# SIMPLY

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# SIMPLY 2009

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# Overview of content

# Director's preface

As mentioned in the 2008 preface, the Institute has for several years produced a large number of doctoral theses. In order to keep some of these candidates at the Institute for further research, we have in 2009 had several post docs working on new projects. Most of these are included in the Safety, Security and Discharge Control at Sea Project, which was the main research activity at the Department of Maritime Law during 2008. The project, which is chaired by Professor Erik Røsæg, includes several post docs, PhD candidates and research assistants, and has already generated numerous publications. The project also encompasses the Department of Petroleum and Energy Law, where one PhD candidate is writing about safety issues in the petroleum sector. The project is financed from different sources including the Norwegian Research Council, the Scandinavian Council of Ministers, the Norwegian Oil Industry Association and Johan and Mimi Wessmann's Foundation. **More information about the project may be found at** http://www.jus.uio.no/nifs/forskning/prosjekter/sjosikkerhet/index.html.

In addition, at the Department of Maritime Law, we are continuing our research in traditional maritime contract law with a main focus on multimodal contracts and the newly signed Rotterdam Rules. We are also extending our focus to consumer protection in maritime law, in particular, passenger liability. Further, we had our second research assistant financed by the P&I Club Skuld, who is writing about co-insurance in P&I insurance.

At the department of Petroleum and Energy Law, research is concentrated on issues of petroleum contract law (which has resulted in two contributions to this edition of Simply) and energy market law, but we also look into international investment law and topics on the borderline between energy and environmental law, including renewable energy and $CO_2$ capture and storage. Developments in Norwegian licensing policy are also subject to research.

As in previous years, in 2009 the Institute received 25% of its funding from the Scandinavian Council of Ministers, something for which we are 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
- Johan and Mimi Wessmann's Foundation
- Skuld

All our sponsors` contributions are highly appreciated.

We would also like to express our gratitude to the numerous practitioners who help us with lectures, student advice, information and examination proceedings year after year, in most cases without charging 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 Programmes.

During 2009, the Master of Arts in Marine Insurance and Risk Management has been developed and renamed Risk Management and Marine Insurance. The purpose of the restructuring has been to shift the focus from marine insurance to the total handling of risk in maritime sector. The second round of the programme will start in January 2011. The programme is still offered in cooperation with the Norwegian University of Science and Technology and the University of Gothenburg.

Together with sister institutions at the universities of Aberdeen, Copenhagen and Groningen, the Institute has also established the North Sea Energy Law Programme (NSELP), which is an advanced two-year programme for practitioners, covering all aspects of

energy law. NSELP is supported by the EU Erasmus Lifelong Learning Programme. The first two weeks of intensive teaching took place in Oslo in January 2010.

More than two dozen evening seminars were held during the year, as well as half-day seminars in cooperation with the Norwegian Shipowners' Association. Seminars extending over two or more days, on the other hand, have been less numerous, as these often take place every second year. The planned Biannual Colloquium in Maritime Law (IBCML), to be held in Southampton in the autumn of 2009, was postponed to the autumn of 2010 due to financial problems. The seminar, which is organized in cooperation with the University of Southampton, UK, and the University of Tulane, USA, will be held in October 2010 instead.

The energy law seminar in Noordwijk aan Zee, Netherlands (in co-operation with Nederlandse Vereniging voor Energierecht and the University of Groningen), did, however, take place as scheduled in 2009.

We hope to be able to promote more joint seminars in the future.

Trine-Lise Wilhelmsen

# Editor's preface

We hereby present the annual edition of Simply 2009, published by the Scandinavian Institute of Maritime Law. This yearbook follows a well-established tradition of covering a wide range of topics within maritime, transport and petroleum law.

The article collection of Simply 2009 begins with Professor Trine-Lise Wilhelmsen's article which discusses the regulation of marine insurance in several European countries and examines the effect of regulation on the attainment of perfect competition in the marine insurance market. Professor Wilhelmsen's article is based on her presentation at the European Colloquiums of Maritime Law Research held in Athens, May 2008, in a coordinated effort between the Law Faculty of the University of Athens, the Hellenic Association of Maritime Law and our Institute. This article was originally published by Koninklijke Brill NV in the book *Competition and Regulation in Shipping and Shipping-related Industries* (2009) and is re-printed here with the kind permission of the publisher.

The following article of the yearbook dedicated to *lex mercatoria* in international private maritime law was written by Donato Di Bona, attorney, PhD, and researcher at University of Palermo, Economics, Transport and Environment law Department, who was a guest researcher at the Institute in August-September 2009.

We are also very glad to present two articles that address legal issues arising in the petroleum sector. The article written by Attorneys-in-Law Vidar Strømme and Svein H. Bjørnestad broaches the topic of Professor Hans Jacob Bull 's article in Simply 2008, p. 41, opposing his arguments with respect to liability implications of the operator in fabrication contracts in case of CAR (Construction All Risks) insurer's bankruptcy.

Further, Professor Knut Kaasen contributes to the petroleum law topic by analysing formal rules in offshore construction contracts applied to disputes between the parties (in an ongoing con-

tract). Professor Kaasen analyses the advantages and disadvantages of formalistic procedural rules in this sector, such as preclusive time limits for presenting claims.

Professor Thor Falkanger examines freight forwarders' means to secure in advance their claims for compensation against the customer, particularly where cargo transported is used as security. Professor Falkanger's article is written from the Norwegian perspective and is based on the NSAB 2000 (General Conditions of the Nordic Association of Freight Forwarders).

Professor Erik Røsæg writes about the implementation of international conventions in Scandinavian countries and examines whether the Rotterdam Rules (the 2009 United Nations Convention on Contracts for the International Carriage of Goods Wholly or Partly by Sea) should be transposed into the domestic laws of these countries in a traditional way (by rewriting and adapting the text of the convention) or whether they should rather be incorporated en bloc to keep them as close to the text of the Convention as possible.

Last but not the least, two Master theses have been chosen for publication in Simply 2009. Iris Østreng, an LLM student in 2008–2009, ventured to write her thesis on the control of vessel-source pollution in the disputed area of the Barents Sea. Although the maritime boundary dispute recently has recently been settled between Norway and Russia, the problems discussed in the thesis remain relevant for the debate on environmental protection in the HHigh North.

The 2009 edition is wrapped up by Joar H. Støylen's (University of Bergen, 2009) Master thesis, which deals with a topical issue of EU competition law, namely that of the repeal of the liner conference block exemption and the new competition regime of the European Union for liner shipping.

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

Alla Pozdnakova

# Marine insurance regimes and their impact on shipping competition[1]

Trine-Lise Wilhelmsen, Professor and Director of the Scandinavian Institute of Maritime Law, University of Oslo

[1] This article was first published in Antapassis, Athanassiou and Røsæg (ed): "Competition and Regulation in Shipping and Shipping Related Industries", Martinus Nujhoff Publishers, Leiden 2009, p. 290 ff.

# Content

# 1 Introduction

The purpose of this paper is to discuss the extent to which the regulation of marine insurance in different European countries encourages or discourages the attainment of perfect competition in the marine insurance market. Since this seminar is focused mainly on the shipping business, the discussion here relates to hull insurance. I will approach the issue by discussing the various insurance regimes in the context of economic efficiency. Since economic efficiency is the goal of perfect competition, this approach will also describe the effect of the various regimes on competition in shipping.

The framework for the discussion is a theory in law and economics known as the theory of the perfect contract. However, the framework will also include some aspects of the EU's regulation of competition. Although it is not the intention here to discuss these rules in detail, some basic features of the regulation are outlined in chapter 2 as background to the legislative position in relation to marine insurance. Thereafter chapter 3 describes the theory of the perfect contract. A major issue raised in the context of this theory is the extent to which legislation is mandatory: this issue of mandatory legislation is discussed in relation to marine insurance in chapter 4. Chapter 5 discusses the marine insurance product in different countries in order to shed light on two other important issues, both in relation to the theory of the perfect contract and in relation to EU law: namely the question of transaction costs and the issue of cooperation among companies.

The discussion covers the marine insurance regimes in Norway, Denmark, Sweden, Finland, the United Kingdom, Germany, Belgium, France, Spain, Italy and Greece.[1]

[1] According to 2007 CEFOR Statistics – Part 2, these countries effect hull insurance for ca 55 % of the marine hull premium in the world, jfr. http://www.cefor.no/statistics/statistics.htm.

The material on which this paper is based has been gathered mainly through my work in the CMI's working group on the harmonisation of marine insurance clauses. This means that some of the information has been gathered from questionnaires sent by the CMI to the various Member States, rather than by studying the provisions themselves.[2] This is particularly true in relation to national insurance legislation, which is often not translated into English. Most of the insurance policies, on the other hand, have been translated and have therefore been consulted directly.

## 2 EU regulation: some starting points

The starting point when considering EU regulation of marine insurance is that insurance is defined as a financial service and, accordingly, articles 49 *et seq* of the EU Treaty apply. Further, the rules on the right of establishment in articles 43 *et seq* of the Treaty apply to insurance. Articles 43 and 48 presume a gradual reduction of restrictions that may prevent free establishment and free movement of services throughout the Union. In addition, several directives have been implemented with the aim of securing free establishment of insurance companies and free movement of insurance services.[3] However, these rules have few implications for insurance

[2] The full analysis of this material is found in Wilhelmsen: "The marine insurance system in Civil Law Countries – Status and problems", in: MarIus no. 242 (1998), p. 15 *et seq*, "Issues of marine insurance (Wilhelmsen 1998). Duty of disclosure, duty of good faith, alteration of risk and warranties in the civil law countries", in: SIMPLY Scandinavian Institute Yearbook of maritime law 2000, pp. 239–292. "Issues of marine insurance. Duty of disclosure, duty of good faith, alteration of risk and warranties", in: SIMPLY Scandinavian Institute Yearbook of maritime law 2001, pp. 41–169, CMI Yearbook 2000 Singapore I, "Issues of marine insurance. Misconduct of the assured and identification", SIMPLY Scandinavian Institute Yearbook of maritime law 2002, pp. 117–172.

[3] Directives 73/239/EEC, 88/357/EEC and 92/49/EEC on casualty insurance, *cf.* Bull: Innføring i forsikringsrett. 9th edition. Oslo, 2003 pp. 67–68.

contract law. Until 1980, the EU had plans to harmonise legislation governing insurance contracts,[4] but it proved difficult to obtain agreement between the Member States.[5] Instead, the insurance directives contain rules on choice of law in insurance. However, these rules are not mandatory in relation to the insurance of ocean-going ships.[6] Some directives apply to insurance contracts, but not marine insurance contracts. This implies that the Member States and insurance companies are free to regulate marine insurance within the ordinary framework of EU competition law.[7]

Agreements between insurance companies that limit or prevent competition, or that may influence trade between Member States are prohibited, *cf.* article 81 (1) of the EU Treaty. However, in 1991, the Council provided the Commission with the authority to declare that article 81 (1) (previous 85 (1)) shall not apply to certain categories of agreement between insurance companies, decisions of associations of insurance companies and concerted practices in the insurance sector, which have as their object cooperation with respect to, *inter alia,* the establishment of common standard policy conditions and the common coverage of certain types of risk.[8] Any regulation adopted pursuant to this provision must be of limited duration.[9] The Commission has used this opportunity to provide a group exemption for these kinds of agreements.[10] The presumption is that collaboration between insurance companies goes beyond the type of collaboration the Commission has permitted in its notice concerning cooperation between enterprises and, is caught

4 Draft directive "on the coordination of laws, regulations and administrative provisions relating to insurance contracts" 1979, and revised draft 1980.

5 Bull (2003) p. 69.

6 Directive 88/357 articles 7 and 8, Directive 92/49 article 27 and the Norwegian act on choice of law in insurance § 9 (a) first subparagraph.

7 According to *Verband der Sachversicherer v. Commission*, judgment 45/85, the competition rules in the EC Treaty also apply to insurance companies.

8 Council Regulation (EEC) No 1534/91 article 1, 1 letters (b) and (c).

9 Ibid. Art 1, 2 (b).

10 Commission Regulation (EEC) no. 3932/92.

by the prohibition in article 81 (1).[11] The exemption applies to agreements, decisions and concerted practices which have as their object the establishment and distribution of standard policies for direct insurance. The regulation lists several conditions that must be satisfied in order for the exemption to apply, *inter alia,* that the standard conditions are accompanied by an explicit statement to the effect that they are purely illustrative and that different conditions may be agreed.[12] It follows from this that standard agreements in marine insurance are permitted within the conditions of this group exemption.

# 3 The economic theory of the perfect contract and its conditions

## 3.1 The theory of the perfect contract

This section of the paper will establish the relationship between freedom of contract and the perfectly competitive market. The starting points for this analysis are welfare economics and the goals of private and social allocation efficiency. The framework used is Cooter and Ulen's theory of the perfect contract.[13] The theory establishes freedom of contract as a prerequisite for a perfect market, but also defines the limitations of this relationship and situations where it is necessary to limit the freedom of contract.

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11 Ibid. preamble (3).

12 Ibid. articles 5 and 6 (1) (a) and (b). Further, the exemption shall not apply in cases where the conditions contain clauses as listed in article 7.

13 Cooter and Ulen: Law and Economics, 2000 p. 229 ff., 2004 p. 195 *et seq*, Wilhelmsen: Fairness and Efficiency under Section 36 of the Nordic Contract Acts, in: Law and Economics: Methodology and Application, pp. 34 *et seq*., Wilhelmsen: Section 36 of the Nordic Contract Acts in an Economic Perspective, in: Dahl/Nielsen (ed): New Directions in Business Law Research, pp. 121–123.

The perfect contract is a contract enabling the parties to the contract to achieve their private economic goals. This theory of the perfect contract combines the use of a contract as a legal instrument with the micro-economic theory of rational decision-making. The analytical method is the same as that employed for analysing the perfectly competitive market: the identification of the assumptions under which the contract is perfect. If the contract is perfect, it is defined as being consistent with economic efficiency and consequently it is not efficient to refuse to enforce it. On the other hand, if the assumptions for the existence of a perfect contract are not fulfilled, it is not inconsistent with economic efficiency to refuse enforcement.

Micro-economic theory focuses on choices arising in immediate transactions. For example, should the decision-maker purchase an apple or a newspaper? In the theory of rational decision-making a legally binding promise is unnecessary, because the purchase will occur immediately. But if the exchange involves the passage of time for completion – *i.e.,* the exchange is deferred – then a legally binding promise is required to ensure the enforceability of the exchange. Promises are prospective; they are meant to limit the promisor's actions in the future. Rational decision-makers willingly promise to limit their future actions when the expected benefit of so doing exceeds the expected costs.[14]

One of the main conclusions of welfare economics is that a perfectly competitive market is socially optimal because it is efficient with respect to both the production of goods and their allocation to consumers. This is the familiar concept of "Pareto efficiency". Cooter and Ulen extend this result to contract law by stating that a perfectly competitive market results in perfect contracts, and that a perfect contract by definition is efficient – *i.e.* Pareto efficient – and should be strictly enforced according to its terms.

[14] Cooter and Ulen (2004) p. 196.

The argument is as follows: if it is possible to revise a contract so that at least one party is better off and the other parties are not worse off, then the contract is inefficient. On the other hand, if such a revision is impossible, then the contract is efficient, *i.e.,* Pareto efficient. Perfect contracts are complete: every contingency has been anticipated; the associated risk has been efficiently allocated between the parties; all relevant information has been communicated; nothing can go wrong. A perfect contract is also efficient: each resource has been allocated to the party who values it the most and each risk has been allocated to the party who can bear it at least cost. The terms of the contract exhaust the possibilities for cooperation between the parties.[15]

If the parties have negotiated a perfect contract, the contract will have no failures, so the parties will not require recourse to a court to interpret its terms. The parties to a perfect contract need the State to enforce their agreement according to its terms, but nothing more is required of the State.[16]

In the same way that few markets achieve the ideal of perfect competition, promises seldom achieve the ideal of the perfect contract. The model of perfect competition is constructed from a set of assumptions about the structure of the market and the conduct of its participants. If these assumptions are satisfied, then the market is efficient. But if the market does not satisfy these assumptions, then it is usually inefficient. The term "market failure" describes a situation in which a market departs so far from the assumptions described above that its performance is impaired. By determining which of the assumptions have been violated, the cause of the market failure can be identified and measures effected to remedy it.[17]

15 Cooter and Ulen (2004) p. 218.
16 Cooter and Ulen (2004) p. 218.
17 Cooter and Ulen (2004) p. 218.

## 3.2 The assumptions of the perfect contract

According to the Coase Theorem, rational parties will draft a perfect contract when transaction costs are zero. When transaction costs are zero, the contract will be complete because negotiating additional terms costs nothing. Given a perfect contract, State regulation that discards or modifies terms will create inefficiencies. In general, regulation of contract terms negotiated by rational people under zero transaction costs causes inefficiencies.[18]

Conversely, contracts are imperfect when the parties are irrational or transaction costs are positive. The assumption of rationality is less important in the marine insurance sector where the parties are generally highly professional. However, the assumption of rationality includes an assumption of voluntary exchange. Economic theory assumes that the decision-maker, within the constraint of his budget or income, has freedom to choose which transactions he wishes to enter into. When freedom of choice is limited, there is a contract failure.[19] This part of the assumption of rationality is closely connected to the concept that monopoly constitutes a market failure, as described below.

On the other hand, the assumption concerning the absence of transaction costs is relevant. Making a contract involves searching for parties, negotiating terms, drafting the contract, and enforcing it. Searching takes effort, negotiations takes time, drafting takes expertise and enforcement takes perseverance. In many contracts, these transaction costs are small relative to the benefits of cooperation. In other cases, the transaction costs will be large relative to the benefits generated through contractual cooperation and will sometimes be sufficiently large to preclude cooperation.

The theory distinguishes three kinds of obstacles to efficiency that arise when transaction costs obstruct bargaining. The first

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18 Cooter and Ulen (2004) p. 218 and pp. 44–45.

19 Cooter and Ulen (2000) pp. 234 and 241, Cooter and Ulen (2004) p. 219 and pp. 44–45

obstacle is called spillover, which means that the contract has third-party effects that are not included in the negotiations between the parties and therefore not included in the transaction costs. This can be compared to external costs that cause the individual's self interest to diverge from social efficiency. An example of spillover relevant in our context would be contracts between companies not to compete with each other. This type of obstacle to efficiency is consistent with the prohibition against cartels in the EU Treaty.[20]

Closely related to spillover are monopolies that are created because high transaction costs or other barriers prevent alternative sellers from competing. Competitive markets contain enough buyers and sellers to allow each person many alternative trading partners. In contrast, oligopoly limits the available trading partners to a small number, while monopoly limits the available trading partners to a single seller.[21] Monopoly also represents an obstacle to efficiency because it is inconsistent with the theory's assumption of individual rationality, as the presence of monopoly power undermines the condition that a promise must be voluntary in order for it to be enforceable.[22]

A third obstacle, which arises in relation to transaction costs, is asymmetric information.[23] In the competitive model, full information means information about the price and quality of the goods. When forming a contract, lack of information about the terms or consequences of the contract can constitute a contract failure.[24] In the insurance market, the insurance contract is the "product". If the buyer of insurance has the same information about the product as the seller, there is no asymmetry of information. On the other hand, if the buyer has less information about the product, the information will be asymmetric. In general, ignorance is rational

[20] Cooter and Ulen (2004) p. 220.
[21] Cooter and Ulen (2004) p. 223.
[22] Cooter and Ulen (2000) p.p 235–236.
[23] Cooter and Ulen (2004) p 221.
[24] Cooter and Ulen (2000) pp. 235 og 241.

when the cost of acquiring information exceeds the expected benefit from being informed.[25] Accordingly, if the buyer's cost of defining the content of the insurance product is high, there is a risk of asymmetric information in which the buyer lacks full information. This may constitute a contract failure.

## 3.3 Application to the marine insurance regimes

It follows from the theory of the perfect contract that the parties in a perfect market will enter into perfect contracts and that these contracts will conform to economic efficiency. In a perfect market, freedom of contract should therefore be the rule. Mandatory regulation of contracts may prevent some people from maximising their benefits, even though others are not making a corresponding gain. [26] This may be illustrated by the following example:

The insurer will calculate a premium that includes all the costs inherent in the insurance product. This includes the risk involved. A narrow scope of coverage will involve a lower premium, whereas a broad scope of coverage will raise the premium. Similarly, rules for the protection of the assured in relation to his own acts (disclosure, negligence *etc.*) will raise the premium, whereas provisions that exclude casualties caused by negligence *etc.* will transfer more risk to the buyer and result in a lower premium. The buyer of insurance will also calculate the risk in the insurance contract. However, different buyers will calculate the risks involved differently and they may also calculate the risks differently from the insurer. This is because buyers will have different attitudes to risk and thus different needs for various levels of protection. One buyer may be willing to pay more for insurance in order to get a higher monetary amount of coverage or broader protection, whereas another less risk-averse buyer may be willing to accept a higher risk in exchange for a reduced premium. If the content of the insurance is deter-

25 Cooter and Ulen (2004) p. 221.

26 Wilhelmsen: Rett i havn. Oslo, 2007. p. 316.

mined by mandatory regulation, the less risk-averse, or more risk loving buyer will not be able to buy insurance corresponding to his needs. If the legislation is discretionary, less risk-averse buyers will be better off. At the same time, a more risk-averse person will be able to keep his preferred level of protection by obtaining a policy that adheres to the provisions of the legislation.

An analysis of the extent to which mandatory legislation applies to marine insurance is therefore useful in studying the potential obstacles to the perfect contract, as discussed in chapter 4 below. However, a contract is only perfect if there is no contract failure due to transaction costs or lack of rationality due to barriers to the making of a voluntary choice. In order to shed light on potential contractual failures in the form of spillover costs, monopoly and asymmetric information, it is necessary to examine how marine insurance contracts are produced in different systems and the content of the product, as discussed in chapter 5 below.

# 4 National mandatory legislation

All the civil law countries appear to have some sort of public legislation concerning insurance contracts, either incorporated into a more general commercial act or in the form of an act specifically applicable to insurance contracts. In most of these countries, however, this legislation is mostly either discretionary in its application to marine insurance in general or discretionary in general subject to a few exceptions.

The four **Scandinavian** countries previously had a common Insurance Contract Act (ICA), dating from around 1930. This act was discretionary unless there was provision to the contrary, but contained several mandatory rules that also applied to marine insurance. This act still applies in **Denmark**, although it was

amended in 2003.[27] The other three Scandinavian countries have new ICAs.[28] The approach in **Norway, Sweden** and **Finland,** is that insurance regulation is generally mandatory, but marine insurance is excluded.[29] Accordingly, in Norway, Sweden and Finland there is full contractual freedom in relation to hull insurance.

The Danish ICA contains general provisions that apply to all kinds of insurance as well as separate provisions applicable to marine insurance. The latter provisions are not mandatory and in little use as these rules are contained in the more specific Danish Marine Insurance Convention, as discussed below. The mandatory application of the act includes the duty of disclosure,[30] increase of risk,[31] safety regulation,[32] the insurer's right of sanction against an assured who breaches his duties concerning the insured event,[33] the concept of insurable interest,[34] negligence of the assured,[35] and valuation.[36]

The Scandinavian legislation also contains a common rule concerning unfair contracts, stating that contracts that provide for unfair results may be set aside partly or in full. [37] This rule is mandatory and applies also to professional contracts.

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27 Danish Insurance Contracts Act dated 15 April 1930 (Danish ICA), as amended by Act no. 434 10 June 2003 and Act. no. 451 9 June 2004.

28 Norwegian Insurance Contracts Act (Norwegian ICA) dated 16 June 1989, Swedish Insurance Contracts Act 2005:104 (Swedish ICA), Finnish Insurance Contracts Act 28 June 1994 (Finnish ICA).

29 Norwegian ICA sections 1-3, excluding insurance in relation to ships that have to be registered according to the Maritime Code of 24 June 1994, Swedish ICA chapter 1 § 6 cf, § 7 excluding commercial marine insurance, and Finnish ICA § 3 third subparagraph, excluding commercial marine insurance.

30 Danish ICA § 10 ref. § 5, 7, 8 and 9.

31 Danish ICA § 50 ref. §§ 45-49, .

32 Danish ICA § 51.

33 Danish ICA § 23 *cf.* §§ 22-21.

34 Danish ICA § 35.

35 Danish ICA § 20.

36 Danish ICA § 39.

37 Norsk avtalelov av 31. mai 1918 nr. 4 § 36, dansk Lov om aftaler og andre retshandler på formuerettens område, Lovbog nr. 600 af 8. september 1986 § 36, svensk Lag om avtal och andra rättshandlingar på förmögenhetsrättens område (1915:218) § 36, finsk Lag om rättshandlinger på förmögenhetsrättens

**France** has a general Insurance Contracts Act (ICA)[38] that deals with marine insurance in chapter VII. The French ICA contains some mandatory rules, but the number of mandatory rules is limited due to the international character of marine insurance. There are, however, general mandatory rules concerning, *inter alia,* insurable interest, duty of disclosure, duty of disclosure in the case of alteration of risk, fraud regarding the insured value, and obligation of good faith in the declaration of the insured event.[39] In addition there are mandatory rules applying to marine insurance concerning wilful misconduct and gross negligence.[40]

In **Germany,** a general Insurance Contracts Act dates from 1908,[41] but this Act does not contain provisions applicable to marine insurance. The previous German administration proposed a draft reform of this act which will also apply to marine insurance, but the parties will still be able to contract out of its provisions.[42] In addition, the German Commercial Code contains legislation on marine insurance.[43] This legislation is discretionary and in practice is no longer applied. Apparently, the rules of the Commercial Code have been replaced in practice by Standard Insurance Conditions which were introduced into the German Marine Insurance Market in 1919, as described in more detail below.

The **Belgian** Maritime Code (MC) contains special provisions applicable to marine insurance[44] that are complementary to the

område (1982/956) § 36.

38 Loi no 67-522 du 3 juillet 1967 sur les assurances maritime. This legislation is not translated into English and so information about the rules has been obtained from the CMI questionnaires.

39 Article L 171-3, L 172-2, L 172-3, L 172-6 and L 172-28, *cf.* CMI questionnaire.

40 Art. L 172-13, *cf.* CMI questionnaire.

41 VVG, or Versicherungsvertragsgesetz, *cf.* CMI questionnaire.

42 CMI Yearbook 2005/2006 p. 389.

43 HGB, or Handelsgesetzbuch section 778-900.

44 VI "Assurances Maritimes", articles 191 to 250, *cf.* information from the CMI questionnaire. The legislation is not translated into English.

general Insurance Law.[45] Both the 1874 Insurance Law and the provisions of the MC are discretionary in relation to marine insurance.

In **Greece,** rules on insurance contracts were incorporated in the Commercial Code until 1997. The relevant provisions of the Commercial Code have now been superseded by Law 2496/1997. In addition, the Greek Code of Private Maritime Law of 1958 (CPML), chapter 14, contains special provisions applicable to marine insurance. According to section 257 of the CPML, sections 189 to 225 of the Commercial Code also apply to marine insurance, unless they are incompatible with the nature of marine insurance and insofar as they are not modified by the specific provisions if the CPML. As mentioned, the Commercial Code has been replaced by Law 2496/1997. The provisions in the CPML are mostly discretionary, although there are some mandatory provisions.

Under **Italian** law, sections 1882 to 1932 of the Civil Code (Italian CC) regulate insurance contracts. According to section 1885, these provisions also apply to marine insurance insofar as marine insurance is not governed by the Code of Navigation (C Nav).[46] Apparently, the insurance provisions of the CC have the status of special rules of maritime law and apply to marine insurance unless the C Nav specifically provides otherwise. The C Nav contains a section relating to marine insurance (Articles 514–547).

As a starting point, the Italian CC is discretionary, but some rules are mandatory. These include, *inter alia,* those applicable to the duty of disclosure, the alteration of risk, and the duty to salvage property, with the related right to compensation for salvage.[47]

In **Spain,** marine insurance is regulated by the Spanish Code of Commerce (C Com) of 1885 (sections 737-805). Provisions appli-

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45 dated 1l th June 1874 (1874 Insurance Law).

46 This material is from the CMI questionnaires, cf. further Wilhelmsen (2001) p. 50–51. A translation of the rules was provided, but not the date of the legislation.

47 Italian CC article 1932 *cf.* 1892, 1893, 1897, 1898, 1914 and 1915.

cable to marine insurance are also found in the Spanish Insurance Contract Act (Spanish ICA), but the application of this act is not mandatory in the case of large risks, including marine exposures.[48] As the application of the C Com, as a starting point, is not mandatory at all, this means that the parties to the contract are free to depart from the legislative regulation. However, there are some rules that are mandatory, including those concerning the concept of indemnity and good faith.

The Spanish ICA is a very consumer-friendly piece of legislation, in sharp contrast to the Spanish C Com and the commercial contractual conditions. These differences between the two pieces of legislation and between the legislation and commercial contractual solutions seem to have caused some problems and the legislation is in the course of being revised. A draft Marine Insurance Act has been prepared under the auspices of the Spanish Maritime Law Association and has been submitted to the "Commission de Codificación" (Codified Legislation Committee) for further analysis.

The statutory basis for marine insurance law in the **United Kingdom** is the Marine Insurance Act 1906 (UK MIA) which sought to codify pre-existing common law relating to marine insurance. By 1901, it was estimated that over 2,000 reported court cases dealt with issues of marine insurance. This judicial precedent and numerous market practices are reflected in the 1906 Act.

The UK MIA contains no specific provision stating whether or not its application is mandatory. Accordingly, each clause must be considered individually to establish whether its application is mandatory. Some clauses contain definitions and thus may not be departed from, while interpretation of others shows their application to be mandatory. However, some of the provisions of the UK MIA apply only "*subject to any express provision in the policy*" or *"unless the policy otherwise provides"*. If so, the parties are free to depart from these particular provisions.

[48] Ley del contrato de seguro of 1980, sects. 44.2 and 107.2, *cf.* CMI questionnaire.

# 5 The marine insurance product

## 5.1 The conditions

Chapter 4 above has demonstrated that, except for a few mandatory provisions in some countries, marine insurance is subject to substantial commercial freedom. This contractual freedom is mainly used to establish standard contract forms regulating marine insurance conditions in each country. However, the manner in which these standard contracts are drafted and structured varies among the different countries.

In **Norway**, marine insurance is regulated commercially by the Norwegian Marine Insurance Plan (NMIP) 1996, version 2007.[49] The NMIP provides all rules relevant for marine insurance, both general rules and rules relating to specific types of marine insurance. Consequently, the Norwegian ICA plays only a minor role as background legislation, if any. As the NMIP is continually amended by a permanent revision committee, supplementary conditions are not necessary. The NMIP is drafted by a broad committee on which all interested parties are represented, *i.e.* the insurers, the assureds and the average adjuster.[50]

In **Sweden,** hull insurance is regulated commercially through a combination of a General Marine Insurance Plan (SP)[51] and the Swedish Hull Conditions (SHC).[52] The SP contains general provisions and special conditions applicable to, *inter alia,* hull insurance. The SP in use today contains only general provisions. The SP is, however, promulgated by the insurers with no participation by

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[49] Introduced in 1871 with amendments in 1881, 1894, 1907, 1930, 1964 and 1996, *cf.* Wilhelmsen /Bull: Handbook in marine insurance. Oslo, 2007 pp. 28 *et seq* and Wilhelmsen (1998) pp. 18 *et seq*.

[50] An overview of the parties that participated in the drafting can be found in Preface of the NMIP 1996 Version 2007, cf. http://www.norwegianplan.no.

[51] The first SP was introduced in 1891. It was revised in 1896, 1957 and 2006, *cf.* Wilhelmsen (1998) p. 21.

[52] Introduced in 1966, revised in 1976, 1987 and 2000.

the assureds; accordingly, the SP tends to favour the insurers more than does the NMIP. Therefore, important parts of the SP are replaced by the SHC, which is a set of standard conditions agreed between the interested parties.[53] The SHC contains both specific rules relating to hull insurance and more general provisions relating to the duty of disclosure and due care. Although the rules are similar to, but not identical with, the NMIP, the structure is very different.

In **Denmark**, the commercial conditions for marine insurance are incorporated into the Danish Marine Insurance Convention (DC).[54] The DC contains both general provisions and special conditions for hull insurance. As was the Norwegian Plan, the Danish Convention was drafted by a Committee consisting of members of the involved organisations.[55] The Danish Convention is supplemented rather extensively by conditions developed in the market and there is a set of conditions for hull insurance recommended by the Danish Central Union of Marine Underwriters. These conditions address both general questions and special regulations for Hull insurance.

Both the Swedish and the Danish Shipowners' Associations are discussing cooperation with the Norwegian Shipowners' Association in order to use the NMIP as a common standard contract.

**Finland** does not have a Plan or Convention, but industry associations have recently produced a set of agreed standard Finnish Marine Hull Insurance conditions.[56] As with the Swedish conditions, the standard Finnish conditions are influenced by the NMIP, but the structure and details vary.

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53 The Swedish Club, the Central Union of Marine Underwriters, the Swedish Shipowners' Association and the Average Adjuster.

54 Introduced 2 April 1850, amended 1934.

55 Assurandør Societetet, Dansk Skipsrederiforening (Danish Shipowners' Union), Foreningen av Danske Sjøassurandører (Danish Union of Marine Underwriters), and Grosserer-Societetets Komité.

56 Finnish Marine Hull Insurance Conditions 2001 approved by the Finnish Marine Underwriters' Association, The Finnish Shipowners' Association, the Cargoship Association and the Aland Shipowners' Association.

Marine insurance is currently commercially regulated in **Germany** by the German General Rules of Marine Insurance, also known as the ADS.[57] The ADS contains both general provisions concerning, for instance, insurable interest and value, duties of the assured, premiums and also special rules on, *inter alia,* hull insurance. An amendment to the ADS in 1978 resulted in the Deutscher Transport-Versicherungs-Verband e. V (DTV) Hull Clauses 1978. These DTV Hull Clauses replaced previous Hull Clauses in the German market, but did not lead to any alteration in the original ADS concerning hull insurance.[58]

The **UK** market for hull insurance is today divided between Lloyd's and several ordinary insurance companies,[59] but both effect insurance on identical conditions. The main set of insurance clauses concerning hull insurance for ocean-going ships is the Institute Times Clauses (Hulls) (ITCH). Apparently, 75 % of the marked is insured on ITCH 1983. These clauses were amended in 1995, but the 1995 version seems little used.[60]

In addition to ITCH, the market also offers the new International Hull Clauses dating from 2002, which were amended in 2003. These clauses were drafted in order to meet some of the criticisms contained in the CMI's work on the harmonisation of marine insurance clauses, which is discussed further below. These clauses are apparently little used today.

In **Belgium**, hull insurance is effected on the so-called Corvette Conditions.[61] These conditions are combined with other traditional

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57 The ADS was drafted by the German Marine Underwriters in consultation with the German Chambers of Commerce and other competent organizations under the leadership of the Hamburg Chamber of Commerce, and was published in 1919. Particular conditions for hull insurance were introduced in 1957.

58 The 1978 DTV Hull Clauses were further amended in November 1982. Two later amendments have taken place, first in 1984 and then in 1992. The 1992 amendment, however, only affected a few clauses.

59 Brækhus and Rein; Håndbok i kaskoforsikring, Oslo 1993, p. 15.

60 Wilhelmsen and Bull; Handbook in hull insurance, Oslo 2007, p. 36.

61 The Corvette Underwriters' Conditions were developed in the early 1980s. The latest amendment is from 1999.

clauses, such as clauses from the English ITCH and the US Hull Conditions. In **France**, the general hull conditions are the "French Marine Hull Insurance Policy for All Vessels" (French HC).[62]

In **Italy**, hull insurance is effected on the "Marine Hull Insurance Form",[63] in combination with the ITCH. The former policy is limited to certain general conditions on cover and does not include risks covered and exclusions. The insurance contract is governed by Italian law, but whenever insurance is effected subject to English policy conditions, these must be construed and applied according to English practice.[64]

The **Spanish** marine insurance market operates with a combination of standard marine insurance conditions[65] and versions of these conditions updated by some companies. American, English or Norwegian clauses relating to, *inter alia,* hull insurance are often integrated into the policy. The incorporation of foreign clauses into the Spanish Marine Insurance Contract causes serious problems because the various terms of the contract are based on quite different legal frameworks. It can thus be difficult to find a feasible instrument to use as a basis for construing the conditions.

There are no national standard conditions for hull insurance in **Greece** and hull insurance is effected using the English ITCH clauses.

## 5.2 Some features of the regulation of marine insurance

A detailed analysis of the regulatory regimes contained in the legislative and commercial regulation applicable to marine insurance

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62 The original policy form was dated 1 December 1983, and was amended 13 December 1984 and 30 January 1992. These conditions were renewed two years ago and the new policy was adopted from January 1998.

63 Assitalia Capitolato di assicurazione corpi marittimi edizione 1988.

64 General conditions article 2.

65 Condiciones Generales del Seguro de Buques" for hulls prepared between 1927 and 1934 by the Madrid Marine Insurance Committee.

lies beyond the scope of this paper, which aims merely to highlight some general features of marine insurance regulation. The purpose of this is to establish how difficult it is to obtain a full picture of the various standard clauses. This is relevant when assessing information-gathering costs, which are an aspect of transaction costs.

The various regimes tend to regulate the same issues, but it is impossible to identify any common structure and the legislative techniques and material solutions vary. The structure of marine insurance regulation differs in different countries, both because the structure of the applicable legislation varies and because the commercial standard forms are drafted differently.

### 5.2.1 The insured interest and valuation

A general requirement in marine insurance is that the insured interest must be legal and have an economic value. However, techniques for securing this requirement vary. These principles are often stated in mandatory legislation,[66] but may also be defined or further developed in the insurance conditions. A lack of economic interest will normally result in the contract being void.[67] In relation to an illegal interest, the conditions will provide for various consequences ranging from automatic termination of the insurance if the ship is used in illegal activities,[68] to the exclusion of losses that are caused either by illegal activity in general[69] or by a defined illegal activity,[70] to the exclusion of specific losses caused by specific illegal

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66 *C.f,* for instance, CPML section 259, Danish ICA § 35, and MIA section 5 concerning legal interest and Italian CC section 1904 and MIA section 4 concerning economic interest.

67 *Cf.* Italian CC section 1904, Danish ICA § 35 and MIA section 4, NMIP § 2-1 and ADS 1 (1) and 2 (1).

68 Danish Hull Conditions (DHC) 2.3 no. 5.

69 See SHC § 7.2 (a).

70 See French Marine Hull Insurance Policy (FMHP) article 3, 1, excluding loss caused by smuggling, forbidden or clandestine trade, and fines.

activities.[71] Illegal activities may also be defined as an alteration of risk, resulting in a combination of the sanctions described above.[72]

The marine insurance of ocean-going ships is normally agreed on the basis of an assessed insurable value. Such an assessed value will, as a starting point, be binding on the parties to the contract. However, the assessed value may be set aside by the underwriters in certain instances. The circumstances under which the assessed value may be challenged, however, differs under the different regimes. In some, the underwriters may be entitled to demand a reduction in the assessed value if it considerably exceeds the real value of the interest.[73] In others, the assessed value may be reduced only if the person effecting the insurance has given misleading information about relevant characteristics of the subject-matter of the insurance.[74] A third alternative is for the assessed value to be decisive except in the case of fraud.[75] The Greek legislation merely states that the valuation may not be contested on the grounds of error.[76] The Italian system also recognises assessed valuation in marine insurance.[77] It is less clear, however, to what extent the insurer can claim to set the valuation aside.

### 5.2.2 The scope of cover

#### *5.2.2.1 Perils insured against*

Marine insurance conditions are normally divided into insurance against marine perils and insurance against war perils. In the civil law countries, insurance against marine perils is based on an all-risks principle, with the starting point that the insurance will cover

71 See DHC 4.9, the insurance does not cover fines or confiscation or similar measures against the ship due to breach of customs, fraud and similar conduct.

72 NMIP § 3-16.

73 ADS 6 (2).

74 See NMIP § 2-3, DC § 10 and SHC § 2.

75 See FMHP 7 first paragraph.

76 Greek CPML section 268 third paragraph.

77 See Italian CC section 1908 second paragraph and C Nav section 515.

all perils to which the interest may be exposed unless there is a provision to the contrary. Perils covered by insurance against war perils are then explicitly excluded from the marine peril insurance.[78] In UK, on the other hand, both marine insurance and war insurance are based on the principle of named perils.[79]

#### *5.2.2.2 Exclusions*

Traditionally, marine insurance cover has excluded **nuclear risk**.[80] After the terrorist attack in New York in September 2001 this exclusion was further developed in the reinsurance market through the introduction of the so-called RACE II clause.[81] This clause excludes both risk connected to the release of nuclear energy and risk connected to **biological, chemical and biochemical weapons**.[82] Because the reinsurance market will not insure these risks, they are normally specifically excluded in all direct marine insurance policies, even if not directly incorporated in the standard clauses.

Another general exclusion often included states that the insurance does not cover loss due to **ordinary use**.[83] The exclusion for damage caused by ordinary use etc. is a general one. If a casualty caused by ordinary use results in a total loss, the insurer will therefore not be liable.

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78 NMIP § 2-8 and § 2-9, DHC 3.1 ref 4.4, SHC § 5 *cf. cf.* § 7.2 litra (b) to (e), ADS 28 ref.35 and DTV Hull clauses 16 and 17, FMHP article 1 first paragraph ref. article 3 and Italian C Nav section 521 with Commentary p. 263 and Mutuamar 1942 1 ref. 5 (b). The all-risks principle is also expressed in Greek CPML section 269 first paragraph, with a definition of war risk in section 271.

79 ITCH clause 6, IHC clause 2, Institute War and Strikes Clauses (Hulls) 1/10/83 clause 1.

80 Wilhelmsen 1998 p. 38.

81 Wilhelmsen/Bull (2007) pp. 103–105, Commentary to Norwegian Marine Insurance Plan 1996 Version 2007 § 2-8 and § 2-8.

82 NMIP § 2-8 litra (d).

83 See, *i.a.*, NMIP § 10-3, DHC 4.10, SHC § 7 letter (a) ref. SP § 81 litra (a). A similar exclusion is not necessary in a named peril insurance, because ordinary use is outside the scope of the listed perils.

A peril similar to ordinary use is **wear and tear**, but this coverage varies a great deal. One approach is to exclude damage and loss caused by "wear and tear".[84] According to this approach, total loss caused by wear and tear is excluded. A less restrictive approach is that the insurer of the vessel is liable for losses caused by "latent defect of the vessel, unless he proves that the Insured could have discovered same by due diligence".[85] The exclusion in the Scandinavian system is less restrictive, providing the assured with cover for the greater part of the maintenance risk. The starting point here is that the insurer is not liable for costs incurred in renewing or repairing part or parts of the ship that are defective because of wear and tear, corrosion, inadequate maintenance and the like.[86] The result of this is that damage to *other parts of the ship* as a consequence of the defective part will be covered. In addition total loss, collision liability, and expenses will be covered in full.

Cover for **error in design, faulty materials** *etc.* is generally wider than cover for insufficient maintenance. The most extensive cover seems to be found in the German and Italian conditions, implying that damage caused by error in design and faulty materials will be covered in full.[87] The same solution applies in Sweden and Norway, subject to approval of the damaged part by the classification society.[88] Denmark and Finland, on the other hand, have a very complicated solution which mainly corresponds to the NMIP 1964, and which also has several similarities with the solution adopted in the UK.[89] The situation regarding this issue in the

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84 FMHC art. 3 (1), fourth part, DTV Hull Clauses 27, MIA section 55 letter (c).

85 Italian C Nav section 525 and Italian CC section 1906. The interpretation of this provision seems somewhat unclear, *cf.* Wilhelmsen (1998) p. 39. The same holds for FMHP article 3 (1) fourth part, excluding losses caused by "inherent vice".

86 NMIP § 12-3, DHC 5.2, SHC clause 7.1 litra (b) no. 1 and FHC section 15.3 1 (a), but this clause excludes some of the consequential losses.

87 *Cf.* in more detail Wilhelmsen 1998 p. 40.

88 NMIP §12-4, SHC clause 7.1 letter (b).

89 DHC 5.1 and FHC sec. 15.2 *cf.* sections 11.3-11.6, *cf.* NMIP 1964 § 175.

UK is extremely complicated and not particularly clear.[90] The main distinguishing feature is that cover is provided for damage caused by the bursting of boilers and breakage of shafts and any latent defect in the machinery or hull, but not for the cost of repairing the boiler, shaft or latent defect itself.[91] Additional cover may be agreed to cover the costs of repairing the boiler/shaft or the cost of correcting the latent defect, but only if the breakage or defect has caused damage to the ship.[92]

#### *5.2.2.3 Causation*

The main rule concerning causation in the civil law countries is the so-called dominant cause rule (*hovedårsakslæren* in Norwegian), which is similar in approach to the *causa proxima* rule applied in common law countries.[93] This rule has not been applied in Norway, however, since the adoption of the NMIP of 1930. Instead, when a loss is caused by a combination of perils, the loss must be apportioned between the individual perils on the basis of the influence each peril must be assumed to have had on the occurrence and extent of the loss.[94] Accordingly, the Norwegian position concerning the regulation of a fundamental principle of marine insurance differs substantially from the position adopted in other countries. The Norwegian provision concerning apportionment does not apply, however, if the loss is caused by a combination of war perils and marine perils.[95] Instead, a modified dominant cause rule is applied.

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90 *Cf.* Wilhelmsen: Hull insurance of "latent defects", in: Scandinavian Studies in Law, vol. 46, p. 257 *et seq*, chapter 5, Wilhelmsen/Bull (2007) pp. 267–270.

91 IHC 2.2.1 and 2.2.2, ITCH Additional Perils Clause 1.

92 IHC 41.1.1 and 41.1.2, ITCH Additional Perils Clause 2.

93 Wilhelmsen/Bull (2007) pp. 122–127 with references.

94 NMIP § 2-13 and Commentaries to NMIP § 2-13. A principle of apportionment is also provided for in DTV Hull Clauses 27.2 (combination of wear and tear and insured peril).

95 NMIP § 2-14.

It should be mentioned that the dominant cause rule in the German conditions is modified in one instance. If damage is caused by wear and tear in combination with an insured peril, and the insured peril is not the proximate cause of the damage, the damage must be apportioned between the different causes.[96]

### 5.2.3 Duty of disclosure

In order to calculate the premium correctly, the insurer needs information about the risk. The person with the most knowledge about the risk will be the person effecting the insurance. Consequently, insurance regulation will normally contain rules on the duty of disclosure. Characteristically, these rules will impose a duty on the person effecting the insurance to provide the insurer with full and correct disclosure of all material circumstances. [97] The conditions under which the insurer may invoke breach and impose sanctions are, however, extremely varied.

The most varied and flexible form of regulation is found in Scandinavia where the consequences of a breach of the duty of disclosure vary according to the insurer's attitude towards the undisclosed circumstances and the degree of negligence on the part of the person who effected the insurance. However, the details vary somewhat between the different Scandinavian countries. [98] The systems in other civil law countries are simpler and apply more strictly. The general approach seems to be that the most serious types of breach will free the insurer of liability, while in other cases the assured has to accept a reduction in the level of cover. A general feature of legislation in these countries is that causation is no con-

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96 DTV Hull Clauses 27.2.

97 NMIP § 3-1 first paragraph, DC § 21, ADS 19 (1), Greek law 2496/1997 § 3, and Italian CC 1892. According to the Greek provision the assured also has to answer the insurer's questions, FMHP art. 8 (1) and SHC clause 9.1, FHC sec. 27.1, MIA sec. 18 and 20.

98 FHC section 27.2 to 27-5, NMIP § 3-2 to § 3-4, DC § 22-24, SP § 11-13 *cf. cf.* SHC clause 9.3 to 9.5

dition for the insurer to invoke the sanctions. There is some variation, however, with regard to the details of this legislation.[99]

The duty of disclosure is most strictly regulated under UK law: an insurer may avoid the contract if the assured fails to disclose a material circumstance that he knew or ought to have known or if he misrepresents a material fact. [100]

### 5.2.4 Duty of due care

The level of risk undertaken by the insurer will also depend on the behaviour of the assured while the insurance period is running. Legislative and commercial regulations of marine insurance therefore contain rules to ensure that the assured acts with due care in relation to the insured object in order to avoid casualties. Of special importance currently are rules to prevent the operation of substandard ships, *i.e.*, to ensure that ships comply with international and national standards for seaworthiness, safety etc. This is achieved through rules on the alteration of risk, seaworthiness, safety regulation, warranties and similar contractual clauses, together with rules concerning the negligence of the assured.

One set of rules employed in the civil law countries, but not in the UK, are rules concerning the **alteration or increase of risk**. The rules regulating this issue in some countries are very similar to those regulating the duty of disclosure. In Denmark and Italy, public legislation imposes mandatory rules.[101] The definition of what constitutes an alteration or increase of risk vary, but basically the rules apply to situations either where the risk is increased compared to the written or implied conditions of the insurance

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[99] *Cf.* Greek Law 2496/1997 § 3, Italian CC 1892 and 1893, ADS 20 (2) and (1), French Law no. 67-522, section 6, here referred to from United Nations Conference on Trade and Development, Marine Insurance, Legal and documentary aspects of the marine insurance contract, Report by the UNCTAD secretariat`, 20 November 1978 (TD/B/C.4/ISL/27).

[100] MIA sections 18(1) and 20 (1).

[101] *Cf.* Danish ICA 1930 §§ 45 *et seq* and Italian CC 1932 *cf.* 1898 second part.

contract[102] or where the risk is increased in such a way that the insurer would not have accepted the insurance on the same conditions if he had known about the increased risk.[103] The sanctions are more varied. The simplest sanction is that the insurer will be free of liability if there is a material or relevant increase in risk and this affects the casualty or the level of indemnity.[104] In the Scandinavian countries[105] and Greece,[106] the sanction is very similar to that for breach of the duty of disclosure. In France, alteration of risk is categorised under the heading "Disclosure", and a duty is formulated whereby the assured must notify the insurer about circumstances affecting the risk as soon as the assured is aware of such circumstances. Non-compliance with this duty will cause the cancellation of the policy or a proportionate reduction in the level of indemnity.[107]

In addition to alteration of risk, some civil law countries employ the concepts of **seaworthiness** and **safety regulation**. Exclusions for **unseaworthiness** apply in Scandinavia, except for in Norway, and in the German and French standard contractual terms. The main feature of the way this issue is regulated in Denmark, Sweden, Finland and Germany is that the insurer will not be liable for loss caused because the ship is not in a seaworthy condition, provided the assured could have prevented this.[108] The Italian approach appears to be that seaworthiness is regulated through the provisions concerning exclusions for gross negligence,[109] *i.e.*, an act or omission by the assured that causes unseaworthiness is deemed to

[102] NMIP § 3-8 first paragraph, SHC clause 18 first paragraph *cf.* SP § 41, FHC section 29 (1), DC § 42. ADS 23 seems to use the same approach, but further defines some circumstances that constitute an alteration of risk.

[103] Italian C Nav section 522 ref. CC 1898, Greek Law 2496/1997 § 4.

[104] Italian C Nav section 522 *cf.* CC 1898, ADS 24 *cf.* 23 and 26.

[105] NMIP § 3-9 to § 3-11, DC §§ 42-44, SHC § 18 *cf.* SP §§ 41-43, FHC section 30.

[106] Greek Law 2496/1997 § 4.

[107] FMHP article 8 (2) *cf.* art. 14 second part.

[108] SHC clause 12, DHC 4.5 and FHC section 43.2, DTV Hull Clauses 23.1 and 23.2.

[109] Italian C Nav section 524 ref. CC section 1900.

be grossly negligent and the insurer's liability for any resulting casualty is excluded.[110]

The concept of **safety regulation** originated in Scandinavia and is little used in the other civil law countries. Essentially, if the casualty is caused by a breach of a provision that is defined as a safety regulation in the insurance contract, and the breach is caused by negligence, the insurer is free of liability.[111] The concept of safety regulation normally encompasses any measure for the prevention of loss issued by public authorities, the classification societies or the insurer, [112] but it may also be limited to requirements imposed by public authorities. [113]

Unlike the civil law countries, which use the concepts of alteration of risk, seaworthiness and safety regulation, the UK employs the concept of **warranties**. A warranty is a guaranty from the assured that must be exactly complied with.[114] If the assured fails to comply with the warranty, the insurance contract will be terminated regardless of fault on the part of the assured and of whether there is any causal link between the failure and the casualty. The standard contract terms in the UK employ this concept to regulate loss of class, change of classification society, and change of flag, ownership or management.[115]

Some of these issues are regulated fairly similarly in the civil law countries. **Loss of class** is treated this way in several countries,[116] although the approach to establishing the principle differs.[117]

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[110] See Tribunale Genoa, 31 December 1968, Court of Cassation, 2 March 1973.

[111] NMIP § 3-22 and 3-23 *cf.* 3-25, SHC clause 11, FHC section 44 *cf.* section 45, DHC 4.7 *cf.* DC § 49.

[112] NMIP § 3-22, FHC sec. 44.1, SHC clause 11.1.

[113] DHC 4.7 *cf.* DC § 49.

[114] MIA section 33, *cf.* Wilhelmsen: (2001) p. 129 *et seq.*

[115] ITCH clause 4, IHC clauses 13 and 14, which also include compliance with conditions from the Classification Society and the holding of a SOLAS certificate.

[116] NMIP article 3-14 second paragraph, DHC article 2.3 (1), FHC sec. 33.2, SHC clause 11.1 *cf.* clause 4 second paragraph.

[117] Wilhelmsen (1998) p. 49 *et seq* and (2001) p. 141 *et seq.*

**Change of classification society** may be treated similarly,[118] but also as an increase of risk.[119] Non-compliance with **periodic surveys** is normally treated as a safety measure,[120] or as part of the regulation of seaworthiness.[121]

**Change of ownership** will normally result in automatic termination of the insurance.[122] This may also apply to a **change of flag** or **management**, [123] but these changes are also regulated as an increase of risk,[124] or through rules on notification and cancellation.[125]

The last example of insurance regulation I will mention here concerns **loss caused by the insured**. The usual starting point is that the insurer will not be liable for loss caused by wilful misconduct and/or with intent.[126] In France, Italy, Sweden and Greece, this exclusion also applies in respect of loss caused by gross negligence,[127] whereas the German standard contract terms generally exclude loss caused by negligence.[128] In Norway, Denmark and Finland, there is no absolute exclusion for gross negligence, but

[118] FHC sec. 32.2, SHC clause 4 second subparagraph.

[119] NMIP § 3-8, and similarly FMHP art. 8 (3) *cf.* art. 14 second part.

[120] NMIP § 3-22 second paragraph, SHC clause 11.1, FHC section 44.2.

[121] DTV Hull Clauses 23.1 and 23.2.

[122] DTV Hull Clauses 13, DHC 2.3.4, NMIP 3-21, SHC clause 4 first subparagraph, FHC section 32 and FMHP article 17 eighth and ninth paragraph.

[123] DHC 2.3.2 and 2.3.3. It may be argued that this regulation is contrary to the mandatory provisions in the Danish ICA, but the clauses may be defended if they are defined as a relevant increase of risk.

[124] NMIP § 3-8 second paragraph and FHC section 38 (change of manager).

[125] DTV Hull Clauses 12.1, 12.2 and 12.5 (change of management), FMHP article 8 nos. 3 and 14 (change of flag).

[126] Italian CC section 1900, NMIP 3-32, DC § 67 first paragraph, SHC clause 13 *cf.* SP § 40 first paragraph, FHC sec. 42.1, FMHP art. 3 third part, ADS 33, Greek Law 2496/1997 § 7 fifth paragraph, and MIA section 55 (2) (a).

[127] Italian CC 1900, FMHP art. 3 third part, SHC clause 13 and Greek Law 2496/1997 § 7 fifth paragraph. In the Greek regulation, however, if there is third-party liability insurance, the insurer is relieved from liability only if the insured acted wilfully, see Greek Law 2496/1997 § 25.

[128] ADS 33 (1), with an exception if the loss is due to a mistake of navigation that is not caused wilfully or by gross negligence.

rather a reduction in the level of indemnity depending on the degree of fault and other circumstances in general.[129]

In the case of loss caused by ordinary negligence, the insurer is thus liable in full according to the Scandinavian, French and Italian rules. In Denmark, this rule is mandatory, see § 20 of the Danish ICA 1930.

In the UK, exclusions for negligence or gross negligence are less important due to the named perils principle. However, some of the listed perils are covered "provided such loss or damage has not resulted from want of due diligence by the assured."[130]

# 6 Attempts at harmonisation

The presentation above clearly demonstrates the great complexity of marine insurance regulation in terms of both structure and the legal approach taken to the different issues, as well as in its details. It is also clear that the legislative and commercial regulation in the UK is in several ways much more to the disadvantage of the assured than in the civil law countries. This is not a new phenomenon and several attempts have been made to harmonise the rules.

One attempt was made by UNCTAD in the period 1975–1989. A report from the UNCTAD Secretariat in 1975 voiced criticism of some of the material solutions found in leading international insurance standard conditions.[131] More important, however, was the

[129] DC § 67 second paragraph, FHC section 42.2 and NMIP § 3-33.

[130] ITCH clause 6.2 and IHC clause 2.2 last sentence, concerning accidents in the loading, discharging or shifting of fuel or cargo, bursting of boilers, breakage of shafts and latent defects, the negligence of the master, crew or pilots, the negligence of repairers and barratry, *cf.* also Wilhelmsen/Bull (2007) p. 188.

[131] The Report from the UNCTAD Secretariat in 1975 voiced criticism on some of the material solutions found in leading international insurance conditions, see Legal and Documentary Aspects of the Marine Insurance Contract (TD/B/C.4/ISL/27). *Cf.* Bull: Opening. Aim of the Symposium. The Norwegian Marine Insurance Plan 1996. Experiences from UNCTAD concerning harmonisation of Marine Iinsurance, in: MarIus no. 242, pp. 1 *et seq.*

Secretariat's strong criticism of the formal structuring and drafting of such conditions, which was particularly directed towards the insurance conditions used in the British market. The Norwegian conditions, in contrast, were highlighted as worthy of emulation in an international context. The report formed the basis for the work of a separate Group of Experts, which over subsequent years produced draft texts for model clauses in hull and cargo insurance. The clauses were adopted in 1985 by the Trade and Development Board, and finally published by UNCTAD in 1989 (TD/B/C.4/ISL/50/Rev.1).[132] The model clauses basically deal with questions on scope of cover under standard marine policies, and do not address questions with a bearing on substantive law. On several points, the clauses provide for alternative solutions. As far as the author is aware, neither the model clauses themselves nor insurance conditions based on them are used anywhere in the world. In this respect, the UNCTAD initiative was a failure.

During the 1990s, the UK MIA was criticised by several countries that had started an evaluation of their own national insurance regulation.[133] As a result, the CMI took the initiative in 1998 to launch a new attempt to establish international principles for marine insurance. At a Marine Insurance Symposium in Oslo in June 1998, the decision was taken to move forward by means of undertaking a comparative study of international marine insurance with the purpose of establishing model clauses. The purpose was to harmonise areas where a measure of uniformity would better serve the marine insurance industry.[134] An underlying assumption was that areas of difference where *differences provided sound reasons for competitive edge* and where seeking uniformity would be undesirable should not be harmonised.[135] Since 1999, an

[132] UNCTAD Report 1989 TD/B/C.4/ISL/50/Rev.1.

