

should be periodically readjusted according to the local capacity. As previously mentioned, although there were no minimum levels, the ANP already used local content requirements in the Concession Agreements before the Resolution came into force.

48 Generally, all changes implemented during Round 7 with respect to local content also apply to the concession agreements of Round 9. Round 8, which was supposed to take place in 2006, was cancelled shortly before the planed date.

occurred in view of the high levels offered in the previous rounds, which turned out to be incompatible with the capacity of the national industry. The weight of the Local Content in the evaluation of bids was also lowered to 20%, of which 5% was attributed to the Exploration Phase and 15% to the Production Development Phase.[49]

In summary, since Round 1 bidders have been encouraged to seek partnerships with local suppliers and to make subcontract associations with Brazilian firms, so as to increase their chances of success in the bidding rounds. Local content as evaluation criteria has, however, also allowed companies to make promises they know they cannot keep, as a means to secure contracts. To illustrate, due to the rules in force during Round 6, a block of high potential in the Campos Basin (CM-61) was awarded to the American oil company Devon, which offered the unrealistic local content of 81%. Petrobras, which had proposed an investment worth one million Reals more, lost the competition because it had offered the realistic and reasonable local content of 60%.[50]

3.3 Minimum "Local Investment Percentages"

The obligation to comply with minimum amounts of local content is set forth in section 20.2 of the Concession Agreement of Round 9. According to this provision, the Concessionaire shall:

> "(a) For each Block within the Concession Area, during the Exploration Phase, purchase an amount of goods and services from Brazilian Suppliers so that the minimum Local Investment Percentage, respectively, is 70% (seventy percent) onshore, 51% (fifty-one percent) in shallow waters with depth equal or inferior to 100 meters and 37% (thirty-seven percent) in shallow waters with

[49] First paragraph of section 4.5.2 of the Final Tender Protocol of Round 9.

[50] See: http://www.anp.gov.br/brasil-rounds/round6/english/index.asp. Last visited on August 20, 2008

> depth between 100 and 400 meters, as well as in deep waters. To the fulfilment of the global percentage of the contracted Local Content in the Exploration Phase, it becomes mandatory the performance of Local Content Percentage of the Items and Sub-items specified in the spreadsheet of the ANNEX X, subject to penalty according to paragraph 20.7.
>
> (b) For each Block within the Concession Area, during the Development Phase, purchase an amount of goods and services from Brazilian Suppliers so that the minimum Local Investment Percentage, respectively, is 77% (seventy seven percent) onshore, 63% (sixty-three percent) in shallow waters with depth equal or inferior to 100 meters and 55% (fifty-five percent) in shallow waters with depth between 100 and 400 meters, as well as in deep waters. To the fulfilment of the global percentage of the contracted Local Content in the Development Phase, it becomes mandatory the performance of Local Content Percentage of the Items and Sub-items specified in the spreadsheet of the ANNEX X, subject to penalty according to paragraph 20.7." (my underlining)

Pursuant to these provisions, the Concessionaire undertakes to reach a determined percentage of acquisition of goods and services from Brazilian suppliers at different phases of a project. Minimum national content required starts at 37% and 55% for deepwater offshore blocks in the exploration and production phases respectively, and increases to 70% and 77% for the onshore blocks.

Some few general remarks must be made before a deeper assessment of the rule takes place. The first issue that must be noted is that the Concessionaire's obligations apply to all costs within the relevant phase (Exploration or Development). Accordingly, during the Exploration Phase, the commitment applies to all costs, and not just those related to the Minimum Exploration Program.[51] It must

[51] This is a "minimum work obligation" defined in the tender protocols of each licensing round. Similarly to local content requirements, the bidder's commitment to perform minimum exploratory work is also attributed weight in the evaluation of bids. As the name implies, these commitments refer to the acquisition of seismic data and/or the drilling of wells.

also be noted that the local content percentages required must be achieved at the end of each phase, and not upon entry into the contract.

As to why the rules distinguish between fields according to on/offshore and the depth of water involved, an overview of the typical goods and services which an oil company purchases during a project provides an answer. Logically, the type of goods and services oil companies need to contract varies during the different phases of a contract. Although not all projects reach the development phase, higher levels of local content are required during this stage due to the higher costs incurred in drilling, construction and installation activities.

Also, the rules are designed in a way that reflects the capacity of the local industry to supply the levels of local content required. It would make no sense to establish minimum local content levels of 90% in areas where the industry manifestly needs to be further developed, e.g. seismic acquisition. Oil companies also tend to distinguish between the types of activity for which they may seek to use local content during the different phases of exploration and development. More generic functions such as construction or catering are normally more easily awarded to local suppliers due to lack of complexity. Specialist technical functions relating to seismic surveys or drilling, however, require expertise which cannot be developed overnight, which illustrates why local content levels are lower during the exploration phase.

3.4 The scope of the Concessionaire's obligation

The first sentences of sections 20.2 (a) and (b) establish that the Concessionaire shall *"purchase an amount of goods and services from Brazilian Suppliers"* so that the *"minimum Local Investment Percentage"* achieves certain minimum levels at the end of each phase of the project.

This wording can lead a reader to think that the Concessionaire's obligation is limited to purchasing goods and services from Brazilian companies. In that case, his obligation would cease upon entry into a contract with a Brazilian supplier for the provision of goods and services, regardless of the origin of the goods or of eventual delegation of work to foreign companies. As a conesquence, Brazilian companies would be able to act as mere intermediaries, selling 100% imported goods in the local market. They would still obtain financial benefits with the transaction, but would not build the necessary competence since they would not be manufacturing the goods or performing the services themselves.