[133] *Inter alia,* Australia, New Zealand and South Africa, which all use the UK MIA, *cf.* Wilhelmsen 2001 pp. 53–57, and the US.

[134] Hare: The CMI review of marine insurance. Report to the 38th Conference of the CMI Vancouver, 2004, CMI Yearbook 2004, (Hare 2004) p. 250.

[135] Hare (2004) p. 250.

International Working Group has been working on a comparative analysis covering several topics, which have been discussed at several international conferences. These comparative analyses have also been published in the form of several articles.[136] A synopsis of several issues was presented at a conference in Singapore in 2000. Here it was decided that the work should proceed. However, so far no model clauses have been proposed. At a conference in Vancouver in 2004 the analysis were summarised in 11 issues by the South African maritime law professor John Hare.[137] These guidelines concern: Good faith, Disclosure, Alteration of Risk & Essential Terms:

1. Marine insurance contracts are contracts of good faith. Good faith requires each party to conduct itself with the other party in relation to all material aspects of their insurance contract according to objective norms recognized by the society in which they are being judged.

2. Acting in good faith requires each party before and at all times during the contract and in the submission of claims, to be honest in relation to all material matters, to disclose all – and not misrepresent any – material facts; and to disclose any material alteration of the risk during the currency of the policy.

3. Certain terms may be stated by the parties in the contract as requiring strict compliance; the contract may stipulate that in the absence of strict compliance by either party, the other party shall have the right to cancel the contract (or even that the contract shall terminate automatically), regardless of whether non-compliance caused the loss. Such should be the case in relation to safety at sea, classification, ownership, management and ISM Code compliance. The description "warranty" should not be used, and the English law warranty and its effects in law should be abolished.

[136] *Cf.* Above note 2.

[137] Hare (2004) pp. 248 *et seq.*

4. Materiality in relation to an absence of good faith, a failure to disclose, a misrepresentation or a breach of a contractual term (not requiring strict compliance) is assessed according to a two-tier test of whether a reasonable insurer and a reasonable assured, both operating within the norms of the society and the context of the transaction in which such materiality is being adjudged, would consider the conduct to have affected the acceptance of the risk, the assessment of the premium and or the evaluation of claims by the insurer, and or the acceptance of cover by the insured.

5. Materiality requires a causative link between the breach and the loss or the claim.

6. Any material absence of good faith or material breach of the obligation to disclose or not to misrepresent or any material breach of an essential term going to the root of the contract, gives the aggrieved party the right to treat the contract as at an end, effective from the date of the breach, with the right to claim damages. Material breach of a non-essential term not relating to good faith, disclosure or misrepresentation and not contractually stipulated as requiring strict compliance, suspends cover until the breach is remedied.

7. A non-material absence of good faith or breach of the obligation to disclose or not to misrepresent not founding a right to cancel the contract of insurance may nevertheless give rise to a claim for damages.

The guidelines are first and foremost addressed to marine insurance markets using Anglo-American insurance conditions. In the Scandinavian marine insurance market, the issues addressed in the guidelines have already been resolved through detailed regulation in the standard clauses.[138] Further, the list is more of a "personal wishlist" from Professor Hare than an actual set of guidelines,

[138] Hare (2004) pp. 257–258.

as it was not prepared by the working group.[139] Since the Vancouver Conference, however, little progress has been made. The guidelines have been characterised as a "discussion document" and activity has taken place only on a national basis.[140] Marine insurance is not a topic listed on the programme for the CMI Conference in Athens 2008.

The situation today is that the harmonisation process has come to a standstill. Thus, each country, Norway included, is using its own separate national clauses. The international initiative did, however, result in the introduction of the International Hull Clauses 2002 in the English market in order to resolve some of the common law issues that had been the subject of criticism. This initiative was further developed with the introduction of the 2003 version.[141] However, sources in the English insurance market indicate that the International Hull Clauses are little used, and that the market participants prefer the ITCH 1983. Apparently, 75 % of the market is insured on the latter clauses.[142]

The conclusion of this work so far seems to be that the market participants believe that competition is facilitated by national regulation.

# 7 Summary and conclusions

## 7.1 The national picture

Chapter 4 showed that in several countries there are no mandatory rules applying to marine insurance, but there may be some general

[139] Hare: Report of the CMI Standing Committee, CMI Yearbook 2005/2006 (Hare 2005/2006) p. 389.

[140] Hare (2005/2006) p. 389, where the national developments in Australia, France, Germany, South Africa, US and UK is described.

[141] Hare (2005/2006) p. 391.

[142] Wilhelmsen/Bull: Handbook in Hull Insurance pp. 36–37. These clauses were amended in 1995, but the 1995 version seems to be in little use.

mandatory contractual principles. This is true in the case of Norway, Sweden, Finland and Germany. In the other countries there is some mandatory regulation, but the extent of this varies. In general, rules concerning the duty of disclosure or the duty of good faith are often mandatory. Mandatory regulation seems to be most extensive in Denmark, while the extent of mandatory regulation in the UK MIA is unclear.

As a starting point, mandatory rules discourage economic efficiency and perfect competition. As several countries manage without mandatory protection in marine insurance, it may be argued that preventing such freedom of choice is unnecessary.

The presentation has also demonstrated that contractual freedom in marine insurance is not generally used by insurance companies in order to establish their own separate contracts. The tendency is rather for each country to operate with a set of standard clauses, or – if no such clauses exist – to use the English ITCH. If these standard clauses are agreed, they should not be problematic in relation to the EU competition rules. On the other hand, where the clauses are not agreed with organisations representing the assureds, it may be questioned whether this practice is permitted in relation to the group exemptions provided for according to Commission Regulation (EEC) no. 3932/92 or whether it is contrary to article 81 of the EU Treaty. It may also be argued that national standard clauses creates monopoly and is contrary to freedom of choice and perfect competition. This problem is countered by the use of agreed documents where the assureds through the participation in the construction of the contract have influenced the content.

The use of standard clauses may be explained by the fact that the insurance product is so complex legally, and the contractual regulation so extensive, that the time and resources required to develop individual contracts would far exceed the benefits of this approach. If so, high transaction costs may be countered by the use of standard clauses, which will also ensure the provision of better information about the product and make it easier to compare prices

offered by different companies. Seen from this perspective, the use of standard contracts does not discourage economic efficiency.

In terms of economic efficiency, however, agreed standard clauses are more preferable than not agreed standard clauses because the reduction of transaction costs and the risk for asymmetric information is combined with freedom of choice on the part of the assureds. An argument to support this is statistics demonstrating that the insurers within the CEFOR group in the Nordic countries does not earn a lot of money. The hull net loss ratio (relationship between premium and losses) was at a very low peak in 192–1995 (between 47 and 54 %), was gradually increased to 1999 (134 %), then gradually reduced to 98 % in 2003. From 2003 to 2007 the hull net loss ratio has varied between 98 % and 110 %.[143]

## 7.2 The international picture: free movement of insurance services

In relation to the EU goal of free movement of insurance services, it may be argued that different mandatory rules in different countries may distort competition in favour of countries with less strict regimes.[144] This result may be prevented by the right in marine insurance to choose another country's legislation as background law. It is, however, questionable how realistic this approach will be. The mandatory regulation in the Danish ICAs is included in the standard contracts used in Denmark, implying that the application of a foreign background regime will not make any difference in practice. In addition, the Danish regulation is very similar to the type of regulation found in the Norwegian, Swedish and Finnish standard contractual conditions. A more valid argument in favour of mandatory rules not distorting competition is, however, that the

[143] 2007 CEFOR Statistics – Part 3, jfr. http://www.cefor.no/statistics/statistics.htm.

[144] *Cf.* for instance Council Directive 93/13/EEC on unfair terms in consumer contracts, preamble, Bull: Forsikringsrett, Draft 2008, chapter 3.6.

level of protection provided is fairly similar and that the variations do not seem to reflect variations in the mandatory regimes.

A major obstacle to the free movement of services, on the other hand, seems to be the complexity of the legislative and private regulation of insurance contracts. This presentation has demonstrated that marine insurance legislation is extremely complicated and regulation of marine insurance will often consist of several layers of legislation, *i.e.,* a general act combined with an insurance act, as well as private codification in the form of a Plan or Convention that is not always directly included in the conditions. Even though the issues are the same, the structure of the regulation, the approach chosen and the detail of the regulation vary. In some systems, a combination of national background legislation and the use of ITCH clauses may also cause problems when interpreting and analysing the extent of coverage.

These differences seem to emphasise that in marine insurance, contrary to, for instance, sale of goods or transport services, competition takes place through the insurance conditions themselves, *i.e.,* the conditions themselves are the commodity.[145] It may therefore take a lot of time and effort to obtain full information about the insurance product, which in turn will result in high transaction costs. It may be argued that the transaction costs in such cases will easily exceed the benefits gained from full information. This implies that effecting insurance on the conditions applicable in another country may easily result in lack of full information on the part of the buyer, causing a situation of asymmetric information. From this perspective, competition may be facilitated by harmonisation.[146] On the other hand, experience from the work carried out under the auspices of the CMI does not seem to support this conclusion.

[145] Honka: Harmonization of hull insurance contracts in light of seaworthiness and safety regulation, in; MarIus no. 242, pp. 165 *et seq.*

[146] Wilhelmsen (1998) p. 57.

# Legal customs and the *lex mercatoria* in international private maritime law

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# Content

# 1 Introduction

The need for uniformity of legal regime within the ambit of international trade is especially felt in the area of commercial relations that could be defined as 'international private maritime law', meaning, for the purpose of this article, that specific branch of maritime law whose aim it is to regulate transnational inter-private relations, apart from the use of conflict of law rules[1].

The reasons why uniformity or, at least, harmonization of different private maritime law principles at the international level are a necessity for operators were already clear in P.S. Mancini's teachings: '*The sea with its winds, its storms and its dangers never changes and this demands a necessary uniformity of juridical regime*'[2].

Taking into consideration the segment of transport law, one may note that conflict of law elements can be found even in cases in which the economic 'operation' takes place in an internal context (as, for example, in the case in which the crew members belong to different states)[3].

In this regard it has in fact been noted that the ship, while navigating, might be considered a moving legal system[4].

Therefore, if the same cases were ruled in a completely different manner by reason of applicable law, according to conflict of law rules, the absolute uncertainty and unpredictability of law would arise, with prejudice to the trade's course.

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1 For a definition of "international private maritime law' and 'private international maritime law', in the thought of W. TETLEY, see 'International Maritime Law, Identity of International Private Maritime Law – The Pros, Cons, and Alternatives to International Conventions – How to Adopt an International Convention', in 24, *Tul. Mar. L .J.*, 2000, 775–856, 779–786

2 Opening lesson at Turin University, 1860, quoted in P. J. GRIGGS, *Obstacles to Uniformity of Maritime Law. The Nicholas J. Healy Lecture*, J.M.L.C, vol. 34, n. 2, 2003, 192.

3 In Italian legislation, see art. 318 nav. cod.

4 E. GOLD, A. CHIRCOP, H. KINDRED *Maritime law*, Toronto, 2003, 6.

It is merely the identity of factual situations that maritime law has had to regulate in different geographical contexts and legal systems and with different actors that explains why this branch of law, more than any other, has had a customary origin and development and has always been considered part of the so-called '*lex mercatoria*'.[5]

While not denying the fundamental role played by international conventions that have followed one after the other since the beginning of the twentieth century in a process of unification of private international maritime law, it is nevertheless undeniable that the conventional method, at least since the final two decades of the last century, has pinpointed critical elements, mainly in the field of private maritime law, and that of maritime transport in particular.

In fact, if, on one hand, in the said field, the regime of the Brussels Convention of 25 August 1924 (The Hague Rules[6]) with its protocols[7] has had an outstanding success in terms of ratifications,

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5 The awareness that many institutes of maritime law formed part of '*lex mercatoria*', intended as a customary law created by merchants and, at the same time, addressed to them, can be clearly grasped, considering that treatises on the topic published in England in the 17th and 18th centuries would dedicate much space to maritime law. See G. MALYNES, *Consuetudo vel lex mercatoria or the Ancient Law-Merchant*, London, 1622, in the first part of which 17 chapters are dedicated to various maritime law institutes: from charterparties to bills of lading (ch. 21); from the authority of the master and his duties towards the shipowner (ch. 22) to maritime insurance (ch. 24 to 28); likewise J. GILES, *Lex mercatoria or, the Merchant's Companion*, Savoy, 1729, commits the first 5 chapters to maritime law institutes, placing in the appendix (chap. XII) a summary of the *Rôles d'Oléron,* with references to the *Lex Rhodia* and the *Ordinances of Wisby*, laws considered to be in force all over the world, in all ports, and to be generally observed.

6 The International Convention for the Unification of Certain Rules of Law relating to Bills of Lading was ratified and implemented in Italy by R.dl. on 6 January 1928, cov. in l. on 19 July 1929, n. 1638; it came into force on 7 April 1939, eight years after its international entry into force on 2 June 1931. The Convention has been ratified by 90 States (see www.comitemaritime.org/year/2007_8).

7 The Protocol to amend the international convention for the unification of certain rules of law relating to bills of lading (Visby Rules/Visby Protocol 1968) signed at Brussels on 23 February 1968, implemented in Italy by l. on 12 June 1984, n. 243, came into force on 23 June 1977 and has been ratified by only 30 States. The SDR Protocol, implemented in Italy by l. on 12 June, n. 244,

on the other hand, it is not less true that the Convention is only applicable, *ratione materiae*, to international carriage under bill of lading and focuses first and foremost on the liability of the carrier. It is also undeniable that if, on one hand, the Hamburg[8] Convention has a wider scope of application than that of the Hague-Visby Rules (see art. 2, c. I), – its scope, *ratione materiae*, is not limited to carriage under bill of lading but extended to 'all contracts of carriage by sea' (with the exception of charterparties) – on the other hand, it has had a scanty following, above all in the States endowed with important commercial fleets[9].

Finally, once the Rotterdam Rules[10] enter into force, they will govern –within the limits of the conflict rules of art. 5 – the international contract of carriage wholly or partly by sea in the ambit of liner transportation, with the exception (art. 6) of charterparties and other contracts for the use of a ship or of any space thereon. In the ambit of non-liner transportation, the Rules will be applicable when there is no charterparty or other contract between the parties

came into force internationally on 14 February 1984 and in Italy on 22 November 1985; it has been ratified by only 25 States (see www.comitemaritime.org/year/2007_8).

8 The United Nations Convention on the Carriage of Goods by Sea (The Hamburg Rules), made in Hamburg on 31 May 1978, has not been ratified by Italy; however, the country adopted the law of implementation (l. of 25 January 1983 n. 40). The Convention came into force internationally on 1 November 1992.

9 The Convention has been ratified by only 33 States (see www.comitemaritime.org/year/2007_8).

10 The final text of the new United Nations Convention on Contracts for the International Carriage of Goods Wholly or Partly by Sea was adopted on 11 December 2008 by the General Assembly of the United Nations, and the signing ceremony was held in Rotterdam on 23 September 2009. Known as the Rotterdam Rules, this convention is intended to replace the Hague-Visby and the Hamburg Rules (art. 89 Rotterdam Rules), in an attempt to overcome the differences to which the adoption of the Hamburg rules has given rise, as well as the differences that have emerged between many states following the adoption of the original text of the Hague Rules without the adoption of the 1969 and 1979 Protocols. In the Italian doctrine, F. BERLINGIERI – S. ZUNARELLI – C. ALVISI, 'La nuova convenzione UNCITRAL sul trasporto internazionale di merci "wholly or partly by sea" (Regole di Rotterdam)', in *Dir. mar.*, 2008, 1161.

for the use of a ship or of any space thereon, and when a transport document or an electronic transport record is issued.

In the field of tramp trade it may be said that the attempt to unify legal regimes by means of an *ad hoc* convention could be a less suitable tool, as there are too many general principles of law involved in carriage by charterparties.

In this particular field, the operators have made up for the regime's lack of uniformity by drawing up general conditions of contract and standard forms, which are the result of long-standing commercial experience generally and spontaneously observed, and can be said to form part of a new maritime *lex mercatoria*.

After examining the theoretical underpinnings of the so-called *lex mercatoria* as an international system deriving from spontaneous sources and given an autonomous force of law, the aim of this article is to focus on the prospective existence of a *lex mercatoria* in the field of maritime law. This will be done by a brief review of cases.

## 2 Lex mercatoria and international trade customs

The ambition of this article is not to review all doctrinal positions regarding the *lex mercatoria* that have been presented in the post-war period.

Therefore, the subject will be discussed in a functional way in respect of its application to maritime private international law and with particular reference to international trade customs, which are, according to the point of view of this article, the core of what may be called the modern *lex mercatoria*[11].

[11] The doctrinal debate about *lex mercatoria* is extensive; with no claim to exhaustiveness, here is a list of Italian and international doctrine: F. MARRELLA 'La Nuova lex mercatoria. Principi UNIDROIT ed usi del commercio internazionale',

in *Trattato di diritto commerciale e di diritto pubblico dell'economia*, dir. by F. GALGANO, vol. XXX, Padua 2003; A. FRIGNANI, 'Il contratto internazionale', *ibidem*, vol. XII, Padua, 1990; S. M. CARBONE – R. LUZZATO, 'I contratti del commercio internazionale', in *Trattato di diritto privato*, dir. by P. RESCIGNO, vol. XI, Turin, 1984; F. GALGANO, *Lex mercatoria*, IV ed. Bologna, 2001; M. J. BONELL, *Lex mercatoria*, Dig. comm., Turin, IX/1993, 10; *idem Le regole oggettive del commercio internazionale*, Milan, 1976; *idem* 'La moderna lex mercatoria tra mito e realtà', in *Dir. comm. int.*, 1992, 315; see also the recent monographic issue of the review *Sociologia del diritto*, XXXII/2005/2–3, with contributions by V. FERRARI, 'Quesiti sociologici sulla lex mercatoria', 7–28; M. FORTUNATI, 'La lex mercatoria nella tradizione e nella recente ricostruzione', 29–42; R. MARRA, 'Max Weber: razionalità formale e razionalità materiale del diritto', 43–74; A. PADOA-SCHIOPPA, 'Brevi note storiche sulla lex mercatoria', 44–75; N. BOSCHERIO, 'La lex mercatoria nell'era della globalizzazione: considerazioni di diritto internazionale pubblico e privato', 83–156; M. R. FERRARESE, 'La lex mercatoria tra storia e attualità: da diritto dei mercanti a lex per tutti?', 157–178; F. GALGANO, 'La lex mercatura e la legittimazione', 179–2004; W. KONRADI – H. FIX-FIERRO, 'The lex mercatoria in the mirror of empirical research', 205–228; P.G. MONATERI, 'Lex mercatoria e competizione fra ordinamenti', 229–240; A. GAMBARO, 'Alcuni appunti sugli aspetti istituzionali della cosiddetta globalizzazione', 241–248; F. MARRELLA, 'La nuova lex mercatoria tra controversie dogmatiche e mercato delle regole. Note di analisi economica del diritto dei contratti internazionali', 249–286; U. MORRELLO, 'L'efficacia della lex mercatoria nel sistema italiano: tendenze e prospettive', 287–308; L. PANNARALE, 'Delocalizzazione del diritto e lex mercatoria: linee-guida per una politica dei diritti in una società transnazionale', 309–328; G. SCHIAVONI, 'Il contratto astronave', 329–332; G. ALPA, 'Commercio elettronico e protezione del consumatore', 333–350; V. OLGIATI, 'Lex mercatoria e communitas mercatorum nell'esperienza giuridica contemporanea', 351–378; T. TREVES, 'Lex mercatoria dei naviganti', 379–382; E. RESTA, 'I giuristi e le piccole patrie', 383–388; R. COOTER, 'Structural adjudication and the new law merchant: a model for decentralized law', in *Int'l Rev. L. & Ec.*, 1994, 215; R. B. SHLESINGER – H. J. GÜNDISH, 'I principi generali del diritto come norme oggettive nei procedimenti arbitrali – un contributo alla teoria della denazionalizzazione dei contratti', in *Riv. dir. civ.*, 1997, p. I, 311; O. LANDO, 'The lex mercatoria in international commercial arbitration', in *Int'l C.L.Q.*, 1985, 727; A. GIARDINA, 'La lex mercatoria e la certezza del diritto nei commerci e negli investimenti internazionali', in *Riv. dir. int. priv. e proc.*, 1992, 461; *idem* 'Arbitrato e lex mercatoria difronte alla Corte di Cassazione', in *Riv. dir. int. priv. e proc.*, 1982, 754; F. DE LY, 'Uniform commercial law, and international self regulation', in *Dir. Comm. Int.*, 1997, 525; *idem*, 'Lex mercatoria (New law merchant): globalization and international self regulation', in *Dir. comm. int.*, 2000, 555; K. HIGHET '*The enigma of the lex mercatoria*', in 63 *Tul. L. Rev.*, 1989, 613; R. DAVID, 'Il diritto del commercio internazionale: un nuovo compito per i legislatori nazionali o una nuova lex mercatoria?', in *Riv. dir. civ.*, 577; G. R. DELAUME, 'The internationalization of law and legal practice:

Regarding the general theories on this topic, suffice it to say that basically two different approaches have been taken.

According to the first, *lex mercatoria* would have to be regarded as a body of laws (or rules, or norms) elaborated by the international merchants in general and by the maritime community in particular. The latter would be at the same time creator and addressee of the rules (expressed in standard form contracts) and would have its own dispute resolution methods (namely the arbitrations) and its own legal sanctions (i.e. blacklisting, boycotting).

As a result, any contract, as an expression of the most widespread law principles common to the civilized nations and international trade practice would be self-sufficient and would not require any integration by domestic law.

Moreover, with regard to dispute resolution, this system of law could do without the conflict of law rules, because in the absence of any express choice of law by the parties to the contract, it would be self-applicable, representing generally and universally accepted principles of law and of trade customs.[12]

Hence, the main characteristic of this legal system would be the fact that it could neither be assimilated into the domestic legal

comparative analysis as a basis of law in state contracts: the myth of lex mercatoria', in 63 *Tul. L. Rev.*, 1989, 575; J. H. DALHUISEN, 'Legal orders and their manifestation: the operation of international commercial and financial legal order and their Lex Mercatoria', in 24 *Berkeley J. Int'l L.*, 2006, 129; L. FRANZESE, 'Contratto, negozio e lex mercatoria tra autonomia ed eteronomia', in *Riv. dir. civ.*, p. I, 1997, 771; A. TARAMASSO, 'Lex mercatoria, rassegna di giurisprudenza arbitrale della C.C.I.', in *N.G.C.C.*, 1995, II, 190; see also F. BORTOLOTTI, *Manuale di diritto commerciale internazionale*, vol. I, 31-71.

12 On the judicial plane, M.J. MUSTILL, in his famous essay on *lex mercatoria*, 'The new lex mercatoria: the first twenty-five year', in *Liber Amicorum for L. Wilberforce*, M. Bos, I. Brownlie (ed. by), Oxford, 1987, draws a line between *Lex mercatoria* and transnational arbitration, even if he admits that the two concepts of law are in some way connected. According to the author transnational arbitration is a category of arbitration 'which is, or at least ought to be, detached from the procedural laws of the country where the arbitration takes place, or indeed of any other country, excepting only, in some limited degree, the law of the country where the award is sought to be executed', at 153.

systems nor into the international one, and it would constitute a *tertium genus*[13].

According to the second approach, *lex mercatoria* would not exist as a self-contained system of law, and the set of rules by which it is composed, expressed in contracts, would belong to the contract system, based on the general principle of party autonomy. Moreover, trade usages would be considered as forming part of the contract in so far as any domestic legislation assigns to them a more or less relevant position.

Hence, the possibility of the rules forming part of *lex mercatoria* to be enforced by a domestic Court would depend only on their compliance with the relevant domestic legislation.

Finally, there would not be room for regarding *lex mercatoria* as a legal system, due to its incompleteness and to the fact that rules and principles would be lacunose and contradictory[14]. That would be contrary to the principle of 'coherence', which is proper to any legal system.

Between the two main approaches there is a middle one that has been defined as 'pragmatic', because it considers the debate between the *mercatorists* and the *antimercatorists* as useless, stressing that the most relevant point to see is not '*lex mercatoria*: yes or no', but '*lex mercatoria*: when and how'. According to this third approach

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[13] It is the so-called 'mercatorist theory' headed by B. GOLDMAN, *La lex mercatoria dans les contrats et l'arbitrage international: réalité et perspectives*, Clunet, 1979, 475–499; *idem*, 'Frontières du droit et lex mercatoria', in *Arch. phil. droit, 1964,* vol. IX, 1964, p. 177 ss.; PH. FOUCHARD, E. GAILLARD, B. GOLDMAN, *Traité de l'arbitrage commercial international*, Paris, 1997; F. DE LY, *Lex mercatoria (New Law Merchant). Globalization and International Self Regulation*, op. cit.; for a complete review of the whole of the doctrine on *lex mercatoria*, F. MARRELLA, 'La Nuova Lex Mercatoria. Principi UNIDROIT ed usi dei contratti del commercio internazionale', op. cit., notably in the first part (chap. 1, sec. I e II), in F. GALGANO, *Lex mercatoria,* op. cit.

[14] In the Italian doctrine, see A. GIARDINA, *La lex mercatoria e la certezza del diritto nei commerci e negli investimenti internazionali*, op. cit..; *idem Arbitrato e lex mercatoria difronte alla Corte di Cassazione*, op. cit.; CH. PAMBOUKIS, 'La lex mercatoria reconsidérée', in *Le droit international privé: esprit et méthodes. Mélanges en l'honneur de Paul Lagard*, Paris 2005, 635–659, at 648.

the perspective on *lex mercatoria* should therefore be moved towards 'how and when' *lex mercatoria* would be applicable to international transactions and 'how and when' an arbitral award assessing a dispute on the basis of the *lex mercatoria* could be enforced in a specific legal system. This perspective is a judiciary one[15].

In my opinion the first two approaches are much too dogmatic, whereas the third is too little so.

Specifically, the first two share the common misunderstanding of comparing *lex mercatoria* or the transnational economic and legal relations to the domestic legal system, with special reference to the feature of completeness, which is either strongly affirmed or denied.

Even admitting the possibility for the *Lex* to be applied to international transactions and for contracts and arbitration awards based on it in different domestic legal systems to be enforced, the third approach does not explain the mechanisms through which the application and enforcement operate. Moreover, as the approach is judicial-based, it seems too State-oriented: in brief, the applicability of *lex mercatoria* would not derive from its intrinsic strength of being a self-contained legal system, but would derive from the recognition made by the State through his judges.

In my opinion, *lex mercatoria*, as far as the regulation of so-called B2B relationships[16] between parties with equal bargaining power belonging to different legal systems is concerned, has to be compared to the public international legal system, since the two share the same features.

As has been stated, the *lex mercatoria*, as well as the international public legal system, is characterized by the subjects having the same strength and bargaining power (States on one side; parties to the contract on the other). It is so even when a State is party to

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[15] For a complete exposition and critique of the pragmatic theory see, N. BOSCHERIO, *La lex mercatoria alla luce dell'approccio dottrinale "pragmatico" e "funzionale"*, op. cit., 83–89.

[16] It is well known that B2B is the acronym of 'Business to business'. This article does not deal with the problems related to the protection of consumers' rights in the field of international contracts.

the contract, so much so that Prof. Marrella expresses the following view: '*It seems that States and International organizations, in specific classes of contract frequently used in the international trade, put themselves on the same plane as privates, signing arbitral agreements in case of controversy with economic operators*'[17].

Secondly, the *lex mercatoria*, as well as international public law, is, unlike domestic law, composed of norms lacking in the characteristic of 'territoriality', meaning that it does not refer to a political entity but, going beyond it, refers to commercial relationships between economic entities.

Thirdly, the legislative power in international law, as well as in the system of *lex mercatoria*, is characterized by decentralization and, unlike domestic legal systems, does not include the existence of a legislator standing in a higher position in relation to the other members of the community. Thus, international public law, as well as *lex mercatoria*, is based on the principle of coordination rather than that of supremacy. As a result, it can be said that the law in both systems is always 'spontaneous'[18].

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[17] F. MARRELLA, *Lex mercatoria*, op. cit., at 384, in Italian in the original text.

[18] Regarding the features of international law, in the terms outlined in the text, see S. CASSESE, *Diritto internazionale*, Bologna, 2006, at 18 and 19: '*Nella comunità internazionale nessuno Stato o gruppo di Stati è finora riuscito ad esercitare un potere così diffuso e duraturo da imporre la propria volontà agli altri membri della comunità internazionale. Il potere è frammentato e disperso e, benché occasionalmente siano state create alleanze politiche e militari o si siano sviluppate forti convergenze di interessi tra due o più membri della comunità, tali legami non si sono mai consolidati in una struttura permanente di potere. Non essendosi ancora affermato un apparato istituzionale centralizzato, le relazioni internazionali si svolgono dunque quasi interamente a livello orizzontale. La conseguenza più evidente della struttura orizzontale della comunità internazionale è che le sue norme di organizzazione hanno ancora carattere embrionale [……]. Le attività di produzione, accertamento e attuazione del diritto sono decentrate, spettando cioè ad ogni Stato. Ecco che, dunque, per quanto riguarda l'attività di produzione di norme giuridiche, ciascuno Stato [……] pone in essere i comportamenti necessari per creare o modificare norme giuridiche. Ciò accade principalmente con la stipulazione di trattati, le cui norme vincolano solo le parti contraenti, oppure con la formazione di norme consuetudinarie, che vincolano tutti i membri della comunità internazionale, e si formano a seguito di un processo spontaneo cui partecipano i membri di questa comunità*'.

Finally, in both systems under scrutiny, one of the most important sources of law is custom (*consuetudo est servanda*), which is able to make general or specific rules internationally binding, and which is not weaker than the other sources of public international law.

The above comparison demonstrates how artificial and State-oriented the argument of the non-existence of the *lex mercatoria* is, when citing its lack of completeness or the difficulty to enforce the set of rules of which it is composed, as these are also features of international public law.

Does anyone today deny the existence of the latter legal system?

Actually, the main difference between the two systems lies in the nature of the subjects: States in the case of international public law and private parties in the system of *lex mercatoria*.

Hence, the system of *lex mercatoria* is the segment of international law formed by private parties, designated to govern commercial relationships between private parties endowed with the same bargaining power[19].

Admitting that *lex mercatoria* is part of international law and, as a consequence, part of a more general legal system, it remains to be seen which type of law can be created by the subjects that operate within this system.

[19] Some clarifications must be made about international subjectivity: it is well known that the classic doctrine of international law reserved this characteristic only to the States, with the exclusion of individuals. For years the doctrine of international law has been wondering whether the reservation of subjectivity to the States is still consistent with the new features of international law. Especially in the field of human rights and criminal law it has been noted that individuals can be considered addressees of international norms and, as a consequence, international subjectivity is to be attributed to individuals as well (regarding the dispute, see S. CASSESE, *Diritto internazionale*, op. cit., 187–189 and B.CONFORTI, *Diritto internazionale*, Naples, 1992, 19–21). The answer is controversial, but I venture to say that if subjectivity may be recognized to individuals in the field of criminal law, it is even more recognizable in the field of private law.

In international public law the most important sources of law are, on one side, the treaties that can be conceived as agreements by States, so that the general theory about the law of international treaties is based on the general principle of contracts; on the other side, customs that represent the general international law, which every State is bound to observe only because it is part of the community[20].

In the same way international merchants can create 'private norms' expressed in contracts, which are binding only for them (in compliance with the principle of privity of contract), and customary norms that are binding for every merchant that is part of the community. The latter source of law is, therefore, a general one and its aim is that of governing every type of economic relationship falling within its scope.

Let us examine this closer, with special reference to the nature and functioning of these norms.

The term 'usages' in international trade generally indicates a set of behaviours and rules of conduct that are repeated and adopted by the generality of operators in a specific field of international transactions.

As a matter of fact, this definition neither explains all the functions attributed to usages on the plane of international commercial relationships, nor their relevance on the plane of contractual ones.

Moreover, if it appears clear that the constituent element of usage is the regular repetition of certain behaviour by the majority of *mercators*, it is rather more problematic to specify its operational ambit.

Using categories drawn up by municipal law, but perfectly applicable to the field of international law, it may be verified if the 'usages' we are dealing with have the force of law in the sense that they may be called 'legal customs', or are binding on the plane of contractual relationships, so as to be called 'trade usages'.

The difference between the two types of 'usages' is well known: the first are a source of law consisting in a constant and uniform legal practice adopted by the generality of a specific 'society's'

[20] See footnote n. 18.

members and supported by *opinio juris ac necessitatis*, that is, the conviction of observing the law by means of observing the practice. In the Italian legislation, according to art. 8 of the Civil Code's preliminary dispositions, subjects regulated by statutes and regulations are effective so long as a reference is made to them by the said statutes and regulations. In common law systems, for customs to be enforced by the court, they must be reasonable, certain, consistent with the contract, universally acquiesced in, and not contrary to the law[21].

According to the majority of legal literature and decisions, trade usage or conventional usage (in the Italian legislation, art. 1340 of the Civil Code), instead consists in behaviour carrying into effect a contractual term, which covers a specific area and makes reference to certain contractual forms not supported by *opinio juris ac necessitatis*.

The two forms of 'usage' only share the 'material element', represented by the practice of observation and repetition, but differ deeply as far as the effects are concerned, because functions of trade usage are essentially based on a 'presumed-will mechanism', and the latter is not a source of law. For this reason, trade usages form part of the contract, unless the parties do not prove to have eliminated them from their agreement.

Unlike trade usage, custom, being a source of law, must be considered part of the contract irrespective of any hypothetical or tacit reference by the parties and of any knowledge they have of it (in Italian legislation, within the limits of art. 8 of the Civil Code's preliminary dispositions)[22]. Nevertheless, as contract law is based,

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21 SCRUTTON, *On charterparties*, S. BOYD, S. BERRY, A.S. BURROWS, B. EDER, D. FOXTON, C. SMITH (ed. by), London, 2008, at 13; J. C.T. CHUAH, *Law of international trade: Cross-Border Commercial Transactions*, 4th ed., London 2009, at 13–14.

22 SCRUTTON, *On charterparties*, op. cit.: *'A custom is a reasonable and universal rule of action in a locality followed not because it is believed by the general law of the land or because the parties following it have made particular agreements to observe it, but because it is in effect the common law within that place to which it extends, although contrary to the general law of the realm*', 14. According to my interpretation, the learned author here explains the force

in the most part, on a set of non-mandatory rules, parties are allowed to agree otherwise.

As usages form part of the same phenomenon of spontaneous regulation, it cannot be ruled out that, on the plane of municipal law, even a 'trade usage' could become a 'custom', something that will happen every time the former reaches such a uniform and repeated degree of observation that the generality of a society's members who adopt it believe to be complying with a rule of law.

From a procedural point of view, if a custom has the force of law, a breach or 'false application' of this may, in a civil laws system, found an appeal before the Supreme Court (in Italy under the provision of art. 360, c. I, n. 3, c.p.c.), unlike trade usages, whose binding force within the contract has to be proved by the party invoking it, and whose breach cannot found an appeal in the Supreme Court.

Having outlined the basic notions, we can move on to evaluate the force and scope of the application of usages in the field of international commercial law.

For this purpose a distinction must be made between the hypothesis in which the instant case is brought before arbitration, and that in which it is brought before a State Court.

Examining the hypothesis of the first kind, there needs to be a distinction between the one in which the *lex contractus* chosen by the parties is a body of extra-governmental rules, that is, the *lex mercatoria*, and the one in which the parties have located the contract in a specific municipal system.

In the first sub-hypothesis there is no problem with the application of those usages: it will be up to the arbitrator (or panel of arbitrators) to establish, in respect of the instant case brought

of law proper to legal custom, without expressing the mechanism trough which the rule of action becomes a source of law. In fact, the belief of following a rule of law (*opinio juris*) concerns the forming of legal custom, not its functioning, because once formed, the legal custom, as source of law, is incorporated *ex se* in the contract irrespective of any knowledge or presumed will of incorporation by the parties.

before him/her, whether the international usage has to be considered a trade usage rather than a legal custom.

With specific reference to custom, its strength in respect to other sources of law at the international level – where, as explained above, there is not a hierarchy by which the customary rules are inferior to the other sources – assumes a prominent position.

In fact, when a practice or commercial behaviour becomes so 'mature' and repeated as to be followed by the generality of members of a 'society', in the conviction that they are observing a rule of law (*opinio iuris ac necessitatis*), the trade usage could become a custom and consequently a source of law. If, however, within the ambit of many judicial systems, among which the Italian, the binding force of custom is limited by other sources within the system, the same thing cannot be said about the international commercial law level.

To sum up, when in international commercial law the usage is so mature as to provide the grounds for '*regulae iuris*', the same may have force of law (custom) and so it can be tacitly incorporated in the contract for which it has been created, apart from any mechanism of the presumed will of the parties.

The second sub-hypothesis, namely that in which the parties, through a forum selection clause, have chosen a specific domestic law to be applied to the contract, may seem a little more problematic at first glance.

If there is no doubt about the fact that in this case the arbitrator is bound to apply the law chosen by the parties, there is uncertainty as to whether the international custom applicable to the case is to be put in the rank of the sources of law of the chosen legal system or otherwise be juxtaposed with or overlap that rank.

Let us suppose, for instance, that the parties agree to refer a dispute to the International Chamber of Commerce adopting its Rules of Arbitration, whose art. 17.2[23] says: '*In all cases the Arbitral*

[23] The Rules can be found in 13 languages (Arab, Portuguese, Chinese, Czech, Dutch, English, French, German, Polish, Russian, Spanish, Thai and Turkish)

*Tribunal shall take account of the provisions of the contract and the relevant trade usages*'.

If the custom were put in the rank of sources of law of the chosen legal system, it would follow that the rule under scrutiny would be useless, because it is obvious that by choosing a legal system one also chooses its rank of sources of law. In this case, international custom would lose its characteristic of source of a self-contained legal system, because it would be considered part of the chosen legal system. Its applicability would therefore be conditioned by that system.

As is shown by art. 17.2 of the ICC Rules, once a dispute is referred to arbitration, an international trade custom or usage (as it is called by art. 17 of the ICC Rules), where applicable (*relevant*), has to be taken into consideration *in all cases* to solve the dispute, because it does not lose its feature of international norm[24].

In order to give an answer to the question put above, this means that international customs are juxtaposed with or overlap the system of law chosen by the parties, thus being imposed *ex se*[25] on the transaction, even against the mandatory rules of the chosen law (but within the limits of so-called 'international public policy' and 'necessarily applicable' norms)[26].

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on www.iccwbo.org. For a first commentary, the day after the publication of the Rules (January 1st 1998), see P. BERNARDINI, 'Il nuovo regolamento di arbitrato della C.C.I.', in *Dir. com. int.*, 317 (Rules in appendix).

24 Y.DERAINS – E. SCHWARTZ, *A guide to the new ICC Rules of arbitration*, The Hague-London-Boston, 1998, at 224.

25 G. SACERDOTI, 'La codificazione degli usi del commercio internazionale a cura degli organismi governativi internazionali', in *Fonti e tipi del contratto internazionale*, U. Draetta – C. Vaccà (ed. by), Milan, 1991.

26 F. MARRELLA, *Lex mercatoria*, op. cit., at 339: '*Appare chiaro che la lex mercatoria, oltre che risultare efficace come lex contractus, può combinarsi in modo eterointegrativo con la legge applicabile (statale), ferma restando l'efficacia, in ogni caso, delle norme di applicazione necessaria e la rilevanza dell'ordine pubblico*'. Regarding the identification of the necessary applicable norms and the definition of public policy in the ambit of international private law, see F. MOSCONI – C. CAMPIGLIO, *Diritto internazionale privato e processuale*, 4th ed., Turin, 2007, 204–205 and in the ambit of the *1980 Rome Convention on the law applicable to contractual obligations*, 168 and 231–244;

Moving on to the examination of the hypothesis in which an international commercial custom is brought before a State Court, and already advancing the conclusions, it can be said that the theoretical problems and solutions are not too different from those of the first hypothesis.

The starting points are: *a*) without an express choice by the parties, every judge is bound to apply his own law, and *b*) according to the law in force in most countries, it is not demonstrated that *lex mercatoria* can be chosen as applicable law before a national Court[27].

Even in this case, two sub-hypotheses can be made: according to the first, the Court could be charged with enforcing an award in which an international legal custom has been applied, or, on the contrary, annulling it; according to the second, the Court could be charged with assessing directly the merit of the dispute in the

on the same subject T. BALLARINO, *Diritto internazionale privato*, 3rd ed., Padua, 1999, 298–311 and *Manuale breve di diritto internazionale privato*, Padua, 2008, 56 , 78.

[27] For instance, the possibility of choosing a body of anational laws to govern the contract in the countries that are part of the Rome Convention 1980 on the law applicable to contractual obligations (now Reg. (EC) n. 593/2008 of the Parliament and of the Council, of 17/06/2008, in Off. Jour. L 177/6 of 04/07/2008, the so-called Rome 1) is hardly questioned, and the predominant opinion is negative. The choice of the *lex mercatoria* is therefore considered a non-choice (see. art. 4 of the Rome Convention); T. BALLARINO – A. BONOMI, 'Sulla disciplina delle materie escluse dal campo di applicazione della Convenzione di Roma', in *Riv. dir. int.*, 1993, 939; N. BOSCHERIO, 'Obbligazioni contrattuali (diritto internazionale privato)', in *Enc. dir.*, IV agg., 2000, 801. Besides, it should be underlined that in the original proposal of the Rome 1 Regulation (COM 2005 650 def., 15/12/2005), art. 3, the parties were given the possibility of choosing an anational body of norms, provided that it was based on principles recognized at the international level, for instance, the UNIDROIT Principles. The parties were not allowed to choose the *lex mercatoria* (tout court) considered too indeterminate and not precise enough. The definitive text of the Rome 1 Regulation, which came into force on 17/12/2009, seems to have maintained the possibility for the parties of choosing an anational body of norms, at n. 13 of the preamble, even if art. 3 of the old Rome Convention, under this point of view, has not been emended. For the relationship between the Rome Convention and the Rome 1 Regulation, see art. 24 of the latter. On the same topic in the period preceding the publication of the Regulation, F. MOSCONI – C. CAMPIGLIO, *Diritto internazionale privato*, op. cit., 392–393.

absence of an arbitration clause, either by means of conflict of law rules, or by means of an express choice of law.

The cases that can be ascribed to the first sub-hypothesis are the most numerous, because in international commercial contracts, almost invariably, an arbitration clause is inserted.

In these cases, the Courts, at least in those States in which the New York Convention of 1958[28] is in force and in which advanced legislations regarding arbitration have been adopted, place many restrictions on reviewing the merit of an arbitral award (foreign or domestic) either on point of fact, or (but less) on point of law[29]. The

[28] The 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards has been ratified and implemented by 144 Sates, among which Italy, Norway, the United States and the United Kingdom. Check the status of the Convention on www.uncitral.org/uncitral/en/uncitral_texts/arbitration/NYConvention_status.html.

[29] Regarding the foreign arbitral awards, here I only recall art. V of the New York Convention, which says that, generally speaking, the State Courts, before which the enforcement and recognition are sought, are not allowed to examine the merits of the dispute. In fact, the Court can refuse to enforce or recognize the foreign arbitral award in case of incapacity of the parties, invalidity of the agreement to arbitrate, lack of proper notice of the appointment of the arbitrator or of the arbitration proceedings, if the award deals with subjects or contains decisions beyond the scope of the submission to arbitration, if the composition of the arbitral authority or the arbitral procedure are not in accordance with the agreement of the parties, if the award has not yet become binding on the parties, or has been set aside or suspended by the competent authority in which or under the law of which the award was made, if the subject matter of the difference is not capable of settlement by arbitration under the law of the country in which the award is sought to be recognized and enforced, or the recognition or enforcement would be contrary to the public policy of that country. In general, on the problems connected with the recognition and enforcement of international arbitral award see, H.G. GHARAVI, *The international Effectiveness of the Annulment of an Arbitral Award*, The Hague – London – New York, 2002. In the Italian legislation a foreign arbitral award cannot be recognized if it deals with subjects that could not be submitted to arbitration according to Italian law, or if the award is contrary to public policy (art. 839 c.p.c.). Against the provision that recognizes or refuses the enforcement or recognition of the foreign award, it is possible to appeal to the same Court who could refuse the enforcement only for reasons very close to those seen above regarding art. V of the New York Convention (art. 840 c.p.c). A domestic arbitral award can be challenged before the Court of Appeal through an 'annulment action', a 'third party proceeding' or a 'new trial'. The first action does not allow the Court to examine the merits of the award and the law

only appeal that is always permitted is the one for violation of the public order of the State in which the award is sought to be enforced or recognized, but I venture to say that it is most unusual for an international legal custom not to be in compliance with the public policy of any State. This is so simply because a legal custom embodies and at the same time expresses the commercial values shared by a specific international mercantile community formed by citizens of different Sates who all have the same interest: the one of negotiating worldwide in a way that their rights can be recognized and enforced in every State in which they would seek it.

Therefore, in the cases described under the first sub-hypothesis, object of the two famous French Supreme Court decisions *Norsolor*[30] and *Valenciana*[31], a State Court can make a custom enter into its own legal system through the recognition and enforcement of an arbitral award.

The same result has been achieved by the Italian jurisprudence in cases described under the second sub-hypothesis. The Italian Supreme Court has in fact declared that once the existence of an international legal custom has been recognized, it has to be applied to the transactions within its scope, and its strength cannot be

applied to it, except in cases in which the parties have so agreed. The right to appeal for question of law is always admitted in case of controversies concerning labour law (art. 829 and 409 c.p.c.) and if the violation of a law concerns prejudicial questions on subjects that could not be submitted to arbitration. The right to appeal for violation of public order (art. 829 c.p.c.) is always admitted. The English legislation is less strict than the Italian in this respect because of art. 69 of the Arbitration Act 1996, which, even if within the limits stated in it, allows the right of appeal on point of law; something that, with the few exceptions listed above, is not allowed under Italian legislation. On the Arbitration Act 1996, with special reference to maritime law, see S.C. DERRINGTON – J.H. TURNER, *The Law and Practice of Admiralty Matters*, Oxford, 2007, 291–313.

30 Cour de Cassation, 9/10/1984, 'Norsolor S.A. c. Pabalk Tikaret Limited Sirketi', in *Rev. Arb.*, 1985, 341, with case notes by B. GOLDMAN; in *JDI*, 1985, 679, with case notes by PH. KAN; in *Rev. Crit. D.I.P.*, 1985, 551, with case- notes by B. DUTOIT; in 2 *J.In'l Arb.*, 1985, 67

31 Cour de Cassation, 09/10/1991, 'Compañia Valenciana de Cementos Portland v. Primary Coal', in *Rev. Crit. D.I.P.*, 1992, 113.

ranked in the domestic system of sources of law by virtue of its status as international law.

I am referring to the famous judgement of the Italian Supreme Court (Corte di Cassazione), 8/02/1982, n. 722, *F.lli Daminao SNC* c. *August Topfer & Co. GmbH*[32], in which the Court recognized that international legal customs, when supported by *opinio juris ac necessitatis*, are a source of 'transnational' law and are imposed on the contracts irrespective of the specific incompatible laws of the different countries.

The Court went on to say that: 'The "mercantile" law is experienced through the adoption by the community of the values of their own environment, in such a way that their behaviour conforms to those values, by virtue of the *opinio juris ac necessitatis* that they feel towards these values, that is, the belief (prevailing among them) that they are compulsory'[33].

The same conclusions have been reached by the French jurisprudence in cases regarding the Uniform Customs and Practice for Documentary Credits (UCP), which, although issued by a private international organization, the International Chamber of Commerce (ICC), are now considered sources of the law regarding documentary credits, whose wide and constant application would give rise to a '*cotume*'[34].

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[32] Cass. civ., 8 febbraio 1982 n. 722, 'Fratelli Damiani c. August Topfer £co. GmbH', in *Riv, dir. int. priv. e proc.*, 1982, 829; expressing criticism A. GIARDINA, *Arbitrato transnazionale e lex mercatoria di fronte alla Corte di Cassazione*, *ibidem*, 754 ss.

[33] In Italian: '*…il diritto "mercantile" si sperimenta nell'adesione degli operatori economici ai valori del loro ambiente, sì che le loro condotte si uniformano a quei valori, in virtù dell'opinio iuris ac necessitatis che gli operatori nutrono rispetto ai medesimi, cioè nella convinzione (prevalente fra di loro) che essi siano vincolanti*'.

[34] M. J. BONELL, *Le regole oggettive del commercio internazionale*, Milan, 1976, at 105. The Italian Supreme Court is of a different opinion regarding the UCP, considering them to be only trade usages: Cass. civ., sez. I, 8 March 1996, n. 1842, in Mass. giur. it., 1996; Cass. civ., 10 June 1983, n. 3992, in Mass. giur. it., 1983. About the nature of UCP, E.P. ELLINGER, *The Uniform Customs and Practice of Documentary Credits (UCP): their development and current revision*, L.M.C.L.Q., 2007, 152–180.

In conclusion, from a general point of view, and before examining the cases related to maritime law, it can be said that, at least in the Italian and French jurisprudence, the opinion according to which transnational commercial behaviour may be relevant even as a source of law (in the form of legal customs) has taken shape and, along with it, the transnational commercial legal system.

# 3 In brief, the nature of maritime law

The influence of customs in the field of commercial maritime law[35] has always been greater than in any other field of commercial law, insomuch as it may be well said that this branch of law more than any other has an origin and development that are basically customary.

This is not the place in which to deal with the evolution of maritime law, but the subject can be briefly broached, just to reveal the characteristic that makes it a *sui generis* branch of law, and to explain why the influence of custom is stronger than in any other field of commercial law.

It is known that the origin of some basic institutes of maritime law date back to the Babylonian law (3rd millennium BC). The contract that we today call a charterparty, for example, was assimilated to the one that we would call a bareboat charter[36].

Those institutes, adapted to new commercial needs, spread over the whole Mediterranean region by means of the Phoenicians, who are believed to have elaborated the first form of general average, afterwards acknowledged in the *Lex Rhodia de jactu*[37].

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35 For a brief history of maritime law, see W TETLEY, *International Maritime and Admiralty Law*, Cowanswille, 2002, 3–30.

36 F. A. QUERCI, 'Il diritto marittimo fenicio (a proposito di un recente studio)', in *Riv. dir. nav.*, 1960, I, 421.

37 F. A. QUERCI, *Il diritto marittimo fenicio (a proposito di un recente studio)*, op. cit. and A. BISCARDI, *Continuità della Tradizione ed esigenze di*

Moreover, it is undeniable that ever since Hellenistic times a body of customary rules existed, spread among the sea traders of the Mediterranean sea and was regularly observed in every system of law, known as *Lex Rhodia*, which constituted the basis for classic maritime Roman law and later would be collected in the Digest under the title of *De lege Rhodia de jactu*[38].

Two centuries after *Corpus Juris Civilis* all of these maritime customary traditions would influence the digest of customs and usages known as *Nómos Rodion Nautikós*, created for supplying maritime traders with a sort of handbook on trade and judiciary practice in a period of flourishing commerce among the different ports of the Mediterranean.

Applied for many centuries, the *Nómos* constituted one of the main sources of medieval maritime law, a bridge between ancient and modern times, and in whose footsteps the medieval maritime Statutes and codes followed, such as the *Amalphitan Table*, the Statute of Bari, that of Ancona, and those of the north-eastern Adriatic cities (currently known as Dubrovnik and Split), and the Consolato del Mar of Barcelona.

Customary Mediterranean maritime law spread across the Atlantic coasts, from Spain to Scandinavia, through three fundamental digests: the *Roles of Oléron* (datable to around the 12th

*rinnovamento nella compilazione bizantina del Nomos Rhodion Nautikos*, proceedings of *La legge del mare in Italia dall'evo antico alle moderne codificazioni*, Trani, 1983, 14.

[38] D. XIV. II. A misunderstanding has to be dispelled, namely that the *Lege Rhodia de jactu* dealt only with the general average in the form of jettison. Actually, in this *lex*, as collected in the Digest, flowed all the body of *Leges Rhodiae*, of customary origin and regularly observed since the 5th century BC in the Mediterranean basin, to which the jurists of the Roman classic age, dealing with maritime affairs, would refer. For instance, Cicero was the promoter of the *Lex Manilia de Imperio Cn. Pompei*, in which, 18,51, the following can be read: '*Rhodiorum, quorum usque ad nostram memoria disciplina navali set gloria permansit*', A. BISCARDI, *Continuità della tradizione ed esigenze di rinnovamento*, op. cit., 13. On the customary origin of many institutes of maritime law, see. W. TETLEY, 'The general maritime law – The lex maritima (with a brief reference to ius commune in arbitration law and the conflict of laws)', in 20 *Syracuse J. Int'l L. & Com* (1994), 109.

century), which is a casebook of the maritime court of the island of *Oléron*; the *Ordinance of Wisby* (15th century), based on the *Roles*, on which the Scandinavian maritime legislation has been founded, and the Statutes of the Hanseatic towns, on which the German maritime legislation has been based.

These three digests of customs and judgements constituted a *jus commune* or, one may say, a *lex mercatoria*, of the Atlantic Ocean and the North Sea[39], which for many centuries would be the core of the English Admiralty Law[40].

Still in the 17th and 18th centuries in England there was the awareness among English merchants and jurists that maritime law belonged to a *jus commune*, namely a body of law intended to

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[39] A. LEFEBVRE D'OVIDIO, G. PESCATORE, L. TULLIO, *Manuale di diritto della navigazione*, 11th ed., Milan, 2008, 13–16; W. TETLEY, *The general maritime law*, op. cit., 110, 111. J. GILES, *Lex mercatoria*, op. cit., 360: '*King Richard the First of England, in his return from the Holy Land, arriving at the Isle of Oleron, situated in the Bay of Acquittain, of which that Prince was then in possession, did there make and publish certain Laws and Statutes for the Regulation of Maritime Affairs, which were for many ages famous under the Title of Laws of Oleron: and these Laws, tho' they were published there, did not only take Place in that Island, and the adjacent Countries, but likewise in all the Seas and the Maritime Places in this Part of the World. For it hath been observ'd, that as soon as they came to be known, they were approv'd by all honest Men who us'd the Sea: And according to the Nature of the ancient Customs, they insinuated themselves by Degrees and got Footing in Courts of Law and Justice. They agree with, in many Things, the Ancient Laws of Rhodes, a City in the renown'd Island of that Name in the Mediterranean Sea: and Upon the foundation of the Laws of Oleron are built the Ordinances of the famous City of Wisby in the Isle of Ghotland; which were in Force in all Ports, Harbours, and seas of Europe, as far as the Strait of Gibraltar*'.

[40] About the historical origin of the expression Admiralty Law, see *Roscoe's Admiralty Practice*, 4th ed., by G. HUTCHINSON, London, 1931, 2: '*In medieval times not only was there a Lord High Admiral, but also Admirals for different portions of the seas around the British Islands: there was, for instance, an Admiral of the West and an Admiral of the North. These officers necessarily possessed disciplinary powers over vessels under their command, and in addiction were in a sense sea magistrates, for they were the only maritime officials with both authority and power. They had especially to determine dispute in regard to the capture at sea of enemy property: in other words, in regard to prize. By a natural evolution they became also arbitrators in maritime disputes*'.

govern commercial relationships, which was different from common law (being of civilian origin) and whose application was not limited to the realm. This body of law was called *lex mercatoria*[41].

Finally, it is worth noting that the autonomy of maritime law, administered in the civilian Court of the Admiralty[42], in respect of common law, would end only in 1875, when the Admiralty Court merged with the common law courts[43].

At least up to that date, the law administered by the *Admiralty Court* was civil law and maritime customary international law based on the *Roles of Oleron* as emended by statutes.

So Roscoe says: '*But if precedents or principles were wanting upon which to found a decision, it was natural that civil lawyers should refer to the civil law, and that maritime rules known to seamen and merchants generally should also be invoked. It is therefore probably accurate to state in a general way "that (in 1802) the Instance Court is governed by the civil law, the laws of Oleron and the customs of the Admiralty modified by statute law"*'[44]

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41 G. MALYNES, *Consuetudo vel lex mercatoria or the Ancient Law-Merchant*, op. cit.

42 About the struggle between the common law courts and the Admiralty Court *Roscoe's Admiralty Practice*, op. cit., 3–15; A. Mandaraka-Sheppard, *Modern maritime Law and Risk Management*, 2nd ed., London 2009, 5–7.

43 In 1875, when the civilian Courts merged with the *common law* ones (Supreme Court of Judicature Act 1875, 38 & 9 Vict. c. 77), the latter, situated in *Westminster*, were the *Court of King's Bench*, the *Court of Exchequer* and the *Court of Common Pleas*, while the *civilian Courts*, besides the *Admiralty Court*, were the *Court of Probate*, the *Court of Matrimonial Causes* and the *Court of Chancery* (the latter appointed to equity judgements). M. RHEINSTEIN, 'Common Law – Equity', in *Enc. dir.*, VII, Milan, 1960, *passim*, and especially under point 916; on the origin of *common law* and on the different meanings of the expression, L. MOCCIA, *Common Law*, Dig. civ., III, Turin, 1992, 17, especially 22 and 23; about the last period of the Admiralty Division, F.L. WISWALL, *Development of Admiralty Jurisdiction and Practice since 1800*, Aberdeen, 1970.

44 G. HUTCHINSON, *Roscoe's Admiralty Practice*, op. cit., 25. On the civilian nature of maritime law in England, F. D. ROSE, 'The action in rem in English Law', in *English and Continental Maritime Law after 115 Years of Maritime*

This brief historical summary explains that the nature of maritime law cannot be ascribed only to one family of law (continental or common), and that, on the contrary, it derives from civil law and has evolved, especially from the second half of the 19th century, according to principles of law stemming from common law sources[45]. Maritime law therefore has to be regarded as a mixed legal system[46].

As a consequence, it is not surprising that many institutes and principles of maritime law are well established and applied in much the same way in different countries of different legal traditions, and that more than in any other field of law, legal customs have played a part, as will be shown through the cases commented on in the next chapter of this article.

*Law Unification: a Search for Differences between Common Law and Civil Law*, E. VAN HOOYDONK (ed. by) Antwerp, 2003, 47; F. L. WINWALL Jr., *The development of Admiralty Jurisdiction and Practice since 1800*, op. cit., 79; *Halsbury's Law of England*, 1 (1): Admiralty, par. 301, 418, sub-footnote 2: '*The original and common law jurisdiction of the court must be ascertained from the continuous practice and the judgements of its judges and from the judgements of the courts of Westminster; the former, in their court, using the law of Rhodians, of Wisby, the Hanse towns, of Oleron (incorporated in the 15th Century Black Book of Admiralty), the Digest and French and other ordinances, which, though they are not part of the law of England, contain many valuable principles and statements of marine practice*'.

45 F. L. WINWALL Jr., *The development of Admiralty Jurisdiction and Practice since 1800*, op. cit.

46 W. TETLEY, 'Maritime law as a mixed legal system (with particular reference to the distinctive nature of American Maritime Law, which benefits from both its civilian and common law heritages)', in *Tul. Mar. L. J.*, 1999, 23, 317–350, *passim*; W. TETLEY, 'Nationalism in a mixed jurisdiction and the importance of language (South Africa, Israel and Québec/Canada)', in *Tul. L. Rev.*, 2003, 78, 175 – 218; G. CAMARDA, 'Prime linee per una comparazione italo-canadese nel diritto marittimo', in *Riv. Studi canadesi*, 16/2003, 5 and in *Dir. Mar.*, 2003, II, 386–397.

# 4 Review of cases

As stated at the end of the previous chapter, the problem of the application of international maritime customs has been dealt with by the courts of different countries, which, in some cases – by recalling the similitude of maritime institutes and principles all around the world – have discussed and sought to apply to the cases under scrutiny a 'maritime law of the world' or a 'maritime law of the nations'; in other cases they have sought to apply legal customs developed in certain segments of international maritime trade.

Some examples will be given through the examination of cases decided by common and civil law Courts.

As for the former, and with special reference to international customs, it is worth noting that in England the influence of custom in the field of dispute resolution has always been taken for granted, insomuch as M.J. Mustill, in his essay on the topic discussed in this article and on the sources of transnational law, writes that '*Nobody could deny that usage […..] can be an important element in the assessment by a tribunal of the rights and duties created by contract, either because in a codified or inexplicit form it is tacitly incorporated into the contract, or because it has been received into the relevant national law. But there is nothing special about international trade in this respect, nor anything special about arbitration. Any worthwhile national court ought to be capable of taking usage into account, without the need to accord usage the status of a prime element in a self-contained system of law*'[47].

I think that the learned author *plus dixit quam voluit*: by applying the Lockwood test we are forced to say that, at common law, a custom is such if it has existed from time immemorial without interruption within a certain place and is certain and reasonable in itself. In this case it obtains the force of a law, and is, in effect, the

[47] M.J. MUSTILL, *The new Lex Mercatoria,* op. cit., 158.

common law within that place to which it extends, though contrary to the general law of the realm[48].

As can be easily seen, the above test is relevant to domestic customs rather than international ones, simply because, according to the test, the main characteristic of a usage if it is to have force of law is that of territoriality, something in which an international custom is lacking, as it is usually addressed to a 'market'. In the maritime trade the latter is of course not a place, but is generally composed of subjects acting in different lines of navigation, touching different ports of different nations, and with reference to different trades.

Secondly, saying that a custom can be incorporated into the relevant national law does not explain the crucial problem, viz. the mechanism of the incorporation. In other words, is the custom incorporated and ranked in the hierarchy of sources of law of the relevant nation? If the answer is yes, is the custom then to be considered a source of international law (and, in the words of M.J. Mustill, to be considered a prime element of an international self-contained legal system), or is it to be consistent with domestic legislation (and so to be considered in the same way as any domestic law)?

In short, saying that any worthwhile national court ought to be capable of taking usages into account does not explain the way in which the custom has to be taken into account. The view of this author is presented in Chapter 1 of the present article, to which the reader is referred.

The comments to the following cases will show that even in United Kingdom case law there have been attempts to apply international customs and the 'maritime law of nations', and sometimes these attempts have been successful.

[48] Lockwood v. Wood (1844) 6 Queen's Bench Reports 50, at 64.

## 4.a. Reardon Smith Line Ltd. v. Black Sea & Baltic General Insurance Co Ltd[49]

The case arose from an action brought by Reardon Smith Line Ltd, the plaintiffs (as they were then called) v. the Black Sea & Baltic General Insurance Company (the defendant). The former – owners of the vessel *Indian City*, chartered to Meganexport of Berlin, a company controlled by the Soviet government – claimed that the defendant insurance company was liable, among others, to pay them the contribution due from the cargo towards general average losses and expenditures incurred in respect of the stranding of the *Indian City* at Constanza, where the vessel had called for bunker.

The vessel was fixed for a voyage from Poty, as port of loading, to different ports of the United States, at the charterer's option, among which the one of Sparrow's Point was nominated as port of discharge. The charterparty contained a liberty clause providing that the vessel should be (as for the relevant part) at liberty to call at any port or ports in any order or places to bunker.

The defence was that the claim should be dismissed because bunkering at Constanza after loading was a deviation from the contractual voyage from the Black Sea to the United States (Constanza being far to the north of the direct route to the Marmara Sea).

Mr. Justice Goddard[50], basing his decision on the existence of a custom of the Black Sea trade, held that there was no deviation and allowed the claim. The insurers appealed.

Three opinions were delivered on appeal, namely by L.JJ. Greer, Slasser and Clauson.

Advancing the conclusion, it has to be said that the appeal was allowed and, accordingly, the decision of Mr. Goddard was reversed, but it is worth noting the dissenting opinion of L.J. Greer of the Court of Appeal.

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49 (1938) 60 Ll. L. Rep. 353 (Court of Appeal).

50 57 Ll. L. Rep. 241.

The L. Lord considered that the correct approach to the question was not to ask the meaning of the liberty clause contained in the charterparty, but, on the contrary, to solve the problem of the existence of the alleged custom of the Black Sea trade, which, if existent, would have overridden the provision of the contract. This was so because the existence of the custom should not be regarded as a matter of fact, or as a construction of the contract, but as one of law.

Accordingly, if by custom of the Black Sea, the route to Constanza had been an ordinary trade route in the business sense, then the call at that port for bunkering, even if the port was off the geographical range of ports, would not have been deemed a deviation as otherwise it would have been.

Approving the decision of Mr. Goddard, L.J. Greer expresses himself thus:

*'I think the learned Judge approached the question in the right way by asking himself, before considering the liberties in the charter-party, whether or not the route taken via Constanza was an ordinary trade route in a business sense. If it was, it was unnecessary then to consider whether the route so taken was within the liberties granted by the contract of affreightment. I have come to the conclusion that the learned Judge was right in holding that when she grounded the Indian City was on a route generally recognised in the Black Sea trade as an alternative route to the direct route, and accordingly that the defendants were liable as standing in the shoes of the charterers'*[51].

To support his opinion the L. Lord quoted Arnould on Maritime Insurance, 11th ed., sect 60, at 85, according to which it is a general usage of maritime trade, incorporated in all policies, that the ship, in absence of any express permission on the face of the policy to do otherwise, shall follow a direct route between the port of loading and that of discharging, without calling at any intermediate port. If, however, it is the notorious and well-settled usage of any given

[51] (1938) 60 Ll. L. Rep. 353 (Court of Appeal), at 356.

trade to stop at certain intermediate ports, this usage would countervail the general maritime usage, and stopping at such ports, although not authorized by any express clause in the policy, is deemed no deviation.

As for the possibility of the charterers (and, in their place, the insurers) of having knowledge of the trade customs L. Greer, relying on the authority of the *Frenkel* case[52], says that:

'*It does not seem to me to matter whether the plaintiff knew it or did not know it if it was in fact a usual route, because once it is established that it is a usual route it is unnecessary to go further and decide whether the charterer or shipper knew it*'.

Finally, having held that the custom alleged by the claimants was well-established in the Black Sea trade and that it did not matter if the respondents knew or had to know it, the L. Lord concluded that the calling at Constanza was not a deviation and would not require a special liberty clause in the contract of affreightment. As a consequence he dismissed the appeal.

The opinion of L. Greer, which at first glance could seem to be very linear and consistent with the principles of law related to custom, actually takes for granted some points that it may be worth looking into.

First of all, the problem of the existence of the custom is not considered a matter of contract, but a point of law, from which follows the L. Lord's position that private merchants, while acting in a given market, can create norms by means of commercial behaviour.

Secondly, if the custom is law, that law is lacking in the feature of territoriality, as it has been created in the ambit of a market involving ports located in different States.

Moreover, the L. Lord seeks to apply the custom without verifying the consistency of it with the contract.

In this regard, L. Greer simply stated that once the custom was recognized as having the force of law, it was unnecessary to con-

[52] Frenkel v. MacAndrews & Co, [1929] A.C. 545.

sider whether it was in compliance with the contract and, accordingly, whether the route via Constanza was within the liberties granted by the liberty clause.

The decision of L. Greer, even if some elements of it could be criticized – especially the one stating that once the custom has been recognized as having force of law, the L. Lord considered non-relevant its compliance with the liberty clause, while it is undeniable that every non-mandatory law, whether international or domestic, can be departed from, if the parties so agree – can be seen as very innovative for the year in which it was taken, especially because it sets out, even implicitly, the principles referred to above, which still can be applied today.

For the sake of completeness, the opinions of L. Slesser and L Clauson will be briefly examined: both L. Lords approached the problem in a completely different manner from that of L. Greer, maintaining that the question was one of construction of the contract. In other words, the question to consider was whether, based on the authorities, there was room for the evidence before the judge, which might be construed as to vary the obligation to proceed along the ordinary commercial route.

The answer that both L. Lords gave to the question was negative, and the appeal was allowed.

## 4.b. N.V. Bureau Wijsmuller v. Owner of the Motor Tanker Tojo Maru (Her Cargo and Freight) ('The Tojo Maru')

In February 1965 a Japanese tanker, the Tojo Maru, loaded a cargo of oil in a port of the Persian Gulf. While leaving the port she collided with an Italian tanker, the Fina Italia, suffering damages. She had a gaping wound in one side, which a Dutch tug, the Groningen, owned by the plaintiffs, offered to repair under a 'No cure – no pay' standard form of salvage. The contract was signed by the captain of the damaged tanker. The salvage plan provided for the placing of a

big patch of steel over the wound in the side of the Tojo Maru. The patch was hauled to the wound, but before bolting it, the tanker had to get rid of the gas she had inside. The chief diver made the bad mistake of trying to bolt the patch, by firing a Cox bolt gun under water before the Tojo Maru had been cleared of the gas. The bolt went through the shell plating of the tanker, provoking an explosion that was followed by many others. Fire broke out, and the vessel suffered extensive damage.

It took over a fortnight to get the Tojo Maru in a fit state to be towed, first to Singapore, and then to Kobe where she was fully repaired.

The salvors claimed for salvage reward, while the owners counterclaimed damages for the negligence of the diver. The issue went to arbitration, in which it was found that the contractors were liable towards the owners, but that the former could limit their liability according to the tonnage of their tug.

The case then came before Willmer J.[53], who found that the owners were entitled to counterclaim, whereas the contractors were not entitled to limit their liability.

The Dutch contractors appealed[54], and the following points of law were discussed: 1) whether the owners of the Tojo Maru were entitled, on their counterclaim, to recover full damages for the negligence of the diver; 2) if, in this case, the salvors were entitled to limit their liability according to the tonnage of their tug; 3) which would be the way of applying the limitation and, hence, the setting off of the sums requested by the salvors and owners respectively; 4) which sum the contractors had to pay to the owners if no limitation had been applicable.

As far as it is of interest in this article, the opinion of L. Denning M.R. will be commented on.

The L. Lord, in answering to the first point of law raised before the Court, drew a line between the common law of England and

[53] [1969] 2 All ER 155.

[54] [1969] 3 All. E.R. (C.A.), 1179.

the law that he called the 'maritime law of the world', stating that the case fell within the second rather than within the first, and adding that if the case was to have been decided according to the common law of England, the counterclaim would undoubtedly have been allowed. In underlining the difference between the 'maritime law of the world', and the common law of England the L. Lord compared the 'No cure – no pay principle', to be ascribed to the maritime law of the world, with the principles governing the contract of work and labour, at common law.

When defining the nature of the maritime law of the world that, according to his view, the English Court of Admiralty had done so much to form, he quoted the words of L.J. Brett in *The Gaetano e Maria*[55]:

*'It is not the ordinary municipal law of the country, but it is the law which the English Court of Admiralty either by Act of the Parliament or by reiterated decision and traditions and principles has adopted as the English maritime law'*[56].

Adopting this definition, L. Denning takes his place on the trail blazed by other judgements issued in the United Kingdom, according to which maritime law is neither the common law of the country nor a pure domestic law, but, even if altered and modified by statutes, a common law of the nations.

In this regard, it may be worth citing *Steamship Company, Ltd. v. Compania Trasmediterranea*[57], in which the Court of Session approved, as a matter of principle, the citations of *Boettcher v. Carron Company, (1861),* [23 M. (2nd Series) 322, at p. 330], and of *Currie v. M'Knight, 24 R.* [(4th Series) H.L. at p. 3] , which read as follows. The first:

*'The Admiralty law [of England and Scotland] is derived from the same source, namely the ancient customs of the commercial nations of Europe, which have grown up into a system with the*

55 (1882) 7 P.D. 137, at p. 143.

56 *The Tojo Maru*, *per* L. Denning, at 1183.

57 (1930) 36 Ll. L. Rep. 197.

*knowledge and assent of both England and Scotland, as members of the commercial community of nations, and which, within certain limits and with certain exceptions, have all the force of an international code*'.

The second: '*From the earliest times the Courts of Scotland exercising jurisdiction in Admiralty causes have disregarded the municipal rules of Scottish law, and have invariably professed to administer the law and customs of the sea generally prevailing among maritime states*'.

These authorities show that for centuries the maritime law has been considered part of a sort of international unwritten code, having force of law in different sovereign States irrespective of the applicable law of the State. As it was not written down, the core of that international maritime code was the custom of the sea, which was created by and addressed to the maritime community.

It is worth noting that it was the law of the international maritime community that was considered of general application within certain limits, not the contrary, as happens today, when the application of an international legal custom by a domestic Court is considered the exception.

Turning back to *Tojo Maru* case, L. Denning found that according to the maritime law of the world that he was seeking to apply, the 'No cure – no pay' principle did not entitle the owner of a vessel in distress to counterclaim for the recovery of damages done to the vessel by negligence of the salvors.

In the opinion of the L. Lord, where the salvors have done more good than harm, the only consequence for them of having performed badly their services would be the one of diminishing or forfeiting the salvage reward.

In commenting on the authorities to which he referred to support his reasons and conclusions (to which L.JJ Karmiski and Salmon[58] agreed), he stated that '*the long line of cases represent[ed]*

[58] The opinion of L. J. Salmon was slightly different because he found that the arbitrator had not made any findings as to whether the contractors had done

*the maritime law of England and of the world on this subject*' (at p. 1185).

The case was brought before the House of Lords[59] on appeal by the owners.

Insofar as the issue of the applicable law is concerned, the opinion of Lord Diplock was the most relevant, as L. Reid[60] and Viscount of Dilhorne[61] dealt with the subject very briefly, while L. Morris of Borth-Y-Gest[62] and L. Person, did not discuss it at all. All

more good than harm. He did not deal with the problem of which law should be applied to the case (whether common or maritime) because, as I read his opinion, it was taken for granted by him that maritime law, with no other adjective, had to be applied, and according to maritime law and to the principle of 'no cure no pay', the owners were not entitled to any counterclaim (*per* L.J. Salmon, see pages 1189–1193).

59 [1971] 1 All. E.R. (H.L.), 1110.

60 *Per* L. Reid (at 113–114): '*The argument for the contractors is that there is a rule of maritime law that a successful salvor cannot be liable in damages to the owner for the result of any negligence on his part; such negligence entitles the court, or the arbitrator, to reduce or forfeit the salvage reward but it cannot give raise to any claim for damages. The maritime law of England has a long history. It differed in many respects from the common law; statutory emendment of the common law has removed some of these differences but no means all. So if examination of the authorities led me to the conclusion that any such rule or principle as that for which the contractors contend has been established, I would have no hesitation in giving effect to it. But after hearing full argument I have come to the clear conclusion that no such rule exists*'.

61 *Per* Viscount Dilhorne, at 1126: '*In the Court of Appeal reference was made to the maritime law of the world. This appeal falls to be decided in accordance with English maritime law though owners of the vessel are Japanese and the contractors Dutch. They had entered into the Lloyd's standard "no cure-no pay" agreement which provides for arbitration n London. It was not contended that the law of any other country than that of England should apply, and while, no doubt, there are many resemblances between English maritime law and the other nations, it is not, in my view, proper to regard the law relating to the salvage of ships as if formed part of international law*'.

62 As I have said in the text, L. Morris of Borth-Y-Gest did not deal with the issue specifically, but I cannot share his opinion in the part where he says that (at 118): '*If in any of these cases there is a claim for salvage the claim will be adjudicated on by reference to that part of the common law of England which has been evolved in and is administered as English maritime law in the English Court of Admiralty. The Lloyd's salvage agreement entered into in this case provided for arbitration in London and I consider that the parties intended that the arbitrator would decide the issue before him on the basis of the*

the L. Lords reached the same conclusions, allowing the appeal and reversing the decision of the Court of Appeal.

L. Diplock's opinion can be summarized in three logical steps. First, the L. Lord asked himself which was the law governing the dispute, namely the proper law of the contract; second, after finding it, he asked what were the principles of law pertaining to the dispute; third, how those principles had to be applied in the case at issue, on the basis of the authorities. The first and second steps are of interest for this article.

As for the first step, the approach of Lord Diplock in identifying the proper law of the contract was strictly based on the principles of conflict rules: he found that even if the parties to the contract were foreign and resident abroad, and the contract itself was entered into abroad, and the service was rendered to a foreign ship in foreign waters and (in part) on the high sea, the mere fact that the parties had entered into a Lloyd's standard form of salvage agreement, which provided that many functions had to be performed by the Lloyd's committee and arbitrator, meant that the parties had the intention to submit the contract to the English law, rather than to the law of any other country. In brief, the proper law of the contract had to be considered the internal municipal law of England.

After stating what was the proper law, the L. Lord moved on to consider the decision of L. Denning MR., according to which the proper law to be applied to the contract was not the internal municipal law of England, but the one that he called the 'maritime law of the world'.

*law applicable to salvage cases in the English Court of Admiralty*'. As stated in Chapter 2 of this article, the maritime law of England was not originally part of common law and was administered by the civilian Court of Admiralty until the year 1875. From then on maritime law and common law were administered in the same court and would therefore influence each other. However, one thing is absolutely clear: the law administered by the Admiralty Court was by no means, and unlike what L. Morris of Borth-Y-Gest says, part of common law.

Lord Diplock firmly denied the existence of a maritime law of the world, dismissing such a construct as based on a misconception by stating that: '*Outside the special field of "prize" in times of hostilities there is no "maritime law of the world", as distinct from the internal municipal laws of its constituent sovereign states, that is capable of giving rise to rights or liabilities enforceable in English Courts. Because of the nature of its subject-matter and its historic derivation from sources common to many maritime nations, the internal municipal laws of different states relating to what happens on the seas may show greater similarity to one another than is to be found in laws relating to what happens upon land. But the fact that the consequences of applying to the same facts the internal municipal laws of different sovereign states would be to give rise to similar legal rights and liabilities should not mislead us into supposing that those rights or liabilities are derived from a "maritime law of the world" and not from the internal municipal law of a particular sovereign state*'[63].

As can be easily seen, the approaches of L. Denning and L. Diplock were completely antithetical; the first corresponding to what today would be labelled *mercatorist*, and the second to the *anti-mercatorist* view.

In fact, Lord Denning tried to find the solution of the case by examining the principles governing the salvage reward as it (according to his view) is understood in the maritime world (what we today would call the maritime industry), without considering the problem of the choice of law, whereas Lord Diplock found the solution of the case only after stating what was the proper law of the contract, based on the presumed will of the parties as to the choice of law. After stating that the proper law of the contract was the English one, he found the solution of the case in English maritime law.

L. Diplock's approach is the traditional approach for a jurist of the 20th century (the State one), because in his view no law exists

[63] At p. 1133.

beyond the State, and any court of every sovereign State is bound to apply the proper law of the contract, to be determined according to the conflict of law rules.

Relying on the judgements quoted above, I venture to say that this approach will be abandoned in many countries where the creation of law is no longer considered a State monopoly.

We can now move on to the second step of L. Diplock's reasoning, the one regarding the application of English maritime law, whose nature was discussed in the Court of Appeal and which is relevant to confirm the view of maritime law as a mixed legal system, as I have described it in Chapter 2 of this article.

First of all L. Diplock examined if there still was a dichotomy between maritime law and common law (calling them, at p. 1133, 'the two rival systems'), after 1875, the year in which the Admiralty court merged into the comprehensive system of English law administered by the High Court[64].

The L. Lord examined the state of jurisdiction prior to the enactment of the Supreme Court of Judicature Act 1875, recognizing that the Admiralty Court was separated from those of common law, but at the same time, and notwithstanding the separation, the courts were not unrelated to one another. Especially after the Admiralty Court Act 1840, the L. Lord pointed out, in many causes of action the Admiralty and the common law courts had concurrent jurisdiction, leading to a cross-fertilization of ideas between the courts, even if only slowly.

According to L. Diplock the reason why the process of cross-fertilization was slower than that between the courts of common law and chancery (which also merged in 1875) was that the practitioners in the Admiralty were all civilian.

Anyway, as no court is '*an island in itself*' (at p. 1133), that cross-fertilization happened because the Admiralty Court practitioners, even if civilian, could not remain immune to the gradual

[64] I am referring to the Supreme Court of Judicature Act 1875, cited under note 43.

changes in the general principles of law related to obligations and contracts, among which the concept of negligence (the relevant one in this particular case).

L. Diplock thus compared the salvage contract to the contract of work and labour, at common law, as L. Denning did in the Court of Appeal, but to declare – after a profound historical analysis regarding the evolution of the concept of negligence in maritime and common law – the applicability of the same legal regime.

Accordingly, L. Diplock reversed the decision of the Court of Appeal and held that the owners of the *Tojo Maru* were entitled to counterclaim for damages against the salvors.

The judgement of L. Diplock reveals the very nature of maritime law as a law civilian in origin but influenced by the common law after 1875 and, even if to a lesser extent, after 1840. At the same time L. Diplock recognizes the process of cross-fertilization between the institutes and principles of maritime law and those of common law, so that it can be said that if common law has influenced and fertilized maritime law, at the same it has been influenced and fertilized by maritime law[65]. In brief, the judgement recognizes the nature of a mixed legal system proper to maritime law.

## 4.c. The Father Thames[66]

The *Father Thames*, a vessel owned by an English company, was chartered by way of demise to another English company for a period of two years. Accordingly, the owners divested themselves not only of the possession of the vessel, but also of the control over her. The vessel, master and crew of the *Father Thames* were, hence, under the control of the demise charterer, and the rights of the owners in respect of the vessel were limited only to the bare right

[65] About this topic (and with special reference to the law of contracts), see F. REYNOLDS, *Maritime and other influences on the common law*, in LMCLQ, 2002, 182.

[66] [1979] 2 Lloyd's Rep. 364.

to receive the hire and to take the vessel back into possession on the expiration of the charter.

On 26 April 1978, a collision occurred on the River Thames between the *Father Thames* and the *Office*, caused by negligent navigation of the former.

The owners of the *Office* claimed damages as well as the losses and expenses suffered as a result of the collision, and the *Father Thames* was arrested.

The owners of the *Father Thames* applied to set aside the claim and all subsequent proceedings on the grounds that: a) there was no valid cause of action against the vessel; b) there was no valid cause of action against the owners either *in rem* or *in personam*; c) there was no jurisdiction to proceed against the *Father Thames in rem*, as the foundation of the maritime lien was liability in negligence of those who were the owners at the time of the collision.

Finally, it has to be premised that the Admiralty jurisdiction was established at the time the cause of action arose, pursuant to the Administration of Justice Act 1956[67], s. 1, sub-s. (1), par. (d), and the modes of exercise of the jurisdiction were established in sec. 3.

The first issue that Mr. J. Sheen had to deal with was if the jurisdiction of the Court could be invoked under sec 3, sub-s. (4) of the said Act which, unlike the Supreme Court Act 1981, did not provide for the alternative requirement that the person who would be liable *in personam* could be the demise charterer when the claim was issued. The owners of *The Office* urged the judge to follow the decision in *The Andrea Ursula*[68], in which J. Brandon held that the words 'beneficially owned as respect all the shares therein' appearing in s. 3, sub-s. (4) of the Act then in force applied to the demise charterer. Nevertheless, J. Sheen felt compelled to follow the deci-

[67] 4 &5 Eliz. 2 Ch. 46

[68] *Medway Drydock & Engineering Company Ltd*. v. *The 'Andrea Ursula' (Owners)*, [1971] 1 Lloyd's Rep. 145.

sion of J. Goff in *I Congreso del Partido*[69], in which it was held that the said words, appearing in s. 3, sub-s. (4), did not apply to the demise charterer.

Nevertheless, the writ *in rem* was not set aside because the Court held that a maritime lien attached to the *Father Thames* due to the collision and, accordingly, the jurisdiction of the Court could be invoked under sub-s. (3) of s. 3 of the Administration of Justice Act 1956.

Insomuch as the topic I am dealing with in this article is concerned, the reasoning behind the attachment of the lien ought to be examined, since the owners of the *Father Thames* argued that no maritime lien attached to the vessel, seeing as the latter was under a charter by demise and, as a result, they had divested themselves of the control over and possession of the vessel and were not liable for the negligence of her master and crew. In sum, according to the owners' submission, for a lien to be attached at the time the latter was created, the vessel had to be owned by a person liable *in personam*, and they were not.

The decision of J. Sheen relied on the one held by Sir Robert Phillimore in *The Lemington*[70], who, in turn, quoted with approval the words of Dr. Lushington in the *Ticonderoga*[71].

I will quote the reasoning and quotations of Sir Phillimore as J. Sheen did:

'*We must recollect that this is the proceeding in rem. I am not aware, where there has been any proceeding in rem, and the vessel so proceeded against has been clearly guilty of damage, that any attempt has been made by this Court to deprive the party complaining of the right he has by maritime law of the world of proceeding against the property itself*' (emphasis added).

Sir Robert Phillimore continued:

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69 [1971] 1 Lloyd's Rep. 145.

70 [1874] 2 Asp. Mar. Law. Cas., 475.

71 [1958] Sw. 215.

*'This is the language of the year 1857 of that learned and experienced Judge, and must be taken to be his deliberate opinion upon the law applicable to the subject. He goes on to say as if anticipating this very case: "Supposing a vessel is chartered so that the owners have divested themselves, for a pecuniary consideration, of all power, right and authority over the vessel for a given time, and have left to the charterers the appointment of the master and crew, and suppose in that case the vessel had done damage, and was proceeded against in this Court – I will admit for the sake of argument, that the charterers, and not the owners, would be responsible elsewhere, although I give no opinion on this point – ; but still I should say to the parties who had received the damage, that they had, by maritime law of the nations, a remedy against the ship itself"'* (emphasis added).

These important decisions of Dr. Lushington and S. Robert Phillimore were intended first of all to state what was the proper law to be applied to the case: as it would be done by L. Denning Mr. in the *Tojo Maru* case commented on above, they did not look at the English law related to maritime lien, but they applied the maritime law of the world (or of the nations) to understand what English law should be applied. In other words, they applied what we could call today the *lex mercatoria maritima*, as it was perceived by the maritime community at that time. And it is very interesting to note how the arguments of the two judges relating to the law applicable to the cases were conducted by general principles of law, which today are considered one of the primary sources of the *lex mercatoria*.

The same did J. Sheen, who identified the general principle of the maritime law of the nations in the subject matter as stating that all the damage caused by a vessel employed in a lawful trade under a charter by demiseis to be regarded as caused by the owners. As a result of this *fictio,* the owners of the vessel suffering damage caused by a vessel under a demise charter are entitled to maritime lien upon her.

Significantly, J. Sheen quoted some authorities, among these *The Tervaete*[72], in which the Court of Appeal held that it was a *general principle of maritime law* in the case of a claim for damages arising out of a collision that a maritime lien must have its root in the personal liability of those who were the owners of the vessel at the time the collision occurred, or of those who for this purpose where in the said position.

The judge went on to outline a short history of the relationship between maritime liens and limitation of liability of the owners by quoting the judgment of L.J. Scott in *The Tolten*[73], according to which there is an integral connection between the two institutes of law deriving from the 'ancient law of the sea': '*Both rules were in truth adopted from the custom of the merchant (who then included the shipowners) in whose usage they had been applied as a measures of the public policy for the encouragement of sea commerce*'[74].

Conclusively, J. Sheen made some interesting remarks about the need for uniformity in the ambit of maritime law.

After regretting that the Administration of Justice Act 1956, sect. 3 – which was intended to give effect to art. 3 of the Brussels Convention on the Arrest of Seagoing Ships 1952 – failed to give the Court the same extent of jurisdiction agreed upon in the convention,[75] and that in view of this fact the point of law related to the existence of the maritime lien arose, he stated that, in the absence of authorities, he would have decided the case in the same way. And this was so because it is in the interest of maritime law

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72 (1922) 12 Ll. L. Rep. 252.

73 (1946) 79 Ll. Rep. 349.

74 *The Tolten*, at 355.

75 The said art. 3 (4) reads as follows: '(4) *When in the case of a charter by demise of a ship the charterer and not the registered owner is liable in respect of a maritime claim relating to that ship, the claimant may arrest such ship or any other ship in the ownership of the charterer by demise, subject to the provisions of this Convention, but no other ship in the ownership of the registered owner shall be liable to arrest in respect of such maritime claim. The provisions of this paragraph shall apply to any case in which a person other than the registered owner of a ship is liable in respect of a maritime claim relating to that ship.*...'

that British Admiralty should not unnecessarily diverge from the general law of the sea among other nations. Once again citing L.J. Scott in *The Tolten: 'If there is a doubt about some rule or principle of our national law and one solution would conform to the general law and the other would produce divergence, the traditional view of Admiralty judges is in favour of the solution which will promote uniformity. For this there are two good reasons, first, because that course will probably be the true reading of our legal development, and, secondly, because uniformity of sea law throughout the world is so important for the welfare of maritime commerce that to aim at it is a right judicial principle'*.

Once more I can only approve of the judgment of J. Sheen who demonstrated that it is the duty of the judge in the field of maritime law to promote the uniformity of law among the nations and hence to draw the principles of law to be applied in concrete cases not only from the municipal law of the country, but also from the general principles of law and customs of the sea followed by the maritime community worldwide.

## 4.d. S.G.L. Carbon S.p.a. v. Agenzia Marittima La Rosa S.r.l. and Agenzia Marittima Clivio S.r.l.[76]

Under a bill of lading dated 01.03.1996, and issued by the carrier Nippon Yusen Kaisha in favour of the shipper Mitsubishi, who, in turn, endorsed it to S.G.L Carbon, a cargo of oil was shipped from Osaka to Civitavecchia, to be delivered to S.G.L. Carbon. During the voyage, the cargo was damaged and, as a result, S.G.L Carbon claimed for damages against Agenzia Marittima La Rosa S.r.l. as agent for the ship and against Agenzia Marittima Clivio S.r.l. as the carrier's general agent for Italy.

The defendants argued that the Court had no jurisdiction to hear the claim, as the District Court of Tokyo was competent.

[76] Cass. Civ., Sez. Un., 17 January 2005, n. 731, in *Dir. Mar.*, 2006, 154. Very critical of the judgment F. BERLINGIERI, *ibidem*, 155–157.

In fact, the bill of lading contained a forum selection clause (n. 3), by means of which the District Court of Tokyo had jurisdiction to hear the claims arising in connection with the carriage. Moreover, on the back of the bill, incorporated by reference to clause 41 of the charter-party, dated 01.03.1996, made between Nippon Yusen Kaisha and Mitsubishi, the parties were bound to use the Nippon Yuse Kaisha standard form of bill of lading.

At the first and second instances, the Tribunal and the Court of Appeal (of Geneva) dismissed the claim declining its jurisdiction in favour of the District Court of Tokyo.

The claimant appealed to the Supreme Court, submitting that: a) a forum selection clause inserted in a bill of lading, where validly stipulated, is binding for the endorsee; b) in that case, according to the applicable law, i.e. the Italian law, the clause was not validly stipulated; c) the parties to the bill did not want the clause because the charter-party, dated 01.03.1996 and incorporated in the bill (which was in the GENCON form), provided (cl. 41) that the parties would employ the standard form of bill of lading of N.Y.K., which, in turn, contained an arbitration clause. Thus, in any case, if the Italian Court was not competent, arbitrators would have been.

The first issue that the Court had to deal with was the one of the law applicable to the merit of the dispute. As the shipper and the carrier were Japanese and the consignee Italian, the Court held that the Brussels Convention of 27.09.1968 on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters[77] (now Regulation 44/2001)[78] and subsequent amendments could not be applicable, and that the Italian law was the proper one.

The relevant disposition, the Court added, was art. 4, II, l. 218/1995[79] (on the reform of the Italian system of international private law), according to which 'Italian jurisdiction can be

[77] Ratified and enacted in Italy by l. 804/1971, G.U. n. 254 of 08/10/1971.

[78] Council Regulation (EC) No 44/2001 of 22 December 2000, in OJ L 12 of 16 January 2001.

[79] In G.U. n. 128, of 3 June 1995, S.O. n. 68.

departed from by agreement in favour of a foreign Court or of an arbitrator if the agreement conferring jurisdiction is evidenced in writing and the claim concerns disposable rights'.

According to the Court, the above art. 4 was clearly inspired by art. 17 of the said Brussels Convention, as amended by the Conventions on the Accession of the New Member States of 1978[80] and 1989[81], according to which: '*If the parties, one or more of whom is domiciled in a Contracting State, have agreed that a court or the courts of a Contracting State are to have jurisdiction to settle any disputes which have arisen or which may arise in connection with a particular legal relationship, that court or those courts shall have exclusive jurisdiction. Such an agreement conferring jurisdiction shall be either a) in writing or evidenced in writing or… c), in international trade or commerce, in a form which accords with a usage of which the parties are or ought to have been aware and which in such trade or commerce is widely known to, and regularly observed by, parties to contracts of the type involved in the particular trade or commerce concerned*'.

In fact, it has to be remembered that up to 1995, Italian law did not allow the party to an agreement to depart from Italian jurisdiction (former art. 2 of the Code of Civil Procedure).

After stating which was the proper law of the contract, the Court went on to construe the meaning of art. 4, l. 218/1995 and hence the meaning of the clause 'evidenced in writing'. In brief, the

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[80] Council Convention of 9 October 1978 on the accession of the Kingdom of Denmark, Ireland and the United Kingdom of Great Britain and Northern Ireland to the Convention on jurisdiction and the enforcement of judgments in civil and commercial matters and to the Protocol on its interpretation by the Court of Justice (OJ L 304, of 30 October 1978), art. 11.

[81] Convention of 26 May 1989 on the accession of the Kingdom of Spain and the Portuguese Republic to the Convention on jurisdiction and the enforcement of judgments in civil and commercial matters and to the Protocol on its interpretation by the Court of Justice with the adjustments made to them by the Convention on the accession of the Kingdom of Denmark, of Ireland and of the United Kingdom of Great Britain and Northern Ireland and the adjustments made to them by the Convention on the accession of the Hellenic Republic (OJ L 285, of 3 October 1989), art. 7.

Court asked itself if, to be correctly evidenced, the agreement conferring jurisdiction to the foreign Court had to be literally in writing, or whether the Italian law could admit an equivalent form, even with the silence of art. 4 in this respect.

The Supreme Court compared art. 17 of the Brussels Convention, which inspired art. 4, l. 218/1995, with the latter, underlining the evolution of art. 17 from the first version to the one in force, resulting from the aforementioned amendments enacted in 1978 and 1989.

According to the Court, the possibility for parties operating in international trade or commerce to confer jurisdiction by agreement in a form which accords with the practice of the trade or commerce was the official acknowledgement, by the Member States of the Convention, of the need for international traders to 'soften' the formal requirement of such agreements and, accordingly, of their customs.

Therefore, according to the Court, the relevance of international trade usages can be affirmed as a general principle, and the maritime commerce has done much to this end.

Turning back to the construction of art. 4, l. 218/1995, the Court held that the wording of the law had to be overcome, and the relevance of international trade customs had to be acknowledged.

As regards the case under scrutiny, it was necessary to investigate whether there was an international maritime trade custom that considered equivalent to writing another form of expressing the will of the parties.

The Court held that in maritime trade the bill of lading is invariably signed by the carrier and always evidences the contract, besides being a document of title; on the other hand, the bill is never signed by the shipper, not even when it contains clauses that abstractly would require to be signed by him. According to the Court, this constant behaviour had created an international trade custom, so it would be inconsistent with it to infer the existence of the agreement as to the prorogation of jurisdiction by the presence, or not, of the shipper's signature on the bill of lading.

Accordingly, the Court held that the bill of lading, which incorporated a forum selection clause signed by the carrier only, could be considered, by trade custom, the evidence that the parties had agreed upon the prorogation of jurisdiction, irrespective of the fact that, as required by art. 4, l. 218/1995, the clause should have been signed by both parties.

This judgment of the Italian Supreme Court, as I read it, is a striking example of how international trade customs can override domestic law and, hence, as the *lex mercatoria*, can be a suitable way of achieving uniformity in the international maritime trade.

# 5 Conclusions

This article is based, in the most part, on the research I carried out in Oslo, at the Scandinavian Institute of Maritime Law[82] in August-September 2009, and which was the object of a seminar on the 1st of September.

On that occasion I closed my speech by saying that, contrary to common beliefs, the disputes about the *lex mercatoria* are not only a scholar's rhetoric exercise, but the fruit of a polycentric vision of the theory of sources of law that does not recognize as a postulate the monopoly of the State in the creation of law.

I also said, and here repeat, that the problem of the sources of the *lex mercatoria*, as I tried to explain in the first chapter of this article, can be placed in the classic frame of the sources of international law, and more precisely among the customary sources.

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[82] My research stay at the Institute has been financed through the YGGDRASIL Mobility Programme by the 'Research Council of Norway', under the coordination and supervision of Prof. Trine Lise Wilhelmsen and Prof. E. Røsæg. To everyone my most sincere thanks. A special thank you to Prof. Erik Røsæg for the contribution of thought he gave me during several discussions and for the preparation of the seminar I gave at the Institute on 1 September 2009.

The brief review of cases in Chapter 3[83], on the other hand, shows how the Courts of different States often have had to deal with the international maritime legal customs and general principles of law, sometimes seeking to apply them under the name of 'maritime law of the world' (or 'of the nations'), sometimes under the name of international legal customs, taking for granted, in the latter case, their applicability.

In other words, the *lex mercatoria*, intended as a set of international legal customs, has been standing on the threshold of maritime law for a century, occasionally crossing this threshold to become a part of it, under various names.

The definitive 'consecration' of the *lex mercatoria* as a source of international private maritime law[84] must be submitted to a rigorous analysis of the theoretical underpinnings of customary international law and of the mechanisms of its application on the plane of domestic legislation.

This will help Courts and arbitrators to find proper solutions to international maritime disputes, preserving and promoting the uniformity and predictability of law.

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[83] I could have discussed other cases in which the Courts of different Sates have had to deal with the problem of the applicability of international legal customs in the field of maritime and commercial law, but Chapter 3 of this article is intended to give some examples rather than to be exhaustive, so I limit myself to quote the following cases: (in English case law), *Kum and Another* v. *Wah Tat Bank Ltd. and Another*, [1971] 1 Lloyd's Rep. 439; *Coppee Lavalin S.A./NV* v. *Ken-Ren Chemical & Fertilizer Ltd. (in liquidation in Kenya)*; *Voest Alpine Aktiengesellschaft* v. *Ken-Ren Chemical & Fertilizer Ltd. (in liquidation in Kenya)*, [1994] 2 Lloyd's Rep. 109; (in U.S. case law) *De Lovio* v. *Boit*, (1815), 2 Gall. 398, (7 Fed. Cas. No. 3,776); as for Italian and French case law I refer to the aforementioned cases (Chapter 1). Finally, I cannot do without citing A. FALL, 'Defence and Illustration of the Lex Mercatoria in Maritime Arbitration. The Case Study of "Extra-contractual Detention" in Voyage Charter-party Disputes', in 15 *J. Int'l Arb.*, 1998, 83–94, in which the author focuses on the elaboration by the case law of the Chambre Arbitrale Maritime de Paris (CAMP) of the institute of 'extracontractual detention' in the field of voyage charterparties.

[84] For the meaning of this expression, see footnote n. 1, at p. 1.

# Company's duty to provide CAR insurance under a fabrication contract: What happens if the insurer becomes insolvent?

## A response to professor Hans Jacob Bull

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# Content

# 1 Introduction

In SIMPLY 2008, Professor Hans Jacob Bull discussed whether "Contractor" or "Company" bears the risk if the insurer under a CAR policy goes into liquidation.

Professor Bull advocated the view that it was "Company" that must bear this risk.

The background to Professor Bull's article was a Stavanger City Court judgment in July 2007. The court decided that it was "Contractor" that had to bear the risk. Professor Bull criticised this solution.

We should immediately clarify that the authors of this article were involved with these legal proceedings: Svein H Bjørnestad was General Counsel for ExxonMobil in Norway and Vidar Strømme was Outside Councel from the lawfirm Schjødt assigned to handle the case. Accordingly it may not come as any great surprise that the present authors disagree with Professor Bull's reasoning. Our reasons for writing this response are, however, founded in a belief that because the issue represents a point of intersection between insurance law, the general law of contract and tort, and construction law, it may be worth some additional comments.

Very briefly, the background to the case was that Kværner Rosenberg AS ("Contractor") had delivered the production vessel *Jotun A* to ExxonMobil ("Company") under a so-called EPCRIC (engineering, procurement, construction, relocation, installation and commissioning) contract. The contract provided that ExxonMobil should take out a CAR insurance policy *"in the joint names of Company, Contractor and Subcontractors containing a waiver of subrogation against any member of the Contractor Group"*.

ExxonMobil used Aon Group Limited as insurance brokers to place the insurance, and 49% of the first USD 5 million was placed with the insurance company Independent Insurance.

It became apparent the paint used on the *Jotun A* was defective, and in the circumstances the parties agreed that this gave rise to a

claim against the insurance company. Accordingly the basis for the claim was defective delivery, that is to say circumstances that *prima facie* belonged within "Contractor's" sphere of risk.

Independent Insurance then went into "provisional liquidation" in somewhat dramatic circumstances in 2001, leaving Kværner with an uncovered claim for nearly USD 2 million. The dispute ended up in court, and Stavanger City Court decided in favour of ExxonMobil on the basis that the insurance company's inability to pay was Kværner's risk.

According to the court's reasoning, ExxonMobil could not be reproached for how things had turned out. The insurance companies in question had been selected on the basis of relevant ratings, among other criteria, and subsequent investigation of Independent Insurance revealed that senior management had fraudulently concealed the company's true financial situation. Three members of Independent Insurance's senior management were sentenced to several years in prison and a press release from the UK's Serious Fraud Office, which conducted the investigation, stated

> *"This has been one of the most technical and complex cases we've had to deal with. It took a diligent and painstaking investigation involving a mountain of documents. Around 30,000 pages constituted the prosecution case, nearly 240 witness statements were taken and over 1,500 documents shown to the jury. This is the nature of serious fraud investigations and prosecutions. We now have to deal with the important issue of confiscation."*

In his article, Professor Bull mentions that, after the Court had rendered its decision, the parties to the proceedings entered into an agreement on unknown terms. In fact what happened was that the City Court's decision was appealed, but the appeal was subsequently withdrawn. No settlement agreement was entered into between the parties, but ExxonMobil refrained from its claim of legal costs in connection with the appeal.

# 2 Legal background

Professor Bull's analysis was based on a different contract than the one actually used. Since this latter contract was not reproduced in full in the judgment, Professor Bull's article was instead based on the standard Norwegian Fabrication Contract (NF 05), which also included provisions on CAR insurance. In the circumstances, it seems natural to cite the relevant provisions from the contract that was actually applicable

*Article 22 – Contractor's Liability for Defects and Breach of Guarantee*

*22.1 If the Contract Object is found to be defective after the Work is completed or after the Delivery Certificate has been issued, or if Contractor is in breach of its guarantee according to Article 21, Contractor shall promptly remedy the defect at its cost. Contractor shall consult with Company as to the remedial measures Contractor intents to effect.*

*[…]*

*If Company is unwilling to permit Contractor to perform rectification Work, Contractor shall pay to Company an amount equal to the costs Contractor would have expended had Contractor promptly performed such rectification Work.*

*In addition, Company may, based on failure of any of Contractor's guarantees at any time, claim damages for breach of guarantee according to law.*

*Article 31 – Liability and indemnification*

*31.1 Notwithstanding the provisions in Paragraph 31.2, Contractor shall be liable for and shall release, defend, indemnify, and hold Company Group harmless from and against all losses, expenses and claims arising from any death of or injury to any personnel of Contractor Group or damage to or loss of any property owned (wholly or partially) or used by, or in the custody of, Contractor Group (including, but not limited to, the Contract Object prior to Custody Transfer) when such*

*death, injury, damage or loss has arisen out of or is in any way connected with this Contract.*

*31.2 Subject to paragraph 31.1, Company shall be liable for and shall release, defend , indemnify, and hold Contractor Group and its Affiliates harmless from and against all losses, expenses, and claims arising from any death of or injury to any personnel of Company Group or damage to or loss of any property owned by Company Group, when such death, injury, damage, or loss has arisen out of or is in any way connected with this Contract.*

*[…]*

## *31. Article 33 – Insurance by Company*

*33.1 Without limitation of its obligations and responsibilities and those of Contractor Group, Company shall maintain for the duration of the Contract the following insurances in the joint names of Company, Contractor and Subcontractors containing a waiver of subrogation against any member of Contractor Group:*

*a) All risks insurance of the Contract Object during construction, relocation and installation including marine shipment and land transportation thereof and Company's equipment in connection therewith against physical loss or damage to the value thereof until the expiration of the Guarantee Period for loss or damage arising from a cause occurring before the beginning of the Guarantee Period or arising from the Contractor fulfilling its obligations during the Guarantee Period;*

*b) Marine equipment insurance providing all risk hull and machinery coverage to the full value of the Contract Object;*

*c) Protection and Indemnity Insurance including wreck and debris removal and oil pollution liability in respect of the Contract Object and in a minimum amount of fourhundred (400) million US dollars ($ 400.000.000,–);*

*d) Third party risks insurance against legal liabilities to third parties arising from Contractor's or Subcontractors operations related to this Contract. Company's Third Party Risk Insurance shall at all times operate in excess of the Insurance arrangement by Contractor, its Contractors or Subcontractors as required under Article 32.*

*33.2 Contractor shall notify Company of any occurrence likely to give rise to a claim under the above insurance without undue delay. In the event of death, serious injury or major property damage, Contractor shall give notice to Company without undue delay.*

*33.3 Deductibles applying under the insurances arranged by Company shall be for the account of the relevant member of Contractor Group to the extent such member shall be liable according to this Contract.*

*33.4 Company shall use reasonable endeavours to provide insurance at least as good as the coverage set forth in the Co-ordination Procedure – part 5, Company's Conditions of Insurance. Any increase to the amounts of deductibles stated in the aforesaid conditions of insurance shall be subject to Contractor's written approval. Contractor, Bluewater Offshore Production Systems Ltd., and their Affiliates shall be joint assureds under the policy.*

# 3 Interpretation of the actual contract

Stavanger City Court based its interpretation on the contract actually used in the case, which on some points was worded differently than NF 05, on which Professor Bull based his arguments. In our opinion, the contract actually used leads fairly obviously to the interpretation that the risk was placed on "Contractor".

We are also doubtful as to whether NF 05 should be understood as giving rise to the opposite result. The contract actually used by the parties may also shed light over some more general points of significance for the interpretation of NF 05 and similar contracts.

One such point concerns an arrangement under which one of the parties is to obtain insurance for the benefit of both parties, and whether such an arrangement should have any significance in assigning risk and liabilities for deficiencies. Neither NF 05 nor the contract actually used addresses this question explicitly. As a result, conclusions have to be drawn from general principles of interpreta-

tion and basic contractual thinking in this area, as well as by drawing analogies with equivalent tripartite relationships in the law of contract and tort.

Paragraph 33 of the contract actually used by the parties contains introductory wording that does not appear in NF 05, namely that "Company's" duty to obtain insurance is *"without limitation of its obligations and responsibilities and those of Contractor Group …"*.

The contract accordingly *emphasised* that the question of insurance cover should be kept distinct from underlying issues concerning liability. The damage in the case basically consisted of defective delivery by "Contractor" itself and, according to the wording of the contract, such liability should not be limited by issues relating to insurance. In our view, this distinction is of central importance, even though it may not have been expressed in this way. Our reasons for this view are stated in section 4 below.

One may also ask whether the solution follows from a further stipulation in paragraph 33, namely that "Company" shall not only take care of obtaining such insurance, but shall also maintain the insurance *"for the duration of the Contract"*. Does this mean "Company" must bear the risk – in all cases – if the insurance lapses? On this point the wording in the contract actually used and NF 05 is the same.

The provision provides clearly enough for a duty for the Company to obtain new insurance if the original insurance lapses before the insured event takes place. Clearly this must apply regardless of whether a new insurance policy would be, for example, more expensive. The provision may not be understood, however, as meaning that "Company" has an obligation to obtain new insurance with retrospective effect *after* the insured event has been discovered and declared. In any event, if one were to imagine that it were possible to do this, the premium for such a policy would be at least as large as the losses caused by the event in question. A requirement to obtain a "new policy" after the damage had been

discovered would effectively be the same as attributing the disputed liability to "Company". If the provision were interpreted in this way, it would not be a provision about insurance, but a rule about liability. At least in our understanding, there is general agreement that the provision cannot be interpreted in this way.

Accordingly, the contract actually used in this case must be interpreted – and in our view this interpretation is fairly obvious – to mean that "Company" does not bear the risk for the insurance company's inability to pay. The following paragraphs examine some general arguments that may shed light over those cases where the contract is formulated differently.

# 4 Remaining arguments

A key argument in Professor Bull's article concerns the fact that the insurance was obtained by "Company", which meant that "Contractor" had no influence over the process. Bull points to a possible danger that "Company" may attach less priority to "Contractor's" interests because of a desire to achieve a lower premium. Insurance cover such as that under discussion here may have a complex construction and be divided up into several "layers" with different levels of cover and different risks. Professor Bull fears that there may in any event be a tendency for "Company" to place less emphasis on "Contractor's" interests in those areas that may particularly affect "Contractor". When interpreting the contract, one should endeavour to aim for the solution that gives the parties motivation for optimal performance of the contract.

We are in agreement with this general principle of interpretation, but are doubtful as to the realism of the hypothesis that "Company" may fail to attach importance to "Contractor's" interests. In our opinion, it seems rather artificial to claim that there would be any danger in practice of "Company" exposing "Contrac-

tor" to increased risk by obtaining unfavourable CAR insurance. It is true that assembling complete CAR insurance cover is a complicated process and that different types of insurance companies are often selected to cover different risks. As we understand it, this has mainly to do with the fact that different insurance companies have expertise in different areas. We understand moreover that typically criteria will be established for rating different insurance companies. This means it is unlikely that "Company" would select an insurer whose lack of financial soundness makes its cover cheap, because this lack of soundness would prevent the insurer from satisfying the rating criteria. In the exceptional event that, despite the rating process, the insurance company goes into liquidation, this will be for reasons that one would scarcely be likely to have known in advance. And if there were indications of insolvency at the time the insurance contract was entered into, it should not be too difficult to establish that the party who entered into the contract was negligent and as such liable in damages.

Finally, it will be impossible to know in advance that "Contractor" will be the only party to suffer in the event of an insurer's insolvency. CAR insurance covers many types of damage and it is far from always the case that it is only "Contractor" that is insured against defective delivery. This is only the case in certain circumstances. The "Company" has its own interest in ensuring that insurance is taken out with a suitable company.

It is possible that "Contractor" instead should fear that "Company" will take out insurance that is unfavourable because of certain *terms and conditions*. Provided the insurance is taken out in good faith and complies with the contractual description of CAR insurance cover, there is nothing "Contractor" can do about this. The economic risk that "Contractor" takes on here with open eyes must be significantly greater than the threat of an insurer's insolvency.

Rather than weighing factors relating to the Company's motivation in obtaining insurance, in our opinion decisive weight should

be placed on the contractual context and the *purpose* of having the CAR insurance cover taken out by one of the parties for the benefit of both.

The starting point here is that the parties are free to choose whatever solution they please to this question. The reasons why "Company" is often left to take out the insurance are quite simply practical and economic. This type of insurance is for the benefit of both parties, but requiring each party to take out its own insurance is not a very favourable solution. Doing so would be more expensive and would easily lead to overlapping and increased case-handling costs. In addition, major oil companies will generally be in a stronger negotiating position and have more expertise about insurance, enabling them to achieve more favourable conditions than a contractor would be able to negotiate. This economic benefit is to the advantage of both parties when the project is viewed as a whole. The Stavanger City Court judgment mentions this as the reason for the arrangement, and it has also been observed in legal theory (Kaasen).

When the contract's provisions on this point are based on such considerations, it is difficult to use this arrangement to justify placing the risk of the Insurer's insolvency on "Company". Even the underlying loss is caused by circumstances for which "Contractor" is responsible. Making "Company" liable would mean that the insurance cover would contribute towards undermining the basic allocation of liability under the contract, which is not a result that ought to be aimed for. The introductory wording to the actual contractual provision in question, that the insurance will be taken out *"without limitation of its obligations and responsibilities and those of Contractor Group …"* is, in our opinion, a clear expression of a fundamental distinction between insurance and risk that must apply regardless of whether or not is it explicitly expressed.

Finally Professor Bull draws on the "knock-for-knock" principle, which involves the contractual theory that losses should lie where they fall in the absence of agreement to the contrary. Profes-

sor Bull bases his view on the notion that, except in the situation where the knock-for-knock principle applies, it is unheard for one party to a contract to obtain insurance (which may turn out to be worthless) for the benefit of both. We are unable to see, however, that the fact that insurance is taken out for the protection of both parties can be decisive in determining where losses should lie under the knock-for-knock principle. To the extent that it is relevant to refer to the "knock-for-knock" principle, in our view this should rather favour the result that the risk is placed on "Contractor". This depends, however, on one's perspective and what is considered to be the cause of the loss. If it is "Contractor's" defective delivery that is seen as the cause, the loss can be said to lie where it falls if the risk is borne by "Contractor". However, if the damage is caused by the insurance company's insolvency, it does not seem equally obvious that this would have "fallen" *prima facie* on "Company".

We also mentioned above that it may be relevant to draw analogies with other tripartite legal relationships. Is there support to be found in the general law of contract and tort?

A parallel may be found in the rules in the Norwegian Bill of Exchange Act regarding the transfer of instruments of debt. Very broadly, a person transferring such an instrument is liable for the genuineness of the debt ( "veritas"), but not for whether the debt is in fact paid upon maturity("bonitas"). A person transferring a debt instrument is only liable for the debtor's ability to pay at the time he positively assumed this obligation. This follows from the Bill of Exchange Act, section 10. The situation under an insurance policy is similar, in that "Company" has produced a "security" from which "Contractor" may benefit.

Another parallel in Norwegian law is the principle that a party to a contract is liable for the performance of all parties used by him to fulfil his obligations under the contract *(kontraktshjelpere)*. Here there is a distinction between the principal and subsidiary obligations under a contract. In the case of principal obligations, a contractual party is liable for the defective performance of his

subcontractors, but such liability does not exist in the absence of a particular legal basis in the case of subsidiary obligations. In our opinion, the obligation to obtain insurance must be viewed as a subsidiary obligation in a contract as wide-ranging as the one at issue in this case.

# 5 Conclusion

In our view, the background rules of law support the view that "Contractor" bears the risk if the insurance company providing CAR cover goes into liquidation. The risk should not be placed on "Company" unless there is good support in the contract for reaching such a solution.

# Formalism in complex onshore and offshore construction contracts

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# Content

# 1 Topic

"Formalism" has a bad reputation in Norway. A man is a man, a word is a word, and the country has been built with steel and concrete – not paper and lawyers. But perhaps things are different offshore. With so many men out there, and so many words – many of them not even Norwegian – perhaps there is a need for some extra paper after all.

The topic of the following discussion is the trend to increase the level of formalism in the standard contracts used in on- and offshore construction projects.[1] Our aim is to assess the need to establish formal procedural requirements for contract management, broadly speaking, and to explore different options for accommodating this need, as well as their potential consequences. Do the standard forms go further than necessary in imposing formal procedural rules within contracts? Are we moving towards a level of formalism that will be intolerable?

Only someone with very little experience of managing construction projects – whether on- or offshore – would be surprised to learn that disputes tend to arise during the contractual period with regard to practical, as well as legal, matters. The dynamics of these types of projects are an important factor here: frequently much time passes between the signing and completion of a contract, and, during this period, the parties have to co-operate on day-to-day activities, decision-making and project management, while their wishes, possibilities and requirements will undergo a continual process of enforced evolution as a result of the relentless interven-

[1] Similar questions arise in relation to IT contracts, such as the Norwegian Computer Society's *(Den Norske Dataforening)* standard form PS 2000 and standard public sector IT contracts, but these are not discussed further in this article. In the shipping sector, while the *Standard Form Shipbuilding Contract 2000* is less complex in its approach to the issues considered here, BIMCO's standard newbuilding contract, *NEWBUILDCON* (introduced in 2007), represents a step in the "offshore direction". Neither of these contracts is discussed in this article.

tion of planners and official bodies, not to mention the natural environment.

In recognition of this fact, significant efforts, and many words, have been devoted in the drafting of standard form contracts[2] to the development of contractual mechanisms intended to help the parties deal with potential and actual situations where one of the parties – generally the contractor – decides there are grounds for making a claim against the other. A characteristic feature of these mechanisms is their establishment of formal procedural rules.[3]

While "formalism" is not a precisely defined concept, neither in our context here nor in any other, it does provide a focus for our discussion. Here we will examine the concept in relation to procedural rules set forth in a contract, with which rules the parties must comply to establish or preserve rights under that contract. In practice, the most significant examples of such rules are those that establish preclusive time limits for the serving of formal notices/claims or "requests". These include, in particular, rules that establish preclusive time limits within which the contractor must submit requests in relation to variations, or alleged variations, to his contractual obligations.

Contracts in both the on- and offshore construction sectors contain a number of other formal requirements – and accordingly an element of "formalism" – with regard to matters such as the form and documentation of invoices and the communication of information about contractual work, as well as the management of third-party liability and the handling of insurance claims. Very few

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2 The term "standard contracts" is used here to refer to "agreed documents" developed through a process of negotiation between the parties or their representatives (*e.g.,* industry bodies). This process is separate from contractual negotiations between individual parties.

3 Contractual mechanisms for dealing with instances of "trouble at' mill" during the contractual period have gradually become fairly sophisticated. The many features these techniques have in common – regardless of the sector involved – may justify the application of a common term: dynamic contract law. See Kaasen, "*Dynamisk kontraktsrett" – et fruktbart grep?*, Tidsskrift for Rettsvitenskap (2005) pp. 237–263.

of these other requirements, however, have any preclusive effect. An exception is the rules regulating claims brought by the petroleum operating company or building site owner (referred to collectively here as "the company") for defective performance, but the application of preclusive time limits to claims that the company has submitted too late, including claims submitted after expiry of the guarantee period, is hardly surprising in a contractual context.

Accordingly, the following discussion addresses formal rules and preclusive time limits as they relate both to variations of the contractor's original contractual obligations, and also to the wider systems of contractual regulation of which these provisions form a part.

## 2 "Concrete is more important than paper"

Objections have been raised to "contractual formalism" on several grounds in both the on- and offshore construction sectors. One objection is that the mechanisms involved may impose results that are unfair. For example, a preclusive rule in the contract may allow the company to avoid the contractor's claim for additional compensation, even though the company recognises that additional compensation would otherwise have been justified because of the contractor's additional efforts.

Another objection is that the contractual rules regulating the submission and processing of claims conflict with the contract's fundamental objective – the construction and delivery of the contract object at the agreed time and for the agreed price. The requirements sour the relationship between the parties: any attempt to use the contract's formal mechanisms will generally be perceived as "hostile". If a party decides to go ahead and invoke the mechanisms anyway, this will reduce the prospects of finding a constructive

and flexible solution in both parties' interests – the parties will be forced into a formal, as opposed to a "real-life", environment.