However, when these provisions are read together with the definition of *"Local Content"* set forth in section 1.2.11 of the Concession Agreement, the scope of the Concessionaire's obligation appears to be more extensive. According to this section, Local Content in the Exploration and Development phases means:

> "The proportion expressed as a percentage between: (i) the sum of the amounts of the National Production Assets and the Services Rendered in Brazil, acquired, directly or indirectly, by the Concessionaire, related to investments in the Exploration/ Development Operations in the Concession Area and (ii) the sum of the amounts of goods and services, acquired directly or indirectly by the Concessionaire, related to investments in the Exploration/ Development Operations in the Concession Area, pursuant to the paragraph 20.2(a)". (my underlining)

Thus, for the calculation of the percentages defined in the paragraphs 20.2(a) and 20.2(b), the value that each *"National Production Asset"* and *"Service Rendered in Brazil"* represents to the total value of the project is also relevant. Even though the agreement does not contain a definition of these terms[52], it follows clearly from

[52] Due to the creation of a "Local Content Manual" in 2004, the term *"Nationally Produced Goods"*, which was in use since Round 3, was removed from the Concession Agreement of Round 7. For more infor-

its wording that the goods and services included in the local content calculation must have a strong connection to Brazil. That is, the fact that they are provided by Brazilian firm does not suffice for them to be included in the local content calculation. Goods must contain a certain level of Brazilian content and services must be rendered locally. The true scope of the Concessionaire's obligation is thus to acquire certain amounts of *"National Production Asset"* and *"Service Rendered in Brazil"* from Brazilian Suppliers.

3.5 Brazilian Supplier

A number of other issues arise in connection with the definition of the term *"Brazilian Supplier"*. What type of connection with Brazil must a company have before it can be regarded as a *"Brazilian Supplier"*? The connection criteria could be, e.g., (i) that the company's headquarters was located in Brazil; (ii) that the company or the majority stake in the ownership of the company was possessed by Brazilians; or (iii) that the company has operated in Brazil for a given period of time. Each of these criteria could, of course, apply individually or cumulatively. However, the contractual definition does not contain any of these criteria. Pursuant to section 1.2.21, any supplier of a *"National Production Asset"* or of a *"Service Rendered in Brazil"* will be regarded as a Brazilian Supplier insofar as the supply is made through a company *"incorporated under the laws of Brazil"*.

This definition has been modified a number of times throughout the rounds. For example, during the two first Bidding Rounds, *"Brazilian Supplier"* was defined as:

> "(i) with respect to any seller or supplier of assets, goods or services, a Person that is organized and registered as a Brazilian legal entity,

mation about the modification of the local content calculation system, see chapter 5.

> whose sold or supplied goods have been produced in Brazil or whose services have been performed in Brazilian national territory, and (ii) with respect to any employees, any individual who is a Brazilian citizen (my underlining).

Under this definition, any person *"organized and registered as a Brazilian legal entity"* could be considered a *"Brazilian Supplier",* while the definition used in the contract of round 9 required the supplier or manufacturer to be *"incorporated under the laws of Brazil".* Although these wordings are different, under both systems the supplier is required to follow Brazil's regulations. The most significant difference between the two definitions, thus relates to the type of goods and services supplied by the *"Brazilian Supplier",* rather than to the type of organizational structure of the company.

Previously, the definition required the goods/services to be produced/performed in Brazil so the supplier thereof could qualify as Brazilian. Such definition led to a number of interpretation problems. For example, should the services supplied by Brazilian subsidiaries of foreign companies be included in the calculation of local content? A typical situation was where the Concessionaire contracted a non-Brazilian seismic vessel to acquire seismic through a Brazilian subsidiary of a foreign contractor. There were also uncertainties as to how costs of services partially performed in Brazil would be treated (e.g. if the seismic data was processed outside Brazil).

Pursuant to the definition used during the two first Rounds, regardless of the origin of any equipment involved, provided that services were *"performed in Brazil"* by a company organized under Brazilian rules, the service would be included in the calculation of local content. Thus, whether the supplier was a Brazilian subsidiary of a foreign company did not matter. Services carried out in Brazil by Brazilian subsidiaries of foreign companies were thus taken into consideration in the calculation of local content. In cases where

such services were only partially completed in Brazil, only the costs associated with the services carried out in Brazil would count as part of the commitment to local content. So, in the example above, the costs associated with the acquisition of seismic data would be fully taken into consideration, while the costs associated with processing the data would only count to the extent the processing was carried out in Brazil.[53]

The definition of *"Brazilian Supplier"* changed again during Round 3, and every supplier who complied with minimum levels of national indexes of goods and services was considered a Brazilian Supplier.[54] Minimum levels of national index were 60% for goods and 80% for services. Accordingly, if certain goods or services had at least 60% and 80% of its value consisting of components originnated from Brazil respectively, they were considered as local and their suppliers were considered as Brazilians.