While such objections would be unlikely to provoke most project participants into describing the level of formalism in these contracts as "intolerable", many would at least appreciate that a problem exists. But is the alternative any better? If a party, for the reasons cited above, were to hold back from exercising the formal mechanisms in the contract, the likely result would be an undesirable level of uncertainty as to the actual positions of the parties when difficulties arose.

Very few of us would favour the adoption of unfair solutions, nor wish to narrow the parties' options for dealing, as rationally and effectively as possible, with the types of challenges that arise in the day-to-day running of these large-scale projects. So are we on the wrong track when employing "formalistic" contractual techniques, typically in the form of preclusive time limits for the presentation of claims?

To answer this question we need to examine how formalistic rules operate in practice. What functions do they perform and could they be performed by systems of a less formalistic nature? Finally, do the advantages of a formalistic approach outweigh the disadvantages?

## 3 An example: preclusive time limits linked to variation orders

The standard contracts in both the on- and offshore construction sectors contain many examples of situations where notices and claims submitted by the contractor will be valid only if they are submitted in the prescribed form before the relevant deadline. While provisions of this type apply in many different situations, a key example is where the company instructs the contractor to carry out work that, in the

contractor's opinion, goes beyond the scope of the work he originally agreed to perform in consideration of the contract price.

Both of the established standard contracts – respectively NS 8405[4] and NF 07[5] – require a contractor who receives such instructions to submit a variation order request "without undue delay".[6] If the contractor is late submitting his request, he will have to carry out the instructions with no entitlement to a variation of the contract price and/or schedule. This will be the case even if the instructions self-evidently exceed the scope of the work originally provided for in the contract and, in principle, even where this is recognised by the company – although in this latter case, the company will perhaps be less likely in practice to rely on the preclusive time limit.[7]

The *offshore standard contracts* widen the scope of the variation mechanism significantly. The mechanism must also be employed in situations where the contractor does not purport to have received instructions from the company, but is entitled, pursuant to the contract, to additional compensation and/or an extension of the contract schedule on *other grounds*, namely: alleged breach by the company of its contractual obligations; *force majeure* affecting one of the parties; subsequent changes to the laws or regulations applicable at the time the contract was entered into; termination of the contract; defective performance by sub-contractors appointed by the client; and other more specialised situations. In all these cases, the contractor must request variation of the

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4 Central to the following discussion is the Norwegian Building and Civil Engineering Contract *(Norsk bygge- og anleggskontrakt* – NS 8405:2008), as revised October 2008.

5 There are many agreed standard contracts in the Norwegian offshore industry, but they all derive from the Norwegian Fabrication Contract *(Norsk Fabrikasjonskontrakt – "NF")*, first published in 1987. The currently version is NF07, dating from 2007.

6 NS 8405 clause 23.2, first paragraph; NF 07 article 16.1, second paragraph.

7 Even so, PetrIus (Sjørettsfondet, University of Oslo) 1995, at page 145, gives an example of a situation where the company did so. See section 4 (a) below for a more detailed discussion.

contract price and/or the contract schedule "without undue delay" after becoming aware of the relevant information or, in some cases, after he *should* have become aware of it, otherwise he will lose all rights to make a claim in that regard. The contractor must moreover submit his request in the prescribed format: a request for the company to issue a "variation order".

Under the NF family of agreed standard contracts[8], whenever an "event" occurs during the contractual period that, in the contractor's opinion, entitles him to make a claim against the company, his rights are inextricably linked to the rules regulating the issuance of a "variation order". This document is the means by which changes are implemented to the parties' original rights and obligations under the contract in all situations where the parties do not make such changes jointly by means of an ordinary agreement to amend the contract.

Under these standard offshore contracts, therefore, the contractor's rights are determined largely by *whether* he is entitled to a variation order and, if so, what *effects* this will have on his entitlement to extra payment and/or adjustment of the contract schedule. Preclusive time limits are important in relation to both these questions. Most remarkably of all, the contractor will lose any right to a variation order if he fails to meet the deadline for submitting his request. Moreover, many – but not all – of the effects of a variation order may be precluded if time limits for requiring them are not met. [9]

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[8] The "NF family" includes, in addition to NF 07, NTK 07 (for EPC contracts), NTK 07 MOD (for modifications) (all available at <http://www.norskindustri.no/kontrakter_olje_og_gass/>) and NSC 05 (for subsea operations) (available at <http://www.olf.no/modellkontrakt-undervanns-operasjoner/category189.html>). Both websites last visited on 24.10.2010.

[9] If the parties disagree about the amount of compensation due in respect of a variation, the contractor must submit a claim for additional payment within six months of the company's issuance of the variation order in which the company stated its views as to the appropriate level of payment, see NF 07 article 15.2, second paragraph. If the contractor misses this deadline, the company's views will prevail. No corresponding rule exists concerning the effects of the variation on the contract schedule, see article 15.3.

The *standard onshore contract* implements this system less consistently. It is true the contractor is potentially entitled to require changes to the contract schedule and/or the price in a number of situations other than those where the company issues instructions positively varying the contractual work, and it is also true the contractor is subject to preclusive time limits in this respect. For the most part, however, the time limits for serving notice operate independently – they are not linked to any general variation mechanism. Even though the position of the contractor may in practice be very similar to that of his offshore equivalent under an NF 07 contract, there is a significant and instructive difference between on- and offshore contracts in this regard: NS 8405 has no universal variation mechanism applying to all situations where a contractor may feel justified in submitting a claim, *i.e.*, a mechanism that regulates both the process (preclusive deadlines for the submission of claims in the prescribed form, together with systems for deciding the claim) and the practical result (the consequences of the claim being found to be legitimate). The concept of the variation order does not pervade the whole contract, as it does in NF 07 (and the family of contracts derived from it). Instead, the onshore contract regulates the contractual relationship largely on the basis of the *effects* of the situation in question – the extent to which changes to the contractual schedule and extra compensation would be justified – without linking this to the fundamental condition operating in the offshore contracts, which concerns the extent to which the situation justifies the issuing of a variation order. This fundamental difference continues to exist, even though there seems to be a clear trend for the standard onshore contract to move towards the approach taken in the offshore contracts in its regulation of variations.[10]

[10] For example, NS 8405:2008, article 21.1, final paragraph, provides that the contractor's claim for an adjustment to the contract price or an extension of the contract schedule on the grounds of the company's breach of its duty of cooperation "shall […] notified and processed according the provisions of Chapter IV", i.e., the rules on "Variations. Delay and breach etc. of the

Does this difference mean that the standard onshore contract is more or less formalistic than their offshore equivalents?

On the most significant material point – preclusion – the systems are identical: claims not submitted in time may be lost.[11] The offshore contract's use of variation orders in situations that are not classic "variation scenarios", however, implies that procedural rules are thrown in for good measure to regulate the process of determining whether the issuance of a variation order is justified and, if so, what the effects of an order should be. This is part of the intention, but using variation orders in this way may be alleged to be a further twist of the "screw of formalism". The question here is whether the approach has advantages that outweigh its possible undesirable effects, namely the risk of outcomes that are unfair in practice, as well as of a general souring of the contractual relationship. Are preclusive rules justified? And do they exist within a context – a "higher order of formalism" – that implies that an outcome may be acceptable, even though it is inequitable in practice? These questions are discussed below in sections four and five respectively.

# 4 Preclusive rules – some background

Preclusive rules are sometimes of a penal nature. In a contractual context, however, they are normally used to speed up the process of clarifying the parties' positions with regard to developments affecting the contract. Often there are highly practical reasons for having such rules – typically a party needs to have the situation clarified so it can take steps to protect its own position; there may

Company's duty of co-operation". Similarly, under clause 23.2, second paragraph, the Contractor must request a variation order if he "receives an order from a public authority imposing an obligation that involves a variation". In both cases, claims that are otherwise legitimate will fail unless they are submitted "without undue delay".

11 There is a difference in principle, however, see section 4 (d) below.

also be a risk that relevant documents may be lost or become difficult to obtain. Relationships with third parties may also play a part – for example, there may be a time limit for filing a claim against the next party in a chain, and that party may bear ultimate responsibility for the costs. Preclusive rules are also used, however, within the framework of larger systems of contractual regulation that are intended to re-establish the balance between the parties in situations where developments during the contractual period have disrupted this balance.

All these reasons are relevant in the case of offshore contracts: so much may happen during the course of a large-scale, long-lasting and dynamic project that there are compelling reasons why a party who thinks there is cause to adjust the project timetable and/or the contract price should give notice of this fact as promptly as possible. Relevant documentation may then be secured before it disappears under a tide of new events that will generate their own inextricably tangled mesh of causes and effects – not least because contractual contributions in kind are made by both parties. For there to be any hope of following up a particular thread, it must be identified as early as possible. Prompt notification also allows the other party to take steps to limit the alleged consequences of the subject of the notice, and in a dynamic project involving many parties this is particularly important. Relationships with third parties – such as subcontractors or co-contractors – will often necessitate the prompt submission of claims.

Even so, are preclusive rules absolutely necessary? Would it not suffice to put the burden of proof on the party making the claim – in practice usually the contractor – in cases where causation could no longer be established?

(a) A possible alternative to the use of precisely-defined preclusive rules might be the introduction of such rules to regulate the burden of proof, supplemented by the usual contractual requirement of good faith. This might be a way of obtaining a fair result in practice and of avoiding a situation where contractual requirements

cause disruption to what both parties regard as their central objective – completion of the work "on schedule within budget".

On the other hand, there is a compelling need for *control* in projects that are very large, lengthy in duration and dynamic in nature. Anything that creates uncertainty as to the contractual basis for the work to be carried out, its timing and payment, is reasonably certain to result in a loss of control. Establishing preclusive deadlines for submitting claims based on allegations of change to what was originally agreed in the contract is an effective means of avoiding such uncertainly.

The preclusive rules in offshore contracts are, moreover, not "precisely defined". While it is true that the right to make a claim is lost permanently if it is not submitted in accordance with the rules, the time limit for submitting a claim is discretionary – it must be done "without undue delay".[12] This means that a request for a variation order may remain viable long after the company has issued instructions or, for example, breached its contractual obligations. The decisive factor is whether the contractor had a reasonable cause to wait to submit his claim, which is a matter primarily of whether the contractor was yet aware of information indicating he should do so. Consequently, the applicable time limit in any particular case will depend on the circumstances, which also makes it more difficult to see how such preclusive rules could be considered unreasonable under § 36 of the Norwegian Contract Act – factors that might otherwise have suggested that the preclusive rule was unreasonable will often have already been addressed when the

[12] Preclusive time limits rely on the clear definition both of their duration and the point at which time starts to run. The reasonableness of the definition of the starting point may also be open to question. An example would be where the contractor's deadline for submitting a claim for a defective item supplied by the company is linked to the time when the defect "ought to have been discovered", *cf.* NF 07 article 6.2, third paragraph. In contrast, the deadline for making a claim on the grounds of alleged breach by the company is linked to the more absolute criterion "after discovery" of the breach, *cf.* article 27. 2. Similarly, time starts to run for claims relating to instructions given by the company at the time the instructions are given, *cf.* article 16.1, second paragraph.

timing of the deadline was fixed and, to some extent, when the deadline started to run.

Finally, the stringent effect of preclusive rules in these contracts may be defended on the grounds that the parties are generally extremely professional and experienced and understand that structured systems are necessary to maintain control of complex and dynamic projects.

(b) Another alternative to the use of rigid preclusive rules might lie in emulating, for example, the offshore contracts' provisions on notifying the company of defects in the drawings and materials supplied by it. If the contractor misses the deadline here, the effect is that he will be responsible for any additional costs that may arise as a result.[13] Although this idea may seem attractive, it is of little use in our context. Estimating what costs would have been saved if the request for a change order had been submitted "without undue delay" requires certainty about what would have happened in that event. While such an estimate may sometimes be possible, this clearly will not always be the case. There is a material difference between a situation where the company replaces a defective "company-provided item" and a situation where it considers a range of possible responses to an allegation by the contractor that its instructions exceeded his contractual obligations. In the latter situation, it will usually be difficult in retrospect to establish possible alternative scenarios and extra costs associated with them. This becomes even more obvious if we assume that the variation mechanism would apply to *all* situations where the contractor alleged that his obligations were being altered as a result of circumstances for which the company bore the risk – as is the case in the offshore contracts.

In view of these considerations – further discussion of which is beyond the scope of this article[14] – there is, in this author's opinion,

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13 NF 07, article 6.3.

14 For more details (in Norwegian) see Kaasen, *Fabrikasjonskontrakten: Utvikling under avvikling av kontraktsforholdet* in 'Lov, Dom og bok, Festskrift til Sjur Brækhus 19. juni 1988', pp. 309 *et seq*, particularly at pp. 317–320.

no real doubt that, in the case of large-scale on- and offshore construction contracts, there is a need for the formalism that these preclusive rules provide. There are strong general arguments in their favour that are not sufficiently outweighed by the need to achieve a fair outcome in individual cases.

(c) These considerations are, in principle, relevant to both parties to these contracts: both may be envisaged as being entitled to make a claim as a result of developments during the period of the contract, and both need to be clear as to their positions and to be able to secure relevant documentation. Does this mean both parties' claims should be subject to preclusive rules?

The contractor in a major on- or offshore construction project is the "hub" connecting all the information, materials, equipment, activities and decisions that will collectively achieve the point of the whole operation – timely production and delivery of the contract object. Accordingly, the contractor may be presumed to be in possession of all the information and insight necessary to identify a situation or development that may justify an adjustment of the contract price and/or the schedule. In some circumstances, of course, the company may be closely enough involved to be aware of aspects of such situations. In offshore projects, for example, the company will typically keep close track of the contractor's activities. But only the contractor is able to see the whole picture. For the company to put itself in the same position, it would have to involve itself so extensively in the project, by effectively duplicating the contractor's role, that the consequences would be undesirable both financially and practically (as well as, and not least importantly, in principle) as the result would be uncertainty regarding the allocation of liability and risk.

On the basis of this somewhat rudimentary argument, it is clear that preclusive rules should be directed against the contractor: it is the contractor who needs to have a strong motivation to "speak up if he's got something to say", positioned as he is like a "spider at the centre of the web".

We may make another practical observation in this regard: it is certainly possible to envisage that the company's obligations may change during the period of the contract as a result of various changes in circumstances, but such changes will normally be the consequence of a change in the contractor's obligations (typically because the company has required this) not because the company's obligations have independently been subject to change. This also suggests that it is the contractor – normally the party exposed to the "primary change" – that should be obliged to give notice under the threat of preclusion.

(d) So far we have seen many parallels between on- and offshore standard contracts. Both types impose on the contractor a preclusive deadline to give notice if circumstances arise which, in his opinion, entitle him to additional compensation or more time. And once a situation has been *identified* under this procedure, both types of contracts lay down rules determining the procedure for establishing whether the contractor is in fact entitled to an adjustment of the contract schedule/price and, if so, what form the adjustment should take.

In this respect the onshore contracts go furthest, however, in regulating what happens once a situation has been identified that may potentially qualify as a variation. These contracts use preclusive time limits to drive the process forward and, in some cases, these time limits may also apply to the company: if it fails to respond without undue delay to a request from the contractor for a variation order, either by issuing or refusing to issue a variation order, the contractor's request will be presumed accepted.[15] Rules of this type are not found in the offshore contracts, in which the company is generally free of any exposure to preclusive rules. The exceptions

[15] NS 8405:2008 clause 23.3 first paragraph. Similarly, by reacting too slowly the company may lose its potential contractual right to extend the deadline or to adjust unit prices in certain situations or to object to the contractor's demands for more time or an adjustment to the price.

are rules regulating final settlement, notices of default and provisional expert decisions.[16]

Clearly the standard onshore contract does not lag behind the offshore contracts in this respect, in fact quite the reverse.[17] There seem to be good reasons for this: by forcing a party to respond "without undue delay", through the application of a threat that it may otherwise lose its bargaining position, problems that arise under an onshore contract, and the consequences for the parties' contractual obligations, will often be clarified more quickly than would be the case under an offshore contract. The arguments against such rules are also weaker: it is less controversial to apply preclusive rules to the later phases of the parties' dialogue than to initial identification of the situation. Once the problem has been identified, the process of following it up is less demanding.

The extent to which there are sound reasons for this difference between the two types of contracts cannot, however, be assessed in isolation from other aspects of the variation mechanism, namely the rules that apply until the situation has been clarified. This is the issue examined below.

# 5 Using preclusion and formalism to balance contractual interests

To view preclusive rules as isolated phenomena would be overly narrow. These rules are a part of, and must be viewed in the context of, larger contractual mechanisms.

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16 See, respectively, NF 07 articles 20.4, third paragraph; article 25.1, second paragraph; and 16.4 third paragraph.

17 In contrast to many other aspects of the construction contracts' rules on variations and similar situations, these are not inspired by provisions found in the offshore contracts. As we will see in section 6 below, this is because these rules are found in different contexts in the two types of contract.

This is most apparent in the offshore contracts. Elements of the same mechanisms may undoubtedly be found in the onshore contract, but they are applied less consistently, even though the most recent version of the standard contract[18] has, in this respect, taken another step in an "offshore direction".

Accordingly, we will focus here on the offshore contracts. These contain a relatively complete mechanism that consists mostly of rules regulating how the parties' obligations may be varied and, if such variation occurs, how the balance of the contractual relationship should be re-established. The rules are precisely designed to ensure a balance between the company's right unilaterally to vary the contractor's obligations and the contractor's right to additional payment for such variations. And as mentioned above (in section 3), this mechanism also has general application in the sense that it also regulates other situations where the contractor's obligations are varied, although not by any positive instructions from the company.

The core of this mechanism is undoubtedly that if there is something – and in principle it could be pretty much anything – that could justify a claim by the contractor for additional compensation or more time, the contractor must give notice of this fact (by requesting a variation order) within a preclusive deadline, otherwise he might as well forget about it. But this notice or request is no more than the starting serve in a game of ping-pong between the parties.

Once the contractor has put in his request, the ball is in the company's court: if it wants the contractor to get on with the work, even though he alleges it to exceed his contractual obligations (and therefore to be contingent on an adjustment to the contract schedule/price), the company has an irresistible weapon at its disposal in the form of the variation order (which includes disputed variation orders).[19] In return for granting the company this weapon,

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[18] NS 8405:2008, see in particular chapter IV on variations etc.

[19] By issuing a "clean" variation order, the company indicates that it recognises the existence of a variation (without necessarily agreeing with the contractor's

however, the contract requires company actually to *use* it – other methods of proceeding do not have the same effect. There is nothing the contractor can do to avoid carrying out the work once a variation order has been issued (other than – and this is somewhat theoretical – to invoke the limits that do ultimately exist on what may legitimately be required in a variation order);[20] on the other hand, there is no other device in the contract that creates this level of compulsion. Both these observations are significant.

The powerful effect of issuing a variation order is balanced by the third stroke in the ping-pong match: the contractor can use the variation order or (by means of slightly more complicated mechanisms)[21] the disputed variation order as a lever to obtain more money and/or time. The extent to which he will actually *achieve* this is subject to other rules – the point is that (in general) there is no other way of obtaining such additional compensation.

From the contractor's point of view, this does indeed mean that he must perform the instructions contained in the variation order, although in return for doing so the same variation order provides him with a means of getting extra compensation. And from the company's point of view, the crucial point is that while it does have the means unilaterally to compel the contractor to undertake work that may be outside the scope of the original contract, the company by using this means is in return exposed to a potential obligation to compensate the contractor by providing additional time and/or money if the work *is* subsequently determined to exceed the scope

views as to its consequences). In contrast, by issuing a disputed variation order, the company indicates that it considers the allegedly additional work *etc.* to fall within the existing scope of the contract. See NF 07, article 16.2.

[20] See NF 07, article 12.1: variations may not cumulatively exceed "that which the parties could reasonably have expected when the contract was entered into". Such a commonly held assumption is not easily established.

[21] The choice here is either to employ an "expert" who will quickly and cheaply reach an interim decision, or to commence legal proceedings, perhaps in the form of arbitration. See NF 07 article 16.3 – 16.5.

of the original contract[22] *and* is determined to provide grounds for additional compensation and/or an extended schedule.

The ping-pong game continues with rules regulating how disputes about variations (both as to their *existence* and their *consequences*) should be resolved, and how the amount of any additional compensation should be assessed. Here the standard offshore contracts provide, among other things, mechanisms for dispute resolution where the obligation to act switches between the parties during the different phases of the process.

The key mechanism in all these systems is the variation order, which acts to maintain a balance between the parties' different contractual goals. The company's basic objective is to get what it wants when it wants it – even if, for various reasons, what it wants changes while the contract is underway. In contrast, the contractor's basic objective is reasonable reward for his efforts – at least an amount corresponding to the original contract price – even if his obligations change underway. In offshore contracts, the relationship between these fundamentally different contractual objectives is irrevocably linked to the instrument known as the "variation order". Accordingly our attention will be focused, academically as well as from the perspective of contract drafting and contract management, on the conditions that apply to the issuance of variation orders and their consequences once they have been issued. Preclusive time limits are central to this mechanism – but even so, they are only one of its components.

The mechanism sketched out above would be considered to comply with most definitions of formalism. In this author's opinion, however, the mechanism is logical, practical and efficient – subject to the significant proviso that both parties need to be aware of, understand and use it. We will return to this proviso in section 7 below.

[22] Such clarification is of course only necessary if the company has responded to the contractor's variation order request by issuing a disputed variation order (DVO), stating that the company stands by the instructions that gave rise to the contractor's request, but that the company considers the work to be within the scope of the contractor's original obligations under the contract..

# 6 Onshore and offshore

Neither onshore contracts nor offshore contracts are unambiguous concepts. Although offshore contracts are typically large-scale, long-lasting and of a dynamic nature, some are small and uncomplicated, with few surprises occurring during the contractual period. Similarly, onshore contracts are just as likely to cover the building of a small municipal kindergarten as they are to provide for the construction of a major hospital.

Clearly the provisions of a contract – including the formalistic requirements under discussion here – must be adapted to suit its context. Relevant factors include the size, duration, organisation and nature of the project; problems that are likely to be encountered underway; and the nature and identity of the parties themselves. Other considerations include the balance between the parties' bargaining positions, the extent to which they are experienced and professional, the extent to which they are assisted by third parties, *etc.*

In practice, there is probably a greater need to take account of such diversities in onshore contracts than offshore. Over recent years this has led to the development of a simplified standard contract (NS 8406) for use in onshore construction projects whose size and organisation suggest less need for stringent rules on notice procedures and cooperation between the parties.

In the context of our discussion here, however, large-scale onshore construction projects are generally not so *significantly* different from a typical project offshore, even though the former will not usually give rise to the extreme challenges we often see offshore, both in relation to technological innovation and because the project engineering is frequently at an early stage at the time the contract is entered into. From a contractual point of view, the construction of the new Oslo University Hospital *(Rikshospitalet)* has been described as having more in common with the construc-

tion of a major offshore production facility than a classic building project. In a large-scale onshore project there is just as great a need as offshore to have systems in place to regulate the notification and submission of claims and to establish what should happen thereafter. The objections to such systems are no different in principle either. It is true, though, that it has taken some time for this fact to be acknowledged – the experiences of former construction giant Selmer when developing the Aker Brygge site in Oslo may serve as an example of the learning curve. And, to be slightly disrespectful, one could suggest that the standard Danish onshore construction contract does not indicate that this view has been whole-heartedly embraced in Denmark[23] – somewhat in contrast to the attitude of our brothers in Sweden.[24]

In this author's opinion, the difference in the level of formalism used in the on- and offshore standard contracts is not primarily the result of fundamentally different objectives in the two areas of contracting. The cause is rather the fact that onshore projects tend to be more varied, as is also perhaps the case with the parties to specific contracts – site owners are not always as experienced and professional as offshore operators, although major contractors on- and offshore tend to be more equal in this regard.

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[23] Ole Hansen, *Det entrepriseretlige hjemmelsproblem,* p. 281 (in Danish), refers to the fact that the requirement for notices to be given in writing in the Danish AB 92 § 14 point 2 (the company's variation order and the subsequent variation agreement), according to the preparatory works and "general understanding" does not affect the validity of the notice, "but is only an evidentiary rule", and that "this view has support in long-held and express scepticism in Danish case law and arbitration practice regarding agreements on requirements as to form in construction contracts". He also notes at p. 282 the "[f]ormalisation of the variation system in the Norwegian standard contracts goes in the opposite direction to the development of Danish law. The background to this is first and foremost the influence of Norwegian offshore contracts on the law governing onshore construction."

[24] See for example the rules on variations and notices in the Swedish Allmänna Bestämmelser för bygnads-, anläggnings- och installationsentreprenader (AB 04) chapter 2 §§ 3-9 and the corresponding provisions applying to "total contractors" (ABT 06) chapter 2 §§ 3-9.

This suggests it is necessary to respect the more varied nature of the onshore construction industry when discussing contractual formalism. But having made this point, this author sees no reason to draw a fundamental distinction between on- and offshore contracts for our purposes here.

In fact, as we have seen, the standard onshore contract, NS 8405, equals NF 07 – "the mother of Norwegian offshore contracts" – in establishing preclusive time limits for serving notices and submitting claims (in the prescribed formats) with regard to areas of practical importance, which typically means variations. Admittedly, the patterns of regulation differ to some extent – partly because NS 8405 is not as consistent in employing variation order requests as the key to all adjustments to the contract time/price, whatever the cause. But the standard onshore contract does not lag behind its offshore equivalent in establishing stringent requirements regarding the actions necessary to preserve or obtain rights under the contract.

Quite to the contrary, we have seen that NS 8405 contains an element that is lacking in NF 07: if the company does not reject the contractor's request for a variation order "without undue delay", it will lose its right to object and the variation order will be presumed to have been issued.[25] No corresponding clause exists in the offshore standard contracts – subject to a minor reservation in respect of a particular situation in the youngest member of the NF family, the Norwegian Subsea Contract 2005 (NSC 05).[26]

[25] See NS 8405:2008, clause 23.3, second paragraph.

[26] The rule here is that the company is presumed to have issued a disputed variation order if the contractor's request for a variation order is not responded to without undue delay, but only when the request relates to "Offshore Work", *i.e.,* work that is carried out offshore, as opposed to on land. See NSC 05, article 16.2, second paragraph. This rule must be seen in connection with the fact that the contractor in the case of "Offshore Work" is expressly required to perform work that is required of him by means of an instruction, even if he has requested a variation order in respect of the work, see article 16.1 second paragraph. The background to this discrepancy compared to the other NF-based contracts is the time pressure resulting from the use of specialized vessels for these subsea operations. Delaying may have very serious consequences, both

As already mentioned (section 4 (d) above), there may appear to be no good reason for this difference between standard contracts in the on- and offshore sectors. However, several factors may explain the difference, apart from the most obvious explanation that the site owners did not have the same negotiating power as offshore operating companies when the standard contracts were agreed. Firstly, the site owner/contractor balance may be less equal with regard to professionalism and project management abilities. Secondly – and in principle more importantly – the NF contracts' consistent employment of variation orders in all situations where the contract price and/or time may be subject to adjustment, with associated mechanisms to determine when this key device shall be deployed, and what happens if it is not, lead to there being no *need* to impose this type of preclusion on the company. Once the contractor has (in the form prescribed) requested a variation order, he may, according the system adopted in the contract (which could certainly have been more clearly stated in the text) suspend the relevant part of his work. In fact there are good arguments in favour of him being *obliged* to do so – in order to avoid anticipating the company's decision as to how further to handle the situation.[27] Accordingly the contract may confidently be content with requiring the company to respond to the variation order request "within a reasonable time" – it is for the company to decide, by issuing either a variation order or a disputed variation order, how quickly it wants the contractor to start work again, or whether it would rather abandon the instructions – if this is a viable alternative. There is no corresponding arrangement in the standard onshore

in the form of vessel day rates and in relation to the contractor's obligations under other contracts where the vessels are required.

[27] See the more detailed discussion in Kaasen, *Petroleumskontrakter* pp. 443–449 (in Norwegian). As argued there, a variation order could very well increase the efficiency of the variation mechanism: it is precisely the uncertainty about the obligation to continue work during this phase that is likely to undermine the mechanism, because the contractor realizes the risk of interpreting his contractual position wrongly on a completely decisive point.

contract. The contractor here explicitly does not have the option of suspending work while awaiting the site owner's response to the request for a variation order (clause 23.1). Accordingly there is a need for a preclusive time limit to prevent the situation dragging on for too long without clarification.

These considerations may, however, be more use as an example of academic logic than in an ongoing project. To achieve balance between the parties, the variation mechanism used in the offshore contracts depends on the contractor actually suspending work until the company forces him to start again by producing a variation order (meaning everything is fine) or a disputed variation order (whereby the company risks having to pay up if the contractor's request for a variation order is subsequently proved to be legitimate). There may be several factors, however, acting as disincentives for the contractor to bring things to a head by suspending work. The most immediate is that it is almost nonsensical to stop work that in all likelihood will have to be carried out anyway – although perhaps at a later time, when the formalities have been dealt with. However, the very question of timing is, commercially speaking, a more significant factor: if the contractor suspends work for which he has submitted a variation order request, but subsequently fails to obtain such an order, he will have to carry out the work at his own expense. While the costs incurred by the work itself need not be higher than if the work had been done immediately, normally the need to coordinate with other activities and adhere to the contract schedule will cause a significant increase in costs. Such increase would be solely attributable to the contractor having stopped work in the erroneous belief that it would exceed his contractual obligations. The risk associated with making such a mistake is a strong incentive to continue work even after a request for a variation order has been submitted.

One might, of course, hope that a company would contribute to clarifying the situation by coming to a swift decision on its response to the contractor's request. But if the contractor is doing the work

anyway in the absence of a formal order from the company, in the form of a (disputed) variation order, it is easy to see that the company may see advantages in keeping the situation somewhat unresolved. Even a disputed variation order will expose the company to having to make additional payments if the contractor's claim is subsequently shown to be justified.

This situation evidences a breakdown in the essential conditions for maintaining a balance between the parties in the event of an alleged contract variation. Take, for example, a situation where the contractor continues with the work, despite having submitted a variation order request to which the company has failed to issue a clear, formal response. There is now a risk that the contractor will carry out work that does in fact exceed his contractual obligations but will lose his right to additional compensation. This will be the outcome if the company in the end, rather than issuing a (disputed) variation order, decides to revoke its instructions.

The solution must lie in making the parties' game of ping-pong more efficient. This may scarcely be achieved by expressly stating that the contractor does not have an obligation, or even the *right*, to continue the work in respect of which he has requested a variation order. Such a rule would not eradicate the strong disincentives mentioned above for the contractor to suspend work. A more effective rule would instead attack the core of the problem by directly forcing the company to respond to the request in the form required under the contract. On this issue there is much to suggest that the standard onshore contract has found a solution that could advantageously be applied offshore: the company loses its right to dispute the contractor's request if it fails to respond without undue delay.

An immediate response might be that this appears to alter the company's exposure to an unacceptable degree. On closer consideration, however, this author does not believe this to be correct. The situation's existence has been clearly flagged by the contractor's request for a variation order, so the company is hardly at risk of overlooking the need to respond. In addition, the company does not expose itself

to unreasonable costs by issuing a disputed variation order – no payment under such an order is required until either an "expert" or a court has found in favour of the contractor's claim and it will be difficult for the company to object to *that* exposure, given its initial insistence that the contractor should perform work that the contractor has so clearly stated as exceeding his contractual obligations.

The system would be even more practical if the preclusive time limit for the company's response were to be combined with an express requirement for the contractor to continue the work, even though he has requested a variation order in respect of it – that is, the exact opposite of the solution currently provided for in the offshore contracts. Only then would the contractor be completely free of the risk that is otherwise attached to judging his contractual position wrongly. Of course there is a risk for the company that work will be performed that it would not have wanted carried out if it had known that the work would give rise to a variation, but the company should be able to avoid that outcome by reacting swiftly to the contractor's request – typically by revoking the instruction giving rise to the request. This instruction was after all the cause of the situation, which means that the problem was created by the company in the first place.

In this author's opinion, the above discussion confirms that, with regard to a contractual issue of central importance, the standard onshore contract outstrips its offshore equivalents in finding an efficiency-promoting balance between logical and practical considerations. This balance is achieved through what we can only describe as formalism, namely the imposition of a preclusive time limit on the company for responding to the contractor's request for a variation order.

# 7 Is formalism "intolerable"?

(a) There are good grounds for arguing that the formal requirements imposed on the parties' conduct that we have been examining here are, in the case of large on- and offshore construction contracts, in principle well-founded. Does this mean, however, that they are suited to the everyday running of a project and their effects are tolerable in that context? Is it realistic to expect the parties to fulfil the assumptions that these contracts make about their awareness, understanding and ability to use these formal mechanisms?

Objections to the formal rules fall into slightly different categories. First of all, the rules are alleged to be so complicated that it is impossible to understand and use them in practice, even where the parties wish to do so. In addition, some see the contractual mechanisms as tending to encourage disputes and, accordingly, as more damaging than beneficial. Another possible objection could be that the rules do not produce satisfactory outcomes in practice – their effects are unfair on one or both parties. Finally, the formal mechanisms may be alleged quite simply to be technically deficient – unclear, inconsistent and/or insufficient in their scope.

A more detailed evaluation of these objections would require an examination of the specific provisions of the standard contracts, which is beyond the scope of our discussion here. We may, however, make some remarks in the general context to which we are confined.

None of the objections can be rejected out of hand. It would be arrogant simply to dismiss the experiences of many involved in the on- and offshore sectors. Even so, it is difficult to see that most of the objections are particularly relevant to large-scale, long-term projects involving professional parties.

We should, however, allow a couple of points. Firstly, the way the onshore standard contract was previously drafted made the variation mechanism difficult to understand. In this author's

opinion, the revised version (NS 8405, dated 01.10.08) is a significant improvement. Secondly, there are strong arguments (see section 6 above) in favour of making the ping-pong regulation of the offshore contracts more efficient by imposing a preclusive time limit on the company's response to a variation order request, as well as, preferably, by providing that the company's instructions impose an express duty to carry out the work on the contractor, even where the work is the subject of such a request. Such an amendment, as well bringing about a more balanced solution in practice, would be an example of "theory following practice" on an issue that is clearly important for everyday project management. Since the resulting contractual regulation would also seem more realistic, it would also have more thrust in practice.

(b) Even if the objections mentioned above do not carry much material weight, there does remain another significant consideration that for purely empirical reasons must be taken seriously: some people involved in projects *perceive* these formal systems as damaging to a project's climate of co-operation. This perception prompts them to look for alternatives. The causes and effects of this require closer examination.

The rules we are discussing here have existed happily in standard offshore contracts since 1983 and in many operators' "house contracts" since the dawn of time, which in this case means Norway in the early 1970s. For the onshore sector, the most significant step came in 1991 with the transition from NS 3401 to NS 3430. As a result the contracts' formal requirements are well known to parties obliged to abide by them. There are also many experienced people in the sector who view the rules as well suited for handling the types of situations that virtually always arise during the course of a project and that require proper handling if the project is to remain on track.

Even so, it is noticeable – although less so as time goes on – that even experienced and competent project participants perceive the sending of a formal notice or request pursuant to the system pro-

vided for in the contract as "hostile". The sending of, for example, a request for a variation order is claimed by both parties, although for different reasons, to sour the atmosphere and the climate of co-operation in the project: the company may see the request as a meritless claim that is just the contractor's way of "trying his luck", while the contractor may see the company's refusal to handle his request in accordance with the contract as just its way of trying to get the best of both worlds.

To avoid this happening, the parties may instead try to manage technical or commercial disagreements – or near disagreements – in what they like to see as a "flexible and non-confrontational and therefore professional" manner. Their need to do this is apparently great, as significant efforts are sometime made to avoid going by the book and to establish "shadow" systems. The methods employed vary, but often centre around either informal discussions or formal systems not found in the contract – linked, for example, to concepts such as potential variation orders (PVOs) or site instruction requests (SIR). Such shadow systems are never completely coherent and usually not particularly well thought-out technically. Only rarely do they have any clear relationship with the rules of the actual contract and, accordingly, create uncertainty in this regard. But one thing the shadow systems do have in common is that they are perceived as less antagonistic.

(c) These "shadow" systems could be claimed to result from the parties' failure to read the contract – a company that had done so would find it would be a "cheap move" to dismiss a variation order request by issuing a disputed variation order if it thought the request to be groundless. And one could refer (see section 5 above) to the fact that the contractual balance depends on the link between the company's unilateral right to issue instructions to the contractor and the contractor's corresponding right to demand additional payment from the company if the work involved lies outside the scope of the original contract. This balance hinges on the instruments represented by the variation order request, the variation

order and the disputed variation order being employed as provided for in the contract. While we may lament the lack of appreciation afforded to these mighty contractual systems by those involved in on- and offshore construction projects, this does not alter the fact that they consider other mechanisms more attractive. It is no use for lawyers to say that the contractual mechanisms are carefully thought-out and balanced systems well suited to assist in maintaining a detached attitude – just as long as they are used professionally. Nor is it enough to point out that homemade shadow systems are rarely sufficiently robust when a project runs into difficulties.

A striking example of this kind of situation arose in the offshore sector in the early 1990s. At that time the mantra was "win-win" and, as oil companies and contractors were alleged to be in the same boat, the idea was that traditional contracts should be thrown overboard and replaced by so-called "partnership contracts". Some individuals suggested that it was somewhat naive to ignore the basic conflict of interest between the two parties in a typical construction contract – in contrast, for example, to a joint venture agreement.[28] The phenomenon faded out after a while, following some unfortunate experiences. The pendulum of history is inexorable, however, and interestingly enough there has been a trend towards partnership contracts in the construction sector – we must hope the consequences we saw offshore will be avoided.

(d) In the light of these observations, it may be tempting to follow the old Norwegian saying that you should listen to the person who's actually wearing the shoe: whatever motivates those involved in projects to short-circuit sometimes advanced contractual mechanisms, we have to appreciate the fact that this is how they want to do it. Even lawyers may be defeated by project psychology.

Things are not that straightforward, however.

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[28] See Kaasen, *Partnering: The Emperor's new Clothes?* in MarIus no. 247 (1999) pp. 233–247.

One the one hand, the retention of contractual mechanisms that are not used in practice is not a satisfactory solution – there is a risk they could become traps for the unwary. Or as the committee known as the *Investeringsutvalget*, which investigated the causes of cost overruns in offshore projects, put it:[29]

> "Too great a gulf must not arise between, on the one hand, the solutions that must be presumed to follow from dealing with the question [the allocation of costs] by legal means and, on the other hand, the solution seen by the parties as reasonable in the particular circumstances and which they therefore strive to achieve in their negotiations. When such a gulf arises, the parties will gradually negotiate themselves away from the contractual solutions to specific issues, until the tension becomes so great and the underlying economic interests so significant that one of the parties sees benefits in reverting to the contractual solution. In this way the parties will lose control over their relationship because they are riding two horses – flexibility and formality – without being clear as to when each should be used. This tendency has often been seen previously in the handling of variation orders."

On the other hand, nor is it satisfactory to avoid any attempt to regulate these situations, trusting that the parties themselves will find the best methods of resolving them on a case-by-case basis – most likely based on general contract law principles. Of course it is fine if the parties manage to negotiate solutions without making use of the systems provided for in the contract (but it does make the contents of the contract pretty much irrelevant). And if the parties fail to do so, experience shows that when there is a lack of contractual regulation at the day of reckoning (which here means the time for final payment), the parties will be left to attempt to reconstruct the course of events, which means reconstructing the causes and effects of everything that happened during the contrac-

[29] NOU 1999:11 Analyse av investeringsutviklingen på kontinentalsokkelen, s. 33 (original in Norwegian).

tual period, *i.e.,* everything contributed by the parties themselves as well as their surroundings (official bodies, the natural environment and third parties). As this will seldom be possible, the parties will be forced to divide up large figures without reference to any particularly concrete criteria. In short, if the parties fail to reach agreement, they will lose control of the situation and also be unable to rely for assistance on contractual mechanisms. This may also be the outcome, of course, even where such mechanisms exist and the parties attempt to comply with them in good faith – but this is not a good argument for failing to provide the contractual tools that are available.

In the light of this discussion, the aim should still be to attempt to bring the parties together to a mutual understanding of the tools that are in fact available to them, in recognition of the fact that it is not particularly professional to behave as though technical or commercial disputes never arise – and should not arise – in the course of a project.

In more good-humoured moments the parties to a project may acknowledge that formalism, used correctly, is an appropriate means of providing them with the control they need. But how can we prolong these moments? This is most easily achieved independently of any acute problems involving a specific contract. Accordingly it may be a good idea to separate the process of gaining such acknowledgment from specific contractual negotiations – typically by linking it to joint efforts to develop "agreed standards", such as NS 8405 and NF 07. *Investeringsutvalget* addresses this point by stating (p. 34) that the parties' lack of suitable contractual tools to tackle situations that arise in practice is a problem, but that the development of such tools is a demanding task and accordingly best carried out through "mutual efforts separated from the negotiation of individual contracts".

The message is clear: the challenging everyday environment of a project, with the uncertainties and outright disputes that arise between the parties, is scarcely the best forum for developing tech-

nically sophisticated and commercially balanced mechanisms of the complex nature we have been discussing here. This is a task that should be undertaken during the drafting of agreed standard form documents.

# 8 Conclusion

Complex construction contracts – both on- and offshore – are exposed to many stresses during the contractual period, frequently with the inevitable consequence that the parties' original obligations are – or should be – altered. This factor must be taken into account if systems of contractual regulation are to be both realistic and effective. Such systems must provide the parties with appropriate tools to enable them to work through changes without losing control of their positions or being exposed to commercial strains beyond those that follow from their original contractual obligations. When designing such tools, one cannot assume that the parties will always be in agreement on measures that must – or should – be taken. One also cannot assume that there will be agreement on the extent to which such measures come within the scope of the contract and the appropriate consequences if they lie outside it. Finally, it is an absolute requirement that such tools must secure the fundamental contractual interests of both parties: timely production of the contract object (the company) and reasonable compensation for the effort involved (the contractor).

Accordingly the task is nothing less than to create a mechanism that ensures a reasonable balance between, on the one hand, optimal technical, commercial and legal solutions and, on the other, what is tactically acceptable, psychologically tolerable and realistically possible in relation to contract management.

Unsurprisingly, designing such contractual tools is demanding work – and using them is also demanding. But this is because the

tools are used to tackle demanding situations. The complex realities for which these contracts are designed will not become less demanding if we pretend such complexity does not exist.

This author's view is that recognising these challenges makes it more difficult to argue that there is a conflict between "concrete and paper" – between getting the job done and complying with the formal requirements of the contract. It is simply unrealistic to "get the job done" with reasonably satisfactory outcomes for both parties without complying with some fairly sophisticated rules of play – and these need to be relatively formal in nature if they are to function in all the various situations in which they may be required.

But, as Kåre Willoch no doubt calmly replied when asked whether he was ever roused to passion, the answer must be: "Yes, but with moderation." So what about the question we posed earlier? Are we moving towards an intolerable level of formalism?

With regard to the offshore contracts, there have been scarcely any developments worthy of mention on this point in recent years. As mentioned above (see section 6), there are very good arguments in favour of adjusting the contractual mechanism in respect of the phase following a contractor's request for a variation order. So far, however, the formal systems contained in the offshore contracts have remained materially unaltered since 1987 (subject to a number of special adaptations in the NTK total contract, published in 2000). Such developments as have occurred have instead focused on the area of contractual practice. This suggests that the parties, slowly but surely, are becoming more and more accustomed to these formal rules, causing the psychological barriers against *using* them gradually to be broken down. This tendency would, it is submitted, further benefit from an adjustment of the contractual mechanism in respect of the phase following a contractor's request for a variation order, as mentioned.

Meanwhile, developments affecting the regulatory systems used in the onshore contract have been much more significant. The

transition from NS 3401 to NS 3430 was a significant step towards a more formalistic approach – although the primary motive may have been editorial, with the intention of making the contract's formal requirements more accessible. NS 8405 represented a further – and in this author's opinion successful – step in the same direction, a trend that was continued in the version published on 1 October 2008. In the case of this contract, a process of "formalisation" has indeed taken place.

But is it "intolerable"? I believe I have explained why the answer is no.

# The freight forwarder's security for earnings and outlays – with particular view to NSAB 2000 and Norwegian domestic law

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# Content

# 1 Topic: Securing the freight forwarder's claims against the customer

The freight forwarder (FF) plays an important role in both international and national carriage of goods – either as an intermediary between the cargo interest and the carrier, or as a carrier 'on his own account'. For his performance he is, of course, entitled to a compensation from his contractual counterparty (hereinafter 'the customer'), depending upon the nature of FF's services. In addition FF may, in both instances, have outlays, which the customer shall reimburse him. Thus, FF may have substantial claims against the customer and more so if the relationship covers transportation on numerous occasions. The topic discussed in this article is how FF can secure his interest in these respects in advance, which is important, as the enforcement of a non-paid and non-secured claim may be a long-winded and sometimes costly and futile process. There are several alternatives for protecting the interest of FF (prepayment, deposits, bank guarantees etc.), but we will pay particular attention to the possibility of using the cargo transported as security. In practice, this is a question of obtaining a right to the goods, protected against other creditors of the customer with contractual rights in the goods, as well as against the creditor enforcing his claim with the assistance of the enforcement authorities and the bankruptcy estate of the customer.

The issues arising from this situation will be considered in a Norwegian perspective, with a view to transport within Norway or ending up in Norway. Furthermore, it is presumed that the contract between FF and the customer is based upon the standard terms of NSAB 2000 (NSAB). This document – with the full title 'General Conditions of the Nordic Association of Freight Forwarders' – is an agreed document that routinely is made part of a contract with a FF.[1]

[1] Even if there is no express reference, the terms of the document regarding the right of retention may be deemed to apply, cf. Rt. 1973, p. 967 et seq.,

First, we will give a short overview of the services rendered in modern freight forwarding business, and how and on what terms the customer is invoiced (Chapter 2 below). Then we will examine to what extent FF is secured under general rules of a formal or non-statutory character (Chapter 3 below), before discussing the possibilities of improving FF's position by contract (Chapters 4 and 5).[2]

# 2 Background: A survey of NSAB

The document consists of 32 sections, covering five A4 pages of comparatively small print, which indicates that the relationship between FF and the customer is regulated in detail. Here we can only give a brief outline of the structure to the extent that it is relevant to our topic.

In § 2 there is list of services that may be included in the contract: (i) carriage of goods, (ii) storage of goods, and (iii) other services in connection with (i) or (ii) – e.g. clearance of goods, handling and marking of goods. Such services FF may carry out 'either on his own account or as an intermediary' (§ 2, second paragraph). The sometimes difficult question as to whether FF acts in the first or second capacity is to some extent answered in § 2A. We will, however, presume that the position is clear in the concrete instance, adding only that the tendency is that FF contracts 'on his own account', i.e. as a carrier when the contract is for transportation.

In this latter situation, FF may e.g. give a promise of undertaking seaborne transportation or he may give a general promise of

concerning an earlier version of the standard document. There is no reason to assume that the attitude would be different in respect of NSAB 2000.

[2] In Norwegian legal theory, FF's security in the cargo is discussed by Chr. A. Jensen, 'Speditørens sikkerhetsretter – tilbakeholdsrett, panterett og realisasjonsadgang', MarIus no. 265 (2000). A thorough analysis of the right of retention in general is found in *Brækhus*, 'Pant og annen realsikkerhet' (3rd ed. by Høgetveit Berg, 2005) pp. 567–613; this book also covers the pledge (see note 4 regarding terminology) and realization questions dealt with in this article.

transportation, i.e. to have the goods transported by the mode of transport that FF finds preferable (of course within the framework of the contract).

Whether FF acts as carrier or intermediary regarding transportation, he may – as indicated – undertake additional services, e.g. to see to it that the cargo is insured during the transportation period and that import dues are paid. In respect of insurance, FF may act purely as an intermediary, contracting on behalf of his customer as well as paying the insurance premium on his behalf. In addition, he may be entitled to have himself qualified as co-insured. In the second example, it is merely a question of paying on behalf of the customer.

The invoicing of the customer is clearly of great importance to our topic. Naturally, the way it is done may depend upon the concrete circumstances, so what we can do here is only to give some indications.

When FF acts 'on his own account', one may have the usual pattern where a cargo owner contracts with a shipowner: freight prepaid or freight collect (i.e. payment when the cargo is delivered from the ship at the port of destination). Extensive use of subcontractors and cargo consolidation (cargo belonging to many customers on the same transport vehicle) complicate matters, as does the fact that FF often has undertaken services in addition to the actual transportation, Therefore, the exact amount to be charged may not be (easily) determined at the time of delivery. The impression of this author is that to a substantial degree payment day for the customer comes some time after FF has parted with possession of the goods. In a running relationship it may be practical to settle the accounts once a month or once a quarter. Behind the transportation there is usually a sales contract, and the payment structure between the customer and FF will, with the indicated invoicing pattern, enable the customer to use part of the purchase price for payment to FF.

When FF acts as an intermediary, his compensation will be a fixed sum or a percentage of the costs of transportation arranged by him, to which are added charges for other services. Also here practical considerations may lead to payment day coming after the conclusion of the transport.

> NSAB establishes some rules on payment in §§ 9, 10 and 12, see also § 13 – giving a somewhat confusing impression. Briefly, § 9, subsect. (2), says that unless otherwise agreed, 'the customer is obliged, upon request, to make advance payment for such *expenses* as *may be* incurred in the performance of the contract' (the author's italics). Also, § 10, subsect. (1), includes rules on payment upon request of 'what is *due* … (remuneration, advance payment, *refund* of outlays) against *appropriate* documentation'. And this duty applies notwithstanding to 'the customer's obligation as to payment under contracts of sale or freight agreements with parties other than the freight forwarder'. According to § 12, if FF has paid 'additional amounts for agreed services' the customer has 'upon request to refund these amounts subject to *appropriate* documentation.'

Summing up, the practical possibility of retaining the cargo arises when FF acts on his own account, but also here there are practical considerations which make it difficult to combine efficient transport service and effective right of retention for claims connected with the actual transport. This implies that the protection of the interests of FF to a great extent depends upon whether he can have security in a cargo lot for claims originating from previous transport. Our task is to investigate whether the claims of FF are secured, or can be secured, with the goods in transport as security.

# 3 The security possibilities deriving from formal or non-statutory law

## 3.1 The general principle of right of retention – some characteristics

In Norwegian law there is a general principle giving the possessor of a moveable object a right of retention against the owner (or a third party having a right in the object) in respect of claims due, provided that there is a natural connection between the claim and the way in which the possession was established. A number of statutory provisions on the right of retention are seen as more concrete manifestations of this principle. A typical example is the Maritime Code (MC) of 24 June 1994, no. 39, section 54, which gives the shipyard a right to retain the ship until the building or repair price has been paid (provided, of course, that credit has not been extended). Such stipulations may, depending upon the circumstances, be supplemented by the rules flowing from the general principle; however, in some instances such stipulations may give the creditor a better position – as will appear from the following.[3] Before examining some of these stipulations with particular relevance for FF, some remarks on the general conditions regarding the right of retention should be briefly touched upon.

The basic requirement is that the creditor is rightfully in possession of the object. Primarily, possession is physical possession: The creditor has the effective control of the object, to the exclusion of the owner. The requirement is met also when a third party has the actual possession, but is subjected to instructions given by the creditor, for example, when the third party is carrying goods under an ordinary bill of lading and the creditor is in possession of this document. In short, the requirement is the same as that which is necessary for obtaining protection when moveables are pledged; cf.

[3] See *Brækhus* op. cit. pp. 567–568.

the Mortgage and Liens Act (MA) of 8 February 1980, no. 2, section 3-2, cf. section 4-1.[4] [5]

The requirement that there must be a natural connection between possession and claim secured may give rise to difficult questions of delimitation. However, in the present context it is sufficient to state that the core of the concept refers to claims for finishing work, repairs, maintenance etc. – in short, services to the object that increase or preserve its value. The services rendered by FF clearly fall within this category.[6] The negative is that the right of retention cannot be exercised in respect of object x when the claim has no 'natural connection' to x, typically a claim for services rendered to the same person but in respect of different objects (in our context: different lots of cargo).

It would seem reasonable that when the object is divisible, the creditor has to limit his right of retention to what is considered sufficient to cover the claim, and, closely related to this, the creditor should be obliged to release the object against e.g. a bank guarantee. There are, however, no authoritative decisions on these two points.[7]

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[4] The terminology is difficult. The Norwegian word 'pant' covers all types of charges on real property, chattels, monetary claims etc., based upon contract, enforcement (execution) orders or directly on formal law – provided that there is a right of realization. In this article *mortgage* is reserved for the contractual charge on real property (with the anomaly that 'panteloven' is translated as the Mortgage Act), and *pledge* is used for charges on chattels, including a stock of wares/goods (a *universitas rerum*). Finally, charges created by the enforcement authorities are called *execution liens*.

[5] In ND 1995, p. 299 et seq. (Eidsivating Court of Appeal), the cargo owner to some extent had uncontrolled access to the goods. With such an arrangement a security in the goods could not have been accepted in a conflict, say, with the bankruptcy estate of the cargo owner, but was accepted here as the issue before the Court was between the retainer and the cargo owner (on the extent of the right of retention, see below).

[6] Of course, one may imagine exceptions; the transportation from A to B s (or proves to be) senseless as the value of the goods is less at B than at A, etc. Such cases are outside the scope of this article.

[7] See *Brækhus*, op. cit., pp. 577–588. However, in ND 1995, p. 299 et seq., the Eidsivating Court of Appeal stated that 'it is commonly accepted that there is a requirement of proportionality in retention relationships'.

Finally, it should be noted that the right of retention is a defensive right; it does not give the creditor the right to sell the object, as the pledge does. However, the right of retention has an important potential: When the creditor has obtained 'an enforcement ground'[8] for his claim, he can demand an execution lien, and thus be entitled to have an execution lien on the object retained, with the same priority as the retention claim.[9] Furthermore, it should be noted that some of the special enactments give the creditor a right to sell according to rules outside those contained in CoE, thus blurring the distinction between retention and pledge.

## 3.2 Special enactments of relevance for FF

### 3.2.1 General remarks

There are no enactments specifically dealing with FF's right of retention – be it as an intermediary or one acting 'on his own account', but we have several stipulations that are of relevance also for FF. These will be briefly examined in the following, first with a view to FF when he is acting 'on his own account'. This means an outline of rules pertaining to the different branches of transport law, with the main emphasis on sea carriage.

### 3.2.2 Carriage by sea

When FF has given a promise of transportation by sea 'on his own account', he has assumed responsibility as a carrier, and to simplify matters, we say that the transportation falls within MC, chap. 13 (carriage of goods as opposed to carriage under a charterparty). In most instances FF will leave the actual carriage to a third party (with whom FF has a contract). Thus, the customer has FF as a

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8 See Code of Enforcement of Claims (CoE) of 26 June 1992, no. 86, sect. 4-1, listing in subsect. (2) the types of enforcement grounds, the first being a judgment by a Norwegian court ordering payment.

9 Rt. 1923 I, p. 113 et seq.

contracting carrier with liability defined in MC, sect. 285, and, in addition, a performing carrier with liability as spelled out in MC, sect. 286. The picture becomes more complicated if a bill of lading is issued by the performing carrier and given or transferred to someone other than the customer of FF.

What is then the security position of FF?

For the sake of simplicity we will assume that the transportation is fulfilled as anticipated, and we will consider two elements only: (i) The freight, which is typically either prepaid or collect, and (ii) the outlays, e.g. those which the FF has had in connection with the customs clearance of the goods at the port of discharge.

In MC, sect. 270, cf. sects. 271 and 272, there are rules on retention that may be applicable. MC, sect. 270, covers two types of claims.

The first encompasses the claims for which the receiver becomes liable on receipt of the goods, as regulated in sect. 269. The main rule in sect. 269 is that the receiver is

> 'liable to pay freight and other claims according to the contract of carriage if the receiver had notice of the claims at the time of delivery [to the receiver] or was aware or ought to have been aware that the carrier had not received payment' (subsect 2).

When a bill of lading has been issued, the receiver's obligation is more limited; he becomes liable for 'freight and other claims due to the carrier pursuant to the bill of lading'.

The second type includes 'other claims secured by a maritime lien on the goods pursuant to sect. 61'.

The right of retention in respect of these claims is combined with important additional effects as per sects. 271 and 272, in short, the carrier may, if necessary, store the goods ashore and eventually sell them in order to have his claim covered, without e.g. previous clearance from any public authority.[10]

[10] In particular, it should be noted that the rules on maritime lien in this way is supplemented by practical rules on realization – outside the scope of CoE.

From our perspective this means that the customer's debt position is transferred to the receiver, who normally is not the customer. And against the receiver FF has a right of retention. It should be added that the customer is not necessarily relieved of all liability, cf. sect. 273 stating that the shipper, with some modifications, remains liable – and the customer is ordinarily the shipper.

### 3.2.3 Road carriage

Section 20 of the Act on Road Carriage Agreements of 28 June 1974, no. 68 – based upon the CMR Convention – lays down rules regarding the receiver demanding delivery of the cargo at the place of destination. When doing so he becomes obliged to pay 'the amounts due according to the transport agreement', and the carrier is not obliged to give delivery unless the amounts are being paid – however, with the qualification that delivery can be demanded against security. The right of retention is combined with a right, if necessary, to sell the goods in such a manner that due consideration is given to the interests of all parties (sect. 26).[11]

### 3.2.4 Air carriage

The Aviation Act of 11 June 1993, no. 101, sects. 10-13, also gives the carrier a right of retention for amounts due at the time of delivery.

### 3.2.5 Rail carriage

International transport is regulated under the Act relating to International Rail Traffic of 10 December 2004, no. 82, incorporating int .al. the CIM convention. Art. 17 of CIM gives the carrier a right of retention to secure payment of the amounts that the receiver according to the transport agreement shall pay. In national traffic there is freedom of contract. In the standard terms used by CargoNet[12] there are far-reaching retention clauses:

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[11] See *H.J. Bull*, Innføring i veifraktrett (2nd ed. 2000), p. 59.

[12] CargoNet is a partially owned subsidiary of state-owned NSAB AS.

> '7.4. CN has the right to retain goods and load carriers that are in CN's possession, in part for all the expenses resting on the goods and load carrier – freight and storage costs included – and in part for CN's total other claims on the Customer that concern jobs performed according to the CN terms and conditions – freight and storage costs included.
>
> 7.5. Even if CN has granted the customer a postponement of payment, CN preserves the right of lien … .'

### 3.2.6 General promise of transportation

Very often the choice of transport mode is left to FF. His promise is to transport the goods to the place of destination, in the manner which he finds most advantageous. In such circumstances, the right of retention would, it may be argued, depend upon the general rules, see 3.1 above. The alternative is that the rules of retention are decided according to the actual mode of transport chosen: If FF has chosen sea transport, he is entitled to rely upon MC, sects. 270-272. This would imply that he may be entitled to sell the goods, whereas such measures are outside the compass of the general rules.

In my view, FF is entitled to exercise retention in accordance with the rules most advantageous to him. The customer has accepted that FF has wide options regarding mode of transport, and it should not come as a surprise that e.g. seaborne transport is preferred. In such a case, the liability regime in MC, chap. 13, is applicable (see also NSAB § 23), including the retention stipulations in sects. 270-272. The choice of transport mode and its effects may only in quite extraordinary circumstances be considered unfair or illegitimate. Furthermore, I cannot see that this freedom on the part of FF, with the indicated consequences, produces results that are unacceptable or unfair to other parties with interest in the goods.