Hence, the focus moved from the place where the goods were produced or the service was rendered to the amount of national index that each good or service contained. Such innovation was clearly based on the desire to correct the abovementioned inconsistencies and to assure that only those who supplied "genuine"

[53] With regard to leasing of production vessels (e.g. FPSOs), paragraph 20.1.6 of the Concession Agreement of these Rounds established that expenses associated with renting or leasing of mercantile marine, petroleum production and storage units could only be included in the commitment to Local Goods and Services in the Development Stage if these units were made in Brazil. So, although the leasing was effected by a Brazilian company, if the vessel was built abroad, the costs associated with the leasing thereof would not be included in the calculation of local content.

[54] Section 1.2.18 of the Concession Agreement of Round 3 defined "Brazilian Supplier" as: *"any seller or supplier of Nationally Produced Goods or Services Supplied in Brazil."*

Brazilian goods and services would benefit from the rule. In other words, the change intended to assure value adding in Brazil.[55]

3.6 Authorization to hire overseas

As a starting point, all Concessionaires are obliged to fulfil the *"Local Content Percentage of the Items and Sub-items specified in the spreadsheet of the ANNEX X"*. However, the Concessionaire will only be able to achieve the contractual percentages of local content if the national industry is capable of meeting its requirements under reasonable conditions in terms of price, quality and delivery time. In view of that, the ANP may, on an exception basis, authorize the procurement of goods and services abroad in three specific situations. In the present section we will analyze when the exception rule will apply so that the Concessionaire will be *"exempted from its obligation of performing the respective percentages of local content"*.

The three exceptions are described under items (e), (f) and (g) of section 20.2, which read as follow:

> "(e) If the Concessionaire receives a proposal of excessively high prices for the acquisition of local goods and services when compared to international market conditions, the ANP may, with prior request from the Concessionaire, on an exceptional basis, previously and expressly authorize the procurement of the goods and services abroad, and exceptionally exempt it from the obligation of performing the respective percentage of Local Content.
>
> (f) In case of receiving a term proposal for the delivery of goods and the performance of local services which is higher than the international market conditions, so that it may compromise the proposed activities schedule, the ANP may, as prior request of the Concessionaire, on an exceptional basis, previously and expressly authorize the procurement of the goods and services abroad, and

[55] For more information about the the local content calculation system, see chapter 5.

> exceptionally exempt it from the obligation of performing the respective percentage of Local Content.
>
> (g) In case of electing to use a new technology, during the Exploration and Development Plan, which is not available because of the bidding and it is not mentioned in the ANNEX X, the ANP may, upon previous request of the Concessionaire, on an exceptional basis, previously and expressly authorize the replacement of the old technology and exempt the Concessionaire from the obligation of performing the percentage of Local Content, referring to the activities that are being replaced by this technology, in case it is not being provided by the local suppliers." (my underlining)

Two main questions arises in connection with this rule, namely (i) when will the prices proposed by local suppliers be deemed as *"excessively high"* and (ii) when will the terms for delivery of goods or performance of services be considered *"higher than the international market condition"*?

Although subjective, these are strict conditions for the awarding of waiver by the ANP.

With respect to the delivery term, the Final Tender Protocol indicates that the term proposed by the local supplier must be greater *"in a significant extent"* before the Concessionaire may be authorized procure abroad.[56] The same applies to the prices, i.e. this must be *"excessively high"* when compared to international prices. However, how should these prices be compared?

The ANP does not specify how this analysis will take place. Moreover, the term *"excessively"* is highly subjective and allows for different interpretations of what the threshold should be. The rule thus confers a great amount of discretion on the ANP, which can reject the application of authorizations based on its sole opinion. Such a position seems to violate the transparency principle upon which the industry claims to be built.

[56] Section 8.5.2 of the Final Tender Protocol of Round 9

Other general remarks about the authorization to hire overseas must be provided. Although the Concessionaire may be exempted from the obligation to achieve the percentage of Local Content of a given item or sub-item, sub-paragraph (j) of section 20.2 expressly establishes that the Concessionaire *"remains obliged to comply with the global percentage of the Local Content offered in the bidding"*. Such global percentage is calculated from the percentage of the local content offered to each item and sub-item related in the spreadsheet as per the weight of the said item or sub-item in the investment forecast to the respective activity (exploration or development).[57]

Accordingly, the Concessionaire will be discharged from the obligation to comply with the corresponding local content percentage of a given good or service, but will remain obliged to comply with the global percentage offered in the bidding to such phase or stage. That is, the Concessionaire will have to compensate for the shortage of local content with the purchase of higher amounts of other items or sub-items included in the spreadsheet. However, since local content is calculated individually for each phase of the project, can the local content shortfall be compensated for by any other item regardless of the phase in which it will be used?

According to the wording of sub-paragraph (j), the Concessionaire remains obliged to fulfil the percentage offered in the bidding

[57] Section 4.5.2 of the Final Tender Protocol provides a detailed explanation on how the global percentage of Local Content is calculated. As already noted, the ANP establishes minimum amounts of local content for each item and sub-item included in the list. The weight of each item and sub-item must be proposed by the bidder based on the total cost of the undertaking, i.e. bidders are free to allocate higher weight of local content to a given item or sub-item than the minimum levels established by the ANP. The weight allocated, however, will only confer points in the evaluation of the bids up to a certain point established by the ANP.

to each phase, i.e. every phase must meet the percentage offered by the Concessionaire by virtue of the bidding. However, pursuant to sub-paragraph (i), if the Concessionaire carries out local investments in the exploration phase that result in a local content percentage superior to that offered in the bidding, the ANP may, upon the Concessionaire's request and under exceptional circumstances, authorize the transfer of the larger difference to the development phase, respecting the minimum percentage of local content of each item and sub-item of the spreadsheet. So, if the Concessionaire is authorized by the ANP to procure abroad an item included in the spreadsheet of the exploration phase, the corresponding local content shortage will have to be compensated for by another item used during the same phase. However, if the item procured abroad was included in the spreadsheet of the development phase, the local content shortage may be compensated for, by an eventual transfer of an excess percentage from the exploration phase.

4 Petrobras' Local Content Requirements

4.1 Relevance of Petrobras' procurement policies

The key drivers for the development in the oil, gas, offshore and maritime sectors in Brazil, and the related activities, are linked to what Petrobras is doing in these sectors. With the monopoly position the company still enjoys in practice, it will still take a few years before other oil companies influence the overall demand of products and services in the oil related business in the same way as Petrobras, if this ever happens.

The company's procurement strategy is therefore very important for the overall development of Brazil. Together with governmental

initiatives and incentives, like BNDES' financing requirements[58], Petrobras' procurement strategy represents one of the main factors in the development of the local industry.

4.2 Relationship between local content in the Concession Agreement and local content in Petrobras' contracts

With the end of Petrobras' monopoly in 1997, in order to be awarded Concession Agreements, the company has now to compete with other oil companies on a free market basis. As already noted, the winner of this competition will enter into a Concession Agreement with the ANP.

Under section 20 of this agreement, which is the only provision dealing with the *"Commitment of the Concessionaire to the Local Content"*, the Concessionaire has no direct obligation to enforce local content requirements upon its contractors. Notwithstanding this, such requirements are normally imposed upon the Concessionaires' main contractors and "pushed down" the contractual chain.

Since oil companies tend to outsource a considerable part of their activities, it is quite normal that they enforce similar local content requirements upon their contractors so that they can fulfil the minimum levels of local investments required by the ANP. It must be noted, however, that in addition to the local content requirement imposed by the ANP, there is another factor which also makes Petrobras impose a similar obligation upon its contractors.

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[58] The Government National Development Bank - BNDES, is the primary Brazilian source of longer-term credit, also providing export credits. The Bank runs a program called FINAME (Special Agency for Industrial Financing) which provides capital financing to domestic and foreign companies operating in Brazil for the acquisition or leasing of new machinery and equipment which contain a minimum of 60% of domestic content.

As previously noted, the fact that the government is the controlling shareholder of Petrobras means that the majority of the executive officers responsible for the day-to-day management of the company is elected by the government itself. As a result, the company quite often engages in activities that give preference to the objectives of the Brazilian government rather than to its own economic business objectives.

As widely known in the Brazilian media, President Lula's government has been very focused on the importance of the oil industry in the promotion of the welfare of Brazilian society. During his campaign, the slogan "Everything which can be done in Brazil should be done in Brazil" was largely used. The recent giant discoveries at Tupi[59] and Jupiter in 2007, and Carioca in 2008, have also increased the pressure to see revenues distributed throughout the population.[60] His election in 2003 has thus served to strengthen and consolidate the local content role, even to the extent that long term goals for energy self-sufficiency have been stepped back in order to ensure that production platforms could be built locally.[61]

With the President arguing that Petrobras should be used as a development tool, it should be assumed that local content requirements in Petrobras' contracts are not only a reflection of the terms of the Concession Agreement, but also a means used by the govern-

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59 In November 2007, Petrobras announced that it believes the offshore Tupi oilfield has between 5 and 8 billion barrels of recoverable light oil and neighbouring fields may even contain more, which all in all could result in Brazil becoming one of the largest producers of oil in the world.

60 Revista Istoé Special Edition: "O Petróleo é Todo Nosso". Also available at www.istoe.com.br

61 As noted earlier, the bidding procedure for the construction of the platforms P-51 and P-52 were delayed, and when it was determined that local shipyards had the capability to engineer such platforms, minimum local content requirements were introduced.

ment to pursue its economics and social objectives through the company. The weight that each of these two factors have in the implementation of local content policies by Petrobras is, however, difficult to determine.

4.3 Development of Petrobras' contracting strategy

Following the international trend, in the nineties Petrobras outsourced a considerable part of the functions that the company performed in the development of its offshore projects up to that date. The control and integration of the projects were some of the main functions outsourced by the company. As a result, the company entered into a number of agreements with *main contractors,* often adopting the Engineering, Procurement and Construction (EPC) contract format. Under these EPC contracts, the contractor was often responsible for the full execution of the project for a fixed price. The scope of the work normally involved the centralization of activities, negotiation of prices with subcontractors and the quality control of the different equipments used during the project.[62]

Failure to comply with any requirements, including functionality, timeliness and labour, would usually result in the contractor incurring liquidated damages. Accordingly, a considerable part of the risks associated with the execution of a project was apparently transferred to the contractors, who could find themselves at the mercy of local suppliers where local content targets were imposed.