### 3.2.7 The right of retention when FF is an intermediary

When FF is a true intermediary, he will not have possession of the goods, and consequently the question of retention does not arise.[13] One may, however, envisage a storage period prior to shipment, with FF as storage keeper. If the remuneration connected with the actual transportation is payable before transportation begins, then FF may have a right of retention.

### 3.2.8 Are there mandatory transport rules prohibiting an agreement of the type found in NSAB § 14?

We have seen that FF's right of retention according to NSAB § 14 is in conformity with the rights deriving from transportation law as long as there is connectivity between claim and possession. This legislation is in many respects mandatory, giving the cargo interests a minimum protection, and, consequently, the question arises whether the extended right derived from § 14 is invalid.[14]

The mandatory nature of maritime transport rules, to the benefit of the cargo owner, is laid down in MC, sect. 254. Here it is sufficient to observe that the protection does not include the retention rules in sects. 269-270. In other words, MC does not appear to bar the extended right of FF, but the bill of lading rules may do so: The holder of such document is, as explained above, entitled to get possession against paying 'freight and other claims due to the carrier pursuant to the bill of lading'. Similar considerations are applicable regarding other modes of transport, also here with reservations because of the transport documents used.[15] However, the Act relating to Road Carriage Agreements, sect. 5, subsect. (2), calls for some additional remarks. The subsection does not permit devia-

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[13] However, FF may have constructive possession, e.g. when he is in possession of bills of lading.

[14] This question is discussed by *Jensen*, op. cit., pp. 36–41.

[15] See e.g. *Ramberg*, Spedition och fraktavtal (Stockholm 1983), pp. 166–167, with further references. He argues, though, that this restriction flowing from the nature of the transport documents is not applicable as regards the sender.

tion from the rules of the act to the detriment of the sender or receiver. Clearly, the extended right cannot be invoked against a receiver who is not the sender, and presumably the same is true when the receiver is also the sender.[16]

# 4 Generally on the possibility to obtain security by way of contract

## 4.1 The problem

The right of retention, outlined in Chapter 3 above, is characterized by the connection factor: The claims connected with the goods that FF may wish to withhold are protected. Still, we have seen that exercising this type of retention may cause some problems in practical life – e.g. presentation of the full claim, duly documented, may take some time, and in the meantime the receiver does not get his goods, and the carrier may have problems with storing the goods. The ideal solution seems to be that where the parties have a continuing relationship, FF has security in the goods which at a given time are in his possession. The Norwegian terminology often used is 'koblet panterett' – i.e. 'coupled pledge' – indicating that the clause purporting to establish such a right couples a security object to claims adhering to another one. In the absence of a better expression we will use the term coupled security (or, as the case may be, coupled pledge or coupled right of retention) for the indicated agreement.

There appears to be two possibilities for obtaining such security regarding non-connected claims: either a contractual pledge or a contractual right of retention. Here we see two principles of importance for a contractual arrangement:

[16] Cf. *Jensen*, op. cit., p. 37–38; he accepts an exception in the case where the sender takes the goods because the receiver does not receive.

(i) MC sect. 1-2, subsect. (2), states that a contractual lien (including a pledge on moveables) can be created only with authority 'in this act or other enactment' (often called the legality principle of the act of mortgages and pledges).

(ii) CoE, sect. 1-3, subsect. (2), states that an agreement to the effect that enforcement may be carried out otherwise than by the assistance of the enforcement authorities is, in principle,[17] not valid when it is concluded prior to a default situation.

Both principles require some remarks.

## 4.2 The legality principle

This principle makes it necessary to consult the law book to ascertain whether there is a basis for accepting a coupled pledge.

MA sects. 3-1 and 3-2, regulating pledges on moveables, may appear as a natural starting point. Here one finds the basic rule that moveables can be pledged, with perfection obtained by transferring possession to the creditor (the pledgee) or to someone acting on behalf of the creditor.[18] So when the customer delivers the goods to FF, there is no problem with FF having a valid pledge.[19] The crucial question is whether he can have a pledge on future lots of goods delivered for transportation (a pledge on '*res futura*'). In many instances a security *in res futura* is accepted – a typical example is that the mortgage on an unbuilt piece of land will encompass the

[17] The Code accepts some exceptions, but they are irrelevant in the present context.

[18] In Norwegian, this type of pledge is called 'håndpant' – literally, hand pledge. The characteristic feature is that the creditor has the object 'in his hand', i.e. he has the physical control over the object.

[19] In most cases the customer is the owner of the goods, thus being entitled to pledge them. Subsequent transfer of ownership (e.g. by transferring the bill of lading) does not alter the position as the transferee takes the goods subject to the pledge (unless, in rare instances, the pledge is extinguished according to the rules on acquisition in good faith). It may, however, happen that ownership is transferred before transportation starts (e.g. Incoterms clause 'Ex works'), with an additional obligation on the seller to provide transportation. Depending upon the terms, it may be that the seller/customer is considered authorized to pledge the goods owned by the buyer.

buildings that the owner thereafter erects on the land. Another important example will be mentioned below. However, MA, sects. 3-1 and 3-2, do not permit such an arrangement.[20]

For a business enterprise the law accepts, in a number of instances, that the security object is a collection of moveables, as this collection is at any time ('*universitas rerum*'), without the transfer of possession (a so-called 'floating charge'), with protection obtained by registration in the Chattels Register.[21] A typical example is the business enterprise giving its stock of goods as security, cf. MA, sects. 3-11 to 3-13.[22] Like any other person, FF may, provided the customer is considered a business enterprise as defined in MA, sect. 3-5, have security in the form of a floating charge on the customer's stock of goods for any claim – the object being the total stock without possibility of limitation e.g. to goods in transport.

We must, therefore, conclude that a basis for a coupled pledge as envisaged in NSAB § 14 does not appear to exist.

## 4.3 Is the legality principle relevant in regard to rights of retention?

The borderline between pledge and retention is sometimes difficult, particularly so in instances where the right of retention has been 'refined' in statutory law, see e.g. MC, sects. 270-272. We can, however, state that neither the principle in MA, sect. 1-2, nor the *res futura* restriction has explicitly been extended to rights of

[20] On the question of security in the form of a mortgage or a pledge or an execution lien on *res futura*, see *Brækhus*, op. cit., pp. 233–234.

[21] This is an electronic register primarily used for the registration of charges (pledges) and liens on chattels and monetary claims – with procedural rules and rules on effect of registration to a great extent similar to those that apply to land registration, cf. Land Registration Act of 7 June 1935, no. 2, sect. 34.

[22] The charge encompasses all goods of the type defined in the law, regardless of where the goods are located geographically. Thus, goods in transit to or from the customer may fall within the charge, see e.g. *Skoghøy*, Panteloven (2nd ed. 2003), p. 301.

retention. The courts have, with important limitations, accepted – as will appear from the cases mentioned below – a right of retention, even of the coupled type. In this regard the pledge restrictions have been mentioned, but not decided upon.

### 4.4 The scope of CoE, sect. 1-3

Obviously, if one cannot agree on the realization of a pledge under other terms than those of CoE, the same restriction applies when the security is defined as a right of retention. By statute there may be exceptions, and once again MC provides a good example, see MC, sects. 270-272. In other words: To the extent that an agreed right of retention is accepted, be it for an identified cargo or future cargoes, a contractual right of sale outside the rules of CoE is not valid.

## 5 Security for FF in accordance with NSAB § 14

### 5.1 Introduction

Subsect. (1) of NSAB § 14 reads:

> 'The freight forwarder has a lien on the goods under his control for fees and expenses in respect of such goods – remuneration and warehousing charges included – as well as for all other amounts due from the customer under contracts according to § 2 above.'

Here we see the coupled security covering FF's claim for remuneration and all expenses, regardless of whether the claims originate from one or more contracts, the only qualification being that the contracts fall within the wide definition of § 2.[23] Thus, FF has secu-

[23] The reference to § 2 precludes FF from exercising the right of retention for claims not related to the goods, e.g. consultancy services of a general nature.

rity for claims arising from a contract entered into and performed in goods being transported according to a later concluded contract.

Subsect. (2) gives FF a security in substitutes for the goods, typically the amount recoverable under an insurance policy.[24] Subsect. (3) gives FF far-reaching rights, if need be, to sell the goods. If the amount due is not paid to FF,

> 'he has the right to arrange the sale, in a satisfactory manner, of as much of the goods as is required to cover the total amount due to him, including expenses incurred.'

Some short remarks concerning subsect. (3) are deferred to 5.4 below. In the following we will primarily discuss subsect. (1). With regard to connected claims it does not add anything to what follows from the general principles examined in Chapter 3 above. It should be noted that there is no provision on releasing the cargo against a guarantee. Furthermore, it may be queried whether the right of retention, where the cargo is 'divisible', is limited to what is sufficient to cover the actual claim, cf. the express stipulation in this regard when it comes to the realization phase.[25] Consequently, our topic is to ascertain to what extent *the coupled right* of retention is valid. As between the parties the agreement is clearly valid (provided, of course, that the ordinary rules on concluding contracts are complied with). The issue is whether the interests of other parties may set limits which cannot be transgressed. This requires an examination of case law with a view to:

(i) the interest of others with contractual rights. We shall limit this discussion to the seller with a charge on the goods to secure his claim for the purchase price, and, primarily, the creditor with a floating charge on the stock of goods, and

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[24] The Act relating to Insurance Contracts of 16 June 1989, no. 69, sect. 7-1 lays down rules on the automatic cover of security rights in insured chattels; but these rules do not protect FF, int. al. because his right is not registered.

[25] On this issue, see *Brækhus*, op. cit., pp. 577–578.

(ii) the interest of the unsecured creditor and the bankruptcy estate of the owner of the goods.

## 5.2 The case law

Before we try to draw some conclusions on the status of § 14, subsect. (1), regarding the coupled right, there are four decisions of the Supreme Court that deserve mention.

*a. Rt. 1973, p. 967 et seq. (The caravans):*

When the customer went bankrupt FF had in his transit warehouse 24 caravans belonging to the customer. It was common ground that the right of retention was valid for claims relating to these caravans. The issue was whether the right of retention could be exercised as against the bankruptcy estate for claims related to previously warehoused and released caravans, or whether the claims should be regarded as ordinary unprotected claims in bankruptcy.

The Court found that a previous version of NSAB with a clause corresponding to the present § 14 was part of the agreement, even if there was no express reference to it:

> '… when there is – as in the present case – an established trade custom (Norw.: 'innarbeidede bransjeregler'), and these rules neither are unusual nor unreasonable – which I find that
>
> the rules of the Freight Forwarders' Association cannot be regarded as – the contract must, in the absence of other regulation, be deemed to be concluded on the basis of the custom of the trade' (p. 971).

The coupled right in these rules were accepted, with reference to current practice in the freight forwarding business:

> '… the usual requirement of connectivity – the relationship between possession and claim – is not a hindrance for a right of retention in a situation such as the present one. I mention that there was a contractual relationship where the warehouse holder, precisely in the interests of the owner of the goods, arranged customs and duties clearance, so that the owner of the goods could, according to his requirements, take out the caravans he needed at any given time, without having to settle the customs duty or other dues and disbursements' (p. 971).

It should also be mentioned that support for the extended right was found in the Commission Act of 30 June 1916 no. 1, sect. 31, cf. sect. 32, giving, said the Court

> 'the commission agent selling the goods a charge on goods received for sale, also for claims originating from other commission contracts for the principal, provided that the principal is a business man and the contract falls within the scope of his business activity. Freight forwarding concerns an intermediary relationship that in many respects has significant similarities with that of a commission' (p. 971).

*b. Rt. 1985, p. 298 et seq. (the semi-trailer):*

A semi-trailer, to be used in regular traffic between Norway and Scotland, was acquired with the seller's retention of ownership until the purchase price was paid in full.[26] When the owner got into economic difficulties, FF claimed – based upon a similar document as the one mentioned in the case above – the right to withhold the trailer for amounts related to previous transport. He did not succeed:

[26] This type of security (comp. 'hire-purchase arrangements') was redefined in MA, sect. 3-14 as a 'seller's lien'; such a lien is an exception to the general 'hand pledge' rule (see note 18), according to which realization based upon the rules of CoE requires that the debtor gives up possession. This change of terminology is without consequence for the material importance of the 1985 decision.

> '… I can see no reason for letting the freight forwarder's security right concerning previous transport have priority over this seller's lien. A right of retention may have priority over other rights in the object where the retainer has done something to increase or protect the value of the object, but views of this type are not, as I see it, applicable in the present case' (p. 302).

A further question was whether the seller's lien was extinguished by FF, based upon the rules of acquisition in good faith (i.e. without knowledge of the lien); see Act relating to Acquisition of Moveables in Good Faith of 2 June 1978, no. 37. Ownership or a pledge in accordance with MA may be extinguished, but the Court refused to extend the extinction principle to a contractual right of retention in the present conflict.

*c. Rt. 1995, p. 990 et seq. (frozen fish manufacturer's right of retention v. floating charge)*

The case does not involve a FF, but is nevertheless of relevance. The owner of frozen fish had a contract with A that A should cut and pack the fish; the work of A increased the value by about 40 percent. The bank had a floating charge on the stock of wares (the frozen fish) – see 4.2 above on MA, sects. 3-11 to 3-14. When the owner went bankrupt, the stock of wares was abandoned to the bank. The issue was whether A's right of retention, not based on a specific agreement but on general principles, covered claims related to processed and delivered fish, with priority before the older rights of the bank. A argued for the extended right, referring int. al. to Rt. 1973, p. 967 et seq., but the judge speaking for the Court stated that there are strong counter-arguments in regard to older rights:

> 'In this respect great weight must be attributed to the consideration of clarity and safety in credit relationships.

> As explained by the Court of First Instance and the Court of Appeal, the right of retention is not regulated by formal law, except for some special provisions that are not applicable here.
>
> Amongst the court decisions the judgments in Rt. 1973, p. 967 et seq., and Rt. 1985, p. 298 et seq., both regarding cargo forwarding, have in particular been discussed before this Court. I mention that the 1973 judgment, where an extended right of retention was accepted, has been criticized by Brækhus in [op. cit., p. 593].[27] Otherwise, legal theory does not, as I see it, give an unequivocal contribution …
>
> … In a conflict between two rights regarding the same object, the rule is that the one with prior perfection prevails. There is an exception when a right of retention is claimed for added value to the object. The reason for this is that there is an added value due to the efforts of the retainer, which a holder of an older right has no reasonable ground to benefit from. Beyond this, case law does not provide arguments for deviating from the main rule' (pp. 994-995).

*d. Rt. 2008, p. 920 et seq. (retention v. floating charge)*

When the customer went bankrupt he had eight lots of goods in transport under a contract with FF, based upon NSAB 2000. FF claimed a right of retention also in respect of previous, non-paid transport, but the bank, having an older floating charge on the customer's stock of goods, protested – and won.

Obviously, Rt. 1973, p. 967 et seq., was of central importance in the pleadings before the Court. The judge, speaking for a unanimous Court, said, however:

> 'In that case the bankruptcy estate was in no other position than the debtor himself. Thus, the judgment does not give any guidance in regard to third party conflicts between several rights based upon contract or customary law' (sect. 32).

[27] His view is, primarily, that the court did not pay sufficient regard to the interest of the other creditors, see below.

He found some support in Rt. 1985, p. 298 et seq., and Rt. 1995, p. 990 et seq., and then he said:

> 'According to the Mortgage Act, sect. 1-2 subsect. (2), a contractual mortgage/pledge can be created only when this is allowed under the Mortgage Act or other legislation. The right of retention is based upon general and non-statutory customary law, which does not require authority in law, cf. Skoghøy, Panterett, 2008, p. 316. In the decision of the Supreme Court in Rt. 1973, p. 967 et seq., a coupled right of retention is accepted in relation to the bankruptcy estate of the customer, but this does not automatically imply, according to my view, that the same should be accepted in general as towards third parties. As emphasized in Rt. 1995, p. 990 et seq., there are strong arguments "against accepting such a point of view as towards holders of older rights. In this respect great weight must be attributed to the consideration of clarity and safety in credit relationships." In the same judgment, NSAB 2000 § 14 is characterized as a combined retention and pledge right. Without a further discussion of the limits of the Mortgage Act, sect. 1-2, subsect. (2), in relation to a coupled right of retention, it is, as I see it, clear that this stipulation strongly supports the view that a coupled right of retention cannot have protection against a third party. In reality, a coupled right of retention means security in a variable collection of goods (a *universitas rerum*) in a way which is in conflict with the rules applying to the creation of such charges, e.g. a charge on the stock of goods' (sect. 37).

## 5.3 The conclusions to be drawn from case law

The decisions of 1985, 1995 and 2008 clearly indicate that an extended right of retention (a coupled right of retention) based upon contract is not easily accepted when such a right is to the detriment of third parties. This begs certain questions: What is the law in other configurations than those directly dealt with in these cases? And, not least, to what extent is the 1973 decision still good law? In the following discussion we will divide the third party group in three: (i) those with contractual rights, (ii) the unsecured

creditors, who eventually may obtain an execution lien on the object, and (iii) the bankruptcy estate.

For the first group we have the decision of 1985, holding that § 14 does not affect the seller's lien. Then we have the 2008 decision, drawing the lines from the 1985 and 1995 decisions and giving the clear answer that a coupled right cannot be asserted against a holder of a previously established floating charge which is protected by registration in the Chattels Register.[28] But what is the position when the floating charge is created *after* a contract with reference to NSAB? In 2009, for example, an agreement is concluded between the customer and FF, covering transportation in 2010. Shortly afterwards the customer agrees that the bank shall have a floating charge on his stock of goods, and this agreement is duly registered.[29] At the end of 2010, FF has an accumulated claim of 100, whereof 10 are connected with the consignment then in his possession, a consignment with a value of 90. Clearly, FF has priority for the first 10. The further distribution of the value raises the question of whether the agreement on an extended right is in principle valid and, if so, whether the bank has the possibility of pleading extinction in good faith.

We are here on the borderline to pledges. This implies that one should not without due consideration accept an extension of the right of retention based upon case law.[30] One should also have in mind that if an extended right is accepted, it is difficult to see that the principle can be limited to freight forwarding, cf. Rt. 2008, p. 920 et seq., where the argument that there are special circumstances in this trade requiring special rules was rejected (sect. 39).[31] If the

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28 See MA, sect. 3–12. About the Register, see footnote 19.

29 It may be said that the customer should have informed the bank of the agreement with FF. This aspect will not be developed here, but reference is made to Rt. 1994, p. 775 et seq.

30 Cf. Rt. 2008, p. 1090 et seq. at sect. 37.

31 It is noteworthy that in Rt. 1973, p. 967 et seq., the Court refused to consider whether there is a general rule on extended right of retention similar to the one that the Court accepted for freight forwarding (p. 971).

extended principle is accepted – which I do not think it should – the registration of, say, a floating charge in favour of a bank will have no extinctive effect. Extinction according to the Act relating to Acquisition of Moveables in Good Faith presupposes that the bank gets the possession of the goods, which is not the case here, and registration in the Chattels Register (cf. MA, sect. 3-12) has no extinctive effect in regard to those with rights based upon contract.[32] There is, however, an exception: The holder of the floating charge has to accept a seller's lien on goods acquired after the creation of the floating charge, see MA, sect. 3-11, subsect. (5), with reference to sect. 3-4, subsect. (3). This right, based upon contract, is regulated by law, see MA sects. 3-14 to 3-22, and gives no argument for upholding an extended right according to NSAB § 14.

We now turn to the second group: the originally unsecured creditor who eventually gets an execution lien on the goods. In the same way as the bank with a floating charge, the holder of the execution lien has to accept the right of retention in respect of FF's claims related exclusively to the goods in FF's possession. If FF loses as against the bank regarding the extended retention right (see above), there is, in my view, no grounds for another result in the conflict between FF and the holder of the lien. Should one hold otherwise, there is, of course, no question here of extinction in good faith for the lien creditor.

Finally, we have FF's position vis-à-vis the bankruptcy estate. Apparently there are no difficulties here: The 1973 decision gave priority to FF, and in the 2008 decision the 1973 decision was referred to in the following way:

> 'In that case the bankruptcy estate was in no other position than the debtor himself. Thus, the judgment does not give any guidance in regard to third party conflicts between several rights based upon contract or customary law' (sect. 32).

[32] See e.g. *Skoghøy*, Panteloven (2nd ed. 2003), p. 306.

Further it was stated that the acceptance of

> 'a coupled right of retention in relation to the bankruptcy estate of the customer … does not automatically imply, according to my view, that the same should be accepted in general as towards third parties' (sect. 37).

Clearly, the Supreme Court is hereby limiting the effects of the 1973 decision, without saying that the rule laid down in 1973 is unfortunate or weakly based. There is no reference to what the Court found in 1973 concerning the custom in the trade and the regard paid thereto:

> '… I find that in the freight forwarding business one generally is practicing, and in more than 50 years have practiced, that in a case as the present there exists an extended security right for the freight forwarder' (Rt. 1973, p. 971).

Also, it should be noted that the interest of the parties in having a practical arrangement,[33] which apparently was given great weight in 1973, is not mentioned in 2008. Further, while the Court in 1973 found support in the Act relating to Commission, sect. 32, arguments based upon this act were rejected in 2008:

> 'I cannot see that the rules in the Act relating to Commission, sect. 32, cf. sect. 31, on pledge security for the selling agent have anything to contribute to the decision in the present case, as the two situations differ too much' (sect. 38).

The 1973 decision is explained or distinguished by the statement that 'the bankruptcy estate was in no other position than the debtor himself'. This is a somewhat surprising statement. As between the parties – here: FF and the customer – there may be a valid agree-

[33] Cf. *Brækhus*, op. cit., p. 593: '… seemingly the 1973 decision is a result of concrete considerations as to what is reasonable, not of what follows from general principles'.

ment outside the scope of MA.[34] But, clearly, the bankruptcy estate is bound only by agreements falling within and having acquired protection (through registration or similar measures) prior to the declaration of bankruptcy. As concluded above, the extended right in NSAB § 14, when considered as a pledge, is outside MA. If the right is accepted purely as a right of retention, the objections derived from MA do not apply *directly*. It is, however, strongly indicated in the 2008 decision that MA, sect. 1-2, subsect. (2), 'supports the view that a coupled right of retention cannot have protection against a third party'.[35] It is not obvious that the bankruptcy estate falls outside this 'third party' category. My conclusion is that the 1973 decision ought not to be followed, even at the cost of setting aside a unanimous Supreme Court decision which has laid out the law for nearly 40 years. But the scope of the decision has been cut down to such an extent that setting aside the remainder is not a dramatic event.

## 5.4 FF's right to sell the goods

NSAB § 14 entitles FF to sell the goods, in his discretion. There is no external controlling party. Thus, FF decides what his claim amounts to and the manner and extent of the sale – of course with the possibility that his decisions later on are challenged in court by the customer. On this right it is sufficient to refer to 4.4 above, adding only that there is no indication in case law – related directly to freight forwarding or sectors of possible relevance for freight forwarding – that the contractual right to sell as in NSAB § 14 is supported by practice and/or other arguments of such strength that the purported right will be accepted by the courts.

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[34] Cf. the discussion on the validity of agreements on pledges where the pledgor retains possession; see e.g. *Brækhus*, op. cit., p. 29 and *Skoghøy*, op.cit., p. 58.

[35] It should be pointed out that in 1973 there was no similar formal law statement as MA § 1-2 subsect. 2 and probably no clear unwritten law to the same effect.

# Implementing Conventions – Scandinavian Style

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# Content

# 1 The problem

In the Scandinavian States (with some exceptions for Iceland), maritime law is codified in Maritime Codes with a similar structure and very similar wording. The Codes include a chapter on carriage of goods, which implements the Hague-Visby Rules and also includes a number of other provisions.[1]

If carriage of goods conventions – and I particularly think of the Rotterdam Rules – are to be implemented in the Scandinavian States, this will obviously have some impact on the carriage of goods chapter of the Maritime Codes. But how? Should, *e.g.*, the tradition of implementing by writing (transcribing) the tenor of the conventions into the Maritime Codes be upheld, or should the Rules be incorporated into Norwegian Law *en bloc*, as is common in many other States?

In the following, I will use Norwegian law as my point of reference in Scandinavia.

# 2 The need for implementation

There are mainly two reasons why implementation measures are necessary in Norway: The dualistic system of law and the need for translation.

## 2.1 Dualism

In Norway there is a dualistic system of law.[2] This means that the Parliament must be involved if a Convention shall be given the force

[1] A translation of the Norwegian Maritime Code is available at <http://folk.uio.no/erikro/WWW/NMC.pdf>.

[2] See NOU 1972: 16 'Gjennomføring av konvensjoner i norsk rett' (Oslo 1972) p. 32 *et seq*.

of law in the sense that the courts must abide by it, regardless of whether or not the Minister of Foreign Affairs has the constitutional power[3] (or apparent power[4]) to commit Norway under international law. This means that the Parliament must be involved whenever a carriage of goods convention shall enter into force for Norway.

States – perhaps in particular those with a monistic system – may attribute a higher rank to conventions in legal argument than to national laws.[5] This is not so in Norway, not even if the convention is incorporated *en bloc* into national law. Another matter is that the courts tend to interpret national law – whether in the form of an incorporated convention or a transcription of it – as much as possible in harmony with the international law to which Norway as a State is bound.[6]

## 2.2 Translation

It is inconceivable that the Rotterdam Rules can be made Norwegian law without translation: By custom, Norwegian acts must be in one of the official Norwegian languages, and the official Norwegian languages do not include any of the official UN languages, in which the Rotterdam Rules authenticated texts are written.[7]

The translation will unavoidably cause some nuances to be adjusted. In principle, this is not much different from the United Kingdom choosing one of the texts that are equally authentic – namely, of course, the English – when implementing these types of conventions, disregarding the other authentic texts.[8] Most likely,

3 Constitution of the Kingdom of Norway, 1814, Sect. 26.

4 Vienna Convention on the Law of Treaties, 1969, Art. 46.

5 See, *e.g.*, Arts. 95–96 of the Spanish Constitution (which have been pointed out to me by Terese Hallén: Third parties' right to compensation for oil pollution damage caused by ships (Oslo 2009), <http://www.duo.uio.no/publ/jus/2009/92463/92463.pdf>) p. 34.

6 Eckhoff/Helgesen*: Rettskildelære* (5th ed., Oslo 2001, p. 286 *et seq.*).

7 Arabic, Chinese, English, French, Russian and Spanish.

8 UK Carriage of Goods by Sea Act, 1971, 1971 Ch. 19.

the other authentic texts could have added some valuable insights into the true construction of the convention.

A particularly important part of the translation concerns terminology. Obviously, terminology is very similar in maritime law across jurisdictions. However, there may be variations, so special care must be taken to find the right terminology in the translation. Old doctrine tends to survive if the same terminology is used, and one must make sure this is not inadvertent. Moreover, the terminology may reflect an understanding of the law or of facts that may differ from that of the new Convention.

An example is the term shipper. Both in the Rotterdam Rules and in the Hague-Visby Rules this is defined as the one that enters into a contract with the carrier (that is, a contractual term),[9] and not as the person who brings the cargo to the ship (that is, a logistical term). This means that it must be translated by the term 'sender' as defined in the Norwegian Maritime Code rather than by the more common translation 'avlaster', which is defined as a term of logistics.[10]

# 3 The implementation methods

In the process of incorporating the Convention into Norwegian law, one can do more or less. The following four issues are core issues in this respect.

## 3.1 Transcription

In Scandinavia, the texts of carriage of goods conventions have usually been rewritten quite extensively in the process of incorporating them into the national Codes, far more than necessary for

9 Rotterdam Rules, 2009, Art. 1(8).

10 Norwegian Maritime Code, 1994, Sect. 251.

translation purposes. An example is the main provisions on the basis of liability for cargo damage in the Hague-Visby Rules: [11]

| *Convention* | *Norwegian Maritime Code* |
|---|---|
| **Article IV**<br>**Rights and Immunities**<br>**1.** Neither the carrier nor the ship shall be liable for loss or damage arising or resulting from unseaworthiness unless caused by want of due diligence on the part of the carrier to make the ship seaworthy, and to secure that the ship is properly manned, equipped and supplied, and to make the holds, refrigerating and cool chambers and all other parts of the ship in which goods are carried fit and safe for their reception, carriage and preservation in accordance with the provisions of paragraph 1 of Article III.<br><br>Whenever loss or damage has resulted from unseaworthiness, the burden of proving the exercise of due diligence shall be on the carrier or other person claiming exemption under this article. | **Section 275 Liability for Cargo Damage**<br>The carrier is liable for losses resulting from the goods being lost of or damaged while in his or her custody on board or ashore, unless the carrier shows that the loss was not due to his or her personal fault or neglect or that of anyone for whom he or she is responsible.<br><br>The carrier is not liable for losses resulting from measures to rescue persons or reasonable measures to salvage ships or other property at sea.<br><br>When fault or neglect on the part of the carrier combines with another cause to produce losses, the carrier is only liable to the extent that the loss is attributable to such fault or neglect. It is for the carrier to prove to what extent the loss was not caused by fault or neglect on his or her part. |

[11] Some provisions, such as the definition of the carrier's duty to keep the vessel seaworthy, are omitted in the excerpt from the Norwegian Code. The rewriting of this provision is also commented below (section 4.3).

| *Convention* | *Norwegian Maritime Code* |
|---|---|
| **2.** Neither the carrier nor the ship shall be responsible for loss or damage arising or resulting from<br>(a) act, neglect, or default of the master, mariner, pilot or the servants of the carrier in the navigation or in the management of the ship;<br>(b) fire, unless caused by the actual fault or privity of the carrier;<br>(c) perils, dangers and accidents of the sea or other navigable waters;<br>(d) act of God;<br>(e) act of war;<br>(f) act of public enemies;<br>(g) arrest or restraint of princes, rulers or people, or seizure under legal process;<br>(h) quarantine restrictions;<br>(i) act or omission of the shipper or owner of the goods, his agent or representative;<br>(j) strikes or lock-outs or stoppage or restraint of labour from whatever cause, whether partial or general;<br>(k) riots and civil commotions;<br>(l) saving or attempting to save life or property at sea;<br>(m) wastage in bulk or weight or any other loss or damage arising from inherent defect, quality or vice of the goods;<br>(n) insufficiency of packing;<br>(o) insufficiency or inadequacy of marks;<br>(p) latent defects not discoverable by due diligence; | **Section 276 Loss Due to Nautical Fault and Fire** The carrier shall not be liable if he or she can show that the loss resulted from:<br><br>1) fault or neglect in the navigation or management of the ship, on the part of the master, crew, pilot or tug or others performing work in the service of the ship, or<br>2) fire not caused by the fault or neglect of the carrier personally.<br><br>The carrier shall nevertheless be liable for losses in consequence of unseaworthiness because the carrier personally or a person for whom the carrier is responsible failed to take proper care to make the ship seaworthy at the commencement of the voyage. The burden of proving that proper care was taken rests on the carrier.<br><br>The present Section shall not apply to contracts for carriage by sea in domestic trade in Norway. |

| *Convention* | *Norwegian Maritime Code* |
|---|---|
| (q) any other cause arising without the actual fault and privity of the carrier, or without the fault or neglect of the agents or servants of the carrier, but the burden of proof shall be on the person claiming the benefit of this exception to show that neither the actual fault or privity of the carrier nor the fault or neglect of the agents or servants of the carrier contributed to the loss or damage.<br><br>**3.** The shipper shall not be responsible for loss or damage sustained by the carrier or the ship arising or resulting from any cause without the act, fault or neglect of the shipper, his agents or his servants.<br><br>**4.** Any deviation in saving or attempting to save life or property at sea or any reasonable deviation shall not be deemed to be an infringement or breach of these Rules or of the contract of carriage, and the carrier shall not be liable for any loss or damage resulting therefrom. | |

The text may look better to the local eye in this way. But such transcription obviously enhances the risk of non-uniformity. If the wording is not identical in two texts, chances are that the construc-

tion of them will not yield the same result. There is a reason why one agrees on a wording, and not on a set of abstract ideas, to ensure uniformity.

T o a large extent, however, one can ascertain that the original and the transcribed text will yield the same results by testing them on a number of hypothetical cases. There is still no method to make sure that the results will be the same also in cases one has not considered.

This way of implementing makes it virtually impossible for other States Parties to ascertain whether or not the convention is properly implemented. It is, however, unheard of that a State Party should submit a diplomatic note to another, pointing out that the obligations under a convention of this type is not adhered to. However binding the convention is said to be, this is in the fringes of soft law.

Surprisingly, conventions like the Rotterdam Rules do not state exactly what the obligations of the States Parties are in respect of the text. Typically, there is a statement that the Parties have agreed on a text which does not deal with the obligations of States Parties, but the rights and obligations of private shipping parties.[12] The intention must be that the States Parties commit themselves to implement such rules. The way they implement them is for them to decide. Indeed, if their courts already have a rule in accordance with the convention, no implementation at all seems necessary.

The basic structure of the obligations under international law has been maintained even in the Rotterdam Rules, which form a quite extensive code. There would perhaps be reasons to require States Parties to implement the rules as such when there is a system of rules, and not only piecemeal rules as in the Hague Rules.

As it is more pragmatic, a transcription is likely to require more work than a mere translation, both for the draftsmen of the implementation legislation and for the commercial parties familiar with the convention who wish to provide orientation for the implemented version. It is an open question whether these extra efforts are worthwhile.

[12] The preamble of the Rotterdam Rules is a typical example.

## 3.2 National travaux préparatoires

A more significant problem in practice is, however, not the text itself, but rather the extensive use of national *travaux préparatoires*. Any legislation proposed to the Parliament is commented on in detail, and the Parliament itself also adds its own comments. One example is the clarification in the national *travaux préparatoires* of the provisions quoted in the table above (section 3.1) that when the shipowner himself is the master of a vessel (which is not unlikely in Scandinavian cabotage), his fault or neglect in the navigation or management of the ship shall be considered an error of the master rather than of the shipowner.

The courts tend to pay significant attention to such glosses.[13] Knowing this, legislators may legislate by means of the national *travaux préparatoires* rather than by the text of the enactment itself.

The importance of national *travaux préparatoires* cannot fully be appreciated unless one understands the role of the courts in commercial cases in Scandinavia. Unlike in England, courts do not take a leading role in the development of commercial law, and seem only too happy to adopt the analysis and find support for their conclusions in statements in the national *travaux préparatoires* or legal theory.[14] And the other way around, although court decisions obviously are referred to, it is rare that new concepts, new analysis or entirely new ideas emerge in the court system in commercial law. A very limited – if any – doctrine of *stare decisis* makes other arguments than court decisions attractive when available.

For the legislator, the question is whether incorporation rather than transcription of the Rotterdam Rules will limit his chances to comment on the rules. Usually, there are no or few comments to a convention incorporated *en bloc*. There are, however, some exceptions. If one would like, an incorporated convention could have as

[13] See above, footnote 6.

[14] Admittedly, this is my subjective view.

extensive national *travaux préparatoires* as one that is rewritten into the Maritime Code. Indeed, the possibility of making explanations in the comments and directing the judge in a specific direction may make the need to rewrite the provisions less pressing.

From another point of view, such authoritative comments are just as bad – if not worse – than a liberal rewriting. While the text of the enactment pays lip service to the convention, a judge will also look to the comments, and will most likely construe the words of the convention in that direction if at all possible. To me, an open rewriting of the text of the convention in one particular direction would be better if one cannot leave it as it is. (And if one cannot, then perhaps one should not ratify it.)

## 3.3 Clarification of intentional ambiguities

The instinct of the lawyer is to clarify ambiguities unless the ambiguity is intentional.[15] Should then the implementation process be used to clarify the text of conventions such as the Rotterdam Rules?

If the ambiguity is due to the draftsmen being unable to agree on a more precise text, I believe the ambiguity should be reproduced in the implementation legislation. It could be particularly tempting to clarify the text in these cases, especially if opinions have been very divided and (therefore) one of the constructions of the text is viewed as obviously right by the implementing State. But for uniformity, it would be a catastrophe if the different States opted for different constructions in their implementation legislation. It would be much better to leave the issue open, and thus open the way for a convergence in the courts of different States in the course of time.

An example is Article 17 of the Rotterdam Rules on carriers' liability. The starting point in this Article is that the carrier is liable for negligence with a reversed burden of proof. Then there is a catalogue of exceptions, introduced in this way:

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[15] If the ambiguity is unintentional or intended as an option for States Parties, see below in 4.1.

> '3. The carrier is also relieved of all or part of its liability pursuant to paragraph 1 of this article if, alternatively to proving the absence of fault as provided in paragraph 2 of this article, it proves that one or more of the following events or circumstances caused or contributed to the loss, damage, or delay:
> (a) Act of God;' *etc.*

How much of a contribution of the factors in the catalogue is necessary in order to relieve the carrier of liability? Apparently, one could not agree on this:

> 'Concern was raised that this second proposed redraft of paragraphs 14 (1) and (2) would allow the carrier to escape 'all or part of its liability' by proving that there was at least one cause, however incidental, of the loss, damage or delay that was not the fault of the carrier, even where the loss, damage or delay in its entirety would not have occurred without the carrier's fault. In response, there was support for the view that the provisions were to be interpreted as referring to causes that were legally significant, and that national courts could be relied upon to interpret the provisions in that fashion and to apportion liability for those legally significant events accordingly.'[16]

It is tempting, but in my view not advisable, to clarify this issue in the implementation legislation. However, it would be a bad harmonization strategy. If left to the courts, there would at least be a slight hope that consensus would emerge.

The quotation above refers to the courts, but later in the *travaux préparatoires* of the convention the issue has been said to refer to 'national law'.[17] National law could include implementation legisla-

[16] UNCITRAL Document A/CN.9/572 para. 32. The text was later modified without intending to alter the substance (UNCITRAL Documents A/CN.9/WG.III/WP.81 footnote 50 and A/CN.9/621 para 67). The reference to 'paragraphs 14 (1) and (2)' should obviously be to 'article 14, paragraphs (1) and (2).' Article 14 in the draft corresponds to Article 17 in the final text.

[17] UNCITRAL Document A/CN.9/621 para. 66.

tion. However, for the sake of harmonization, it would still not be advisable to clarify the matter in the implementation process.

In this example, the national positions are likely to have been influenced by court decisions on similar issues, in particular those relating to the Hague Visby Rules. In that case, it is likely that the national traditions will be upheld even without the intervention of the legislators. But there is also a chance that the courts look further than the national tradition.

## 3.4 Correction of errors

It seems unavoidable that some errors or even self-contradictory[18] statements occur when drafting a convention. In the implementation stages, alleged errors are likely to be pointed out. In particular when the text is rewritten and it is obvious what is intended, it is tempting not to reproduce the error, but to correct it.

If the error does no harm, it is perhaps better to leave it for the sake of uniformity, and perhaps comment on it in the *travaux préparatoires* of the implementation legislation. One example is the reference to Article 26 in Article 13 of the Rotterdam Rules:

> 'The carrier shall during the period of its responsibility as defined in article 12, and subject to article 26, properly and carefully receive, load, handle, stow, carry, keep, care for, unload and deliver the goods.'

Article 26 is a reference to certain rules of unimodal liability regimes, *e.g.*, for road transport. It is not easy to see that these regimes would make the duty of care different from that prescribed by Article 13, or why a reference should be in place here, and not in all the other provisions departed from by Article 26. The *travaux préparatoires* of the convention offer no explanation. Most likely, it is a reference that must remain in the texts, but can be disregarded for all practical purposes.

[18] On external contradictions, see below in 4.4.

In some cases, the alleged error may be very significant. It may then be possible to clarify, if not rectify, any errors in the text and decide how to remedy them by raising the issue in a relevant international forum[19] or with the States Parties.[20] After a clarification of this kind the implementation legislation should correct the original text if it is not a mere translation.

In other cases, one should stick to the official text if at all possible in order to preserve uniformity and not make matters worse. It is easy to make a new mistake when attempting to correct the first one. Perhaps the text was not so meaningless after all, or there are other ways of understanding it.

This is well in line with the Vienna Convention, Article 32, which only allows recourse to secondary means of interpretation if the text itself

> '(a) leaves the meaning ambiguous or obscure; or
> (b) leads to a result which is manifestly absurd or unreasonable'

In other cases, one will have to take the text as it is. The point that an error has been identified can still be made before the courts if necessary, but the courts will be bound by the Vienna Convention as well.

One example is perhaps Article 19(1) of the Rotterdam Rules, on the liability of maritime performing parties:

> 'A maritime performing party is subject to the obligations and liabilities imposed on the carrier under this Convention and is entitled to the carrier's defences and limits of liability as provided for in this Convention if:
> (a) The maritime performing party received the goods for carriage in a Contracting State, or delivered them in a Contracting State, or performed its activities with respect to the goods in a port in a Contracting State; and

[19] See, *e.g.*, IMO Document LEG 74/13 para. 59 *et seq.*

[20] Vienna Convention on the Law of Treaties, 1969, Art. 31.

> (b) The occurrence that caused the loss, damage or delay took place: (i) during the period between the arrival of the goods at the port of loading of the ship and their departure from the port of discharge from the ship; (ii) while the maritime performing party had custody of the goods; or (iii) at any other time to the extent that it was participating in the performance of any of the activities contemplated by the contract of carriage.'

Arguably, it makes little sense that (b)(i)–(iii) are alternative conditions for the application of the rule. Instead (i) should be made the main rule and the provision should read:

> ' (b) The occurrence that caused the loss, damage or delay took place during the period between the arrival of the goods at the port of loading of the ship and their departure from the port of discharge from the ship; (i) while the maritime performing party had custody of the goods; or (ii) at any other time to the extent that it was participating in the performance of any of the activities contemplated by the contract of carriage.'

It is indeed somewhat strained to construe examples in which, *e.g.*, the maritime performing party does not have custody of the goods 'between the arrival of the goods at the port of loading of the ship and their departure from the port of discharge from the ship', as the maritime performing party typically is an agent in the ports.[21] (It may be that the maritime performing party takes care of the goods in a temporary storage outside the port.) However, the text is not meaningless, and must stand.

Because of this, the *travaux préparatoires* of the convention are irrelevant. In any event, they do not offer an explanation for the problem pointed out here. The authentic texts – as far as I can read them – all include the (i)–(iii) as in the English text.

Thus, the main view is that one should be very reluctant to correct errors. But if there is no other solution, a choice has to be

[21] See the definition in Art. 1(7) of the Rotterdam Rules.

made. This would be the case if the text as it stands is meaningless and impossible to translate, or there are differences between the authentic texts.

# 4 Added value

Different from correcting and construing a convention in the course of implementation is making use of the implementation process to place the text of the convention in a structured context and to supplement it. Here methods of and limits to such measures shall be discussed.

## 4.1 Points from the travaux préparatoires of the convention

One could think that one way of adding value in the implementation process is by incorporating points from the *travaux préparatoires* of the convention. In my view, this idea is misguided.

The starting point in international law as expressed in the Vienna Convention is that a convention, unlike a Scandinavian enactment, shall be construed on the basis of the text.[22] Secondary sources of interpretation, such as the *travaux préparatoires*, are irrelevant if the text is fairly clear.

[22] Vienna Convention on the Law of Treaties, 1969, Art. 32 (quoted above in 3.4). It is noticeable that the *travaux préparatoires* of the Hague Rules and Hague Visby Rules are sometimes referred to in the *travaux préparatoires* of the Rotterdam Rules, see, *i.a.*, UNCITRAL Document A/CN.9/WG.III/WP.21 para. 132. The fact that the draftsmen of the Rotterdam Rules seemingly value *travaux préparatoires* of conventions highly is no reason to depart from the starting point of the Vienna Convention. UNCITRAL Document A/CN.9/679 p. 2 *et seq.* discusses possible formats for official comments, but such comments will not be issued, see UNCITRAL Document A/64/17 para. 334.

The *travaux préparatoires* of the Rotterdam Rules sometimes give the States Parties certain licences. Then the idea would be to clarify that the Convention shall not be interpreted antithetically.

One example is the remark in the *travaux préparatoires* of the Rotterdam Rules that the omission of a rule/deletion of a draft rule allowing transport documents to include transport legs for which the issuer of the document does not undertake liability as a carrier shall not be construed to disallow such documents.[23]

The result is very clear: The States Parties are free to allow such documents, even by an express provision in their implementation legislation, but also to prohibit them. However, this would already follow from the general rule that the obligations of the States Parties are defined by the wording. As the wording of the Convention does not address whether such documents should be allowed or disallowed, the States Parties have not undertaken to resolve the matter in any particular way or abstained from resolving it.

In general, the relevance of the *travaux préparatoires* of carriage of goods conventions, both the negotiation history and the views expressed on how it should be construed, can easily be exaggerated. It is the text that is decisive.

## 4.2 Structure

It is perhaps fair to say that in the Scandinavian legal tradition, textual structure is valued quite highly. Indeed, the point of the Scandinavian Maritime Codes can be said to be to structure the issues more than to actually resolve them.

The Rotterdam Rules are a challenge in this respect. Even if the Rules have many traits of a codification, the structure seems somewhat arbitrary. Perhaps the time and vast cultural differences did not allow a thorough preparation in this respect.

[23] UNCITRAL Document A/63/17 p. 11.

One example is that the chapter on limitation is not placed in conjunction with the chapter on basis of liability.[24] Although the difference between the two themes is logically clear, it seems strange to separate them.

This is a point where the implementation process can be used to add value by cleaning up the structure (as seen from a Scandinavian perspective). One can simply rearrange the structure so that it appears better or at least more like what one is used to.

This can, of course, not be achieved by an *en bloc* incorporation of the Rotterdam Rules. But it can be achieved by an article-by-article incorporation into the Maritime Codes. In that way, one can also fit the provisions of the Rotterdam Rules into a structure that includes provisions on matters not covered by the Rotterdam Rules. One example is that the provision in the Rotterdam Rules on freight prepaid[25] can be put together with other clauses on freight.[26]

Arguably, such restructuring may conceal the original context of a provision and therefore make contextual construction difficult. However, it is hard to find examples of this kind of argument in this area of law. The method of interpretation has little practical relevance, however correct this point is in theory. Therefore, value can be added in the implementation process by restructuring the provisions of the Rotterdam Rules.

## 4.3 Simplicity and instructiveness

Another point that is often made in relation to implementation techniques is that this will make the text simpler. One example is the catalogue of the Hague-Visby Rules, where only items a), b) and q) (the general negligence rule and the rules on nautical error and fire; albeit with a special provision on salvage) were included in the implementation legislation.[27] The idea was that all the other items were

[24] Rotterdam Rules, Ch. 4 and 12, respectively.

[25] Rotterdam Rules, Art. 42.

[26] See, *i.a.*, Norwegian Maritime Code, Sects. 260, 265 and 269.

[27] For the text, see above in 3.1.

reflected in the general negligence rule. In the Rotterdam Rules, suggestions have been made to reduce the rather detailed provisions on changing burden of proof in Article 17 to a simple negligence rule.

It may be that the implementation legislation becomes simpler in this way. But when implementing the Convention in this way there is no way of knowing that it has been accurately reflected.[28] And as far as the simplicity and instructiveness are concerned, it is right that the Norwegian text will look more familiar to a Norwegian lawyer in this way. But in international matters – and shipping is obviously often international when the Rotterdam Rules apply – the differences between the Convention and the Norwegian implementation legislation will cause more confusion than clarification.

And even in purely Scandinavian relations, the parties are free to argue on the basis of the Convention rather than the implementation legislation; because the courts tend construe the implementation legislation in line with the international obligations to which Norway has committed itself.[29] This means that rather than simplifying, implementation legislation that does not follow the Convention closely in fact complicates matters, since one would have to study the implementation legislation in addition to the Convention and compare the two. And whatever instructive advantage a simplification of the text may have, the advantage is more than outweighed as one would nonetheless have to look into and understand the original Convention to get the full picture.

It may be that the idea of national law simplifying a convention and making the format similar to other national laws was a good idea when foreign sources of law, and indeed the text of the original convention, were not easily accessible. In those times, one could perhaps get away with a semi-implementation of the conventions for national purposes. No one would protest. But those days are forever gone, and simplistic national versions of the rules only complicate matters.

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28 This is the point above in 3.1.

29 See above, footnote 6.

## 4.4 Fringe provisions

The process of implementing conventions like the Rotterdam Rules always triggers issues of supplementary provisions. Obviously, such provisions cannot contradict the Convention. In this respect, there are three problem areas.

**First,** there is the meaning of the scope provisions of the convention. When the Rules state that they do not apply to charterparties, the best reading is perhaps that implementation legislation may extend the scope to such contracts; the Rules simply do not deal with this matter. On the other hand, when the Rules state that

> 'The period of responsibility of the carrier for the goods under this Convention begins when the carrier or a performing party receives the goods for carriage and ends when the goods are delivered',[30]

the better reading is perhaps that the implementation legislation may not extend the period of responsibility. In the latter case, the responsibility under the Convention is exhaustive.

It is not easy to state a general rule on when the Convention prevents regulations in national law outside its scope. A better technique would probably be to define the scope of the Convention and the scope of the individual provisions independently of each other. The rule of the thumb could perhaps be that core issues under the negotiations – such as the carrier's liability – are exhaustively regulated, while other issues are merely sorted out by the scope provisions.

**Second**, there is the issue whether the Convention prescribes minimum rules. The starting point is that the Rotterdam Rules constitute a negotiated deal on how the national law shall be. Even if there are mandatory provisions to protect the cargo side, it is not so that more protection is better or even allowed. A State Party cannot decide, *e.g.*, that the Rules shall be mandatory also for

[30] Rotterdam Rules, Art. 12.

volume contracts, for which the Rules are not mandatory, or be made mandatory also for the benefit of the carrier.[31]

I must admit, however, that it is not easy to find positive support for the views expressed in the previous paragraph. Occasionally, it can be read into the text with a bit of good will, as in the above on volume contracts, which states that the Rules can only be departed from by contract, and, presumably, not by implementation legislation. But the more general point is that States Parties to such conventions have, as far as I know, never even considered improving the protection of the cargo side in the implementation legislation. Such practice would have run contrary to the unification purpose of the Convention.

In these respects, the Convention is mandatory for the States Parties even to an extent that its provisions are not mandatory for the commercial parties. In other words, the Convention (mandatorily) requires the States Parties not to make certain provisions mandatory. There is no logical problem with this. The point would however have come across better if the draftsmen had drafted the Rules as norms for the States Parties on how their national law should be, rather than as a set of rules drafted in a style which could have been used by national legislation, apt to resolve conflicts among commercial parties in litigation.[32]

A **third** issue relating to 'fringe' provisions in the implementation legislation is whether there can be licence to depart from the wording of the Convention. The starting point is, as already stated, that the wording should be adhered to, and that the wording should be interpreted autonomously without the *travaux préparatoires* of the convention, at least when it appears to be clear.

This issue arises, *i.a.*, in relation to Article 12. This is a provision concerning the period of responsibility. Paragraph 3 of the article gives a licence to the commercial parties to limit this period:

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31 Compare Rotterdam Rules, Arts. 78 and 80.

32 See above in 3.1.

> 'For the purpose of determining the carrier's period of responsibility, the parties may agree on the time and location of receipt and delivery of the goods, but a provision in a contract of carriage is void to the extent that it provides that:
> (a) The time of receipt of the goods is subsequent to the beginning of their initial loading under the contract of carriage; or
> (b) The time of delivery of the goods is prior to the completion of their final unloading under the contract of carriage.'

The licence for the parties is a licence to agree that the period of responsibility for the carrier – the time between the 'receipt' and the 'delivery' – shall not include the terminal periods in the very beginning and at the very end of the transport. If the contract is for one sea leg only, this is similar to the 'tackle-to-tackle' limits of the mandatory scope of the HVR.[33] If there is door-to-door transport, however, this provision of the Rotterdam Rules does not allow an exemption of the terminal periods except the first and the last.

This freedom of contract was opposed by some in the negotiations, and the *travaux préparatoires* of the convention clearly state that the implementation legislation may depart from the text here and disallow this contractual freedom of the parties:[34]

> 'Some support was expressed for that proposal and for adjusting the text. However, support was also expressed for an alternative interpretation of paragraph 3, such that the carrier should be responsible for the goods for the period set out in the contract of carriage, which could be limited to 'tackle-to-tackle' carriage. Those that agreed with the above interpretation of paragraph 3 were generally of the view that the text of the provision should be retained as drafted. However, there was general agreement in the Commission that nothing in the draft Convention prevented the applicable law from containing a mandatory regime that

[33] Hague Visby Rules Art. VII. However, the wording here allows national legislation: 'Nothing **herein** contained shall prevent a carrier or a shipper from entering into any agreement,…' (emphasis added).

[34] UNCITRAL Document A/63/17 para 40.

> applied in respect of the period prior to the start of the carrier's period of responsibility or following its end.'

This is surprising, as the *travaux préparatoires* of the convention advise that the text should be departed from. Although perhaps the *travaux préparatoires* should not have been consulted in the first place, strictly speaking, it is hardly possible to imagine one of the States Parties sending a diplomatic note to another, requiring it to stick to the text of the Convention rather than what was clearly agreed. At least for all practical purposes, then, the state of the law is that the implementation legislation can remove the possibility that the parties agree on an exemption of liability in the first and last terminal periods.

There are also several other exemptions to the continuous carrier's liability door to door, in particular

- the contract may be drafted so that it does or does not include the land leg[35]
- the carrier may exempt liability for the stretches or terminal periods entrusted by him to others.[36]

It is difficult to see how the Rotterdam Rules can prevent the implementing legislation of a State Party to make the Rotterdam Rules' liability mandatory also in these cases. There is no indication, based on the analytical paradigms above, that the intention was to prevent national legislation in this respect.

Generally, there is a great opening for fringe provisions outside the core liabilities of the Convention as long as one keeps within the wording.

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35 Rotterdam Rules, Art. 1(1): 'The contract … *may* provide for carriage by other modes of transport in addition to the sea carriage' (emphasis added).

36 See above at footnote 23.

## 4.5 Conflicts of conventions

A particular problem in the implementation process is the relationship to other conventions. This has not been fully developed in the Rotterdam text. These issues could, of course, be left to the courts. But some Parliaments would like to know what they approve ratification of, in particular, when it concerns issues relevant to the politically sensitive issues on distribution of risks between different interest groups, such as shipowners and land carriers. And some governments would simply like to increase foreseeability and avoid costly rounds of clarification in the courts.

One example of an issue that has not been clearly resolved in the Rotterdam Rules is which documents shall be issued for transport under one contract consisting of an international sea leg with a national road leg on each side. Such transport falls both within the scope of the CMR and the Rotterdam Rules.[37] Some liability issues are dealt with in the Rotterdam Rules, Article 26, and CMR Article 2, but the documentation issue is not explicitly dealt with.

There are several ways to resolve this issue, of various qualities:

- One may make a rule in national law disregarding the finer points of treaty law
- One may make a rule based on the Vienna Convention[38] that a new Convention (the Rotterdam Rules) amends an old Convention (CMR) as between the two States Parties. This type of implementation regulation would have to deal with CMR Article 1(5), which disallows such amendments if it implies, as in this case, that negotiable instruments can be issued. And it should perhaps define which connection point to Rotterdam Rules States makes the new regime applicable – can it be applied even if one of the involved carriers, claimants, vehicles or ships is from a non-Rotterdam Rules State?

[37] CMR, Arts. 1 and 2; Rotterdam Rules, Art 1(1).

[38] Vienna Convention on the Law of Treaties, 1969, Art. 41.

- One may define multimodal contracts as something else than the contracts subject to the Rotterdam Rules and the CMR, respectively, despite the fact that the situation in the example is explicitly addressed in both Conventions. If one follows this path, it would be necessary to determine which regime shall apply if none of the Conventions apply; this may, of course, be one of the Conventions applied by force of national law.
- One may read into the Conventions requirement for the contracts being contracts for the carriage by sea or by road, respectively, so that the Conventions do not necessarily apply even if there is a contract for a sea leg or a road leg, respectively, and the relevant scope provisions otherwise apply. In that case, these characteristics would have to be defined, and defined in such a way that they do not overlap. The type of document issued cannot easily be used, because one of the questions to be determined is which document shall be issued, as the carrier tends to determine the type of document unilaterally and the documents may perhaps be neutral in relation to the applicable regime.
- One way is to let the parties determine which regime to apply in case of doubt. This would require provisions that clarify in which cases the parties are free to choose and how clearly an agreement of this sort must be expressed.
- Finally, one could let the implementation legislation clarify that the Rotterdam Rules yield for the CMR in case of conflict. In that case, the conflict situations resolved by Article 82 would have to be defined. The complicated wording of Article 82 indicates that it is not intended to resolve all conflicts, but it is at least a challenge to determine which conflict the article leaves unresolved.

The point here is not to recommend any of these implementation measures, but rather to point out that there may be a felt need to clarify matters in the implementation legislation.

Similar issues also arise in relation to other conflict of convention issues.

If these types of implementation provisions are considered desirable, the Convention allows them. If the conflicts between the Conventions are resolvable, there are no provisions in the Rotterdam Rules that indicate that the way the conflicts ought to be resolved should not be set out in legislation. And if the conflicts are not resolvable, the implementing State errs already by not denouncing the CMR, *etc*., on ratification of the Rotterdam Rules, and the implementing legislation is likely to make things better rather than worse. The better view is probably that a conflict is unintended by the draftsmen of the Rotterdam Rules, so that they in all events can be construed in a way that removes any conflicts.

Different from the question of whether implementation legislation to resolve conflicts is legal is the question whether it is wise. Leaving these issues to the courts may pleasantly conceal the conflict areas, and will allow many years to pass before one must reach the inevitable conclusion that a uniform way of resolving them will not emerge by itself. The legislative approach – typically by addressing the issues to some extent in the *travaux préparatoires* of the implementation legislation – will, on the other hand, create clarity, and can be adjusted (by new legislation) if the mainstream method of resolving the conflicts of these Conventions should prove to go in another direction. For my part, I have no doubt that it is wise to address these kinds of issues.

## 4.6 Extension to domestic transports

While the Rotterdam Rules only apply to international transport, it is clearly allowed, and perhaps even encouraged, to extend the scope to domestic transport as well. Supplementary implementation legislation in this respect is unproblematic. In my view, the interesting point is that such an extension of the scope of the Rotterdam Rules may be quite necessary.

The reason why it may be necessary to extend the scope of the Rotterdam Rules to domestic transport is that domestic transport may

form part of international transport subject to the Rotterdam Rules. In such cases, liability may be channelled to the domestic carrier if the domestic regime is not adjusted to the Rotterdam Rules.

In Norway, a domestic carrier is liable up to 17 SDR per kg, a low privity threshold, and is subject to direct action.[39] If he carries the goods, say, from Voss to Bergen for shipment, this is clearly domestic transport. But this transport may form part of an international transport operation, say from Voss to Manchester via a ferry from Bergen to Newcastle. In this case, the international carrier can invoke the Rotterdam Rules limit of liability (3 SDRs per kg or, in some cases, unit limitation) if the goods are damaged on the Voss-Bergen leg, subject to a high privity threshold.[40] However, the domestic carrier is not protected by the Rotterdam Rules, as he is not a maritime performing party.[41] The cargo owner will therefore most likely sue the domestic sub-carrier rather than the international carrier, as the claimant can recover more from him. Some kind of supplementary legislation is necessary in order to avoid this (if one does not for some reason find the result desirable).