Since Petrobras did not impose strict local content requirements in their biddings for construction of platforms at that time, con-

[62] Revista Gestão Industrial, Uma análise da nova Política de Compras da Petrobras para seus empreendimentos offshore, Unicamp, page 111. Available at http://www.pg.cefetpr.br/ppgep/revista/revista2006/ pdf/vol2nr3/vol2nr3art8.pdf. Last visited on August 27, 2008.

tractors had more freedom to construct platforms abroad. Many EPC contracts were also awarded to foreign EPC contractors. As a consequence, large portion of the goods and services required during construction were purchased abroad, which led to a decrease in the Brazilian local content during this period.[63]

As a result of the delays and difficulties observed in the delivery of some projects by main contractors, over the past few years Petrobras has tried to regain a greater control over the engineering part of the projects.[64] The company has replaced the turnkey[65] structure of some projects with the contracting of separate modules which are later on integrated by the company. This change can be verified in the bidding procedure adopted for the construction of the platforms P-51 and P-52. In these biddings, the project was segmented into a number of modules (generation, compression and hull/topside) and a local content percentage was stipulated for each of them.

4.4 Minimum local content requirements in Petrobras' contracts for construction of platforms

As noted earlier, local content requirement varies considerably from project to project. Accordingly, it is difficult to identify a standard procedure in this respect. Due to the absence of such a standard, in the following section a brief overview of the requirement established

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63 In 1999, only one out of 12 platforms ordered by Petrobras was being built in Brazil, c.f. Revista Brasil Energia, May 1999.

64 Revista Gestão Industrial, Uma análise da nova Política de Compras da Petrobras para seus empreendimentos offshore, Unicamp, page 111

65 The term "turn key" is not a legal term but merely a description of the Client's expectations, i.e. the oil company provides an agreed functional specification and expects a complete offshore Unit delivered at completion.

in the bidding for the construction of the platform P-57, where minimum levels of local content were required, will be provided.

Article 4.2 of the EPC Pro Forma Contract for the Construction of the FPSO P-57 reads as follows:

> "4. 1 – Local Operations
>
> The Contractor and/or Contractor's group shall perform in Brazil the integration phase of the FPSO, as well as major Construction and Assembling activities of the process plant.
>
> 4.2 – Brazilian local Content
>
> Contractor shall cause the value of the Brazilian local content of the Work to be equal to at least 65% of the Contract Price ("Brazilian Local Content") which calculations criteria is set forth in exhibit XVI hereto, all in accordance with ONIP's methods and procedures". (my underlining)"

As we can see, the provision is divided into two main parts. The first part requires the work related to the integration phase of the FPSO and the major construction and assembling of the process plant to take place in Brazil, while the second part establishes the minimum local content percentage to be achieved by the Contractor.

With regard to the first part, the main question relates to the meaning of the term *"perform in Brazil"*. Is the requirement fulfilled if the integration is performed in Brazil by a foreign company? As the provision does not make any specific reference to "Brazilian Shipyards", it appears that the obligation will be fulfilled upon the integration of the different parts of the FPSO within the Brazilian territory, regardless of the nationality of the shipyard performing the work.

The second part of the provision requires the Contractor to cause the value of the Brazilian Local Content of the work to reach a minimum of 65% of the contract price. Since the Contractor undertakes to perform major parts of the integration and construction of the process plant in Brazil, the shipyard subcontracted to perform such activities will be responsible for the purchases of a great part of

the local content required. Accordingly, the provision takes into consideration that a considerable part of the purchase will not be directly made by the Contractor, and thus requires him to impose the local content requirement upon his subcontractors, c.f. the provision that requires the Contractor to ensure that all sub-contracts are consistent with the terms of the EPC contract. As a result, although the subcontractor will not have access to the EPC contract entered into between Petrobras and its main Contractor, the invitations to bid/purchase orders prepared by the latter in connection with the performance of the EPC contract will normally contain instructions that mirror the local content requirement of the EPC contract, i.e. they will be made on back-to-back terms.

Regarding the shipyard's responsibility with respect to local content requirements, the Procurement Manager of the Mauá-Jurong Shipyard in Rio - which was awarded the Petrobras tender to build and integrate the topside modules of the previous P-54 oil platform - has publicly announced that the shipyard intended to acquire a larger percentage of equipment in the Brazilian market *"as long as equipments were available and prices were competitive"*.[66] On the other hand, the yard would opt to pay the applicable fines and to import products if the price, quality, and delivery time offered by the Brazilian suppliers were not competetive.

Such a statement corroborates the understanding that local content requirements are often transferred to shipyards. However, the statement also draws attention to another issue of great importance which is not covered in Petrobras' tenders. As opposed to the Concession Agreement, where it is specifically stated that waivers may be granted when the proposals of local suppliers contain *"excessively high prices"* or too long delivery terms, it appears that

[66] Report prepared by U.S. Commercial Services on July 16, 2004 and available at: www.usatrade.org Last visited on July 20, 2008

Contractors and subcontractors do not have the same option, being responsible for fulfilling the local content requirement regardless of the competitiveness of local suppliers.

Considering that under the EPC Contract the Contractor is subject to liquidated damages for late delivery and to pecuniary penalties in case of non-compliance with the minimum percentages required, the Contractor can be held accountable for damages to which it did not contribute or that surfaced as a result of an unavoidable event beyond its control. Ideally, penalties for non-compliance should not apply where the local content shortfall derives from a local market shortage that compromises the quality of the platform, the final price of the project and/or the fulfilment of the project schedule deadline.

In this respect, it has been noted that Brazilian manufacturers became over confident that shipyards/EPC Contractors would buy locally and therefore increased their prices. However, as some shipyards began opting to pay applicable fines for not having met the minimum local commitment rules, prices seem to be reverting to competitive levels again.

5 Calculation of Local Content

5.1 Introduction

A variety of doubts arises in connection with the calculation of local content in a project. For example, should the full price of a contract be included in the calculation of local content whenever a contract is entered into with a Brazilian firm? Is it only the first level of the contractual chain that is included, or does the use of subsuppliers/subcontractors also influence the calculation of local content? Are the goods/services provided by a subsidiary of a foreign company with an office in Brazil regarded as imported? Is

there any difference if a foreign supplier makes use of Brazilian personnel or goods produced in Brazil? Finally, what happens if only parts of the goods are imported, or a service is performed in Brazil with the use of imported goods?

Some of these questions have already been answered within this paper. In addition to trying to answer the remaining questions, the present section attempts to provide an overview of the calculation system as it applies to the oil activities as a whole.

The Concession Agreement only contains one provision on calculation of local content. This simply establishes that goods and services that present local content inferior to 10% shall be considered as integrally imported goods and services, i.e., 0% (zero percent) of local content.[67]

Accordingly, only one of the questions made above is directly answered by this provision, that is: imported goods are not to be included in the calculation of local content. In other words, fully imported goods contain 0% of local content. However, the provision also indicates that goods that are partially imported may be included in the calculation of local content provided that its imported portion is not superior to 90%. It thus follows from this provision that the key factor for the calculation of local content is the amount of local content that each good/service contains, and locating a project or facility in Brazil does not suffice.

Such understanding differs considerably from the local content calculation criteria used some offshore contracts throughout the world. For example, in the Development contract used in Iran in 2002, it was not relevant for the calculation of local content

[67] Section 20.2 (d) further establishes that, *"(…) As an exception, only the items of seismic acquisitions and drilling rig chartering to offshore projects and the "drills" sub-items shall be considered".*

whether the goods or services used were imported.[68] The contract specifically stated that the purchase of goods or services from Iranian Suppliers was sufficient for the contract price to be included in the calculation of local content. Accordingly, the Brazilian Concession Agreement seems to impose a more stringent requirement in this respect than other countries have done.

However, how far does this requirement go? As we have seen above, the Concession Agreement specifies that goods with a local content inferior to 10% will not be included in the calculation. Nevertheless, the provision is silent as to how goods that are partially imported will be calculated. Such provision can be understood in at least two different ways. Either goods that have an imported portion that does not exceed 10% are deemed as Brazilian goods and count for 100% of its price, or only the local content portion of the goods and services with local content superior to 10% shall be included in the calculation.

In order to answer this and a number of other questions, a distinction will have to be made between the calculation system used until Round 6, and the methodology introduced by the Local Content Manual in 2004. Since this methodology is still under development, the present section will only provide a brief assessment of the main calculation criteria laid down by this Handbook.

5.2 Regulations in force until Round 6

Until Round 6, the calculation of local content commitments was regulated exclusively by the rules set out in the Concession Agreements. Two distinct concepts served as basis for the calculation under these rules. The first concept referred to “goods and

[68] Grønlie, Bjørn Gisle (2006): “Krav til Nasjonale Underleveranser i Iransk Petroleumsrett”, MARIUS No. 345, p. 76

services origin verification" and the second to "local content evaluation".

5.2.1 Origin verification of goods and services

The origin verification of goods and services consisted of verifying whether a certain good or service was Brazilian or imported. This concept was inspired in the methodology adopted by BNDES in the financing through the earlier mentioned Finame program, as well as in regulations used by regional free trade agreements, specially Mercorur, in their so called "origin rules".[69] In view of the absence of similar procedures, either in theory or in practice, in relation to the local origin verification of services, the methodology employed for services followed the premises and guidelines adopted for the case of goods.

Three key definitions were crucial in the verification of the origin of a goods or services, namely: *"Nationally Produced Goods"*, *"Services Rendered in Brazil"* and *"Brazilian Supplier"*.

During Round 6, *"Nationally Produced Goods"* was defined as:

> "all machinery or equipment, including replacement parts, items and components utilized in Operations, notwithstanding paragraph 20.1., the value of the foreign components and services incorporated does not exceed 40% (forty percent) of the price indicated in the bill of sale, excluding from the value of all foreign components and goods acquired all taxes except for import duties". (my underlining).
>
> Likewise, "Service Supplied in Brazil" was defined as:
>
> "services, excluding financial, of any kind including rentals, leasing and similar services, used in Operations and procured directly or indirectly in conjunction with Brazilian companies which evidence adequate knowledge and capacity with respect to such services, where, notwithstanding paragraph 20.1.4, the value of incorporated foreign components and services does not exceed 20% (twenty percent) of the sales price, excluding taxes". (my underlining)

[69] Nota Técnica da Onip, June 2005. Available at: www.onip.org.br. Last visited on August 10, 2008.

Lastly, Brazilian Suppliers were considered to be any seller or supplier of a nationally produced good or service rendered in Brazil.

Pursuant to these definitions, Brazilian manufacturers were allowed to import raw materials, components and/or parts up to 40% of the sale price of the good and still qualify as a Brazilian-made product. Likewise, suppliers were allowed to render services using foreign equipment, provided that the price of such equipment did not correspond to more than 20% of the total price of the service.

5.2.2 Local content evaluation

The second concept referred to "local content evaluation", which was the process of determining the percentage of participation, in value, of goods and services of local origin in a phase of a project. For example, if a phase had a local content of 55%, this meant that of the total goods and services used during that giving phase, 55% (in value) of those goods and services were of Brazilian origin.