If the contractual carrier himself performs the domestic transport, the domestic rules for road carriage will never be triggered. The choice of liability system is dependent on the contract structure, and not the transport. This may be difficult to justify.

There are similar problems today.[42] However, this relates to unimodal transport, and in most cases a subcarrier can invoke the same protective clauses as the contractual carrier. Therefore, the Rotterdam Rules aggravate the problems.

One way of dealing with this is to make the domestic subcarrier immune to direct action claims, or generally to actions other than

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39 Act No. 68/1974 relating to contracts for the carriage of goods by road (Lov om vegfraktavtaler) and Rt. 1995.486.

40 Rotterdam Rules Chs. 4 and 12.

41 Rotterdam Rules, Art. 1(7) *i.f.*

42 See, in particular, the Norwegian Maritime Code. Sects. 276 and 280 and Act No. 68/1974 relating to contracts for the carriage of goods by road (Lov om vegfraktavtaler), Sect. 32.

recourse claims from the contractual carrier. Another is to make the Rotterdam Rules apply to the subcarrier in all cases where there is a contractual carrier.

A problem in either case would be a drastic reduction of the liability of the domestic carrier, which may be politically unfeasible, and in all events difficult to justify. But an even greater problem is that the Rotterdam liability rules can hardly apply to domestic transport not connected to an international transport operation. One will then have two different liability regimes applicable to two boxes in the same truck, depending on their final destination and the structuring of the transport contracts.

I do not think it is possible, even with a well-thought-out implementation legislation, to create anything near a neat system of liabilities. However, implementation legislation can clarify where the disharmonies should be.

# 5 Influence of Scandinavian law abroad

When considering the best method for implementation, one also needs to consider the effects on the influence of Scandinavian law abroad. I take it for granted that it is desirable from a Scandinavian point of view that Scandinavian practice shall be referred to and have an influence on the universal understanding of the Rotterdam Rules to the greatest extent possible.

There is, of course, a language problem. Scandinavian sources will not be regarded if they are not translated into English or another world language. It is, however, likely that this will be done to some extent in the future. In the following, I assume that the language problem has been resolved.

Given this, it is fair to assume that court opinions will be more influential than statements in national *travaux préparatoires*. Judges are respected everywhere, while the tradition to take *travaux*

*préparatoires* into consideration varies. Foreign *travaux préparatoires* in particular may easily be seen as policy-influenced views rather than exemplary construction of the text.

Furthermore, even a judgment by a court is likely to have diminished influence if it relates to a rewritten provision rather than to the text of the Convention itself. How would a foreign court know whether the result is more or less influenced by the implementation procedure? The significance of the Scandinavian decision may in many cases easily be diminished or even dismissed.

In this – admittedly rather limited – perspective, it seems clear that an implementation method that sticks very closely to the text of the Convention is preferable. If the text is nationalized by transcription, so are also the legal sources connected to it.

# 6 Tactical considerations

In the previous analysis, implementation issues have been discussed with a view to possible types of legislative outcome. Here the same issues shall be discussed with a view to the rule-making process.

## 6.1 Possible ratification crisis

It is likely that some governments will not ratify the Rotterdam Rules unless they get widespread acceptance, including ratification by the USA. In these States, preparing the implementation measures is associated with some uncertainty: Will they ever be needed?

From a tactical point of view, this uncertainty could suggest that the preparation of implementation measures should be kept to a minimum until it is clear that the Convention will enter into force. This implies that implementation by incorporation *en bloc* should be preferred, at least at an early stage.

## 6.2 Bias

In Scandinavia the preparation of implementation measures of a maritime law convention in private law is regularly left to a Maritime Law Commission, consisting of persons from different interest groups, academia and public life.[43] The idea is to elucidate all aspects of the implementation issue, including the issue of whether or not the convention ought to be implemented at all.

There are obviously many good sides to this procedure. However, there are certain caveats:

**First**, it is likely that persons who engage in a drafting exercise for more than a year – or at least their employer – already are quite enthusiastic towards the Rotterdam Rules. Even enthusiastic opponents would perhaps choose another strategy, which would require less time and effort. One cannot, therefore, hardly expect that the matter is discussed at a cool distance.

**Second**, a Maritime Law Commission will inevitably take a maritime law perspective on most issues. In this context, this is particularly important when the relationship between the Rotterdam Rules and other transport conventions are to be considered. Whether or not one concludes that the issues should be addressed in the implementation legislation, the possibilities that the maritime perspective has been dominant cannot be ignored. The maritime perspective could in these cases lead to a reluctance to deal with other transport conventions and/or a clearer view of the interests of maritime parties than other parties.

**Finally**, there is a possible bias in that the committee shall advise on whether or not the Rotterdam Rules should be ratified after having worked intensively with implementation legislation for months. It may be necessary with a detailed study to give considered and balanced advice. But it requires more character than most of us have to recommend the rejection of the Convention if one at the same time implicitly makes one's own hard work useless.

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[43] See < http://folk.uio.no/erikro/WWW/sjolov/index.html>.

There is not much one can do about this bias, except to try to neutralize it by critical evaluation. It may, however, be that the methods of implementation which are less demanding and time-consuming for the draftsmen – that is implementation by reference – is to be preferred. By choosing this method, focus is transferred from the details to the big issue: Whether or not to ratify.

## 6.3 Play-off

The more the Convention is to be elaborated on in the implementation process, the more the way is opened for a new negotiation process which ideally should have culminated in the adoption of the Convention itself. There is always room for introducing some nuances or some adaptation to Scandinavian tradition, concepts of practice.

The Scandinavian tradition of rewriting the substance of the Convention into the Maritime Codes provides rich possibilities in this respect. But also a verbatim incorporation of the Convention could provide similar possibilities if accompanied by comments. As already explained, Scandinavian courts tend to rely heavily on such comments when construing legal texts.

Even with the best of intentions, this is difficult to avoid. In the drafting committee, representatives from different interest groups meet. And there are always some who took part in the international negotiations there, who can explain how the text really was intended and what was not really considered.

The morale is, again, to adhere as closely as possible to the text. This will help keep the implementation process on the track towards a result close to the text of the Convention.

## 6.4 Preserving the Scandinavian project

The Rotterdam Rules raise a particular tactical concern because the Scandinavian States are out of phase. Denmark and Norway started the implementation process in 2009, while the other Scan-

dinavian States have yet to sign. If the other States follow Denmark and Norway, the damage to the uniform Scandinavian Maritime Codes may be repaired. But will they be as likely to follow suit if Denmark and Norway choose to implement the Rules by rewriting as if they do so by *en bloc* implementation?

There are two reasons why this is unlikely:

**First**, to the extent that the reason why Sweden, Finland and Iceland are behind is their heavy implementation workloads (and there are not only political considerations behind the situation), then it is likely that they will prefer the simplest form when they finally are ready to implement. Thus there may be a preference for *en bloc* implementation.

**Second**, there is a huge difference between rewriting the Convention into one's own Maritime Code after discussions between various national interests, and an adoption of the result of the discussion in the implementation committees of other States, albeit Scandinavian. Much of the point of this type of implementation process vanishes when others do the job and decisions are made in discussions to which national interest groups are not privy.

One does not know to what extent the Scandinavian States eventually will ratify the Rotterdam Rules. But if they do, chances are greater that they will be implemented in the same way if the rewriting is limited to a minimum, as long as not all the States are involved.

# 7 Conclusion

The above discussions suggest that the advantages by rewriting a Convention such as the Rotterdam Rules are less than one might expect. Implementation measures that keep very close to the text of the Convention, on the other hand, such as *en bloc* incorporation, ensure that the Convention is interpreted in line with the

methods in international law, and that future Scandinavian practice form part of the international corpus. The increased possibility to exchange legal information across jurisdictions only reinforces this tendency.

There is not, however, an entirely clear borderline between the two main methods of implementation. A method in which the text of the Convention is kept intact, but restructured to fit into the Maritime Code, could be a golden mean.

# Vessel-source pollution in the disputed area of the Barents Sea – Norway's access to administrate prevention initiatives

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# Content

# 1 Introduction

## 1.1 The aims of the thesis

This thesis examines the vessel-source pollution regulation in the High North and Norway's opportunity to take measures against and prevent pollution in the Barents Sea.[1] The special problem of marine environmental protection arises from a dispute between Norway and Russia on the delimitation of the maritime border in the Barents Sea. It is interesting to see how the dispute can represent an obstacle to regulation and environmental protection of the area. The disputed area, often referred to as the Grey Zone, is a result of Norway and Russia both claiming the area to be part of their exclusive economical zone, due to the fact that both countries apply different principles for delimitation of their adjacent maritime zones. There is great uncertainty as to how the countries can and shall administrate this area with respect to vessel-source pollution. This thesis will look into the matter by examining if and how pollution can be dealt with in the disputed area.

The topic is not only of theoretical interest. The Barents Sea is rich in natural resources, both living and non-living resources. There are long traditions for exploiting living resources in the area, which naturally involve the use of fishing vessels. In addition, both Norway and Russia are currently engaged in offshore drilling for petroleum in the Barents Sea.[2]. All together there is quite a lot of traffic in the Barents Sea. The growing number of oil tankers represents the most serious threat, however, as the potential damage is far more severe than that represented by fishing vessels. Vessels carrying oil from Russia to Europe and USA today represent a considerable share of traffic in the Barents Sea. In 2009, it is esti-

1 The 40-year old maritime boundary dispute between Norway and Russia has been settled on the 15th September 2010 (editor's comment).

2 Vidas, *Protecting the Polar Marine Environment*, p. 131, containing further referrals

mated that 20 million tons of oil and gas products will be carried through the Barents Sea[3]. The "Shtokman" gas field is situated on the Russian side of the disputed area and quite close to the area in question. The operation and further development of Shtokman represent potential consequences for the marine environment of the Barents Sea, due to the increased number of oil tankers and consequently the increased threat of casualties and discharge from a larger amount of vessels.

Furthermore, the world is experiencing a situation of global warming, and the tendency is towards a situation where the ice in the Arctic is melting, leaving more open sea areas. This may in principle imply that the Northern sea route can be open for even more traffic[4]. The environment in the High North is of an exposed character and it will be an important task for bordering countries to preserve and protect the nature and the resources. However this task is complicated by the dispute in regard to delimitation of the maritime border. There is uncertainty as to how a country can administrate an area that is not definitely part of that country's jurisdiction. This restricts the work of fighting vessel-source pollution.

The bilateral agreements between Norway and Russia concerning environmental protection[5] illustrate the countries' awareness of the risk of pollution in the sensitive area.[6] The awareness of the involved parties is by no means a bad starting point for improving the environmental protection of the Barents Sea.

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3 "Oil transport from the Russian part of the Barents Region. Status per January 2009." p.5

4 Falkanger, *Noen Folkerettslige problemstillinger i nordområdene – i fortid og nåtid*, p. 332

5 Commented on in 3.6.2

6 Vidas, chapter 6

## 1.2 The legal framework on marine pollution

The UN Convention on the Law of the Sea is the fundamental convention in regard to exploitation and preservation of the sea. Rather elegantly, it has been said that the UN Convention on the Law of the Sea is a "constitution for the oceans",[7] in short stating how essential the Convention is. The UN Convention on the Law of the Sea (hereinafter referred to as UNCLOS or LOSC) establishes a legal regime of different maritime zones which determine the rights and obligations of the States. In the various zones, the coastal State's jurisdiction decreases in relation to the distance from shore.

In addition to prescribing a coastal State's general prescriptive and enforcement jurisdiction, UNCLOS specifically deals with States' opportunity and obligation to protect the environment. In Article 192 it is succinctly stated that "States have the obligation to protect and preserve the marine environment". Additionally, Article 194 sets forth that States shall take "all measures consistent with this Convention that are necessary to prevent, reduce and control pollution of the marine environment from any source". Thus it is clear that the Parties not only have the opportunity to preserve the marine environment; they also have a duty to do so.

The obligations in respect of prevention of vessel-source pollution apply to Norway as not only a coastal State and a port State, but also as a flag State. A flag State's legislative jurisdiction is not questioned under customary international law[8] and in LOSC there is even an obligation for States to adopt pollution regulations for their vessels which "at least have the same effect as that of generally accepted international rules and standards".[9] A flag State may prescribe anti-pollution rules applicable to its vessels wherever they might be in the oceans. In regard to enforcement jurisdiction,

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7 Tan, Vessel-source Marine Pollution, p. 192 and containing further references. The phrase is attributed to Ambassador Tommy Koh of Singapore, President of UNCLOS III, speaking at the final session of the Conference

8 Churchill and Lowe, *The law of the sea,* third edition, p. 344

9 LOSC Article 211(2)

LOSC Article 217 prescribes that flag States not only *may*, but *must* enforce violations of pollution laws by vessels flying their flag. As will be outlined in this thesis, a coastal State's enforcement jurisdiction can be limited and consequently flag State jurisdiction has an important role in fighting vessel-source pollution. In this thesis however, flag State jurisdiction is not of key interest, as the topic concerns how Norway as a coastal State can deal with pollution in one particular maritime zone. Thus, throughout this thesis the focus is on the ability Norway has to prevent vessel-source pollution as a coastal State, in addition to comments on port State control in chapter 3.4.

LOSC Article 211(1) establishes that "States, acting through the competent international organization or general diplomatic conference, shall establish international rules and standards to prevent, reduce and control pollution of the marine environment from vessels". Together with an awareness of the harmful consequences of pollution in the marine environment, the result is extensive regulations both nationally and internationally. These regulations can be roughly divided in two groups: (I) Conventions on prohibition of pollution, where the MARPOL Convention is the primary convention, and (II) Conventions on preparedness and response to incidents of pollution, where Intervention Convention is essential. The Conventions covered in this thesis have been selected because of their high degree of relevance to the subject, and this selection has been limited both to maintain a sharp focus and because of the limits of this thesis.

In Norway there is a system of dualism. In short this implies that ratified conventions have to be implemented through national legislation for the regulation to become binding. For the purpose of this thesis, it is of core interest to note that Norway is a party to UNCLOS[10] and the MARPOL Convention. In national legislation, the Ships' Safety Act and the Pollution Control Act represent central works of legislation in regard to vessel-source pollution together with the MARPOL Regulation.

[10] In force as of Regulation of 24th of July 1996

## 1.3 The structure and limits of this thesis

This thesis will begin, in chapter 2, by providing an overview of the legal regime of the waters adjacent to Norwegian land. Focus will be given to the Exclusive Economical Zone (EEZ) and the special area in the Barents Sea where the dispute of delimitation is a hot topic. In chapter 3, the legal framework concerning prevention of vessel-source pollution will be outlined. In the same setting, the enforcement jurisdiction of Norway as a coastal State and a port State will be clarified. Chapter 3 will essentially seek to present Norway's access to regulate vessel-source pollution in its waters and in particular in the EEZ. On the basis of chapter 2 and 3, I will proceed to the analysis of Norway's admission of regulation and preservation of the disputed area in the Barents Sea in chapter 4. Here I will also outline the practice of the International Court of Justice and draw parallels between the early establishment of Norway's EEZ and the potential for expanded regulation in the disputed area today. This leads on to chapter 5 which contains conclusions and thoughts on the futuristic perspective.

By this outline and with the aim of clarifying the topic of this thesis, a number of related and interesting subjects have been left out. The thesis will not cover other aspects of safety regulation such as safety of life, technical safety of vessels etc. The aim of this thesis is to detect and indicate Norway's access to prevent marine pollution in the disputed area of the Barents Sea. In the LOSC, "pollution of the marine environment" is defined in Article 1(4) as "the introduction by man, directly or indirectly, of substances or energy into the marine environment, including estuaries, which results or is likely to result in such deleterious effects as harm to living resources and marine life, hazards to human health, hindrance to marine activities, including fishing and other legitimate uses of the sea, impairment of quality for use of sea water and reduction of amenities". This type of pollution may stem from a variety of sources. This thesis will only deal with vessel-source

pollution of the marine environment, excluding other sources of pollution to the marine environment, in our case the Barents Sea. the International and Norwegian regulation of vessel-source pollution will be examined in the thesis, while Russian domestic regulations will be left uncovered.

# 2 Legal regime of Norwegian Waters, the EEZ and the High Seas

## 2.1 Introduction

Norway's rights and obligations in the waters adjoining the coast are governed by International Law and in particular UNCLOS. UNCLOS operates with different maritime zones to regulate both the coastal States' and foreign States' right to take advantage of the waters. Traditionally, the freedom of navigation for all ships of all States has been a fundamental principle to take into account when establishing rights of the coastal State.[11] At the same time, it has been generally accepted that coastal States have some rights to regulate in the waters adjacent to their coasts.[12] Thus, freedom of navigation can be restricted by which waters a vessel chooses to sail through. The compromises between freedom of navigation and a coastal State's rights in the waters are found in UNCLOS 1982,[13]

In this chapter I describe the legal regime of different maritime zones, starting with a description of the Norwegian Waters in 2.2 and the contiguous zone in 2.3. In 2.4, the special situation of

[11] Churchill and Lowe, p. 81

[12] Churchill and Lowe, p. 71

[13] The Convention, third edition 1982, is ratified by Norway and has been in force as from 24th of July 1996. The Law of the Sea Convention is a widespread convention with 155 contracting states per 31st of July 2008. The broad allocation of the convention together with the well established system it contains makes the convention customary international law and it is thus affects non-contracting states as well.

Svalbard is commented on to complete the outline of Norwegian jurisdiction in the Barents Sea. Most importantly for the subject of this thesis is the Exclusive Economical Zone and this is outlined in 2.5. The Norwegian EEZ meets the Russian EEZ in the Barents Sea, as Russia is an adjacent State to Norway in the High North. This fact calls for a delimitation of the countries' maritime boundary, which in itself has led to a dispute between the two countries. The subject of delimitation and the dispute will also be covered in this chapter's 2.5.2 and 2.6. Lastly, the legal regime of the high seas and the continental shelf is commented on in 2.7 and 2.8.

## 2.2 Norwegian Waters; the Internal Waters and the Territorial Sea

The ports of Norway are undoubtedly part of the State and the sovereignty attaches, making both prescriptive and enforcement jurisdiction as broad as on land. Full sovereignty continues for the internal waters, *cf.* Article 2 of LOSC. As it follows from Article 8(1), "waters on the landward side of the baseline of the territorial sea form part of the internal waters of the State." Due to the geography of the Norwegian coast, the principle of straight baselines applies, see Article 7. In this matter it can be important to keep in mind Article 8(2), which states that when straight baselines have "the effect of enclosing as internal waters areas which had not previously been considered as such, a right of innocent passage as provided in this Convention shall exist in those waters." This has an impact on the sovereignty of the coastal States' ability to give prescriptive regulation. This will be explained in connection to the right of innocent passage through the territorial waters.

See *Figure I* in 2.5.1 for an illustrative map of the sea boundaries.

The territorial sea is the waters adjacent to the internal waters. Just as a coastal State's sovereignty over the internal waters is undoubted, so is the sovereignty in the territorial sea today. It follows from Article 2 that "The sovereignty of a coastal State

extends, beyond its land territory and internal waters […] described as the territorial sea." As it follows from the second paragraph of Article 2, the sovereignty extends to the air space above and the seabed and subsoil as well.

Article 3 states that every State has the right to establish a territorial sea up to a limit not exceeding 12 nautical miles, measured from baselines determined in accordance with the Convention. For a long time, Norway's territorial sea had a breadth of four nautical miles. Today the breadth of the Norwegian territorial sea is the 12 nautical miles admissible by international law, i.e. LOSC. This follows from section 2 of the Norwegian Act no. 57 of 27th of June 2003.

Since the coastal State is secured sovereignty in the territorial sea, the coastal State is essentially free to prescribe regulations concerning the territorial waters according to its own needs and wishes. The area can be compared to a State's soil and this can also be derived from Article 2, which states that sovereignty extends "beyond its land and internal waters". Hence the sovereignty of the territorial waters is comparable to the principles of international law concerning States' sovereignty.

Nonetheless there is an important limitation on the coastal States jurisdiction in the territorial sea. The LOSC grants all States the right of innocent passage through territorial waters, *cf.* Article 17. What is to be understood as "passage" is explained in Article 18. Passage in the meaning of Article 18 is "navigation through" the territorial waters, either without entering internal waters or for the purpose of proceeding to or from internal waters. Further on the second paragraph states that the passage shall be "continuous and expeditious", stopping and anchoring is only admissible when incidental, caused by a force majeure situation or distress. Stated in simpler terms, one could say that foreign vessels are secured the right of passage through the territorial waters, but they are not allowed to be hovering or merely cruising around in the territorial sea.

As for the criterion that the passage must be "innocent", this is developed on in Article 19. The first paragraph states that the

passage is innocent "so long as it is not prejudicial to the peace, good order or security of the coastal State". A list of activities that is deemed to be non-innocent is found in Article 19(2). There is an ongoing debate whether or not the list found in Article 19(2)(1) is exhaustive. Various conclusions are found in the legal literature, but the main opinion seems to be that the list of activities in Article 19 is non-exhaustive.[14] The most important argument for maintaining that Article 19 is non-exhaustive is the construction of the article; how the first paragraph states the main rule, while the second paragraph exemplifies. If the list in the second paragraph covers the only situation when passage is not innocent, the first paragraph would be left without meaning. In addition, the Article does not contain words like "only" or other implications in the wording of Article 19(2) that the list is exhaustive. Compared with the last alternative, litra (l), with the wording "any other activity", it is natural to read the Article so that there are other alternative activities that can lead to non-innocence in addition to the ones listed in article 19(2).

This right of free passage through the internal waters represents a limitation on the coastal State's prescriptive jurisdiction. Before adopting new laws, the State has to ensure that this is not in discordance with the right of free passage of other countries' vessels.

Norway may fully apply its laws in regard to foreign ships in the territorial sea when the ship is considered not to be in passage and/or when it is non-innocent. On the basis of the State's sovereignty, Norway can prevent the passage of a ship that is non-innocent. In cases where foreign ships are in innocent passage through the territorial waters, Norway may still enforce its laws as long as this is in accordance with LOSC.[15] In regard to pollution regulation, the LOSC established a compromise in Article 21(2). Norway may prescribe its national discharge and navigational standards in the

[14] Molenaar, *Coastal State jurisdiction over vessel-source pollution*, p. 197 and Johnson, *Coastal State regulation of international shipping* p. 64

[15] LOSC Articles 21–23

territorial sea, but when it comes to CDEM standards Norway is limited to implementing the international standards.[16]

The general condition is that the coastal State shall not "hamper" the innocent passage.[17] The problematique of free passage arises in connection with enforcement of a coastal State's regulation as well. At the same time as vessels of all States are granted the right of free passage, Norway has sovereignty in the territorial waters and is granted rights through the LOSC, but a wide right of access for Norway to enforcement through, for example, inspection, would undermine the right of free passage. In matters of violation of criminal law, Norway's enforcement power is restricted. Article 27 states that the coastal State should not exercise criminal jurisdiction on board foreign vessels, save for specific situations listed in the article. The fourth paragraph of Article 27 paints a picture of the significance of the free passage when it states: "In considering whether or in what manner an arrest should be made, the local authorities shall have due regard to the interests of navigation". Civil jurisdiction against persons on board vessels and the vessel itself is also restricted, pursuant to Article 28.

Enforcement of the laws for the prevention, reduction and control of pollution[18] is possible where there are clear grounds for believing that a vessel during its passage through the territorial waters has violated Norwegian pollution regulation, which is admissible by the LOSC. In these matters the Norwegian government may physically inspect the vessel, and if the evidence so warrants, it may institute proceedings, including detention of the ship.

## 2.3 The Contiguous Zone

The contiguous zone is, naturally, the continuation of the territorial sea at the seaward side. The contiguous zone is regulated

16 Tan, p. 205
17 LOSC Article 24
18 Art 220(2)

through LOSC § 33. The purpose of the contiguous zone is to give the coastal State an improved ability for control. The zone is limited to reach maximum 24 nautical miles from the baselines[19].

The contiguous zone does not form part of a coastal State's territory and is not an area where the coastal State has sovereignty. To be able to carry out the State's rights in this area, it is absolutely necessary with LOSC Article 33. Since the coastal State does not automatically have rights in the area adjacent to the territorial waters, this has to be explicitly claimed, as the situation is for the exclusive economical zone (see below in point 2.3). Norway has claimed a contiguous zone extending for 24 nautical miles, under section 4 of Act no. 57 of 27th of June 2003.

Within the contiguous zone Norway has the ability to prevent infringements of its laws in respect of customs, fiscal, immigration and sanitary matters within its territory, including the territorial sea. Furthermore, the State may punish these infringements if they are committed within the territory or the territorial sea.[20] In addition to these coastal State rights explicitly regulated in LOSC Part II, Section 4 for the contiguous zone, the rights and obligation for the EEZ also apply to the contiguous zone as they overlap.[21]

## 2.4 Svalbard

Svalbard has a special status under international law. It has given rise to disputes and it shows the complexity of the Norwegian-Russian relationship in the North[22]. As will be described in the following, Norway has sovereignty today and this has an impact on the issue of delimitation between Norway and Russia. In addition, there is a very recent decision from the UN Commission on the Limits of the Continental Shelf (CLCS) regarding Norway's conti-

19 LOSC Article 33(2)

20 LOSC Article 33(1) a) and b)

21 See the following section, 2.6

22 An outline of Svalbard's history can be found in Pedersen, *The Svalbard Continental Shelf Controversy: Legal Disputes and Political Rivalries*

nental shelf which presents a new aspect and provides for an interesting discussion. Lastly, as with the subject of the continental shelf in 2.8, comment on the subject is required in order to complete the overview of the legal regime of maritime zones in the Barents Sea. For these reasons, I will discuss Norway's jurisdiction in the waters surrounding Svalbard.

Pursuant to the Svalbard Treaty, as of 1920 and in force from 14th of August 1925, Norway enjoys sovereignty over the Svalbard Island Group.[23] Article 1 establishes that Svalbard is part of the Kingdom of Norway. The sovereignty is not questioned in itself and is supported by the founding fathers' conscious choice of wording.[24] The Treaty nevertheless regulates a special regime where the sovereignty has to be practised in cooperation with the limitations following the Treaty's Articles 2–9. The articles of most interest are article 2 and 3, where it is stated that the contracting parties shall have an equal right to the natural resources on land and in the territorial sea. These restrictions have not caused any particular problems for matters ashore and in the territorial waters. The question that has been raised is whether the restrictions following the Treaty's article 2–9, in particular article 2 and 3, shall apply to the EEZ and the Continental Shelf as well.

The Norwegian position has been that the Svalbard Treaty does not apply outside the territorial water. On the continental shelf it is the ordinary Norwegian laws that regulate activities. This can be seen by the Royal Decree of 31st of May 1963 that the regulation of the Norwegian continental shelf applies to the continental shelf of "the Kingdom of Norway". According to the Svalbard Treaty, this includes Svalbard-[25] The same view applies to the EEZ, as the Norwegian Act on the Exclusive Economical Zone of 17th of December 1976 applies to "the Kingdom of Norway".

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23 Article 1, Svalbard Treaty

24 Fleischer, *Studier i Folkerett*, p. 187

25 Treaty Art. 1

There has been an ongoing debate whether Norway's position can be accepted under international law and several parties to the Treaty have made their objections[26]. A strong argument in favour of Norway's position is the wording and construction of the Svalbard Treaty. The Treaty ensures Norway sovereignty over Svalbard with the exception of the limitations put forward within the Treaty. As long as there are no limitations to the continental shelf pursuant to the Treaty, the main rule of Norwegian sovereignty shall apply.[27] Now Norway's position has been strengthened by the UN Commission on the Limits of the Continental Shelf (CLCS) decision that the continental shelf around Svalbard is the continuation of the Norwegian continental shelf and hence the whole continuous continental shelf belongs to Norway, with the admissible jurisdiction following the LOSC.[28]

Norway has avoided some difficulties in regard to the EEZ as they have not established an exclusive zone, but rather a non-discriminating 200 miles fishery zone. Nevertheless, the 200 miles zone is claimed for the matter of delimitation in the Barents Sea versus Russia. This will be developed on in 2.6.2.

## 2.5 The Exclusive Economical Zone (EEZ)

### 2.5.1 Overview

The legal regime of the exclusive economical zone (EEZ) is complex because the coastal State has considerably more limited jurisdiction, while flag States enjoy the rights of the high sea and free navigation. The coastal State can give prescriptive jurisdiction in several matters, but it is not always an exclusive competence, as is the case for pollution questions (discussed below). This exemplifies the complexity of the EEZ. Against this background it is said that the EEZ is a zone *sui generis*, meaning that it is unique. Said in the

[26] Ruud, *Innføring i Folkeretten*, p. 159
[27] Fleischer (1997)
[28] See 2.8 below

wording of the Law of the Sea Convention it is a "specific legal regime established" where "rights and jurisdiction of the coastal State and the rights and freedoms of other States are governed by the relevant provisions of this Convention", *cf.* Article 55.

The EEZ has its origins from 1945 when it was claimed and described in the Truman Proclamations.[29] Together with the Latin American State practice from the 1940s and 1950s, this was the first foundation of the doctrine of the EEZ.[30] The EEZ has a close relationship with the doctrine of the continental shelf, which has been said to pave way for the establishment of the EEZ. Concerning the continental shelf, see 2.8. It is now widely recognized that the EEZ is firmly rooted in customary international law and for the States members to the LOSC it is governed by Part V of the Convention[31].

The EEZ extends 200 nautical miles, measured from the same baselines as limits the territorial sea.[32] In this area the coastal State has sovereign rights in regard to the natural resources that exist in the waters, the seabed and its subsoil, as prescribed by Article 56 (1) (a). As for prescriptive jurisdiction, the coastal State can regulate their sovereign rights and in addition the coastal State is free to regulate matters of building installations in the EEZ, marine scientific research and protection and preservation of the marine environment.[33] At the same time the second paragraph of Article 56 provides a reminder that the coastal State shall have due regard to the rights and duties of other States, like it follows from Article 58.

The coastal State's jurisdiction in regard to protection and preservation of the marine environment seems absolute in Article 56, but the access to exercise prescriptive jurisdiction over vessel-source pollution is specifically governed by Article 211(5). Here it is stated that in the EEZ the coastal State can adopt laws and regu-

29 Molenaar, p.361 and Churchill and Lowe, p. 143–144
30 Op.cit
31 Op.cit
32 LOSC Article 57
33 Prescribed in Article 56 (1) (b)

lation concerning pollution, but it is only in so far as it is "conforming to and giving effect to generally accepted international rules and standards established through the competent international organization or general diplomatic conference". By virtue of this sentence, it appears that the coastal States' prescription ability is limited to implementation of international standards. The primary purpose of this rule is to ensure conformity in international shipping and uphold the right to enjoy free passage. The effect is that for the jurisdiction in the EEZ it is mainly international law that is of importance and applies to matters of pollution.

On the other hand, if pollution incidents affect the natural resources, Norway's access to regulate it follows clearly from LOSC Article 56(1)(a). This section could potentially be used as an admission for Norway to regulate vessel-source pollution in the EEZ as well. The necessity to adopt laws and regulations of its own is not that though pressing because of the large amount of international regulation of pollution.[34] Furthermore, the basic principle of *lex specialis* could provide that Article 211 supersedes Article 56.

It is necessary for a coastal State to declare its jurisdiction in the EEZ through legislation. Norway has done so by the Act No. 91 of 1976, "on the Norwegian exclusive economical zone".

Enforcement jurisdiction follows the ability to prescribe closely. The principal provisions governing enforcement against vessels at sea are set out in LOSC Article 220 and 221. The starting point is that intervention by Norway as a coastal State is limited to situations where there are clear grounds for believing that a vessel has committed a violation in the EEZ. Furthermore, for the matter of prevention, reduction and control of pollution, the infringed regulation has to be applicable international rules.[35] Just as we recently saw that Norway's access to prescribe regulation in the EEZ is limited to implementation of international pollution regulation, the enforcement jurisdiction naturally follows the same pattern; only

[34] Pollution regulation is commented on in chapter 3

[35] LOSC Article 220(3)

regulation admissible by the LOSC can be enforced. The enforcement jurisdiction will be more thoroughly discussed in chapter 3.

In short it can be stated that Norway has a right to enforce its pollution regulation in the EEZ, according to the LOSC, but that there is clearly a high standard for intervention.

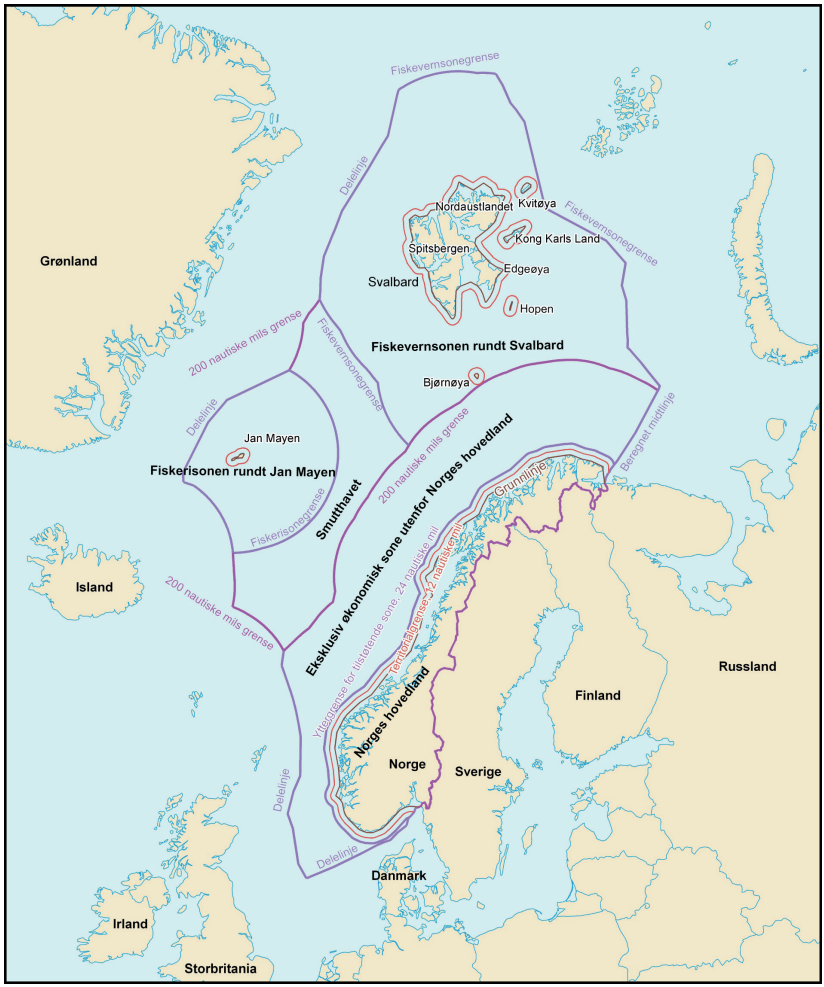


*Figure I: The maritime zones outside Norway*
*http://www.statkart.no/filestore/Landdivisjonen_ny/Kart_og_produkter/gGrenser/Prod_10_ProduktspesifikasjonsjgrenserforNorgemedbi.pdf*

### 2.5.2 Delimitation of EEZ and the occurrence of dispute in relation to delimitation

Where a coastal State has an opposite or adjacent coast with another State, LOSC prescribes guidelines for delimitation of the EEZs in Article 74. The article declares how delimitation should be affected by agreement between the States and that it should be based on international law. In the second paragraph it is evident that a settlement of delimitation is the parties' responsibility. Here it is stated that if no agreement can be reached within a reasonable period of time, the parties shall resort to the procedures provided for in Part XV of LOSC. Part XV of LOSC contains regulation concerning the peaceful settlement of disputes and procedural rules. By virtue of Article 74, the impression is that a dispute concerning delimitation is not acceptable under the LOSC. A solution is necessary, preferably by agreement between the States concerned and if it is not achievable, then by dispute settlement following the rules of LOSC.

The third paragraph of Article 74 further underlines the parties' responsibility; while waiting for the permanent delimitation, the parties shall "make every effort to enter into provisional arrangements of a practical nature", thus signalizing the parties' responsibility to achieve agreement and that a practical solution should only be temporary.

Norway is in an ongoing dispute with Russia concerning the delimitation of their EEZs in the Barents Sea. The parties cannot agree on delimitation, but have sought a provisional agreement of a practical nature as provided for in Article 74, third paragraph[36]. Next follows an overview of the situation of the delimitation dispute in the Barents Sea.

[36] Known as the Grey Zone Agreement

## 2.6 The sea border against Russia. The disputed area

### 2.6.1 Overview

Norway established an exclusive economical zone as of 17th of December 1976 with Act no. 91, while Russia claimed its exclusive economical zone in 1984. Norway and Russia disagree on which principle is to be applied to delimitation of their EEZs. Hence the countries apply different delimitation principles and the countries' claims overlap geographically. The result is a disputed area in the Barents Sea.

International law does not lay down a consistent rule for delimitation of EEZs. This situation of different methods of delimiting the maritime zone is the origin for the dispute between Norway and Russia. Norway claims that the principle of the median line applies to the delimitation in the Barents Sea. The median line is a fictive line measured to be in equal distance from both Parties' coasts. Russia on the other hand invokes the sector principle[37]. The latter is based on a straight line from Russia's western borderline along the meridian up to the North Pole, with only small adjustments due to Svalbard. Originally, Russia used this principle in connection with a claim for their continental shelf and it has its origin from a decree of 1926.[38] The decree and claims according to the sector principle were later extended to the EEZ as well in 1984 when Russia established its EEZ.[39]

The picture in the map is a straight line further to the west according to Russia's claim and a line further east heading in an east-north direction that is the borderline according to Norway. The area in between the two lines is the disputed area in fact. This area forms part of the area known as the Grey Zone (square with

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37 Kovalev, *Contemporary issues in the law of the sea: modern Russian approaches,* p. 177

38 Østreng, Delelinjene I Barentshavet, planlagt samarbeid versus uforutsett konflikt, Perspektiv 04/07

39 Op.cit and , Falkanger, p. 333

dotted line in the illustration below), where Norway and Russia have an agreement of joint fisheries.[40]

It is a fact that Norway and Russia's claims overlap outside the EEZ of 200 nautical miles as well, as the borderline between Norway and Russia needs to be delimited all the way up to the North Pole. In this context however, our concern will only be the disputed area within the EEZ. Outside 200 nautical miles only the continental shelf needs to be delimited and the sea areas are considered as the 'High Seas'.[41] For the purpose of this thesis' topic, which focuses on vessel-source pollution, only EEZ delimitation is interesting and this is the area referred to as the "disputed area" within this thesis.

[40] The Grey Zone Agreement is described in 2.6.2

[41] The legal concept of the High Seas is described in 2.7. What is important in this context is that a coastal state has no jurisdiction on the seas and can thus not deal with vessel-source pollution, as a starting point.

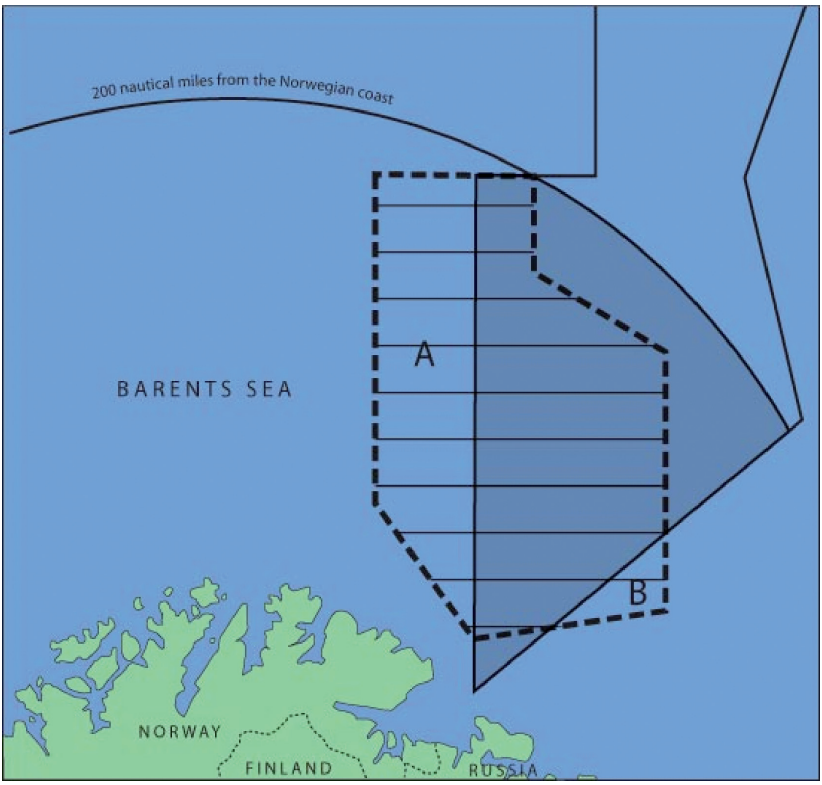


*Figure II: Illustration of the Grey Zone and the disputed area. The Grey Zone is the area within the dotted line and the disputed area is the triangle in darkest grey colour.*

Although there is no consistent rule for delimitation, international law is generally in favour of the median line.[42] The Law of the Sea has a combined rule, but with the median line as a starting point for delimitation in the territorial zone.[43] In regard to delimitation of the EEZ the LOSC Article 74 states:

[42] Falkanger, p. 334 and recent decisions by the ICJ, the Qatar-Bahrain Case from 2001 and Cameroon-Nigeria Case from 2002.

[43] LOSC Art. 17

1. The delimitation of the exclusive economic zone between States with opposite or adjacent coasts shall be effected by agreement on the basis of international law, as referred to in Article 38 of the Statute of the International Court of Justice, in order to achieve an equitable solution.

According to Article 38 of the Statutes of the International Court of Justice, the court shall apply international conventions, international custom, general principles in law recognized by civilized States and judicial decisions and the teachings of the most highly qualified publicists.

Even though Russia has not accepted the competence of the ICJ in the dispute in question,[44] the applicability of Article 38 cannot be circumvented. The ICJ is one of the UN's main bodies[45] and according to Articles 72 of the UN Charter's , the statutes of the ICJ shall be accorded as an integrated part of the Charter. Further on, Article 73 of the Charter states that all members shall be deemed to have accepted the Statues by the ratification of the Charter. Hence Russia, as member to the UN-Charter, is bound by the Statutes of the ICJ and Article 38 is determining the application of law in the disputed question of delimitation in the Barents Sea.

The primary solution of the LOSC is agreement between the parties. If agreement cannot be reached, the LOSC does not indicate which principle is to determine the delimitation. It does not favor the median line nor the sector principle, or other solutions. Nevertheless, the article refers to Article 38 of the Statutes of the ICJ which implies that international conventions will apply to the question. Among the international conventions, the Geneva Convention of 29th of April 1958, hereinafter named the Continental Shelf Convention, must be included. The Continental Shelf Convention is ratified by both Norway and Russia.

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44 http://www.icj-cij.org/jurisdiction/index.php?p1=5&p2=1&p3=3&PHPSESSID=893d3f4f181e10843da1c41903f3b3a7 (last visited 24.08.09)

45 UN Charter, Article 7

Directly, the Continental Shelf Convention only applies to questions related to the continental shelf. Now, the border between Norway and Russia in the Barents Sea is disputed both in regard to the EEZ and the continental shelf. It could be possible with separate delimitation of the maritime zone and the shelf, but it would both be impractical and the parties appear to seek a united solution for the delimitation of the border in the Barents Sea. Furthermore, the ICJ seems to avoid delimiting several borderlines.[46] In this situation the Continental Shelf Convention's regulation of delimitation has impact both through the LOSC, *cf.* Statutes of the ICJ Article 38, and for the cause of finding a united solution on delimitation in the Barents Sea. The Continental Shelf Conventions Article 6 no. 1 reads:

> 1. Where the same continental shelf is adjacent to the territories of two or more States whose coasts are opposite each other, the boundary of the continental shelf appertaining to such States shall be determined by agreement between them. In the absence of agreement, and unless another boundary line is justified by special circumstances, the boundary is the median line, every point of which is equidistant from the nearest point of the baselines from which the breadth of the territorial sea of the territorial sea of each State is measured.

Still, the primary solution is agreement between the parties, but if this is not achievable, the main rule is a boundary following the median line "unless another boundary is justified by special circumstances". This leaves us in a situation where the median line principle should apply unless Russia can prove "special circumstances" that can justify the sector line principle that they claim. In this debate, the special geography of the Norwegian coast is a valid argument. The Varanger peninsula pushes the median line far to

[46] Elferink, *The law of maritime boundary delimitation: a case study of the Russian Federation,* p. 124 and Falkanger, p. 334

the east in comparison to the rest of the countries' land. Taking into account the fact that international law also contains a requirement regarding equity, this is Russia's best chance of proving "special circumstances" to justify another solution than the median line principle. Secondly, Russia claims the Decree of 1926 as a special circumstance, but this has little international support. The sector principle has little support in international law as well.[47]

Even though it is likely that the Continental Shelf Convention and its guidelines on delimitation will have an impact on the delimitation question, the rulings of the ICJ demonstrate that the court has been reluctant to apply the Continental Shelf Convention's regulation directly on the question. The ICJ has rather sought an "equitable solution" as it is the rule in LOSC Art. 74, 2nd paragraph[48]. The approach is nevertheless quite similar for the assessment of an equitable solution. The ICJ's starting point in the assessment has been the median line with further adjustments in case of inequitable results of the median line, *cf.* the Qatar-Bahrain case of 2001 and the Cameroon-Nigeria case of 2002. The situation is thus that the legal assessment of delimitation is more or less the same, whether the legal basis is the Continental Shelf Convention or the LOSC Article 74.

Unless Russia approves the competence of the ICJ in the case of delimitation in the Barents Sea, the conclusion to the dispute will depend on an agreement between Norway and Russia. Most probably it will be complicated for the parties to achieve consensus; so far it has proven to be difficult and with the new knowledge of natural resources in the subsea soil it is reasonable to believe that the Parties will not be lenient against compromises in the disputed area. The status quo of uncertainty increases the need for a temporary solution to deal with pollution matters. This will be discussed in chapter 4.

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47 Elferink, p. 222–223

48 See The Tunisia-Libya case of 1981 and The Gulf of Maine case of 1982

For the part of the sea border between Norway and Russia closest to their shore borderline, the parties had an agreement dating back to 15th of February 1957.[49] Recently, the Parties continued their agreement when they reached consensus and agreed on delimitation within the Varangerfjord area. The agreement was concluded in 2007 through the "Agreement between Norway and Russia on Delimitation in the Varangerfjord Area" of 11th of July 2007. The agreement could be seen as a step towards a solution of delimitation in the Barents Sea, but in reality one would have to read too much into the parties' conduct. This is because the area where the delimitation applies does not concern areas where the States disagree. The line of delimitation is 73 kilometres long and ends at the point where Norway's claim of the median line and Russia's estimations diverge.[50] Further, the Agreement of Delimitation expressly states in Article 4 that the agreement of delimitation shall have no other implications to other questions of delimitation.

### 2.6.2 The Grey Zone Agreement between Norway and Russia

Although Norway and the Soviet Union have a disagreement regarding delimitation in the Barents Sea, the countries saw early on the need for cooperation and administration in this area and managed to reach an agreement. The agreement was called "Avtale mellom Norge og Sovjetunion om en midlertidig praktisk ordning for fisket i et tilstøtende område i Barentshavet", which freely translated means a "temporarily, practical agreement for the fisheries in a contiguous zone in the Barents Sea". The agreement is better known as the "Grey Zone Agreement" and for this reason and for the sake of convenience I will in the following use this term.

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49 http://www.regjeringen.no/nb/dep/ud/pressesenter/pressemeldinger/2007/avtalen-mellom-norge-og-russland-om-avgr.html?id=476347

50 http://www.regjeringen.no/nb/dep/ud/aktuelt/nyheter/2007/varangerfjord-avtale-til-stortinget.html?id=491342

The Grey Zone Agreement was signed by the Parties on the 11th of January 1978. As the original title express, the agreement was meant to be temporary; a temporary agreement to organize the practical side of sharing and administrating resources in the ocean while a dispute on delimitation persists. This is underlined throughout the agreement – in the title, in Article 1 and in the conclusive declaration by Norway. Nevertheless, the agreement has been renewed every year since and was this year, in 2009, renewed for the 31st time.[51] It is clear that a solution to the dispute and a final result of delimitation is desired, but as long as this is not achieved a temporary agreement is the best solution. It is certainly better than a complete absence of regulation which could inevitably lead to disputes and uncertainty.

The parties to the Agreement of 1978 were Norway and the Soviet Union, while it is now Norway and Russia. The Agreement was sustained by the new founded Russian Federation after the fall of the Soviet Union.

The area that the Agreement regulates, commonly called the Grey Zone, is set by seven coordinates with Article 2 of the Agreement as the legal basis. The area is approximately 67 500 square kilometers, where approximately 61.000 square kilometers is the disputed area, *cf.* 2.6.1. This means that part of the area is unquestionably within Norwegian waters (area A in the illustration) and similarly, the area farthest to the east is unquestionably Russian waters (area B in the illustration). For illustration see figure II above.

The total area is located within 200 nautical miles from the countries' shore. Hence the Grey Zone is within the EEZ, no matter how a final delimitation will look like and which country that will obtain jurisdiction in the disputed area. It should be remembered that both Norway and Russia have ratified the LOSC and adopted laws that ensure the countries an EEZ of 200 nautical miles.

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[51] http://www.regjeringen.no/nb/dep/ud/aktuelt/nyheter/2009/graasoneavtale.html?id=570452 (last visited 24.08.09)

The purpose of the Agreement was, and is, to administrate fish stocks. As the letters between the parties show, attached as a kind of preamble to the Agreement, the parties express their mutual interest and responsibility for the fish stocks in the Barents Sea, and that the aim of the Agreement was to control and regulate the fisheries in the area. The Agreement lies down that the parties shall constrain themselves from any enforcement of Regulation above fisheries that vessels flying the flag of the other party carry out. Further, the Agreement regulates how both parties can allow third parties to fish in the Grey Zone and the information the parties shall pass on to each other.

The Agreement solves the question of which jurisdiction the Parties have in the Grey Zone in regard to fisheries. A party's access to jurisdiction, in the form of prescribing regulation, control and enforcement, follows by interpretation by negative implication of Article 3 and the legislative idea of the Agreement. Jurisdiction in the form of control of third parties' vessels is not explicitly regulated by the agreement either. Again, the underlying legislative reasons for the Agreement, which are to protect fish stocks, suggests that a party has the ability to control these vessels as well. Article 5 leads in the same direction, which states that the control should take form through cooperation. Hence both Parties have the right of access to control third parties' vessels. For the other party's vessels, it is clearly stated in Article 3 that parties shall "restrain themselves from enforcement in any form".

The prohibition of control of the other party's vessels is in regard to "regulation of the fishery". A party's access to give regulation and enforce in matters of other interests to the State is not regulated by the Agreement. As long as it is not prohibited, then the ordinary rules in LOSC shall apply. As a starting-point the area of the Grey Zone is within the EEZ and the coastal State's jurisdiction is regulated by international law, i.e. LOSC. However, the Grey Zone is in a disputed area and this raises the question: which consequences does this have for a coastal State's prescriptive and enforcement

jurisdiction? Specifically, which impact does it have on Norway's access to prevent vessel-source pollution in the disputed area? This will be the subject of discussion in chapter 4.

## 2.7 The high seas

The characteristic nature of the High Seas is the freedom it entails. Traditionally, this has been free use of the high seas for all States and exclusively flag State jurisdiction.[52] What we define as the high sea is in LOSC Article 86 described as "all parts of the sea that are not included in the exclusive economic zone, in the territorial sea or in the internal waters of a State, or in the archipelagic waters". The character of the high seas has not changed much by the third LOSC; still the high seas are "open to all States, whether coastal or land-locked".[53] The freedom comprises navigation, overflight, fishing and scientific research in addition to freedom to lay pipelines and construct artificial islands,[54] and Article 89 simply states that no State may validly purport part of the high sea and claim sovereignty. From this it also follows that no State can prevent ships of other States from using the high seas in a way admissible by LOSC and customary international law.[55]

## 2.8 The continental shelf

In this section I have chosen to comment on the continental shelf to fully complete the overview of the Norwegian territory and Norwegian rights. It is a fact that the rights in connection with the continental shelf have limited impact on the question of a coastal State's opportunity of regulating pollution in the EEZ and the disputed areas. On the other hand, the lengthy Norwegian continental shelf can at the same time have significance in the question of delimita-

52 Churchill and Lowe, p. 203
53 LOSC Article 87
54 Op.cit
55 Churchill and Lowe, p. 205

tion between Norway and Russia, which certainly has an impact on Norway's right of access to regulate pollution in the disputed area.

The continental shelf comprises the seabed and subsoil of the areas that constitute the "natural prolongation" of the land mass of the coastal State. It is a complicated methodology established in LOSC Part V that decides where the continental shelf ends.[56] In short one can say that it is geological matters that are decisive. A coastal State has to make a declaration which is then is subject to a review by the UN Commission on the Limits of the Continental Shelf.[57]

The continental shelf jurisdiction is limited to exploring and exploiting the natural resources of the sea bed. It does not affect the legal status of the superjacent waters and the area will be part of the high sea for all other purposes than the coastal State's right to the shelf's natural resources.[58]

In the case of Norway, the length of the continental shelf was recently reviewed by the UN Commission on the Limits of the Continental Shelf (CLCS). Since Norway's prolongation of the land mass continues beyond the 200 nautical miles limit without going down to any great depth,[59] Norway has provided the CLCS with materials to prove that the Norwegian continental shelf is far longer than what follows by the standard solution. The CLCS gave a recommendation that was in line with the Norwegian considerations.[60] One important aspect of the recommendation is that Svalbard is not considered to have a separate continental shelf. The continental shelf around Svalbard is the continuation, and part of, the Norwegian continental shelf. After the Commission's recommendations, the coastal State can then declare the outer limits with final and binding effect.[61]

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56 LOSC Article 76

57 Established under LOSC, see Article 76(8)

58 LOSC Article 78(1)

59 LOSC Article 76

60 http://www.un.org/Depts/los/clcs_new/submissions_files/nor06/nor_rec_summ.pdf

61 LOSC Article 76(8)

# 3 Fighting vessel-source pollution

## 3.1 Introduction

With the area of Norwegian jurisdiction at sea established, the next step is to examine what rights and obligations Norway has to prevent, reduce and control vessel-source pollution within this area. This will represent a maximum of Norwegian influence in the area where the Norwegian jurisdiction is not clear, i.e. the disputed area in the Barents Sea. Within Norwegian jurisdiction, Norwegian laws apply and this implies a responsibility on the State. Furthermore the State has a responsibility for the obligations taken on through the international conventions it has ratified. The access and the obligation to act against pollution will form an important basis for the discussion of Norway's access to regulate vessel-source pollution in the disputed area, in chapter 4.

As one can detect from the outline of maritime zones in chapter 2 above, States may generally prescribe their own, national, pollution regulation for their internal waters and territorial sea. Beyond the territorial sea, however, prescriptive jurisdiction must be specifically conferred by international law. For this reason, the international legal framework dealing with vessel-source pollution is particularly important in regard to pollution in the Barents Sea, which primarily consists of EEZs and High Sea. The LOSC is still fundamental to the outline of a coastal State's possibilities in its waters. While MARPOL 73/78 will be invoked as the basic convention dealing with vessel-source pollution, it is still adjusted in accordance with LOSC. The MARPOL Convention does not deal with jurisdiction issues; in Article 9(3) it is merely stated that the term jurisdiction in the convention shall be construed "in the light of international law". At the interception of the MARPOL Convention LOSC III was not yet a reality and the debate was at that time tempered in regard to coastal State jurisdiction. The MARPOL Convention left the limits of coastal State jurisdiction for the LOSC

to resolve.[62] The result is a close relationship between the two conventions, where the MARPOL convention must be read in conjunction with the LOSC. MARPOL specifies how State jurisdiction should be exercised to ensure compliance with anti-pollution regulation, while the degree to which coastal States may enforce MARPOL regulations in respect of foreign vessels in the EEZ is a subject regulated by LOSC.[63] As we will see below, the relationship is visible through the institute of "GAIRAS".

The conventions and laws that will be examined in the following are chosen because they all are central in combating pollution at sea and they have relevance for the topic. To begin with, the preventive regulation will be commented on; the MARPOL Convention will naturally be described in 3.2, afterwards, in 3.3, the national legislation, where the Pollution Control Act and Ship's Safety Act are essential, will be investigated. In 3.4 and 3.5, this thesis will look at the State's possibilities of enforcing the regulation by examining the port State control and coastal State control. Then in 3.6 an outline of the legal framework in connection to acute pollution will be presented, through comments on regulation of response; the OPRC Convention, a bilateral agreement between Norway and Russia and lastly the Intervention Convention. These conventions show part of the coastal State's opportunity to take action against incidents of pollution. In 3.7, this chapter will be summed up by an outline of Norway's possibilities and obligations in the EEZ.

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62 Tan, p. 185

63 For a comprehensive overview of the relationship between UNCLOS and various IMO instruments (among others MARPOL), see: IMO LEG/MISC.5, Implications of the United Nations Convention on the Law of the Sea for the International Maritime Organization

## 3.2 International Convention for the Prevention of Pollution from Ships (MARPOL 73/78)

The International Convention for the Prevention of Pollution from Ships (MARPOL 73) was adopted at a conference in 1973, the purpose of which was to update MARPOL's predecessor OILPOL 54. OILPOL 54 was a first initiative by the maritime community to reduce oil pollution at sea.[64] The main purpose of these initiatives was to prevent pollution from operational discharges. OILPOL 54 was superseded by MARPOL 73.[65]

MARPOL 73 consisted of many technical requirements set out in five annexes to the convention. The intention of the conventions regime was to achieve the complete elimination of intentional pollution and also to minimize accidental discharges of oil and other harmful substances. Inevitably, this was an ambitious plan. Unfortunately, some of the technical requirements were a little too rigid for the convention to come into force, but luckily a new conference was held to carry out the necessary adjustments in 1978. The result was MARPOL 73/78, i.e. the 73 and 78 editions are to be read together as one piece. The 1978 protocol opened up for this solution together with the consequence that new states ratifying the convention in 1978 would be part of the 1973 convention as well.[66]

Today the convention consists of six annexes: the two first ones are mandatory for contracting States, Annex I and II,[67] while the four remaining are optional. Annex I contains Regulations for the prevention of pollution by oil and Annex II concerns Regulations for the control of pollution by noxious liquid substances in bulk. The optional annexes are Annex III Regulations for the prevention of pollution by harmful substances carried by sea in packaged form, Annex IV Regulations for the prevention of pollution by

64 See De La Rue and Anderson, "Shipping and the environment", p. 822 for details

65 MARPOL 73, Article 9

66 De La Rue and Anderson, p. 824

67 MARPOL 73, Article 14(1)

sewage from ships, Annex V Regulations for the prevention of pollution by garbage from ships and last Annex VI Regulations for the prevention of air pollution from ships. In this thesis I will focus on the mandatory annexes, Annex I and II, as the focus of the thesis is to investigate the possibility of regulating ships pollution in the disputed areas of the Barents Sea, which lie within the EEZ. As we saw above in 2.1.3, a coastal State's prescriptive jurisdiction is limited to adoption of regulation "conforming to and giving effect to generally accepted international rules and standards established through the competent international organization or general diplomatic conference"[68] in its EEZ. In short, I will refer to this as generally accepted international rules and standards –"GAIRAS".