Considering that the local content calculation was based on the ratio of (i) the sum of the values of the Nationally Produced Goods and the Services Supplied in Brazil, acquired directly or indirectly by the Concessionaire, and (ii) the sum of the values of all goods and services acquired directly or indirectly by the Concessionaire during each phase; the key requirement was to establish whether a given good or service fulfilled the minimum levels of national index required in the definitions. These were 60% for goods and 80% for services. Once a particular item of goods or services satisfied this requirement, the whole price thereof would be included in the local content calculation.

Furthermore, since the calculation was primarily based on the amount of national index of the goods and services, the rule did not allow Brazilian Suppliers to act as intermediaries of foreign suppliers by selling 100% imported goods in the national market.

Nevertheless, although the rule attempts to ensure that the goods and services used are truly "Brazilian", the rule does not take into consideration the difficulties in determining the local origins thereof.

It must be noted that the "origin verification" is particularly difficult with respect to the verification of goods, since it forces the parties involved to provide evidence of the values/percentages of all components used in the production of each of the Brazilian goods. The rule, thus, require suppliers to provide highly detailed and confidential information about the costs and components of its goods. The system is also imperfect with respect to the verification of local content of services. To illustrate, in order for a crew to get onboard platforms located in the high-sea, oil companies normally hire the service of "air transport", whose price comprises the lease of helicopters produced abroad and imported into the country. In such case, is the contract treated as a transport contract (service contract), or as a lease of a helicopter combined with the operation of the equipment? These issues have not yet been addressed by the ANP.

5.3 Local Content Manual ("Cartilha do Conteúdo Local")[70]

Minimum local content requirements in the Concession Agreements with the ANP, in the recent tenders for construction of platforms launched by Petrobras, as well as in the financings of the BNDES have called for the creation of a verification system that assured uniformity, transparency and credibility to the various agents

[70] The Manual is a product of the Project IND P&G-5, whose main objective is the creation of a methodology for the verification of Local Content requirements. The Manual is the first step towards the realization of a more complete and detailed work in the future.

operating in the Brazilian oil and gas sector. In view of this need, in 2004 a working group formed by the Ministry of Mines and Energy (MME), BNDES, ANP, ONIP and Petrobras created a Local Content Manual to be employed in the calculation of local content of goods, systems and services used in the oil industry in general.[71] Thus, the Manual applies both to the calculation of local content in the Concession Agreements, as well as to offshore projects such as construction of platforms.

The methodology put forward in this Manual is solely based on costs and confidential information pertaining to manufacturers, suppliers, sub-suppliers and service providers of any component of the supply chain. The Manual requires the companies involved to provide the necessary information for the calculation of local content and to maintain probative documentation in connection therewith. These documents must be kept on file for appraisal purposes for a period of 5 years from the date the Concession Agreement is signed by the ANP.[72]

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[71] The creation of the working group was an initiative from the National Oil & Natural Gas Industry Mobilization Program (PROMINP), which was created by the federal government in December, 2003. The program was created with the objective to maximize national goods and services content, on a competitive and sustainable basis, in the implementation of oil and gas projects in Brazil and abroad.

[72] In compliance with contractual requirements which have been established since Round 7, the ANP has recently concluded the regulation process of the Local Content Certification System. This regulation comprises a set of four Administrative Acts on: Local Content Certification, Entity Accreditation for Local Content Certification, Auditing Certifying Entities, and Local Content Investment Reports. Such certification system, which is based on periodic audits by certified companies, is expected to generate new work opportunities and to create a new market niche. The respective Acts can be found at: http://www.brasil-rounds.gov.br/english/ conteudo_local.asp. Last visited on August 10, 2008.

So, although the Concessionaire remains responsible towards the ANP for information regarding local content, its subcontractors will have to certify the local content of its products and keep available all the information and documents necessary for the calculation of local content so that, should the need arise, probative evidence can be presented for auditing purposes. As a result, the safekeeping of probative documentation for calculating the local content should preferably be subjected to an agreement between the buyer and the Suppliers (and sub-Suppliers), on condition that such items must be delivered on request of the appraiser.

5.3.1 Local Content of Goods

The local content of goods is now divided into equipments, systems and subsystems. With respect to equipment, local content is calculated based on the deduction of the value of the imported parts of goods from their total commercialization value, i.e. only the commercialization value of the national "share" of the equipment is to be included in the calculation.

Hence, as opposed to the rule in force until Round 6, where goods were considered as fully national provided that their imported components did not exceed 40%, the rule now demands the separation between the national and foreign parcels of each item of the goods, which will be added to verify if the Concessionaire has reached the local content volumes foreseen in the Concession Agreements/EPC contracts. In other words, instead of verifying the national origin of each of the goods, where minimum national indexes are considered, the national content of each product must now be determined individually. For example, to evaluate the national content of an industrial unit, only the shares of national value of materials, equipment and services will be considered.

The Manual also classifies as imported components that, although acquired in the domestic market, have been produced outside of the

country. That is, re-sale of imported goods has local content equal to zero. Doing so prevents suppliers from "nationalizing" components imported into the country by third parties.

With regard to the measurement of the local content of systems and subsystems, the materials and services that compose these structures are also considered. Platforms, oil tankers and *offshore* support vessels are normally considered as systems, while the integral parts of these bigger systems, e.g. modules, are considered as subsystems.

5.3.2 Local content of services

In view of the absence of similar procedures in relation to the local origin verification of services, the Manual initially adopted a simplified methodology for them. This methodology is exclusively based on the costs of manpower, and does take into consideration any other element included in the price of a service.

Local manpower was defined as:

> "the manpower applied by the employment of local (Brazilian) citizens, in accordance with current Legislation, or foreigners with permanent visas employed by service rendering establishments as sub contract manpower (which must be registered in the CNPJ – Corporate Taxpayer's Roll), or by free-lance workers".[73]

Accordingly, work carried out by foreign individuals present in Brazil under Temporary Visas, or Work Permits issued to Foreigners, or work carried out by those not legally qualified for work within Brazil, will not be considered as Local Employment Work.

Moreover, if a service is rendered by a company not registered on the Brazilian Companies Register (CNPJ), or is billed in a foreign currency, the service will be considered as totally imported. Notwithstanding this, when applicable, the costs of Brazilian labour

[73] "Cartilha do Conteúdo Local" available at: www.prominp.com.br Last visited on August 05, 2008

arising from the subcontracting of local companies or freelance operators for carrying out the service, can be accounted for in the national portion, based purely on costs effectively incurred and appropriately recorded as such.

Although the use of this method does not lead to significant discrepancies with respect to services basically composed of manpower, its application to services, where the use of imported materials represent a considerable part of the price of the service, causes the local content result to be unrealistic. Moreover, the alteration of criteria creates great discrepancy in the case of services rendered with the same equipment when compared to the rules in force until Round 6. When the previous methodology is applied, the local content of the same service might be materially higher when compared to the result under the Manual's system. This discrepancy has led to many criticisms from the industry's players, who are no longer able to include some services which previously qualified as local content in the calculation thereof.

These players see this alteration of criteria as highly detrimental to their activities and expect changes to occur soon. In this respect, the group responsible for the creation of the Manual is analyzing the possibility of adopting, in the future, a more detailed methodology based on the criterion of "added value", which considers the costs of all the components of a service, not being restricted to the expenses relating to manpower.

6 Concluding Remarks

In summary, it can be concluded that the Brazilian local content system is an important, but unpredictable instrument used by the Brazilian government in the development of its local industry. The different levels of local content required are in principle readjusted periodically by the ANP so as to reflect the actual capacity of the

local industry in the respective period. Over the last years, the contractual provisions have gradually developed becoming even more complex and sophisticated. The development of the local content in the Concession Agreement took place at the same time as Petrobras introduced stringent local content requirements in the company's bidding rules for construction of platforms. Although local content requirements had been used by the ANP since the first Bidding Round for concession blocks in 1999, it was only in 2003, after President Lula took office, that Petrobras' trend to require high percentages of local content became apparent. Local content rules are thus still under constant development and the creation of a Local Content Manual reflects the government's wish to confer uniformity and credibility on the various players of the industry.

It must be questioned, however, if the regulations in force today really achieve its purposes. That is, do they really promote the participation of local firms in oil related activities under competetive basis?

In Brazil, there is a major focus on the fulfilment of the local content percentages in the different projects. However, the achievement of local content percentages does not indicate whether unemployment rates have reduced or whether the competitiveness of the local firms has increased.

In order to obtain a more accurate idea of the achievements of local content rules, the initiatives of PROMINP[74] and the regulations on investment in Research and Development must also be taken into consideration. These rules supplement the local content obligations. Since the creation of PROMINP in 2004, the participation of the national industry in the investments of the sector increased from 57% in 2003, to 74,5% in the first quarter of 2007,

[74] The mobilization program responsible for the maximization of the goods and services national content on a competitive and sustainable basis

which represents a significant additional expenditure of US$ 5,9 billion in local goods and services.[75]

Additionally, investments amounting to R$ 48 million are being made in the development of suppliers. The objective is the competetive substitution of the import of 26 essential materials and equipment, which are currently not being produced by the national industry. So, both in terms of increasing indigenous technical skills and job creation, the Brazilian local content program coupled with the mobilization program initiatives can be said to have worked. Requiring products to be manufactured in Brazil rather than simply requiring contracts to be entered into with Brazilian firms has certainly contributed to the success of this policy. Doing so has avoided the possibility that Brazilian suppliers could be used as mere intermediaries.

However, although "successful", the system contains numerous hidden complexities. The certification of local content is one of them. Manufacturers and sub-suppliers are required to provide extremely detailed and confidential information about all components of the supply chain. Since oil companies remain liable to the ANP for all information provided in this respect, they depend on the information provided by the suppliers and manufacturers in order to prove that the minimum investment percentages have been achieved.

Another drawback of the system is the high level of discretion conferred on the ANP. Any regulation that grants too much discretion to the regulator is liable to have the perverse effect of making those regulators violate the very spirit of the regulation.

Finally, although the policy can be said to have worked, the government should bear in mind that increasing levels of local content might not be the most appropriated measure to guarantee

[75] www.prominp.com.br

the development of the local industry on a long term basis. With the recent discoveries at Tupi, Jupiter and Carioca, it is possible that the government might decide to impose even stronger local requirements, so that the local industry can be responsible for nearly all goods and services required. As we have seen, if these targets are set too high, local firms might become overconfident and increase their prices. If this happens, contractors have already demonstrated that they may opt to pay the applicable fines and procure their goods abroad. As such, local content policies should ideally only be used on a short term basis.

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