Today it is reckoned that Annex I and II of MARPOL is GAIRAS[69]. Hence, the directive found in MARPOL Annex I and II is one element of what a coastal State has the opportunity to regulate in the EEZ. There are also voices that hold that GAIRAS refers to the principal instrument on marine pollution, MARPOL 73/78[70]. Read like this, GAIRAS is not limited to the two mandatory Annexes. The author Tan maintains that as long as it can be established that a specific rule or standard enjoys sufficiently general state practice in a particular field of regulation, the rule of reference (GAIRAS) ought to extend to that rule.[71] In a situation like this, there has to be proven a sufficient general acceptance for the specific rule, not the general acceptance of the legal instrument where the rule appears. This calls for a case-by-case study, also for the rules and standards found in MARPOL's annexes. In any event, MARPOL 73/78 has achieved widespread acceptance and as of 1st of January 2009 149 States were members of the convention and the convention has become an international success.[72]

68 LOSC Article 211(5)
69 Churchill and Lowe, p. 346
70 Tan, p. 195–196
71 Tan, p. 196–197
72 De La Rue and Anderson, p. 847

Annex I is the main source in international law for preventing oil pollution from ships.[73] The content of Annex I is two-sided; it contains technical requirements to the ships, hence reducing the risk of pollution in the case of accidents. A typical example is the requirement of double hulls for oil tankers.[74] Secondly, it contains rules to control initial operational discharges. Annex II applies to all ships carrying noxious liquid substances (NLS) in bulk.[75] The regulation has common features with Annex I and contains both technical requirements for ships carrying NLS in bulk and it regulates the discharge of NLS.

Furthermore, both Annex I and II call for record books[76] and an emergency plan.[77] There is also a requirement for the government of each party to the convention to ensure reception facilities.[78] There are three situations that constitute exceptions to the restrictions on discharge. The first situation is in the case of force majeure, i.e. the discharge is necessary for the purpose of securing the safety of a ship or saving life. Secondly, the discharge requirements do not apply when discharge is the result of damage to a ship or its equipment. Third, it is accepted when the purpose is to combat specific pollution incidents.[79]

The main Convention MARPOL 73/78 lays down the member State's obligations. Article 4 is central in the way it states that violation of the convention shall be prohibited and that sanctions shall be established. According to the first paragraph, this applies to violation by the fleet flying the flag of the contracting party. Furthermore, the obligation to detect and prosecute violations apply to all incidents within the State's jurisdiction.[80] Article 12 states that

73 Op.cit, p. 824
74 Regulation 19 and 20
75 Regulation 2(1)
76 Regulation I/17 and 36 and II/15
77 Regulation I/37 and II/17
78 Regulation I/38 and II/18
79 Regulations I/4, II/3
80 Article 4(2) and Article 6

the parties are obliged to conduct an investigation of any casualty occurring within the applicability of the convention. Furthermore, a contracting party takes on responsibility to promote technical cooperation.[81]

Norway has first and foremost complied with its duties through declaring the MARPOL Regulation of 16th of June 1983 and with the Ships' Safety Act in 2007.

## 3.3 Norwegian legislation on vessel-source pollution

The main legal tool in the Norwegian legislation to prevent pollution is the Pollution Control Act of 13th of March 1981.[82] The Pollution Control Act is general and covers all kinds of pollution and discharge. Hence it is also a relevant national act in regard to vessel-source pollution. One aspect is that it is an act of authorization, which channels the necessary power to enforce the regulation to the government. Various directorates are given authority under the Pollution Control Act,[83] with the chief directorate being the Norwegian Pollution Control Authority under the Ministry of the Environment's supervision. The Act also gives the Government the necessary power to amend further regulations concerning matters of pollution and discharge, which is done to a wide extent. A regulation was passed on vessel-sourced pollution on by Regulation of 16th of June 1983. The Regulation has been enacted in accordance with both the Pollution Control Act and the Ships´ Safety Act[84] and is commonly called the MARPOL Regulation. This regulation on

81 Article 17

82 The Pollution Control Act is available in English at government.no, http://www.regjeringen.no/en/doc/Laws/Acts/Pollution-Control-Act.html?id=171893

83 Pollution Control Act, § 81

84 The former Act of 9th of June 1903, followed up in today's Ships Safety Act in force as of 16th of February 2007

vessel-sourced pollution implements the obligations Norway has according to MARPOL 73/78 (see above).

The Act is applicable to pollution occurring within the realm, pollution threatening to occur within the realm and lastly it also covers pollution occurring within the EEZ and threatening to occur within the Norwegian EEZ as long as the source of pollution is a Norwegian ship or construction, *cf.* section 3. An opportunity to increase the applicability is presented in the section's wording: "otherwise to the extent decided by the King".[85] The applicability is extended in one respect with "FOR 1997-09-19 nr 1061: Forskrift om inngrep på åpent hav og i Norges økonomiske sone i tilfelle av havforurensning eller fare for forurensning av olje eller andre stoffer som følge av en sjøulykke.", freely translated this is the "Regulation on Intervention on the High Sea and in the Norwegian Exclusive Economical Zone in the case of pollution of the sea or threat of pollution by oil or other substances as a consequence of a marine casualty". The Regulation follows the Intervention Convention closely (see below in 3.6.3). Furthermore, the Pollution Control Act is extended to apply to Svalbard and Jan Mayen according to the Regulation of 22nd of August 1997.

In regard to vessel-source pollution, the Pollution Control Act is first and foremost relevant in matters of acute pollution. Its chapter 6 deals with acute pollution and responses to incidents. In regard to discharges besides incidents of acute pollution, the Ships' Safety Act of 2007 is the central act. The Ships' Safety Act contains both provisions on technical standards (ch.3) and discharge regulation (ch.5), which are typical fields of the MARPOL Convention. In section 31 of the Ships' Safety Act, it is simply stated that discharge and dumping from a vessel is prohibited, unless it is explicitly allowed by regulation. The general rules on construction, contingency plans and reception facilities are also found in chapter 5 (§§ 32, 34 and 35) as it is known from the MARPOL Convention. The detailed regulation of discharges is found in the MARPOL Regulation.

[85] Pollution Control Act, § 3(2)(3)

Moreover it follows from section 3, second paragraph, that the Act's regulation is applicable to foreign vessels in Norwegian territorial water and the EEZ as well. In both prescribing and enforcing the regulation in respect of foreign vessels, it is a requirement that it is admissible by international law[86] (it would anyway be a requirement pursuant to international law via LOSC and the requirement of standards to GAIRAS in the EEZ). This opening increases Norway's opportunity to combat vessel-source pollution in the Barents Sea. The opportunity is further extended by the third paragraph of section 3, where it is stated that the King can expand the Act's applicability to waters beyond the EEZ by prescribing a Regulation, as long as this is in compliance with international law. It follows from the preparatory works[87] that the potential situation is the one described in LOSC Article 218. With this article, the LOSC gives the right of access to institute legal proceedings against discharges that have occurred in waters *beyond* Norwegian EEZ if the vessel later enters a Norwegian port. This is a matter of port State control, which naturally leads us on to the next sub-chapter.

## 3.4 Jurisdiction and control by Norway as a Port State

While we have both national and international legislation prohibiting vessel-source pollution prescribed, enforcement of them is another side of a State's jurisdiction. Enforcement represents a State's opportunity of fulfilling the aims of the regulation. As commented on in the introduction, a State has jurisdiction as a flag State and geographically as a coastal State and a port State. Here I will outline the enforcement powers of a port State.

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86 Ships' Safety Act § 3, 2. paragraph "med de begrensninger som følger av folkeretten"

87 NOU 2005: 14, p. 82 and Ot.prp.nr.87 (2005–2006) p.106

The implications of port State control in regard to the subject of this thesis is that Norway has extended possibilities of enforcing its regulation of pollution in the Barents Sea if the vessel suspected of pollution anchors up in a Norwegian port. In the LOSC, the obvious admittance of port State control is found in Article 220(1). Here the customary international law was confirmed, providing that a State may institute proceedings against vessels voluntarily within port that have violated the pollution laws of the State which is in accordance with international law, while inside waters where the port State has jurisdiction.

By introducing Article 218, however, the LOSC was innovatory.[88] The article states that a port State may even take legal proceedings against vessels alleged to have discharged *outside* the State's territorial sea and EEZ. It is a requirement that the case represents "violation of applicable international rules and standards established through the competent international organization or general diplomatic conference". Thus port State may now conduct investigations of all vessels in their port on suspicion of polluting incidents practically anywhere at sea. If the alleged discharge has occurred within another State's internal waters, territorial sea or EEZ, however, the port State cannot take legal proceedings unless the offended State or the flag State requests it.

According to Article 219 a port State shall take administrative measures to prevent further pollution in case a vessel is "in violation of applicable international rules and standards relating to seaworthiness of vessels and thereby threatens damage to the marine environment". The vessel is not allowed to sail until the cause of violation is removed or transported to the closest repair yard. The coastal State control seems to constitute a broad opportunity for a port State to control alleged incidents of vessel-source pollution.

[88] Churchill and Lowe, p. 350

## 3.5 Jurisdiction and control by Norway as a Coastal State

Although port State control seems broad, it is dependent on the vessel suspected of pollution stopping in a port. That is by no means always the case; large vessels in particular can cross huge distances without stopping in ports. Besides, in the case of polluting vessels it is not implausible to suspect that a polluting vessel will leave the polluting area and sail by. In the event a vessel is merely sailing through Norwegian waters and the EEZ, the opportunity for coastal State control is essential in order to give Norway a chance of fighting pollution in the Barents Sea. The basis for a coastal State's enforcement jurisdiction in regard to protection and preservation of the marine environment is found in LOSC Article 220.

In regard to vessels in passage through the territorial waters, there must be clear grounds for believing that the vessel has violated the coastal State's pollution regulation, which is in accordance with LOSC. In these incidents the coastal State may physically inspect the vessel, and if the evidence so warrants, it may institute proceedings, including detention of the ship.[89]

In the EEZ, the right of access to enforcement varies in correlation with the suspicion and the graveness of the pollution. The starting point is the same as for incidents in the territorial sea; there have to be clear grounds for believing that a vessel has committed a violation in the State's EEZ. Furthermore, the infringed regulation has to be applicable international rules.[90] If the violation is not a substantial discharge causing or threatening to cause significant pollution, the coastal State's authorities may only require the vessel to provide them with information.[91] If, however, the violation results in a substantial discharge, the coastal State's powers are broadened to include inspection if the vessel has either refused to give infor-

[89] LOSC Article 220(2)

[90] LOSC Article 220(3), see 2.5.1 for an outline of the prescriptive jurisdiction in the EEZ

[91] Op.cit

mation as requested or the given information is evidentially at variance with the factual situation.[92] Lastly, the coastal State has an unlimited right of access to enforce through inspection when there is clear objective evidence that a vessel has committed a violation that results in discharge causing major damage or the threat of one.[93] The proceedings may include detention of the vessel.

Altogether we see that the coastal State is accoutred with the ability to inspect vessels which are suspected to have violated pollution regulation. However, it is limited to violation of GAIRAS and in the EEZ the enforcement is further limited to grave pollution matters. The positive outcome of the restraint of enforcement to concern GAIRAS is that it secures foreseeable and good conditions for international shipping through an easy passage through territorial waters on the same terms in all oceans and the freedom of the high seas in the EEZ, while the protection of the environment is secured through a coastal State's right of intervention, which has the closest interests and best opportunities for a quick and effectual response.

The enforcement in regard to violation of pollution standards does not apply to warships or other ships of another State used in governmental non-commercial service. A similar rule is also found in MARPOL Article 3-3. Therefore, in pollution incidents by war- and state-ships the responsibility lies fully with the flag State.

## 3.6 Acute pollution response

While the regulation concerned so far in chapter 3 is aimed at prohibition of vessel-source pollution, this section will examine regulation concerning response and preparedness to the occurrence of pollution incidents. This will illustrate Norway's opportunity to take action in the event of pollution incidents in the Barents Sea, which is an important side of preserving the marine environ-

92 LOSC Article 220(5)
93 LOSC Article 220(6)

ment there. Incidents that call for a response will in most matters be defined as acute pollution. In the Pollution Control Act, acute pollution is defined as "significant pollution that occurs suddenly and that is not permitted in accordance with provisions set out in or pursuant to [the Pollution Control Act]". As we will see, a situation more or less similar to acute pollution in the meaning given in the Pollution Control Act is required for a coastal State to be allowed to take action against polluting vessels.

### 3.6.1 International Convention on Oil Pollution Preparedness, Response and Co-operation ("OPRC Convention")

The Convention on Oil Pollution Preparedness, Response and Co-operation (OPRC) is the result of an acknowledgement that the plans for prevention and response to oil pollution prior to the convention were not good enough to cope with the serious risk oil pollution at sea represents. The acknowledgement came after several disasters of vessel-sourced oil pollution.[94] It is certain that it is not enough to have a regulation with the aim of prohibiting and reducing pollution as it is, unfortunately, for there will most certainly be incidents of pollution nevertheless. As the convention's title implies, the OPRC Convention attempts to improve both the preparedness for pollution through plans, the response to a possible incident of oil pollution and to ensure cooperation across borders. The OPRC Convention came into force on 13th of May 1995 and as per 1st of January 2009 there were 98 contracting States, including Norway.[95]

On the subject of preparedness, the OPRC Convention calls for Oil Pollution Emergency Plans.[96] The emergency plans are to be on

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94 E.g. *Exxon Valdes*, an American tanker that broke up on the 24th of March 1989. For details of this incident, see De La Rue and Anderson, p. 48.

95 De La Rue and Anderson, p. 1155. Russia has ratified the OPRC HNS Protocol 2000 per 1st of January 2009, but not the main OPRC Convention.

96 Article 3(1)

board every ship under the flag of a Party to the convention. The same applies to offshore units.[97] Further, the ships and units are obliged to report discharge and probable discharge of oil.[98] As for the response to incidents, the OPRC Convention contains a provision on how the Parties shall act to a report of oil pollution[99] and require the States to establish both national and regional systems for preparedness and response.[100] Lastly, for the purpose of cooperation the OPRC Convention instructs the parties of the convention to cooperate and provide the service and equipment they can afford, taking their capabilities into account.[101] This cooperation also includes financial agreements and cooperation on research and development.[102]

Originally, the OPRC Convention only dealt with incidents involving oil pollution. Today there is an OPRC-HNS Protocol in addition, in force from 14th of June 2007. The protocol requires similar measures for Hazardous and Noxious Substances (HNS) as those mandated by OPRC.

Norway has complied with the obligations laid down in the OPRC Convention through various provisions. The requirement for ships flying the Norwegian flag to have an emergency plan and report is fulfilled through the Ship's Safety Act of 16th of February 2007.[103] The oil reporting procedures are also regulated in Regulation of 9th of July 1992, in case of acute pollution. The government's actions in the event of pollution reports are regulated in the Pollution Control Act, chapter 6.

The bilateral agreement Norway has with Russia – "Agreement concerning the Combating of Oil Pollution in the Barents Sea" – is

97 Article 3(2)
98 Article 4
99 Article 5
100 Article 6
101 Article 7
102 Respectively, Annex "Reimbursements of Coasts of Assistance" to OPRC Convention and Article 8
103 Ship's Safety Act, Chapter 5, in particular § 34

another way in which Norway has complied with the OPRC Convention, especially the obligation pursuant to the Convention's Article 6(2) and Article 7. The quickest reply to the convention was the agreement concerning Co-operation in Measures to deal with Pollution of the Sea by Oil of 1971 between the Nordic States Denmark, Sweden, Finland and Norway, however.[104] The agreement was followed by the Convention on the Protection of the Environment in 1974.[105]

### 3.6.2 Bilateral agreement between Norway and Russia concerning the Combating of Oil Pollution in the Barents Sea

The agreement between Norway and Russia concerning the combating of oil pollution in the Barents Sea was entered into on 28th of April 1994. The agreement was entered into against the background of an awareness of the increased threat of pollution incidents represented by the countries' activities in the Barents Sea, i.e. shipping, fishing and petroleum. Under the terms of the agreement, the Parties shall inform each other in the event of incidents of oil pollution that may influence the other Party. In the case of acute oil pollution, there exists a separate preparedness plan, which sets forth how notification shall be given and how a State administrated response's actions shall be carried out. The preparedness plan exists as of the same date as the Agreement, 28th of April 1994, and is called "Joint Norwegian-Russian Contingency Plan for the Combating of Oil Pollution in the Barents Sea". As prescribed by the bilateral agreement, the contingency plan sets out how response operations shall be carried out (chapter 5) and further how there should be joint planning (chapter 4) and also the establishment of joint response centres (chapter 6).

[104] Churchill and Lowe, page 337
[105] Op.cit

### 3.6.3 International Convention relating to Intervention on the High Seas in Cases of Oil Pollution Casualties

The Intervention Convention is concerned with intervention on the high sea. The objective of the convention is simply to secure the prevention of vessel-source pollution by providing the parties with the opportunity to intervene in cases of grave pollution outside the territorial waters. Article I.1 is the basis for intervention, where it is stated that the parties to the convention can take such measures as may be necessary to prevent grave and imminent danger of pollution that may cause major harmful consequences to the coastline or related interests, following a marine casualty.

Just as the OPRC Convention was a response to tragedies of vessel-sourced pollution, in particular the incident of *Exxon Valdes,* the International Convention Relating to Intervention on the High Seas in Cases of Oil Pollution Casualties (hereinafter the Intervention Convention) was a consequence of the *Torrey Canyon* disaster in 1967.[106] To prevent further pollution, the British government made radical steps through aerial bombardment. This disaster showed the world how it can be absolutely necessary with State intervention, and after only a couple of years the Intervention Convention saw the light of day, on the 29th of November 1969.

The requirements for intervention relate to the situation, the interests at stake and the preventing measures. The situation of pollution or threat of pollution has to have its origin in a "maritime casualty". A maritime casualty is in the meaning of the convention a collision of ships, stranding or other incident of navigation, or other occurrence on board a ship or external to it resulting in material damage or threat of material damage to a ship or cargo.[107] By the wording "other occurrence" it is clear that the list of situations in Article II.1 is not exhaustive, but that other occurrences

[106] For details of the Torrey Canyon disaster see De La Rue and Anderson, p. 10
[107] Intervention Convention Article II.1

should have a similarity with the situations listed. There is a clear requirement that the situation of pollution is "grave and imminent", meaning that the degree of danger is high. This is closely connected to the requirement that the situation must "reasonably be expected to result in major harmful consequences" which serves intervention for situations where the degree of damage is high. Together they form a requirement of danger both in time and expansion.

Intervention is limited to prevention of pollution harming the "coastline or related interests". "Related interests" are outlined in Article II.4, covering a) maritime coastal, port or estuarine activities, b) tourist attractions and c) the health of the coastal population and the well-being of the area concerned. The list Article II.4 contains it not exhaustive as follows from the words "such as". It is not possible to say what can or cannot be included, but together with the purpose of the convention[108] and the context in Article II.4 it is clear that the interest affected is protected out of environmental concerns and not economical for instance.

Intervention can only be done by "such measures… that may be necessary". The constraint on a party's measures is thus that they have to be proportionate. We find the same principle of proportionality in Article V which regulates the exercise of intervention. It states that measures taken in accordance with Article I "shall be proportionate to the damage actual or threatened to" the State. The measures should not extend what is "reasonably necessary".[109] All this restricts a State's measures, at the same time as it leaves a great deal of discretion to the State. Guidelines are given in part 3 of Article V, in considering the measures a State shall take into account the result if measures are not taken, the likelihood of the measures to be effective and what damage will be caused by the measures.

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[108] The Intervention Convention's preamble states: "Concious of the need to protect their peoples against the grave consequences of a maritime casualty resulting in danger of [oil] pollution of sea and coastline"

[109] Intervention Convention Article V.2

The convention does not deal specifically with intervention in the EEZ. The convention only distinguishes between the territorial sea and the high sea. Knowing that UNCLOS III, where the EEZ was established, was set in 1982, 13 years after the Intervention Convention 1969, it is no wonder that the Intervention Convention does not operate with the concept of the EEZ. As of today it is clear that a coastal State can adopt laws preventing pollution for the EEZ when they conform to generally accepted international rules and standards, see above in 2.5 regarding the LOSC and the EEZ. Further, the coastal State has power to carry out various measures in response to suspected violations of international laws for the prevention, reduction and control of marine pollution[110]. More than so, the LOSC also grants the coastal States a right to intervene on the high sea in the matters covered by the Intervention Convention.[111] Hence, even though the Intervention Convention talks about the "high sea" it is clear that the parties' right to intervention in matters of serious pollution that threaten the State's interests also apply to incidents in the EEZ. This can also be derived from the Intervention Convention's wording itself; since the Convention distinguishes between the territorial sea and the high sea it is a safe interpretation to say that the Convention is applicable to the areas outside the territorial sea.[112]

In the Norwegian Intervention Regulation, implementing the Intervention Convention to national legislation, the Regulation's applicability is however limited to the high sea and "the Norwegian exclusive economical zone". The result is a discrepancy where the Norwegian Regulation has an area of applicability which is less than that which is admissible by the international convention.

In the case of a pollution incident in the Russian EEZ of the Barents Sea, the question arises as to whether Norway can utilize the admissible intervention under the international convention,

110 LOSC Article 220

111 LOSC Article 221(1)

112 Same solution by Nordquist, UNCLOS 1982 A Commentary, p. 306

which has not been implemented in the Norwegian Regulation. A legal basis for intervention could be necessity.[113] In utilizing necessity, one would have to apply discretion to the specific case. In general terms, one can say that the actual danger an incident of acute pollution represents would favour necessity. The concrete delimitation the Norwegian government has made by the wording "the Norwegian exclusive economical zone" is nevertheless not very likely to be supplemented and this is in disfavour of allowing intervention in other countries' EEZs on the basis of necessity. Then again, the limitation of the area is stipulated in a regulation, while necessity has the authority of Law.[114] This implies that the regulation will be superseded by the necessity if the concrete situation entails that necessity is applicable. Furthermore, the shipping business on the high sea is of an international character and it is most likely that the operators are familiar with the international framework of law. This adds on to the arguments in favour of allowing intervention on the basis of necessity. Altogether it may be concluded that the Norwegian government can intervene in the event of acute pollution in another country's EEZ, in line with the convention's permission of intervention outside the territorial sea.

By a Protocol of 1973 cases involving pollution or threat of pollution by substances other than oil are also covered by the Intervention Convention.

The Intervention Convention's Article III and IV states how the measures taken by a coastal State shall be carried out. The regulation in Article III lays down the principle of notification while the latter concerns the principle of proportionality of the measures compared with the damage or threat of damage.

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[113] Necessity can in short be defined as a right to perform an illegal act in aim to save persons or interests from a threat that without the act of necessity would be unavoidable

[114] Andenæs, *Alminnelig strafferett*, p. 180 and the Criminal Act § 47. It has also been asserted that necessity is of constitutional rank, *cf.* Andenæs, Statsforfatningen i Norge

In Norway, the Intervention Convention is implemented in the national regulation through the "Regulation of Intervention" of 19th of September 1997.[115] The Regulation is more or less a copy of the admissible intervention set forth in the Intervention Convention, with the exception of the specification of intervention in the EEZ, as discussed above. The national Regulation applies to the Norwegian exclusive economical zone, probably other countries' EEZs, and at the high sea, included the waters around Svalbard and Jan Mayen.[116]

## 3.7 Conclusions on Norway's possibilities and obligations in the Exclusive Economical Zone

The government (with further delegations) is responsible for ensuring that the regulation contained in the Pollution Control Act and the Ships' Safety Act, together with its Governmental Regulations, is carried out. This means that the pollution regulation has to be enforced in the EEZ to prevent pollution, within the confines of the LOSC.

In regard to what is called "operational discharges", outside the scope of acute pollution, we have seen that the main regulation applicable is the MARPOL Conventions Annex I and II. LOSC Article 216 would appear to imply that a coastal State "shall" enforce the MARPOL regulation in the EEZ in the event of violations constituting dumping. Similar obligations follow from the MARPOL Convention itself; which states in Article 4(2) that any party to the Convention shall prohibit violation within its jurisdiction and violations shall be sanctioned. All of this implies that Norway has an obligation to prohibit and sanction vessel-source pollution that violates the Norwegian pollution regulation. However, operational discharges as dealt with in MARPOL do not

[115] FOR-1997-09-19-1061: Forskrift om inngrep på åpent hav og i Norges økonomiske sone i tilfelle av havforurensning eller fare for forurensning av olje eller andre stoffer som følge av en sjøulykke

[116] National Regulation of Intervention, Article 1

necessarily represent the degree of pollution required for intervention in the EEZ by LOSC.[117] The most Norway can do in situations that do not involve acute pollution where the MARPOL-regulation has been contravened is to require the ship to give information, *cf.* Article 220(3). This leaves a vacuum where Norway has obligations to prohibit pollution, but cannot intervene in the event of violations.

The situation is somewhat better for incidents of acute pollution. The Intervention Convention, implemented through the Intervention Regulation, secures Norway the right to take action against acute pollution on the high sea.[118] As discussed above, this includes the EEZ, as intervention is understood to be admissible in areas 'beyond the high sea,[119] and intervention under the Intervention Convention is thus not limited to a coastal State's own EEZ. Pursuant to the Norwegian Regulation, Norway can only intervene in the Norwegian EEZ and at the high sea. However, in a certain situation of pollution following a marine casualty in another country's EEZ, necessity could provide a basis for Norwegian intervention nonetheless[120].

The Intervention Regulation is the only area where Norway has extended the Pollution Control Act to apply to the EEZ. The full Pollution Control Act does not apply either, only as follows from the Intervention Regulation. As stated above in 3.3, Norway has the opportunity to extend the Act's applicability to the EEZ, *cf.* § 3.3 of the Pollution Control Act. The Act on the Norwegian Exclusive Economic Zone also contains a provision that gives access to prescribe regulations concerning environmental protection,[121] but this right has so far not been utilized. Utilization would be in accord-

[117] Cf. LOSC Article 220(5) and (6) -As outlined in 3.5. A similar, strict criterion for intervention follows from the Intervention Convention and the national Intervention Regulation

[118] See 3.6.3

[119] Churchill and Lowe, p. 354 and De La Rue and Anderson, p. 901

[120] See discussion above in 3.6.3

[121] Act No. 91 of 1976, § 7 litra a)

ance with international law as long as the adopted regulation would be "conforming to and giving effect to generally accepted international rules and standards established through the competent international organization or general diplomatic conference".[122]

To provide satisfactory protection of the Barents Sea and the Norwegian coast and waters it would be advisable for the Norwegian government to adopt regulations for the preservation of the marine environment in accordance with LOSC Articles 56 and 211. It could be argued that Article 56 gives a coastal State a wider authority to adopt laws concerning vessel-sourced pollution when it represents a threat to natural resources than what follows from Article 211. In this regard, it is important to bear in mind the *sui generis* character of the EEZ and that vessels are granted the freedoms of the high sea at the same time as the coastal State is given some rights and jurisdiction in the zone. In addition, the purpose behind the requirement of GAIRAS in Article 211 is to ensure conformity for international shipping. Therefore, a coastal State should be restricted in adopting a regulation outside the limits of Article 211 and for Norway the focus should be to secure a pollution regulation for the EEZ as admissible by the Pollution Control Act, the EEZ Act and the LOSC Article 211.

As we saw in 3.3, the Ships' Safety Act is applicable to the EEZ and this is an important shelter for the marine environment and Norwegian preservation of the Barents Sea. This fulfils Norway's duties following the MARPOL Convention and is in line with international law as MARPOL has achieved the standard of GAIRAS.

On the preparedness side, Norway has an obligation to notify other countries in the case of incidents and the benefit of receiving notification from other countries. Notification obligations and contingency plans are also prescribed in the LOSC, *cf.* Articles 198 and 199. The articles confirm the obligations as in the OPRC Convention and the bilateral agreement with Russia on combating pollution in the Barents Sea.

[122] LOSC Article 211(5)

# 4 Norway's access to regulate and enforce pollution regulation in the disputed area of the Barents Sea

## 4.1 Introduction

The disputed area in the Barents Sea that this thesis examines is positioned within the EEZ.[123] As a starting point, the ordinary rules of a coastal State's jurisdiction within the EEZ regulates Norway's possibilities within its EEZ.[124] The problem is of course that it is disputed; it is not definite that the area in question is Norway's EEZ.

As previously mentioned, the western part of the Grey Zone (area A in figure II) is clearly Norwegian, also according to Russia's claim for delimitation in the Barents Sea. Hence, this area is not disputed and here Norway has the same prescriptive and enforcement jurisdiction as in the remaining EEZ. The only limitation is in regard to fisheries and Russian vessels, such as that which follows from the Grey Zone Agreement. Similarly, the area east of the median line (area B in figure II) is clearly Russian and outside Norwegian jurisdiction. The area that remains to detect and the object of the ensuing discussion is the area between the sector line claimed by Russia and the median line claimed by Norway, the area which is in fact truly disputed.

In the following I will start by briefly outlining the Norwegian approach to regulating pollution in the area under Norwegian law. Afterwards, I will examine the possibility of establishing further jurisdiction in this zone according to international law. Hereunder I will try to substantiate what is the voice of the International Court of Justice (ICJ) and continue to look at legislative reasons for Norway to regulate and enforce in the area concerned.

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[123] See Figure II in 2.6.1 and the comment to limitation

[124] See 2.5

## 4.2 Norwegian legislation concerning pollution in the EEZ and applicability to the disputed area

The first Norwegian Act that has an impact on the disputed area is the Act of 17th of December 1976 concerning the Exclusive Economical Zone. Section 1(2) states that "the outer limit of the economic zone shall be drawn at the distance of 200 nautical miles from the applicable baselines, but not beyond the median line in relation to other States". There are no exceptions to this principle and the idea is that Norway has an exclusive economical zone along the whole coast of the country. The Act lays down that the King may make exceptions to the principle of exclusivity principle through agreements with foreign States,[125] as Norway has done with the Grey Zone Agreement. Agreements like this cannot be understood as relinquishment of jurisdiction in the area, however. Now, since there are no exceptions to the principle, the starting point is that the EEZ Act and the rights of Norway as a coastal State apply to the eastern part of the Norwegian territory in the Barents Sea as well.

It follows from § 7 of the Act that the King may prescribe regulations concerning environmental protection in the EEZ within the limits of international law. As the Act in principle applies to the disputed area as well, Norway is entitled to regulate pollution in this area as it clearly represents "environmental protection", *cf.* § 7, litra a. As previously discussed, this opportunity has not been utilized.

The Intervention Regulation establishes that Norway is entitled to intervention in the event of a marine casualty in the EEZ. The right to intervene in other countries' EEZs[126] should make the conclusion of allowable intervention in a disputed part of the EEZ dependable. The conclusion is consequently that intervention in

[125] § 6

[126] See 3.6.3; Allowable according to the international convention and could be based on necessity

the disputed area in the event of acute pollution as described in the Intervention Convention is admissible according to public international law.

It is important to remember the rather restricted right of intervention available, which is delimited to matters of pollution caused by maritime casualties that may potentially cause major harmful consequences.[127]

Furthermore, the bilateral agreements with Russia ensure a right of access to take action against serious pollution in the Barents Sea, irrespective of jurisdiction in the area. Article 1 of the Agreement states that the parties shall assist each other "irrespective of where pollution occurs".[128] By interpretation of this section would tend to indicate that this encompasses Norwegian intervention in the event of an incident in the disputed area as well.[129]

In regard to discharges, the standards required by the Ships' Safety Act apply to foreign vessels in the EEZ.[130] A small notice is done to the fact that the Ships' Safety Act is in line with international law and the question thus remains whether Norwegian jurisdiction applies to the disputed area of the EEZ.

## 4.3 International Law – guidelines from the International Court of Justice of relevance to regulation in a disputed area

The International Court of Justice rendered a case in 1974 that is relevant to the topic of this thesis. The case is known as the *Fisheries Jurisdiction Case,131* where the issue under dispute was Iceland's establishment of a 50-mile exclusive fishery zone in 1972. The establishment of a fishery zone was without basis in interna-

127 See 3.6.3

128 Translated from Norwegian

129 However, it is not known how Russia will interpret this section

130 Cf. Ships' Safety Act § 3(2) and 3.3 above

131 *Fisheries Jurisdiction Case* (United Kingdom v. Iceland), Merits, Judgment, I.C.J. Reports 1974, p. 3.

tional law, at that time, when the farthest point in the sea where the coastal State had any kind of authority was the limit for the contiguous zone at 12 nautical miles measured from the baselines.[132] Although the Court noted that a 12-mile fishery zone had become generally accepted and international custom, this was however not interesting to the case as the applicant, the United Kingdom, did not dispute Iceland's exclusive rights within a 12-mile zone. I will now outline how the Court legitimised the Icelandic fishery zone and see how this applies to the case of Norwegian jurisdiction in pollution matters in the disputed area of the Barents Sea.

First, I will remark that the Court did not deal explicitly with the Applicant's request for the court to adjudge and declare "that there is no foundation in international law for the claim by Iceland to be entitled to extend its fisheries jurisdiction by establishing a zone of exclusive fisheries jurisdiction extending to 50 nautical miles from the baselines hereinbefore referred to; and that its claim is therefore invalid".[133] Like the dissenting Judge Ignacio- Pinto declared, the Court's decision is "devoted to fixing the conditions for exercise of preferential rights, for conservation of fish species, and historic rights, rather than to responding to the primary claim of the Applicant".[134] In other words, the judgment never accepts Iceland's establishment of a 50-mile fishery zone explicitly, but as the judgment discusses how the Icelandic Law cannot be opposable to the Government of the United Kingdom, it implicitly admits Iceland the right of establishing a fishery zone.[135] Here follows the reasoning why Iceland could have this right.

Firstly, the establishment is based on a viewpoint that there is a need for measures of protection. This is based on "the exceptional

[132] *Fisheries Jurisdiction Case* p. 22

[133] I.C.J. Reports 1973, p. 5, para. 8 (a)

[134] Page 35 in the judgment

[135] The common way of how to understand the judgment, see among others, Fleischer, *Folkerett* 8. utgave, p. 127, where he states that the demand for judgment of an breach of international law by the establishment of the fishery zone was not followed

dependence of the Icelandic nation upon coastal fisheries" and "of the need for the conservation of the fish stocks in the Icelandic area".[136] It is clear that Iceland is closest to perform the measures of protection. At the same time as the Court admits Iceland rights in the 50-mile fishery zone, the court underlines, by referring to the *Fisheries Case* against Norway, that the "validity of the delimitation with regard to other States depends upon international law". Furthermore, the judgment refers to the Geneva Convention on the High Sea of 1958 Article 2 where it is stated "The high seas being open to all nations, no State may validly purport to subject any part of them to its sovereignty" and that Article 2 goes on to provide that the freedom comprises the freedom of fishing.

At the time the *Fisheries Jurisdiction Case* was brought before the ICJ, there was a tendency in favour of admitting the coastal State additional sovereign rights in the adjacent waters. This was clear through the conferences held in connection with the development of the Law of the Sea Convention and especially by the discussions and various proposals of preferential rights. Even so, the Court naturally held that it could not render a judgment *'sub specie legis ferendae',* or anticipate the law before the legislator has laid it down.

In spite all of this, the establishment of an Icelandic 50-mile fishery zone was not found void in itself. The Icelandic rights within the zone were based on the need for conservation of fish species and historic rights and the fact that Iceland was "exceptionally dependent" on the fisheries given the vital interests it had for its population. Consequently, it seems like it was equity and the heavy impact of the reasons stated that convinced the International Court of Justice to uphold the Icelandic preferential rights in the fishery zone.

For the cause of extending a coastal State's rights in adjacent waters, we can derive from the *Fisheries Jurisdiction Case* that traditions and a pressing need for conservation are positive factors.

[136] Pages 20–21 in the judgment

Applied to the situation of the disputed area in the Barents Sea, we find that the situation is actually quite similar. Norway has long traditions in the Barents Sea and is highly concerned about the environment in the High North.[137] Concerning the environment, it is clear that an administration and regulation are necessary in an area as vulnerable as the Arctic Ocean. Nevertheless, the similarity with the *Fisheries Jurisdiction Case* can clearly not legitimise Norwegian jurisdiction in regard to pollution in the disputed area. What is useful is to show that the reasoning why Norway *should* be progressive to fight pollution in the disputed area has support by the ICJ's rulings. In addition, it should be remembered that Norway would not be claiming jurisdiction in a new area or purporting a claim on the high sea; the disputed area is from a Norwegian viewpoint part of the Norwegian EEZ.

## 4.4 The need for pollution regulation in the disputed area of the Barents Sea. Legislative reasoning

When Norway established its EEZ in 1976, the concept of EEZ was as yet unknown through international conventions. The third version of the UNCLOS was under development through international conferences, where the "hot potato" was the EEZ. In the cause of detecting whether Norway has an opportunity to regulate pollution in a disputed area it can be interesting to see how the government argued and legitimised the establishment of an EEZ which implied an expansion of territorial jurisdiction.

The EEZ was first and foremost established to secure the fish stocks. In the reasoning given in the preparatory works, Ot.prp. nr.4 (1967–1977), the threat against fish stocks was emphasised in particular. Furthermore, the situation as of 1976 was held as an argument: other countries were expanding their fishery zones and Norway did not want to lose track of developments. This situation

[137] Preparatory works, St.meld. no. 8 (2005–2006)

was also used to underscore the threat against fish stocks, when it became impossible to fish in other countries' 200-mile zones, a growing number of other countries would move to Norwegian waters to exploit the resources there. The reasoning was that a legal regime of EEZ would make it possible to prescribe effective measures and establish necessary protection of the resources.

In the ongoing United Nations meetings to draft the new version of the LOSC, Norway took a position where it stated that it was absolutely necessary that the new regulation for economical zones be outlined in a way that was satisfactory for all involved Norwegian interests.[138] This shows that although the fisheries was the main reason for establishing an EEZ, there were other interests involved as well. Preservation of the coast and the marine environment are natural interests to protect.

The preparatory works describe how the tendency in State practice is and how the concept of an EEZ has broad support internationally. At the same time, the preparatory works note that in spite of broad support, there was also another group in massive opposition to the EEZ. At that time, in 1976, it was not clear what would be the final outcome in regard to maritime zones in the third LOSC. Even so, the EEZ was established in Norway. The establishment was legitimised by the tendency in State practice and the reasoning of preservation of the fish stocks and the environment.

As we can see, the main reason for establishing the Norwegian EEZ in 1976 was exploitation and to preserve and protect the resources in the sea. This is clearly an important intention and a valid argument. The exact same argument applies to the importance of establishing pollution regulation in the disputed area. A complete ability to protect both the resources and the environment pollution regulation should not be absent in a huge area of the Barents Sea such as the disputed area. The practical need for preservation is thus a valid argument in favour of Norwegian vessel-

[138] Ot.prp.no. 4 (1976–1977) p. 2

source pollution regulation in the disputed area, just as it was for establishing the EEZ in 1976.

The international tendency in regard to pollution regulation is moreover positive. A coastal State's enforcement jurisdiction in the EEZ is most extensive in pollution matters.[139] The large amount of conventions dealing with pollution reflects the awareness of and willingness to fight against pollution problems and admits the coastal States extended opportunities to fight pollution. This tendency, together with the practical need for regulation fighting pollution in the Barents Sea, represents a strong argument as to why Norway should be able to regulate pollution in the disputed area to the same extent as in the EEZ otherwise.

# 5 Conclusions: Status quo and futuristic perspective

Regulating vessel-source pollution in the disputed area, in the way admissible in the remaining EEZ, would be in line with the claim Norway has filed. Norway claims that the area west of the median line is a Norwegian EEZ and could put into effect jurisdiction in the area on this basis. To be able to utilize the rights of a coastal State according to the LOSC Articles 211 and 220 in the disputed area, it is absolutely necessary for Norway to assert a claim of and perform jurisdiction according to the median line.

The fact that the Norwegian claim is disputed cannot alone be an obstacle for prescribing and enforcing pollution regulation in the area. The Norwegian claim has broad support in international law[140] and this strengthens the viewpoint that it would be admissible for the Norwegian government to regulate pollution in the disputed area. It seems like Norway will not be running a risk of

[139] LOSC Art. 220 and 221 and see 3.5 above

[140] See 2.6.1

breaching international law. The legal position is thus that Norway has about the same access to pollution regulation as in the EEZ otherwise. This would include applicability of the Ships' Safety Act above foreign vessels in the disputed area.

However, the chance of visualizing Norwegian jurisdiction in the disputed area will first be present when Norway makes full use of the admission to regulate pollution in the remaining EEZ. Today the Ships' Safety Act applies to foreign vessels in the EEZ, but the chance of extending the Pollution Control Act's applicability has not been utilized. A legitimate argument for introducing pollution regulation in the disputed area is how the access already is controlled and limited by the LOSC. As a coastal State's adoption of laws is narrowed down to GAIRAS and the enforcement of them limited by Article 220, it makes it less daring of Norway to introduce pollution regulation in the disputed area of the EEZ.

In addition, it can be derived from the ICJ judgment *Fisheries Jurisdiction Case* and the Norwegian preparatory works for the EEZ Act – which both legitimised an extension of the coastal State's jurisdiction in the adjacent waters – that factors like the need for preservation, traditions and international tendency are important for the access. We have seen that all of these factors are present in regard to vessel-source pollution regulation in the disputed area of the Barents Sea. There is a positive tendency concerning environmental protection and the need for it in the Barents Sea cannot be disputed.

Whether or not the Norwegian government should utilize the opportunity to regulate vessel-source pollution in the disputed area will be a decision of high political character, but from a legal jurisdictional point of view it seems to have support in international law. Another opportunity is for the Norwegian government to seek the protection of the marine environment through extended bilateral agreements with Russia. We have seen that bilateral agreements on pollution response exist and that the Grey Zone Agreement for preservation of fish stocks has proven to be successful. In

light of this, cooperation on the subject of vessel-source pollution could be a reasonable suggestion for environmental protection in the Barents Sea and a way in which Norway could regulate vessel-source pollution in the disputed area.

From an environmental point of view, it would be highly advisable to both prescribe and enforce regulation with the aim of preventing vessel-source pollution in the disputed area of the Barents Sea.

## Abbreviations

| | |
|---|---|
| CDEM | Construction, Design, Equipment and Manning |
| CLCS | (UN) Commission on the Limits of the Continental Shelf |
| EEZ | Exclusive Economical Zone |
| GAIRAS | Generally Accepted International Rules and Standards |
| HNS | Hazardous and Noxious Substances |
| ICJ | International Court of Justice |
| LOSC | Law of the Sea Convention |
| MARPOL | International Convention for the Prevention of Pollution from Ships |
| NLS | Noxious Liquid Substances |
| OILPOL | International Convention for the Prevention of Pollution of the Sea by Oil |
| OPRC | International Convention on Oil Pollution Preparedness, Response and Cooperation |
| UN | United Nations |
| UNCLOS | United Nations Convention on the Law of the Sea |

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# The End of Liner Conferences?

## The New Competition Regime for Liner Shipping: Legal and Practical Consequences for European Maritime Transport

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# Content

# 1 Introduction

## 1.1 Topic

On 18 October 2006, the EU Council Regulation ('CR') 1419/2006 came into force. The regulation was the culmination of a development many years in the making, as the regulatory powers in the European Community had changed their view of maritime transport. The block exemption which had come to the benefit of conferences in liner shipping for over 20 years came to an end, the importance of which is accurately described by Milagros Chouciño:

> *"In liner shipping, the repeal of the block exemption for liner conferences meant nothing but a revolution."*[1]

In this thesis I will discuss the impact of CR 1419/2006 on liner shipping in Europe. The regulation has both legal and practical consequences, the former relating to how carriers must assess their activities in accordance with a different set of regulations, while the latter relates to how carriers will attempt to adapt and continue cooperation post CR 1417/2006. The core focus of the thesis is on the legal differences between the former exemption regulation and the now direct application of ECT Article 81 to liner shipping as well as the factors that carriers previously protected by the block exemption must take into account in order to comply with Article 81.

Regulations concerning the European maritime sector will be taken into account in relation to the future of liner conferences and the ability of carriers to operate and cooperate after the introduction of CR 1419/2006. Commission Guidelines on relevant topics will also be taken into account since carriers will likely attempt to comply with these.

[1] Chouciño, Milagros [2008] page 56

## 1.2 History of liner conferences

Liner conferences as a form of cooperation and organizational structure between carriers arose late in the 19th century as a result of intense competition in the maritime transport market. The industrial revolution and the consequent need for large amounts of raw materials led to a major increase in international trade. Carriers started to operate maritime transport on fixed schedules with fixed prices in order to protect themselves from the risk of sailing with small amounts of cargo with a low profit potential. This development was furthered by the introduction of steamships which to a larger extent could guarantee transport in accordance with fixed schedules.

The increase in maritime trading led to the establishment of shipping lines between fixed ports, where transport users could rely on transport at fixed intervals. Such lines could not be upheld by a single carrier, and the need for carriers to cooperate on shipping lines became evident. By cooperating, investing in new technology and at the same time steadily increasing the cargo capacity on maritime transport, liner shipping grew exponentially.

Events such as the opening of the Suez-Canal in 1869, which vastly reduced the length of the Europe-Asia trade route; in addition, the recession in 1873 led to a downturn in the maritime transport market and overcapacity in the sector,[2] which again led to the deterioration of freight rates. It became necessary for carriers to coordinate their efforts in order to minimize losses and increase flexibility towards a volatile market. This instigated the birth of liner conferences.

The first conference was established in 1875 between the United Kingdom and India.[3] The ship owners organized themselves in order to control competition amongst the conference members by such means as a common tariff, equal distribution of sailings,

[2] Herman, Amos [1983], page 8

[3] Ibid.

capacity control and price regulation. The argument to allow liner conferences to operate in contravention of competition regulations was the stabilization of the transport market and predictable operation and price development. This rationale remained the main argument in favour of liner conferences until the introduction of CR 1419/2006.[4]

The regulations revoked by CR 1419/2006 were initially introduced by CR 4056/1986. The latter contained tailored competition regulation for the maritime sector, both material and procedural. The central provision, Article 3, was a block exemption for liner conferences from the EF Treaty Article 81.

Following the introduction of CR 4056/86, liner conferences grew in market share size, and controlled the majority of global containerized maritime transport through the 1990s. The material exemptions enabled carriers in conferences to influence the market in their favour, chiefly unaffected by competition and supply/demand fluctuations.

The material exemptions remained untouched for 20 years,[5] consolidating conference market power. By the end of this period however, the argument that liner conferences were beneficial to the market had changed, and the block exemption was under pressure from independent carriers, transport users and organizations such as the OECD. This led to the European Council's decision to revoke CR 4056/86 and expose liner conferences to the general competition regulations in the EC Treaty and ordinary market controlled competition.

## 1.3 Demarcation

The thesis focuses on the consequences of the regulations introduced by CR 1419/2006 with regard to liner conferences. Regula-

4 OECD Report, 2002, page 18.

5 The procedural regulations in CR 4056/86 were however revoked by CR 1/2003, see below 4.2.1.

tions concerning tramp shipping, pooling and other forms of cooperation within the maritime sector will not be dealt with.

With ECT Article 81 regulating the areas previously covered by the block exemption there are a vast amount of differences concerning detail regulation. Due to the limits of this thesis, I will concentrate on the main differences and central issues. ECT Article 82 will not be dealt with.

## 1.4 Structure

CR 1419/2006 did not introduce any new material provisions, and consists only of articles which revoke provisions concerning liner conferences in other regulations. To understand the background for and consequences of CR 1419/2006 it is important to study the individual provisions in CR 4056/86 and at the same time examine how the general competition regulation in the EC Treaty has an impact on liner conferences.

Applying this approach, I firstly account for how central concepts related to liner shipping are defined in European competition regulation, after which I briefly account for most of the relevant provisions addressed in this thesis. In Chapter 2, I examine the exemptions in CR 4056/86 before I examine the background for why the block exemption was ultimately revoked in Chapter 3. The impact of CR 1419/2006 will be examined in Chapter 4, emphasizing the legal assessments carriers will have to make in order to comply with Article 81. Finally I describe the development in liner shipping which can be anticipated following CR 1419/2006 under Chapter 5.

## 1.5 Definitions

### Liner Shipping

Liner shipping can be described as maritime transport offered on fixed routes and schedules, to and from fixed ports. Various ship types are utilized depending on the demands of the transport users,

including cargo ships, containerships and specialized vessels,[6] although containerized transport is the freight type most commonly associated with liner shipping. The freight routes are usually publicly marketed and available for any paying customer.[7]

### Liner Conferences

The definition of a Liner Conference is a group of two or more carriers (ship owners[8]) operating maritime vessels offering international liner shipping for the transport of goods on one or more fixed routes within specified and limited geographical areas, and which has an agreement or arrangement under which the carriers operate under uniform or equal conditions such as freight rates and other provisions related to liner transport.[9]

### Transport Users

The definition of a Transport User is a company or other juristic person who has or intends to enter into a contractual agreement with a liner conference or shipping line regarding the shipment of goods.[10] Transport Users include shippers, freight forwarders, shippers' associations and other transportation intermediaries.[11]

## 1.6 Legal sources

### 1.6.1 Article 81

The ECT, herein Title VI, Chapter 2, is the main source of law for European competition regulation. The main material provisions are Article 81 and 82. The former regulates anti-competitive agree-

6 OECD Report
7 CMR 823/2000, Article 2 (2)
8 Pozdnakova, Alla [2008], par. 9.2.2.3.
9 CR 4056/1986, Article 1 (3) b
10 Ibid. Article 1 (3) c
11 Pozdnakova, Alla [2008] par. 8.6.1., fn. 136

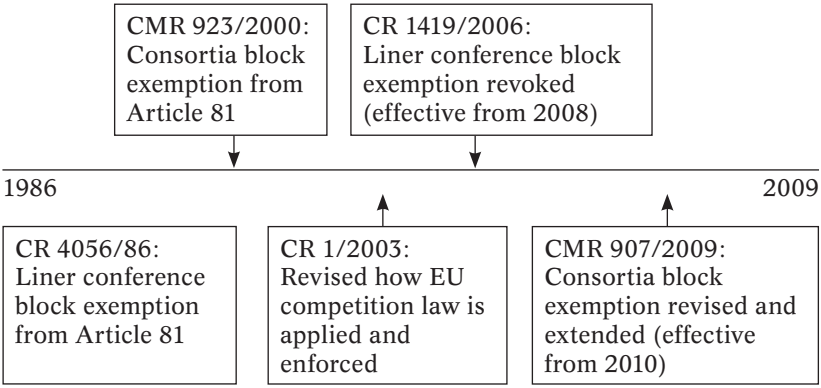
ments such as price fixing and capacity control, while the latter regulates the abuse of dominant position. The exemptions in CR 4056/86 relate to the provisions in Article 81.

The article prohibits any agreements, decision or concerted practice (agreement i.a.) which may affect trade in the union, and which have as object or effect the restriction or distortion of competition.[12] The article also summarizes particular objects or effects to be prohibited.[13]

Article 81 is subsequently the clause that regulates the type of horizontal cooperation that is found in liner conferences, and therefore constitutes the core provision dealt with in this thesis.

### 1.6.2 Regulation timeline

Article 83 imposes on the Council the obligation to introduce "appropriate regulations or directives to give effect to the principles set out in Articles 81 and 82".[14] Such regulations have general application and are binding for EU member states.[15] The main regulations dealt with in this thesis are as follows:




12 ECT Article 81(1)
13 Ibid. a) to e)
14 EC Treaty, Article 83 (1)
15 Ibid. Article 249

To ensure correct implementation and applications of the regulations issued by the Council, the Commission issues guidelines. Guidelines are not binding in the same way as Council or Commission Regulations, but can, however, have legal effect in a limited sense[16] and will be taken into account accordingly. To a limited extent I also rely on preparatory materials in relation to guidelines and regulations in so far as they assist in the understanding and application of central provisions. Lastly, academic research on relevant subjects has been taken into account.

# 2 Council regulation 4056/86

## 2.1 Background

Council Regulation 4056/86 constituted a major overhaul of the regulatory competition scheme for liner conferences in 1986. The Council and Commission viewed carriers operating in conferences as positive contributors to the maritime transport market, stabilizing transport schedules and prices, inducing predictability and effectiveness, and taking into account the needs of the transport users.[17]

Liner conferences were assessed to be of such value that one saw fit to facilitate conference operations through a regulatory scheme tailored to their needs. This orientation towards facilitating conference operations produced the block exemption which has come to the benefit of liner conferences for the last 20 years.

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[16] *Dansk Rørindustri v Commission*; The Court of First Instance's decision that Commission Guidelines were not part of the legal framework for imposing fines was not upheld by the Court of Justice. The latter pointed out that even though the guidelines were not legislation which the administration was bound to follow, the administration could not deviate from an established practice based on such guidelines without proper justification as this would contradict the right of equal treatment.

[17] CR 4056/86, preface

## 2.2 Relation between ECT and CR 4056/86

The relationship between the ECT and CR 4056/86 is important in understanding the contents of the latter. Even though CR 4056/86 contained exemptions from the principle rule, Article 81 remained the primary source of law. Regulations such as 4056/86 are considered secondary, and primary law will traditionally always prevail over secondary legislation,[18] which indicates that the provisions in CR 4056/86 had to be interpreted in the light of the ECT. This includes ECT Articles 2, 3 and 6 which stipulate the core values of the European Community in addition to the specific competition regulation in Article 81.

Regulation of liner conferences was therefore not considered to be solely stipulated by CR 4056/86. The exemptions from Article 81 (1) were as far-reaching only to the extent that they were compatible with the objectives on which the EC Treaty is founded. This is further evidenced by the preface of CR 4056/86 where the Council states that "there can be no exemption if the conditions set out in Article 85 (3) [now Article 81 (3)] are not satisfied". Again, this is reflected in CR 4056/86 Article 7 (2) a), whereas agreements i.a. covered by Article 3 can still be in violation of ECT Article 81 (3) and subsequently be addressed by the Commission.[19]

As a result, when considering the contents of CR 4056/86 and the scope of the exemptions, the targeted objective that the EC Treaty Competition Regulations aimed to ensure, namely an effective market, always had to be taken into account. As will be seen,

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18 Dinger, Felix [2004], page 94

19 The applicability of EFC Title VI Chapter 1, however, has been disputed in the past. In *Commission v France,* it was held by the French that the ECT competition regulations did not apply to maritime transport. No provision explicitly states that the competition regulations apply to this sector. The ECJ replied that as long as no provision states that the competition regulations shall not apply (which is the case for agriculture, cf. ECT Article 36), the competition regulations will apply. In *Ahmed Saeed,* the ECJ stated that ECT Article 82 is directly applicable without the need for secondary legislation, but the same applicability was not given to Article 81. The direct applicability of the ECT Article81 (maritime transport) is now stipulated in CR 1/2003.

providing conferences with exemptions from Article 81 (1) did not unilaterally contribute to this goal.

## 2.3 Outline of CR 4056/86

As its primary function, CR RF 4056/86 regulated the liner conference block exemption from ECT Article 81. Article 1 stipulated the range of the provisions in the regulation, and defined liner conferences, tramp shipping and transport users.

Articles 3, 4 and 5 constituted the core of the material provisions, under which Article 3 was the block exemption, Article 4 stipulated the terms for applying the exemption, and Article 5 contained mandatory conditions the conferences had to implement before being protected by the exemption.

Articles 2 and 6 contained additional exemptions concerning technical agreements and transport user agreements. These could be seen as auxiliary regulations to Article 3 with more specific applicability.

The remaining articles in CR 4056/86 were chiefly procedural regulations. These will not be dealt with, since they were altered or revoked by CR 1/2003.[20]

## 2.4 Scope of the regulation

Council Regulation 4056/86 was applicable to ”international maritime transport services”, tramp shipping excluded.[21] With regard to what can be considered “maritime transport”, conferences held that multimodal transport, this being maritime transport in combination with land transport at the beginning and end of the total transportation, was covered by the exemption in Article 3. Article 3 did not explicitly regulate this matter, but both the CFI and the Commission were of the understanding that conferences

[20] CR 1/2003, Article 38

[21] CR 4056/86, Article 1 (2)

could not implement price fixing under protection of Article 3 for the land leg of a multimodal transport.[22]

The range of the regulation was further dependent upon the contents of the criterion ”international”. It was argued that maritime transport was international once a ship crossed state borders on its voyage.[23] The wording in Article 1, however, did indicate another interpretation, as it could be deduced from the term “international” that the transport had to be carried out between ports/harbours in different nation states. Furthermore, the former argument did not coincide with ECT Article 81 since transport within a state, even though it crossed another state border on its voyage, could not be said to potentially “affect trade between Member States”.[24] As Article 81 is limited to business which influences interstate trade, and CR 4056/86 had to be interpreted in light of Article 81, the logical solution was that CR 4056/86 only applied to international trade in its natural sense.

## 2.5 Block exemption

The basis for liner conferences being exempt from Article 81 was CR 4056/83 Article 3, titled “Exemption for agreements between carriers concerning the operation of scheduled maritime transport services”.[25]

As a result of the exemption, ”[a]greements, decisions and concerted practices of all or part of the members of one or more liner conferences” which by object or effect prevented, restricted or distorted competition, were allowed regardless of Article 81, although taking into account the limitations in CR 4056/96 Article 4 and 5.

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22 Dinger, Felix [2004] page 112 with reference to the CFI and Commission practices

23 Jacobs, Andreas [1991], page 90: a given example is that a ship sailing from Le Havre to Marseille will cross Spanish waters on its voyage.

24 ECT Article 81 (1)

25 CR 4056/86, Article 3

### 2.5.1 Scope of Article 3

Agreements i.a. were exempt from Article 81 when they had as their object "the fixing of rates and conditions of carriage"[26], potentially coinciding with one or more of the specified objectives:

> "
> a) the coordination of shipping timetables, sailings dates or dates of calls;
> b) the determination of the frequency of sailings or calls;
> c) the coordination or allocation of sailings or calls among members of the conference;
> d) the regulation of the carrying capacity offered by each member;
> e) the allocation of cargo or revenue among members."[27]

The exemption was limited to liner conferences. The definition of liner conferences in Article 1 of the regulation stated that members of conferences operate with "uniform or common freight rates". In the *TAA-decision*[28] the Commission held that uniform or common freight rates are in place when transport users get the same price, regardless of which member of the conference it uses, provided the transport concerns the same type of cargo. Consequently, agreements resulting in different prices depending on the carrier used were not regarded as liner conference agreements and were, as such, not protected by the exemption in Article 3.

However, an agreement between conference members was allowed without a demand for all conference members to take part,

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26 CR 4056/86, Article 3

27 Ibid, Article 3, a) to e)

28 The *TAA-decision* concerned an agreement from 1992 between 15 carriers. The agreement was stipulated in such a way that "conference outsiders", these being carriers not part of the original agreement, could only be included by providing these with more leeway with regard to price regulation. The Commission found, as a result of this, that the TAA was not a liner conference as defined in CR 4056/86 Article 1, since the agreement operated with at least two different prices.

cf. ”all or part of the members of one or more liner conferences”. Only agreements between conference members and non-conference members were not covered by the exemption. This was a result of the need to maintain competition between conferences and independent carriers.

### 2.5.2 Limitations of the exemption

The exemption in Article 3 was not unlimited, and a framework for the ability of conferences to operate under the protection of CR 4056/86 was stipulated in Article 4. The limitations in Article 4, however, were far less invasive than those found in ECT Article 81.

As a result of Article 4, liner conferences could apply the exemption in Article 3 only under the precondition that the relevant agreements, decisions or concerted practices did not cause ”detriment to certain ports, transport users or carriers” by enforcing differentiated prices and terms on the same type of goods based on “the country of origin or destination or port of loading or discharge”.[29] Consequently, conferences could not differentiate prices based on the carrier in the conferences responsible for the actual transport, as this was a condition for being regulated as a conference, nor could they differentiate prices based on where the goods came from or were shipped to.

The strict view regarding conference ability to differentiate prices is arguably linked to the need for stability and predictability that conferences wanted to secure for the benefit of transport users, since price differentiation would contradict these values.

However, price differentiation based on origin or destination was an option if such rates or conditions could be “economically justified”.[30] The factors that “justified” price differentiation were not clarified in the regulation, but the term suggested an overall

[29] CR 4056/86, Article 4 (1)

[30] Ibid.

evaluation of the "pros and cons" of each case individually. This illustrates the wide scope of the exemption from which conferences benefitted.

In comparison with ECT Article 81, which covers any agreement which "may" affect trade and which has the object "or" effect to prevent, restrict or distort competition within the common market, the limitations in Article 4 were clearly far less intrusive. Article 81 is formulated in the said manner in order to be best applicable to all types of anti-competitive behaviour. Article 4, on the other hand, demanded proof of "detriment" to certain ports, transport users or carriers in order to exclude the protection of the exemptions in Article 3. The threshold for carriers in a conference to be found guilty of overstepping the boundaries of accepted conduct was therefore much higher following implementation of CR 4056/86.

## 2.6 Transport user exemption

Another exemption for liner conference operations was stipulated in CR 4056/86 Article 6 which regulated "agreements between transport users and conferences concerning the use of scheduled maritime transport services".[31]

Article 6 allowed agreements, decisions and concerted practices between conferences and transport user, as well as between transport users, which concern "rates, conditions and quality of liner services".[32] Such arrangements were exempted from the prohibitions in ECT Article 81.

Consequently, CR 4056/86 allowed not only for horizontal cooperation between carriers in liner conferences, but also for vertical cooperation between carriers and their customers.

Which agreements i.a. that were covered by Article 6 was dependent upon whether or not the agreements i.a. were "provided for" in Article 5 (1) and (2). Article 5 stipulated the obligations

[31] CR 4056/86, Article 6, title

[32] Ibid. Article 6

attached to the exemptions in Articles 3 and 6, with Article 5 (1) concerning consultations and (2) concerning loyalty agreements.

Subsequently, Article 6 allowed for agreements i.a. between carriers in conferences and transport users that concerned consultations regarding rates, conditions and service quality. Such consultations could result in loyalty agreements, also covered by the Article 6 exemption. The terms of such agreements would be the result of negotiation between conferences and transport user organizations.[33] A number of conditions were attached to loyalty agreements, including obligations for the conference to offer rebates, list cargo included and/or excluded from the agreement and list circumstances under which the transport users are released from the obligation of loyalty.[34]

## 2.7 Summary of CR 4056/86

Within the provisions of Article 4, carriers organized in liner conferences were provided significant freedoms in terms of cooperation. Article 3 provided the permission to coordinate price, capacity, timetables, carriage conditions and much more. With conferences controlling the majority of the market on most central trade routes, and the regulatory situation favouring conferences above individual carriers, the liner shipping market became an oligopoly in which true competition was a distant memory.

[33] CR 4056/86, Article 5 (2)

[34] Ibid. a) and b)

# 3 Introduction of council regulation 1419/2006

## 3.1 Liner conferences seen in a different light

The background for introducing exemptions from ECT Article 81 in CR 4056/86 was the desire for stability in the maritime transport market. Carriers argued that a sustainable liner shipping market would not be possible if they were not allowed to cooperate on routes, prices, capacity, and freight conditions.

The legislative powers agreed with carriers in regard to conferences having "a stabilizing effect, assuring shippers of reliable services" and that they "contribute generally to providing adequate efficient scheduled maritime transport services and give fair consideration to the interest of users".[35]

However, since the introduction of CR 4056/86, the opinion has not been unilaterally positive towards conferences. In its report on liner shipping from 2002,[36] the OECD expressed significant concerns relating to how conferences operated in contradiction of true competition.[37] Firstly, the argument that conferences provide shippers with reliable services was confronted, as shippers disagree that efficient capacity, efficient operation, and a stable commercial environment are conference attributes.[38]

Secondly, the OECD argued that the market structure of maritime transport, fuelled by the conference anti-trust exemption, only allowed major operators to survive, while independent operators were referred to as "niche markets" and "secondary roles". Fur-

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35 CR 4056/86, preface

36 OECD Competition Policy in Liner Shipping Final Report 2002 ('OECD Report')

37 Kolstad/Ryssdal, [2006], page 61: Perfect competition (and the possible attainment of the Pareto-optimum) can only exist when none of the players in the market can affect prices individually, and where there are no limitations for entering into or departing from the market.

38 OECD Report , page 29

thermore, anti-trust exemptions were held to induce the exchange of sensitive market information to the detriment of efficient competition.[39]

With regard to the argument that conferences ensure stable prices in liner shipping since they operate with fixed and published tariffs, the OECD held that the volatile aspects of the transfer charges (such as currency and oil price fluctuations) were passed on to the shippers.[40] Subsequently, "shippers are faced with rates that vary highly from the published tariff, and they cannot rely on the rate to be same from one month to the next".[41] As a result, shippers took a disliking to conferences, which is partly the reason why consortia has taken over more and more of the liner market in recent years while conferences have been declining in power. Between Europe and Asia the conferences accounted for 85% of transport capacity in the 70's, while this has fallen to around 60% in recent times.[42] A similar development has occurred on the Trans-Atlantic route, partly due to several carriers departing from the TACA-conference, which has been the main operator on these routes.[43]

This aspect of liner conferences illustrates the desire for a maritime market that is evenly regulated rather than one that benefits the markets operators controlling the majority of containerized liner transport. The OECD concluded by recommending the removal of the conference block exemption, and instead adapting other regulations to accommodate the need for cooperation in liner shipping without allowing hard-core restrictions.[44] The regulations that followed indicate that this recommendation was heard.

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39 Ibid. page 28

40 Ibid. page 44

41 Menachov, D. [2001]

42 OECD Report, p.22, the numbers are from 1999.

43 Ibid, p.22, the departing of carriers from TACA is partly due to better conditions in the market for independent carriers, and partly a result of the Commission's decisions against the TACA conference in 1996 (the TACA Immunity Judgement)

44 OECD Report, page 78

## 3.2 Background for revoking CR 4056/86

In its preface, Council Regulation 1419/2006 provides the rationale for revoking the anti-trust exemptions which had benefitted liner conferences for more than 20 years. The reasoning by the Council reflects to a large extent the opinions of the OECD in 2002. Furthermore, the Council held that conferences were not in need of protection from competition as a review of the industry demonstrated that the liner shipping "cost structure does not differ substantially from other industries".[45] The rationale that liner shipping was a sector unlike any other had been a principal argument from carriers in favour of conferences, an argument now dismissed by the Commission.

### 3.2.1 Limitations in ECT Article 81 (3)

As mentioned previously, the exemptions in CR 4056/86 Articles 3 and 6 were only applicable as far as they were compatible with ECT Article 81 (3). In this regard, the Council held that liner shipping conferences "no longer fulfil the four cumulative conditions for exemption under Article 81 (3)".[46]

The first condition which demands that the agreement i.a. must contribute to improving the production or distribution of goods or promote technical or economic progress[47] was considered unfulfilled as a result of there being "no evidence that the conference system leads to more stable freight rates or more reliable shipping rates than would be the case in a fully competitive market".[48]

The second condition is the compensation to consumers for the negative effects of restricted competition.[49] The Council found no

45 CR 1419/2006, preface (3)
46 CR 1419/2006, preface (8)
47 ECT Article 81 (3)
48 CR 1419/2006, preface, (4)
49 ECT Article 81 (3)

clearly positive effects to counterbalance the severely negative effects of hard core restrictions such as horizontal price fixing.[50]

With regard to the third condition which prohibits imposing conditions not indispensable to the attainment of the objectives relating to the first condition, the Council held that price fixing as done by conferences is not indispensable to providing reliable service to transport users. Consortia are seen to attain the same quality of service without the condition of price fixing.

Finally, the fourth condition requires the conferences to avoid eliminating competition for the substantial part of the products in question.[51] The Council held that there were "hardly any price competition with respect to surcharges and ancillary charges", and only limited competition on the ocean freight rate. Furthermore, the exchange of commercially sensitive information between conferences and consortia provide little competition between the two, resulting in the condition in Article 81 (3) not being met.

CR 4056/86 was therefore revoked not only because conferences were no longer seen as beneficial to the market as initially believed, but also because conference activity no longer was no longer in accordance with Article 81 (3) in general, leading to the inevitable demise of the liner conference block exemption.

CR 1419/2006 also revoked the anti-trust exemption for technical agreements in CR 4056/86 Article 2, although without any explanation other than it was regarded as being "redundant".[52] This phrasing does, however, indicate that technical agreements were regarded as no more limited by ECT Article 81 than by CR 4056/86, leading to the assumption that revocation of CR 4056/86 will not severely impact the application of technical agreements.

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50 CR 1419/2006, preface, (5)

51 ECT Article 81 (3)

52 CR 1419/2006, preface (9)

## 3.3 Contents of CR 1419/2006

Council Regulation CR 1419/2006 did not introduce any "new" regulation. It consists of only three articles, where Article 1 repealed CR 4056/86, Article 2 amended CR 1/2003 and Article 3 stated when the regulation would come into force.

The procedural provisions in CR 4056/86 had already been revoked by CR 1/2003, leaving only the substantive provisions in CR 4056/86 to be repealed in 2006.

Article 1 also introduced a transitional period of two years, where specific provisions[53] were left in force until 18 October 2008 in order for member states to have sufficient time to adapt national legislation.[54] It is natural to assume that the transitional period was also stipulated in order to benefit carriers in liner conferences. Liner conferences are complex cooperation arrangements, and it would be inefficient not to provide a transitional period in order to maintain adequate maritime transport services.

The amendment of CR 1/2003 in Article 2 concerned international tramp services and maritime transport services within a single member, and not liner shipping directly. Article 2 will therefore not be dealt with.

In brief, CR 1419/2006 set out to alter the way liner shipping is regulated, both materially and procedurally. The question then remains: what must carriers in liner shipping do to adjust to the new regulation?

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[53] Articles 1(3) b) and c), Article 3 to 7, Article 8 nr. 2 and Article 26 in CR 4056/86 were left in force for the transitional period

[54] CR 1419/2006, preface (16)

# 4 Impact of council regulation 4056/86

## 4.1 Initial impact

The brevity of CR 1419/2006 does not diminish its importance. The consequences of revoking the liner conference block exemptions are significant, a fact perhaps best illustrated by the Commission itself:

> *"The decision to end the exemption from the competition rules means that as of October 2008 all EU and non-EU carriers which currently take part in conferences operating on trades to and from the EU will have to end their conference activities, that is price fixing and capacity regulation, on those trades."*[55]

The demand for carriers to end their conference activities related to price fixing, capacity regulation and other practices which may affect trade might sound simple enough. However, the statement from the Commission is based upon the principles in ECT Article 81 (1) that regulates activities which "may" affect trade and which prevents, distorts or restricts competition. The types of agreements, decisions and concerted practices in liner shipping affected therefore depend on how Article 81 (1) will be applied to this sector, a sector which has not been concerned with this regulation for 20 years. Consequently, the need for guidance in the market is considerable, and the Commission found it necessary to issue guidelines in order for national authorities and market operators to best adapt to the new regulatory scheme.

Guidelines on the application of Article 81 were issued on 26 September 2008. The guidelines were issued in direct relation to the implementation of CR 1419/2006, and were intended to aid the maritime transport sector in adapting to the new regulation.

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[55] MEMO/06/344 as cited in Bellamy & Child [2008], par. 12.019

The guidelines stated that CR 1419/2006 directly affects "[l]iner shipping services, cabotage and tramp services"[56] in maritime transport, and the guidelines deal with all three aspects. In the following, I will focus on issues relating to liner shipping.

The Commission held that cooperation is a common phenomenon in maritime transport. The fact that carriers often enter into agreements with possible competitors, which is certainly the case for liner conference operations, and the fact that such agreements can affect the terms of competition, is evident. As a result, following CR 1419/2006, carriers in conferences must be particularly diligent in ensuring compliance with competition regulations.[57]

Factors such as prices, costs, quality, frequency and differentiation of the service provided, innovation, marketing and commercialization are elements "particularly relevant for the assessment of the effect an agreement may have in the relevant market".[58] These factors are relevant for any operator in any market with regard to competition regulations in general. With regard to liner conferences in particular, the Commission emphasizes some specific elements of particular relevance, herein technical agreements and information exchange.

The reasoning behind the Commission's focus on these two aspects in preference to other forms of cooperation is arguably founded on the forms of cooperation that carriers who previously have operated in conferences can be expected to apply in the future. It is likely that carriers will attempt to cooperate through informal information exchange as a replacement for the cooperative agreements, and also through technical agreements, since these, to a certain extent, are not covered by ECT Article 81.

The Commission does not elaborate on what other activities carriers must avoid in order to be in compliance with ECT Article 81 other than to state that carriers must "cease all liner conference

56 Commission Guidelines [2008], *Maritime Transport Services*, par. 9
57 Ibid, par. 35
58 Ibid, par. 35

activity contrary to Article 81".[59] There is, however, a reference to the consortia block exemption in CMR 823/2000, which may indicate that the Commission is calling on carriers to apply alternative cooperation arrangements as a replacement for conferences. Furthermore, the Commission stipulates that previous notices on the application of Article 81,[60] which until now have not been applicable to liner shipping due to CR 4056/86, are now relevant to the interpretation and application of Article 81 in this sector.[61]

As a result, the general guidelines for the application of Article 81 are of importance to carriers who are in need of clarification with regard to how Article 81 will be applied to liner shipping in the future. However, due to the block exemption which has governed liner shipping for the past 20 years, the general guidelines have been composed to a very limited degree in a manner suited for liner shipping. On the other hand, since liner shipping is no longer regarded as a "special" type of market apart from any other, carriers have the option of considering how Article 81 is applied in general, and in other markets, in order to anticipate how it will be applied to the liner shipping market.

In the following, I account for the central aspects of liner shipping affected by CR 1419/2006 by looking into what carriers must assess in order to comply with Article 81. However, due to the limitations of this thesis, I can only account for key issues in the overall compliance assessment, herein hard core restrictions, appreciable effect, market concentration and structure, information exchange, technical agreements and the Article 81 (3) exemption.

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59 CR 1419/2006, preface par. 4

60 Guidelines on the Application of Article 81 (3) and Guidelines on Horizontal Cooperation

61 Commission Guidelines [2008], *Maritime Transport Services,* par. 5 and 6

## 4.2 Main issues relating to the application of Article 81 (1) to liner shipping

### 4.2.1 Self-assessment

Council Regulation 1/2003 introduced a new regulatory scheme for how competition regulation is applied procedurally. The regulation revoked all procedural regulations in CR 4056/86, but since the exemption remained, the liner shipping sector did not feel the impact of CR 1/2003 until CR 1419/2006 came into force.

The regulation removed the need for the Commission to decide on whether or not individual cases were in breach of Article 81 (1), and rendered Article 81 directly applicable as law, "no prior decision needed".[62]

Carriers are consequently obliged to self-assess their activities with regard to Article 81 (and 82) compliance. The previous system, whereby market operators would send in activities which might distort competition to the Commission for evaluation and the possible granting of an individual exemption, has been removed, and breach of Article 81 (1) will lead to the agreement i.a. being classified as void, cf. Article 81 (2).

The situation for carriers is anything but easy. As expressed by Nicolette van der Jagt, ESC Secretary General, "carriers will be walking on very thin legal ice".[63] In the following, several factors will be presented, all of which must be taken into consideration by carriers.

### 4.2.2 Hard core restrictions

As the Commission stated, carriers must cease price fixing and capacity regulation. The Commission is referring to "hard-core" restrictions in competition which are in violation of ECT Article 81 (1) in any case. Such restrictions are listed in Article 81 (1) a)

[62] CR 1/2003, Article 1

[63] ESC Press Release, July 1st 2008

through e) and are considered *per se* infringements without the need to identify an anticompetitive object or effect beyond establishing an appreciably negative effect[64] on competition. They have, by their very nature, "the potential of restricting competition".[65] Exactly what constitutes the type of hard core restriction referred to by the Commission is therefore important.

**Price fixing**, as referred to in Article 81 (1) a), comes in many forms, and types of price fixing vary in terms of how they restrict competition. The main forms of price fixing utilized by liner carriers are uniform tariff agreements, joint fixing or discount agreements, non-binding tariff rate levels and discriminatory tariff rates.[66]

The application of uniform tariff rates restricts competition on price by "object", cr. Article 81 (1), and in *TAA*, the CFI established that the price-fixing agreement and agreement on non-utilization of maritime transport capacity was "an agreement which manifestly restricted competition".[67]

Price-fixing is normally associated with raising prices, but tariffs which lower prices with the intention of eliminating competitors or which set a minimum floor on the rate will also be covered by Article 81 (1).[68] Discount restrictions will also be covered by Article 81 (1) as "the ability to grant discounts is an important element of carriers' competitive pricing policies".[69] This is illustrated by the CFI in *FETTCSA* where the parties were prohibited from granting discounts from the published tariff.[70] This was considered an indirect fixing of prices with the object of restricting competition.

In brief, any agreement which binds the parties to a price or prohibits them from offering a price below or above a set value is

64 Se below, par. 4.2.3.
65 Commission Guidelines [2004], *Article 81 (3)*, par. 21
66 Pozdnakova, Alla [2008], par. 8.2.
67 *TAA,* par. 69
68 Pozdnakova, Alla [2008], par. 8.2.2.
69 Pozdnakova, Alla [2008], par. 8.2.3.
70 *FETTCSA*, par. 175

considered price fixing, and will for the most part be considered an agreement the object of which is to distort competition. Consequently, carriers should avoid such rigid forms of cooperation and instead opt for better alternatives in the form of more flexible cooperative arrangements.

**Capacity regulation**, as defined in Article 81 (1) b), is also referred to by the Commission as a hard core restriction. Restricting capacity is an indirect way of maintaining the desired price level, since the market alone will determine the price. Regardless of whether capacity is restricted through frequency of sailings or other forms, the restrictions will be caught by Article 81 (1).

One form of capacity restriction which can be destructive to competition is Capacity Management Programmes, whereby carriers agree to "freeze" capacity and only offer shippers a specified tonnage even though additional capacity is easily accessible.[71] Under CR 4056/86, carriers applied such measures to increase or maintain freight rates and ensure efficient use of the capacity applied. Under Article 81 (1), such measures are regarded as "obvious restriction[s]"[72] of competition, and carriers must consequently find other ways to ensure efficiency and sustainable prices.

Another activity, not mentioned by the Commission but which can still be regarded as a severe restriction of competition, is **market sharing**, cr. Article 81 (1) c). Market sharing can be regarded as "an alternative to agreements on tariffs and capacity"[73], and its application therefore varies in accordance with the alternative the liner cartel deems most advantageous.

Given that liner shipping is quite undiversified with regard to the service provided, market sharing is usually divided geographically. *CEWAL* is one such example, where three liner conferences agreed that no conference member would operate independently in

71 Pozdnakova, Alla [2008], par. 8.4.2.
72 *European Night Services*, par. 136
73 Pozdnakova, Alla [2008], par. 8.4.3.1.

the areas of activity belonging to the other conferences. The Commission found that "their object and effect is to prevent, restrict or distort competition...in an appreciable manner since their object and effect is to partition the European Atlantic coast into several separate areas, with each area taking in one or more Member States, *in breach of [Article 81 (1) (c)]"* [emphasis added].[74]

Interestingly, the Commission added that the agreements also had the effect of "limiting, within the meaning of [Article 81 (1) (b)], the supply of transport services".[75] As a result, market sharing can also lead to violation of the prohibition of capacity regulation in Article 81 (1) b), which is a hard core restriction. Carriers must therefore be very careful in applying such measures.

Beyond hard core restrictions, Article 81 (1) has a broad application, and carriers must assess all forms of cooperation against the provisions the regulation. The first assessment could be the regulation's general threshold of application.

### 4.2.3 The "may affect trade" condition

For carriers, the issues they have to address in order to ensure compliance with Article 81 are numerous. However, Article 81 (1) stipulates a superior condition which, in principle, is a threshold which the relevant agreement i.a. must be able to reach in order for Article 81 (1) to be applicable. Only if the agreement i.a. "may affect trade" is Article 81 (1) applicable, and the assessment of the more specific issues concerned can be performed.

Before assessing if an agreement i.a. "may affect trade" it must be established that there is an "undertaking" present, cf. Article 81 (1). Given the broad definition of an undertaking by the CFI,[76] there is little reason to suspect that this condition will raise any significant issues in liner shipping.

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74 *CEWAL,* par. 38

75 Ibid.

76 Defined in a number of cases, one being *Enichem v Commission*, par. 235. See also Bellamy & Child [2008], par. 2.003

With regard to the threshold, the core of the matter is therefore what can be regarded as a possible effect on trade.

The wording in the article opens up for a broad application, since the mere possibility of an effect is sufficient. Furthermore, the fact that an agreement i.a. can affect "trade" opens up for a broad application. The interpretation of the ECJ is that an agreement i.a. will have such an effect if it is reasonably foreseeable that "the agreement in question may have an influence, direct or indirect, actual or potential, on the pattern of trade between Member States".[77] This entails that an agreement as a rule must have an "appreciable" effect on competition or trade between member states.[78]

Whether or not Article 81 (1) can be invoked to prohibit activities by carriers in liner shipping is subsequently determined by what can be regarded as "trade", and when an "appreciable effect" on the former is at hand.

Effect on trade in liner shipping comes in many forms. Hard core restrictions as discussed above are capable of direct impact on trade patterns, and may also impact on "port and auxiliary services linked to the carriage of goods",[79] thus restricting competition. The same result is possible where the competitive structure is altered, leading to effects on trade. This was the case in *CEWAL I,* where the CFI found that conduct leading to the elimination of a competitor was "inherently capable of affecting the structure of competition in that market and thereby of affecting trade between Member States".[80]

Also indirect effects can fulfil the trade impact condition. This is the case whenever "an agreement or practice has an impact on

[77] *Société Technique Minière v Maschinenbau Ulm GmbH*
[78] Bellamy & Child 2008, par. 2.121
[79] Pozdnakova, Alla [2008], par. 8.8.2.
[80] *CEWALL I,* par. 203

cross-border economic activities of undertakings that use or otherwise rely on the products covered by the agreement".[81]

It is not practical to list all activities that might impact trade, as each case must be assessed individually. However, with both direct and indirect effects on the European market in general being relevant, it is clear that Article 81 (1) has a broad application.

With regard to the requirement of an appreciable effect, however, there is a minimum threshold; the **de minimis rule.** The rule in itself is quite simple: a market operator may not be restrict competition to an appreciable degree, regardless of the actions it takes. Hard-core restrictions can also be excluded from the application of Article 81 (1) if this minimum requirement is not met.

The evaluation of the existence of an appreciable effect involves "[m]arket shares of parties to a cartel and structural conditions of the relevant market".[82] Such an evaluation can be seen in *TAA* where the CFI considered the appreciability of conference operations by looking at its market share through percentage of containers shipped on a specific route.[83]

Market structure and concentration is therefore indispensible to the assessment carriers to make, both with regard to what "may affect trade" and whether or not the agreement i.a. distorts, restricts or prevents competition.

### 4.2.4 Liner shipping market

#### *4.2.4.1 The Conference Market*

The types of cooperation, and the types of information exchange carriers in conferences must avoid can only be defined once the characteristics of the relevant liner shipping market are clarified. Depending on the market, the market participant can influence competition in a variety of ways. Consequently, if the market par-

[81] Commission Guidelines [2004], *Trade concept*, par. 38
[82] Pozdnakova, Alla [2008], par. 8.8.4.
[83] *TAA*, par. 91

ticipants exchanging information have an insignificant effect on the market, the condition of effect on trade in Article 81 (1) will not be fulfilled and the exchange will not be prohibited.[84] With regard to conference activity in the maritime transport market, it is not disputed that this had a significant influence. However, as conferences are now relieved of their anti-trust exemption benefits, it is of greater interest to look towards the individual liner carrier which has far less influence than the conference as a whole.

In the following section, I firstly address the market as it has been under conference influence, before evaluating market changes following CR 1419/2006.

To evaluate the liner shipping market, as with any other market, one must take into account three subsidiary market aspects; the product market, the geographical market and the temporal market.[85] The aspect of the *product market* aids in defining the influence of market participants in terms of whether or not "customers are in a position to switch easily to available substitutes".[86] If the latter is the case, the market participant cannot be held to have a significant impact on the prevailing conditions. With regard to liner shipping, the Commission has determined that on certain routes, air, tramp and break bulk shipping does not present an alternative to liner shipping and cannot be substituted for the latter.[87]

In the view of the product market approach, liner conferences therefore have had a significant market influence and their activity "may affect trade amongst Member States".[88]

The *geographical market* approach takes into account "the area in which the undertakings concerned are involved in the supply and demand of...services, in which the conditions of competition

84 *Völk v Vervaecke*, grounds par. 5/7
85 Bellamy & Child, p. 259 – 294
86 Relevant Market Notice [1997]
87 OECD Report, p. 20
88 ECT Article 81 (1)

are sufficiently homogeneous and which can be distinguished from neighbouring areas because the condition of competition are appreciably different in those areas".[89]

For liner shipping, the various geographical markets can be determined by looking at the different routes and ports utilized in maritime transport. For instance, the trans-pacific trade consists of several routes and port pairs, and the interchangeability between the alternatives can help to define the market. Also to be taken into account is the fact that two nearby ports can be part of different markets depending on their multi-model access to trade, while two distant ports can compete in the same market if they are equally accessible from the same hinterland.[90]

The *temporal market* aspect is somewhat less relevant to liner shipping than seasonal impacts on the market. International liner shipping is unquestionably a year–round service, with only a few exceptions (for example, Montreal is arguably not part of the same market as US ports because the weather in the former can interrupt services); ports relevant for liner shipping will not be differentiated by this factor.

When a liner market is defined mainly by looking at the product and geographical aspects, then the "level of concentration" in the market is of great importance since in "highly concentrated oligopolistic markets, restrictive effects are more likely to occur and are more likely to be sustainable than in less concentrated markets".[91] It can be argued that liner shipping markets affected by conferences were concentrated, given that the characteristic of a concentrated oligopolistic market is the presence of a limited number of suppliers which in turn control the majority of the market. For example, the Far East Freight Conference accounted for approximately 60 % of capacity on the Asia-Europe trades in

89 Bellamy & Child, par. 4.070
90 OECD Report, page 20
91 Commission Guidelines [2008], *Maritime Transport Services*, par. 48

1997, and this number was potentially even higher on individual routes (70 % on the Europe-Japan trades).[92]

Consequently, the liner shipping market indicated that conferences and their members have had a great influence, and the exchange of information and other activities potentially detrimental to competition would be relevant to ECT Article 81 (1) in most cases.

#### *4.2.4.2 The New Market*

As illustrated above, the liner shipping market under the influence of conference activities was quite concentrated, and cooperation in such a market would consequently easily be restricted by the prohibitions in Article 81 (1).

One must however recall that CR 1419/2006 ended the legality of the core functions of conferences, these being price and capacity regulation. With conferences diminishing in power already before CR 1419/2006, and independent operators, consortia and other cooperation arrangements taking over, it is safe to assume that conferences have a very limited influence on the market after 18 October 2008. However, it is less clear how these changes impact on market structure and concentration. With concentration in the market being decisive for whether or not restrictive effects are likely to occur, the question is: will concentration in the liner market increase, decrease or remain unaffected following CR 1419/2006?

The Commission commented on the issue in one of its impact assessments relating to CR 1419/2006, stating that "market concentration in liner shipping will not be affected by the abolition of conferences",[93] based on the argument that vertical integration will increase due to the repeal of the block exemption, while other

[92] OECD Report, page 21

[93] Commission Notice [2006], *Conference Agreements*, par. 41

forms of cooperation on the horizontal level will maintain concentration.

This statement, however, was only an estimate applied to liner shipping conferences as a whole. By applying a more differentiated approach, changes in market concentration could likely occur.[94] The view taken by the Commission may also be a result of not viewing conferences as single entities, but rather as a composite group of individual operators. In this perspective, the introduction of CR 1419/2006 will not lead to significant market changes compared to viewing a conference as 'one' market operator.

On the other hand, the OECD argued already in 2002 that removal of the anti-trust exemptions would "slightly accelerate an already existing trend towards greater industry concentration",[95] referring to a trend amongst liner carriers to cooperate or merge to avoid competition.[96]

The third option, a decrease in concentration, may occur as a result of carriers, previously in conferences, increasingly establishing themselves as independent operators while adapting to the new regulation. In the long term, however, this scenario may also result in an unaffected or increased concentration, since carriers will likely seek cooperation in consortia, for example.

It is unclear which alternatives the Council and Commission intended to generate by introducing CR 1419/2006, but irrespective of this, the outcome could change the parameters of competition for carriers in the market. In any case, as a consequence of CR 1/2003, carriers operating in liner shipping will be responsible for assessing their own market power and will have to consider whether

94 Even though concentration was not regarded as high on a global scale, concentration on trade levels were very high in some markets in favour of conferences (the West Africa Trade being an example). In these markets, concentration will likely drop and lead to a decrease in prices, cf. Proposal for Council Regulation Repealing (EEC) No 4056/86 – Impact Assessment, par. 137

95 OECD Report [2002], page 72

96 A given example in the report is that while the top 20 carriers controlled 48% of the cellular fleet, 80% was controlled by four alliances plus five or six top 20 carriers in 2001.

their activities are in accordance with ECT Article 81 (1). As a result, the development of market concentration in the years to come will be of major interest.

The factors which carriers will have to take into account are numerous. For instance, the TEU volumes in port pairs or in the market as a whole are considered by the Commission as an indicator of market shares. This is an inexact approach which can be used only to describe the potential for market control, but can still be easily evaluated by carriers in order to assess their market position. The distribution of such shared volumes between competitors in the market can also indicate the level of concentration at any given time.

Concentration can also be assessed by looking into the level of cooperation. For example, if carriers are using consortia arrangements to a large extent and exchanging information in order to provide joint-services, such structural links indicate the level of concentration in the relevant market. Carriers will therefore have to consider their own relations to other carriers, as well as cooperation between other competitors, as both these aspects impact on the market structure and ultimately on what the carrier can do in accordance with ECT Article 81.

### 4.2.5 Technical agreements

Certain types of technical agreements do not fall within the prohibitions of ECT Article 81 as they are not regarded as limiting competition. This is the case for "horizontal agreements, the sole object and effect of which is to implement technical improvements or to achieve technical cooperation".[97]

The exemption for technical agreements in CR 4056/86 was revoked, but the Commission seems to argue that technical agreements previously protected by the exemption are not particularly relevant to ECT Article 81. This can also be seen as a reason for the

[97] Commission Guidelines [2008], *Maritime Transport Services*, par. 37

repeal of the exemption on the Commission's rationale that it as "redundant".

Technical agreements intended to improve maritime transport services or attain cooperation regarding technical development are positive initiatives in the market, and consequently not measures which should be prohibited.

On the other hand, it is natural to assume that technical agreements which are not intended to attain such improvements, but instead to attain cooperation to the detriment of competition, will be subject to the prohibitions of ECT Article 81. Technical solutions for the exchange of sensitive market information can be regarded as an example of the latter.

From this it can be deduced that the revocation of CR 4056/86 did not severely impact the applicability of technical agreements. Council Regulation 4056/86 Article 2 only provided protection for agreements i.a. which had the "sole object" of attaining technical improvements or cooperation through such means as uniform regulations, coordinated timetables and so on. Agreements of this sort will most likely be allowed under Article 81[98], and since Article 2 did not provide any protection for cooperation on price or capacity restrictions, liner carriers will not experience a severe impact in this regard.

However, when a technical agreement renders possible forms of cooperation which are now banned, carriers must assess the situation more carefully in order to be in accordance with Article 81. A technical agreement, for example, could establish solutions for efficient information exchange. If the information that is going back and forth between competitors is of such a type as to potentially distort competition, the technical agreement may be deemed void, cf. Article 81 (2).

[98] If a technical agreement should be in violation of Article 81 (1), technical improvements are relevant for the Article 81 (3) exemption. Therefore, such agreements are arguably quite safe against the prohibitions of Article 81.

Conclusively, whether or not a technical agreement is in accordance with regulation is a more complex evaluation after CR 1419/2006. The technical solutions the agreement provides, its purpose and the way the solution is utilized, are all factors which must be taken into consideration. The legality of the information exchanged through a technical solution is of major importance, which again is dependent upon the relevant market concentration and structure.

### 4.2.6 Information exchange

#### *4.2.6.1 General Considerations*

Information exchange has been one of the central advantages provided for liner conferences through the block exemption. Agreements, decisions and concerted practices referred to in CR 4056/86 presupposed a considerable amount of information exchange between conference members concerning trade routes, price adjustment, capacity coordination, conditions of freight and so on.

As ECT Article 81 is now applicable to liner shipping activities in their entirety, the Commission points out that ”the exchange of commercially sensitive and individualized market data can, under certain circumstances, breach Article 81 of the Treaty”.[99] What type of information this might be must be evaluated on a case-by-case basis, but for former conference members, the mere idea of information exchange being considered as an infringement is in clear contrast to the safe haven provided for conferences through CR 4056/86 for so many years.

The Commission differentiates, as does ECT Article 81, between information designed to limit competition, and information which merely limits competition by effect. The former will be easy to differentiate for the carriers, and the exchange of such information, provided it “may affect trade”,[100] will clearly fall under Article 81 (1).

[99] Commission Guidelines [2008], *Maritime Transport Services*, par. (39)
[100] ECT Article 81 (1)

With regard to information not intended to distort competition, but nonetheless having this effect, the situation is less clear for the carriers. The Commission refers to *John Deere v Commission* in 1998, where the ICJ stated that the exchange of information can constitute an infringement when "the information exchange reduces or removes the degree of uncertainty as to the operation of the market in question with the result that competition between undertakings is restricted."[101]

Whether or not information can reduce uncertainty and distort competition must be considered on the basis of several elements. To summarize, compliance of information exchange with Article 81 is dependent on the content of the information, whether or not it is aggregated or individual, the age of the information, the frequency of exchanges and how the information is released.[102] In an assessment by the Commission or the courts, these factors will be part of an overall evaluation in order to take "account of potential interactions".[103] However, each individual factor must be understood before such an evaluation can be performed.

#### *4.2.6.2 Individual or Aggregated Information*

Whether or not the exchange of information reduces certainty in the market is dependent on the characteristics of the information, and the type of market in which the exchange takes place. With regard to the former, the Commission differentiates between individual and aggregated information. The reason for this can be related to the reference to what "may affect trade" in ECT Article 81 since information which provides insight into specific competitors and information on the market as a whole, for example, will provide the carrier with different prerequisites for adjusting to the market.

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101 Commission Guidelines [2008], *Maritime Transport Services*, par. 43
102 Ibid, par. 50 to 58
103 Ibid, par. 57

The Commission refers to individual information as information referring to a designated or identifiable undertaking, while aggregated information concerns undertakings in the market in general. A precondition for information being regarded as aggregated is that the recognition of individual data is impossible.[104]

The exchange of individual information is clearly more likely to be covered by Article 81 (1) as it provides the receiver, depending on the content of the information, with an indication of how its competitor will operate in the market. The exchange of such information has been allowed under CR 4056/86, and based on the formulation of its Article 3, it has arguably been encouraged as a measure to ensure stability in the market. At present, unless covered by the exemption in Article 81 (3), the exchange of individual information is more likely to be prohibited.

In concentrated markets, as is frequently the case for liner shipping, aggregated information can also be prohibited even though such information "in principle, does not fall within Article 81 (1)".[105] Aggregated data on capacity is emphasized by the commission since information on capacity is seen as the "key parameter to coordinate competitive conduct" in liner shipping,[106] since information on where capacity will be deployed can lead to a common policy in the market resulting in services at above competitive prices.

#### *4.2.6.3 Information Duration*

The age of the information is also relevant as "historic information generally is not regarded as falling within Article 81 (1).[107] Historic information is not capable of making an impact on the future conduct of market operators.

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[104] Commission Guidelines [2008], *Maritime Transport Services*, par. 52
[105] Ibid.
[106] Ibid. par. 53
[107] Ibid. par. 54

The Commission differentiates between information concerning "historic, recent or future" market developments.[108] Whether or not information is historic is a factor that must be evaluated by its age. In previous cases, the Commission has considered information "more than one year old" as historic, and younger information as recent.[109] On the other hand, this must be assessed with flexibility as the rate at which the information becomes historic is dependent upon the relevant market and whether or not the information is individual or aggregated.[110]

Future information concerns the strategy an undertaking will follow or information on expected developments in the market. Such information is even more likely to be problematic in relation to Article 81, as it "may reveal the commercial strategy of an undertaking"[111] and consequently reduce rivalry and competition in the market.

With regard to the relevant market impacting on how fast information may become historic, the concentration in the market, as discussed above, does not provide many answers. Instead one must consider the nature of how business is conducted in the market. In liner shipping, the "product" is the transportation of goods. It is not a product one can stock up on in anticipation of a rise in value, but rather a product which, in the words of Dr. H.E. Haralambides, is "consumed as soon as it is produced".[112] In such a "perishable" market, information becomes historic very fast compared to other markets. This is the case especially for volume/capacity data as it changes once the capacity is applied, as opposed to price data which might remain unchanged over a period of time.

The content of the information and the persons to whom it is provided also impact on its durability. Aggregated information will

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[108] Ibid.

[109] Commission Guidelines [2008], *Maritime Transport Services*, par. 54

[110] Ibid.

[111] Ibid.

[112] Dr. Haralambides, H.E., Comments on the 2008 Guidelines [2007]

become historic faster than individual information[113], and the level of aggregation must be considered. With regard to whom the information is provided, Dr. Haralambides points out that liner carriers operate, in principle, with three types of customers: spot market customers, freight forwards and direct accounts.

Depending on the different customer types, carriers exchange different types of information, and the durability of the information varies. From this, carriers can arguably assess whether or not the information exchanged is in accordance with Article 81 (1) based on the persons with whom they are exchanging it. For instance, agreements with spot customers are short in length (two weeks to two months) and information issued quarterly, for example, will quickly become obsolete. For more long term customers such as direct accounts, where contracts are negotiated on a yearly basis, information between the parties to the agreement may have longer durability, although Dr. Haralambides argues that collusive behaviour is unlikely also in this regard.[114]

It must be taken into account, however, that the amendments suggested by the ELAA, and which Dr. Haralambides commented,[115] were not included in the final Guidelines. This indicates that the Commission wanted to avoid any obligation to accepting information exchange in general, and wanted to adhere to the principal rule of assessing the situation on a case-by-case basis. Even so, the comments by Dr. Haralambides are not without merit, as the issues he raised are relevant in an overall assessment.

#### *4.2.6.4 Information exchange systems*

In the guidelines, The Commission addresses the issues which must be evaluated in relation to the types of information that can

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113 Commission Guidelines [2008], *Maritime Transport Services*, par. 54

114 Dr. Haralambides, H.E., Comments on the 2008 Guidelines [2007]

115 The suggestions included a sentence declaring that ”liner shipping data becomes obsolete relatively quickly”, and that six-month old aggregated data could be released without effect on competition

or cannot be exchanged under Article 81. However, the issue of information exchange systems is not dealt with in great detail in the final draft, but some information can be deduced from the preliminary documents to the guidelines.

In the preparation preceding the publication of the guidelines, the ESC commented on the draft with regard to guidance on information exchange.[116] The commented draft stated that Article 81 does not "prevent undertakings from adapting themselves intelligently to the existing or anticipated conduct or competitors".[117] Furthermore, it stipulated that "the Court has found that a system of quarterly price announcements that did not lessen each undertaking's uncertainty as to the future attitude of its competitors did not constitute an infringement of Article 81 (1)".[118]

These statements were not without merit, but the ESC argued that they indicated a permissive approach, which again could be interpreted by carriers as a lenient view on information exchange in the future. This argument was furthered by the ESC through an example of what could happen if an information exchange system was allowed to be established post CR 1419/2006.[119]

The example was a situation where one consortia and one independent operator controlled 50 % and 40 % of the market respectively, a situation not unthinkable after CR 1419/2006 with consortia cooperation on the rise and many new independent operators coming out of conferences. If the consortia and the independent operator were to submit volume and quarterly price announcements, either party might be able to determine through simple calculations whether or not its competitor was taking an offensive or restrictive approach to market development in terms of capacity. Since a restrictive approach would indicate a rise in rates, the competitor would be inclined to follow suit, resulting in a reduction

116 ESC Guidelines Submission
117 Ibid. Annex II, par. 42
118 ESC Guidelines Submission, Annex II, par. 44
119 Ibid. Annex I

of competition on prices. A similar, real-world example can be seen in *CEPI-Cartonboard,*[120] where the exchange of purely statistical data was found to enable the participants to identify individual market operators through analysis, since there were few competitors in the market.

In the final guidelines, it can be seen that the proposed changes by the ESC had been taken into account to a large extent.[121] It is natural to assume that the Commission wanted to avoid such a scenario as depicted in the ESC submission, and consequently changed the formulations of the final guidelines. This indicates that an information exchange system in the liner shipping system (outside what is legalized within consortia through CMR 823/2000) will be regarded as illegal if it in any way enables market participants to diminish uncertainty in the market and anticipate actions from competitors. The information referred to in the ESC example is monthly data on volumes per port and average rate per type of equipment, confirming the position by the Commission on the possible violation of Article 81 (1) by information exchange, even if it is aggregated.[122]

## 4.3 Article 81 (3) exemption

### 4.3.1 General considerations

In the event an agreement, decision or concerted practice is in violation of ECT Article 81 (1) it will be automatically void as a consequence of Article 81 (2), "no prior decision to that effect being required".[123]

In contrast, if an agreement i.a. satisfies the conditions in Article 81 (3) it shall not be prohibited, no decision required.[124] The self-

[120] *CEPI-Cartonboard,* OJ [1996] C 310/3
[121] Commission Guidelines [2008], *Maritime Transport Services*, par. 40 and 43
[122] Commission Guidelines [2008], *Maritime Transport Service,* par. 53
[123] CR 1/2003, Article 1 (1)
[124] Ibid, Article 1 (2)

assessment required of carriers in liner shipping to evaluate whether their activities are in accordance with Article 81 (1) also applies to the assessment of whether or not the activity can be permitted through Article 81 (3).

The EC Treaty competition regulation is based on the idea that a competitive market is the best way to ensure an efficient allocation of resources. However, Article 81 (3) provides the possibility of departing from this fundamental assumption as long as it can be proven that the agreement i.a. restricting competition also provides objective benefits for the economy, benefits which outweigh the negative consequences.

In the evaluation, the four cumulative conditions set forth in 81 (3) must be taken into account, as described above under 3.2.1. In the preface to CR 1419/2006, the Commission provided the reasons why conferences were no longer regarded as in compliance with Article 81 (3). However, this does not mean that Article 81 (3) is irrelevant for carriers in liner shipping. For carriers unprotected by an exemption regulation,[125] Article 81 (3) can render Article 81 (1) "inapplicable" for any single agreement i.a., provided the conditions are met.

### 4.3.2 Conduct relevant for exemption

Carriers in liner shipping (former conference members, consortia members and independent operators alike) are likely to cooperate with possible competitors to some degree. If the threshold for being in violation of Article 81 (1) has been crossed, carriers must assess whether or not the conduct can be exempt by 81 (3). In principle, "no anti-competitive practice can exist which, whatever the extent of its effects on a given market, cannot be exempted, provided that all the conditions"[126] are met. Consequently, even hard core restric-

[125] For example independent operators or carriers which do not fulfil the consortia exemption.

[126] *Matra Hachette,* par. 85

tions can be exempt if the positive effects of the conduct outweigh the negative consequences.

### 4.3.3 Conditions

The **first condition** is that the agreement i.a. contributes to improving production or distribution of goods (the article refers to "goods" but applies by analogy also to services[127]), or promoting technical or economic progress. In brief, the agreement i.a. must provide efficiency gains.

In order to fulfil the condition, the carrier invoking Article 81 (3) must substantiate the "*nature* of the claimed efficiencies", the "*link* between the agreement and the efficiencies", the "*likelihood* and *magnitude* of each claimed efficiency", and "*[h]ow* and *when* each claimed efficiency would be achieved".[128]

With regard to the "link", the alleged efficiency must furthermore be direct, as indirect effects are normally regarded as too uncertain. For example, an agreement which limits competition but provides the carrier with increased profits which in turn could be invested in development to the ultimate benefit of consumers would not be regarded as sufficiently direct.[129]

An argued positive effect of price fixing and agreements on tariff rates from carriers has been stability in the maritime transport sector. However, even as the conference block exemption was in force, the CFI stated that "not...every agreement between shipping companies which may promote a certain stability in the maritime transport sector may be granted an exemption".[130] For example, if no instability in the market can be established, there could be no actual stabilizing effect which would suffice to fulfil the requirement.

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127 Commission Guidelines [2004] *Article 81 (3)*, par. 48
128 Ibid, par. 51
129 Commission Guidelines [2004] *Article 81 (3)*, par. 54
130 *TAA*, par. 261

Other relevant efficiency gains are "technical or economic progress".[131] Liner cooperation arrangements can provide such progress in several ways, for example by ensuring "better servicing or greater safety or convenience to shippers as well as reduction of overcapacity".[132] This would indicate that capacity regulation might have positive aspects, even though it is principally regarded as a hard core restriction. However, "[p]ure price fixing, capacity limitation, and market-sharing...which does not involve any operational cooperation, is unlikely to result in economic or technical progress of such a scope to outweigh the negative effects brought about by tariff rate increases".[133]

Conclusively, hard core restrictions can be exempt by Article 81 (3), but this is not likely when they are applied solely to raise or maintain prices or market power. Only when they are applied in relation to establishing an operational cooperation with focus on improving efficiency and service, and also induce sufficient efficiency gains, can their negative effects be tolerated.

The **second condition** of Article 81 (3) stipulates that consumers must be allowed a fair share of the benefits (benefits being the efficiency gains discussed above). In liner shipping, the direct consumers of services are transport users. However, "consumers" in Article 81 (3) also include indirect consumers such as subsequent purchasers and final consumers.[134]

The benefits provided to the consumers can be in form of reliable services on which exporters and importers can base their commercial strategies. This includes stable pricing and schedules, and lower prices will naturally also be a benefit to the transport user. However, the question carriers must ask themselves is "what is a fair share?". In this regard, what constitutes a fair benefit depends of how much the negative effects restrict competition; "The greater the restric-

131 ECT Article 81 (3)

132 Pozdnakova, Alla [2008], par. 9.3.2.5.

133 Ibid.

134 Commission Guidelines [2004], *Article 81 (3),* par. 84

tion of competition found under Article 81 (1) the greater must be the efficiencies and the pass-on to consumers."[135] Therefore, while hard core restrictions or other arrangements that severely distort competition can be exempt in theory, carriers would have to produce an even larger compensation for the consumers, resulting in a scenario in which carriers would, as described by Nicolette van der Jagt above, "be walking on very thin legal ice".

The **third condition** is the indispensability requirement, which requires the carriers to prove that the benefits of the agreement "cannot be attained by other less restrictive means".[136] Thus the carriers must prove that the invoked benefits (market stabilization, reliable services and so on) are results of the agreement and not other changes in the market (supply and demand), and that the results could not have been produced by less intrusive means.

Such an assessment was made in relation to the introduction of CR 1419/2006,[137] where the Commission found that consortia provided the same level of service as conferences without hard core restrictions such as price fixing. Carriers must therefore always be vigilant in their search for better, more efficient and less restrictive ways of operating, since what is considered indispensible at one point in time may not be so at another.

The **fourth condition** prohibits the elimination of competition "for a substantial part of the products in question".[138] Under the protection of CR 4056/85, conferences sought to eliminate destructive competition by means of heavily integrated cooperation. With the exemption removed, carriers must assess what constitutes a "substantial part" to ensure compliance.

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135 Ibid. par. 90

136 Bellamy & Child [2008], par. 3.059. Pozdnakova and Bellamy & Child differ here, as the former holds that a "causal relationship" between the restrictions and the benefits is sufficient (par. 9.3.4.) while Bellamy & Child holds that the requirement "goes beyond the establishment of a simple causal link".

137 See above, 3.2.1.

138 ECT Article 81 (3)

With regard to conducting the assessment, the CFI stated in *TAA* that the situation must be assessed as a whole, "taking into account in particular the specific characteristics of the relevant market, the restrictions of competition brought about by the agreement, the market shares of the parties to that agreement and the extent and intensity of external competition, both actual and potential".[139] Considering its comprehensiveness, the fourth condition can be considered an assessment to ensure compliance with the core objective of the ECT, in particular Article 3 g) which aims to ensure that competition is not distorted. Elimination of competition would naturally be in disharmony with this objective.

As described in the interpretation by the CFI, both competition restriction between the parties to the agreement and restriction of external competition are relevant. With regard to the parties to the agreement, it must only be established that the agreements provide the parties with the "possibility" of eliminating competition, cr. Article 81 (3). Thus, not only hard core price fixing in conferences can fail to meet this condition, but also discussion agreements since, by grouping together competitors, they "tend to lead to the elimination of effective competition on the trade on which they operate."[140]

The possibility of "elimination" of competition raises the question of when competition can be said to be eliminated. Competition consists of several elements, price and quality of service being the most important of them in liner shipping. Restricted competition on one element does not exclude the possibility of competition on the other. However, the CFI has stated that in liner cartels such as the TAA, "quality of service [is] of secondary importance with the price". On the other hand, the ECJ has stated that "although price competition is so important that it can never be eliminated it does

[139] *TAA*, par. 300

[140] Review 4056/86 – Discussion paper [2004], par. 119

not constitute the only effective form of competition...which absolute priority must in all circumstances be accorded".[141]

As a result, the elements of competition that are decisive must be assessed from the content of the agreement in each individual case.

With regard to external competition, the assessment of whether or not an agreement between carriers has the "possibility" of eliminating competition is similar, but also includes such factors as the market share of the cartel, the market position of competitors as well as the effectiveness of their potential competition and the existence of similar agreements.[142]

In brief, under the direct application of Article 81 (3), carriers must carry out a comprehensive assessment of their actions, weighing the benefits of the agreement i.a. against its restriction of competition.

# 5 Liner shipping after 18 october 2008

## 5.1 Consequenses of the new regulation

Firstly, to answer the question posed in the title of this thesis, the introduction of CR 1419/2006 can indeed be said to constitute the end of liner conferences as we know them, at least on routes in, to and from Europe, since the core functions of conferences have been prohibited.

The introduction of CR 1419/2008 led directly to the abolishment of one of the major liner shipping conferences, the Far East Freight Conference, in October 2008.[143] Likewise, other conferences on trade routes to and from Europe have diminished or

[141] *Metro I*, par. 21

[142] See Pozdnakova, Alla [2008], par. 9.3.5.3. for details on the elements of the assessment.

[143] Wong Peter [2009]

ceased activities during the transitional period provided in CR 1419/2006.

With carriers obliged to self-assess their operations, assessments which as depicted above are quite comprehensive, a heavy load has been put on the liner sector. It is reasonable to expect some scepticism and reserve from carriers wanting to avoid the risk of overstepping the new legal boundary, which could have unintended negative effects on the development in the market.

The timing of the new regulation, in the midst of a global economical crisis which impacts on maritime transport, also has consequences. Firstly, the former conferences have been claimed to protect less efficient operators, shielding them from the challenges in the free market.[144] When such operators are exposed to even competition regulation in a market that is struggling, many operators will probably perish. Remaining carriers, in addition to adapting to the new regulation, must also deal with overcapacity[145] and an overall downturn in trading volumes. In the words of Chris Bourne, executive director of the ELAA, "the abolition of liner conferences in Europe...could not have come at a worse time for the industry".[146]

As a result, carriers are likely to join forces in whatever way possible to secure market positions. The forms of cooperation the carriers choose to apply in the future depends on how they assess the application of Article 81.

## 5.2 The future of liner shipping

### 5.2.1 Alternative forms of cooperation

Liner shipping as a market and important sector within trade will not change due to the revocation of the block exemption. Carriers

144 Pozdnakova, Alla [2008], par. 9.3.2.6.

145 See OECD Report page 47 et seq on problems relating to overcapacity.

146 Global Shipping Summit [2009]

must adapt to the new regulatory reality and, by doing so, will change both the basics of the liner shipping market and the more detailed forms of cooperation utilized by carriers.

Having looked at the developments in the liner shipping market before CR 1419/2006, and the regulatory consequences for carriers following the direct application of Article 81, it is possible to asses likely market development. With conferences no longer constituting an option for carriers, other forms of cooperation will likely emerge. As mentioned under 4.2.2., more flexible cooperation arrangements are a preferred alternative to the conference system. Discussion agreements which deal with price fixing and capacity restrictions, but in a non-binding manner, have been suggested as possible substitutes for the conference system.[147] However, this form of cooperation also has anti-competitive characteristics,[148] and with the effects of such agreements being hard to anticipate, it is likely that carriers will choose alternatives with which the legislative powers are more comfortable.

One such alternative is consortia, which has been on the rise in the years up until the implementation of CR 1419/2006, under the protection of another block exemption.

### 5.2.2 Consortia

An increase in the application of consortia is to be expected following the ban of conferences. Commission Regulation 823/2000 provides several exemptions from ECT Article 81, making consortia the preferred form of carrier cooperation within liner shipping.

In the 2008 Guidelines, the Commission announced a revision of the consortia exemption. Instead of the revision, the Commission issued a new regulation on consortia which will come into force in 2010 when the current regulation expires.[149] This indicates

147 Pozdnakova, Alla [2008], par. 8.2.4.

148 For arguments against discussion agreements, cf. DG Competition, *Review 4056/86- discussion paper* [2004] par. 117

149 CMR 906/2009

that consortia are still viewed as positive contributors in the liner shipping market.

The new consortia exemption is a continuance of the main elements of CMR 823/2000, but also introduces some changes. The most important change is the reduction in market threshold, meaning that only market operators with a less than 30% share of the market (as opposed to 35% in the current regulation) automatically qualify for the exemption regulation.[150]

Other alterations in the new regulation on consortia reflect regulatory changes in the liner shipping sector. Previous guidance on which activities that will or will not be exempted by ECT Article 81 (3) has been removed in accordance with the self-assessment responsibility. The option for carriers to apply capacity adjustments has also been changed, as it now can only be implemented in correlation with fluctuations in supply and demand.[151]

It seems likely that carriers will continue to flock towards consortia. There is already a trend towards consortia, and with CMR 907/2009 somewhat extending the exemption, there is no reason why the trend should diminish. The exemption is no longer limited to services provided "chiefly by container", although this might not have a major impact since almost all shipping services today are provided using containers. Also, consortia can now also consist of "interrelated agreements"[152] which probably reflects market reality to a greater extent than the single agreement to which the current regulation refers.

Otherwise the regulation introduces clarification rather than change, for example by expressly regulating how the member market share is to be established.

The core motive for an exemption regulation for consortia also remains the same as before; consortia are considered positive contributors to the liner market as they "help to improve the pro-

[150] Ibid. Article 5 (1)
[151] Ibid. Article 3 (2)
[152] CMR 906/2009. Article 2 (1)

ductivity and quality of available liner shipping services" through such measures as "technical and economic progress" and "efficient use of vessel capacity".[153]

This argument resembles the reasoning for implementing CR 4056/86, a reasoning which over time turned out to be faulty. Also, the exemptions stipulated in CMR 906/2009 partially coincide with the "specified objectives" set forth in CMR 4056/86, Article 3.[154] The question, then, is what are the practical differences between the regulations?

With consortia not allowing for hard core restrictions,[155] it is unlikely that consortia will lead to the same market situation as conferences did. In brief, consortia are intended for members to be able to rationalize costs and operations, as opposed to conferences which i.a. pursued coordinated tariffs.[156] On the other hand, as pointed out by the ESC in its comments to the Commission Guidelines of 2008,[157] carriers do not need far-reaching block exemptions to distort competition. The options for formalized information exchange, joint operation offices and other forms of cooperation are indeed intended to enable the consortia to operate efficiently, but the long term consequences of these options remain unclear. While consortia have been regarded as a better alternative while conferences prevailed as major market operators, the situation might be different when consortia becomes increasingly popular among carriers.

This is arguably a reason why the exemption is set to expire in 2015, and is not indefinite like the conference exemption. The reduction of the total market share to 30 % can also be seen as a result of the desire to avoid unintended negative effects, as it ensures less concentration of market power. Whether or not the

153 Ibid. preface (7)

154 CR 4056/86 Article 3, a) trough c) are mirrored in CR 906/2009 Article 3, while d) in the former (regulation of carrying capacity) is more restricted for consortia.

155 CMR 906/2008, Article 4

156 Bellamy & Child [2008] par. 12.029

157 See above 3.4.3.

consortia exemption will be extended beyond 2015 is therefore dependent on market development in the coming years.

### 5.2.3 Expected regulatory development

The Commission stated in MEMO/06/344 that "all appropriate initiatives' to advance the removal of price fixing in liner shipping elsewhere in the world" will be pursued.[158] Thus the Commission set its sights on abolishing traditional conference shipping on a global scale.

By introducing CR 1410/2006, the Commission put Europe at the forefront of introducing true competition to liner shipping. However, similar developments, although more gradual in nature, have occurred elsewhere. Developments in U.S. antitrust law towards unrestricted competition started already in the early 80's with the Shipping Act of 1984[159], prior even to the introduction of CR 4056/85. The act introduced competitive instruments such as independent rate action,[160] and individual negotiation of service contracts.[161] This development continued with the Ocean Shipping Reform Act of 1998 ('OSRA'). The act did not remove antitrust exemptions for conferences on the scale of CR 1419/2006, but improved on the competitive instruments of 1984, such as the right to negotiate individual service contracts, herein making restrictions on this right illegal.[162] Following OSRA, most goods transported to and from the U.S. were individually negotiated instead of being shipped under a common tariff.[163] Furthermore, the OSRA instigated a decline of the traditional conference agreement, and

158 Bellamy & Child [2008], par. 12.019

159 Dinger, Felix [2004], page 176 et seq.

160 The right for conference members to depart from the off the official tariffs on any rate or service provided a notice to the conference.

161 Carriers in conferences could individually or together as a conference agree with shippers on rates and service levels.

162 Dinger, Felix [2004], page 181

163 98 % individually negotiated according to the 2001 OSRA Report.

the number of conferences in the U.S. has fallen by nearly one third since its introduction.[164]

This development is quite similar to the development in Europe before the introduction of CR 1419/2006, indicating that regulatory developments in one jurisdiction can impact on liner shipping market development in another.

Consequently, as liner shipping is exposed to common competition regulations and the core functions of conferences are abolished in Europe, we are likely to see a decline in conference market power also elsewhere, at least within jurisdictions dealing in liner trade with Europe.

With regard to regulatory development in Europe, nothing seems to be on the horizon at the present time. The abolishment of Liner Conferences and the introduction of CR 906/2008 represent a decisive turning point in dealing with liner cartels and modernizing liner shipping.

[164] Dinger, Felix [2004], page 183

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**Acronyms and Abbreviations**

- ESC: European Shippers Council
- CFI: Court of First Instance
- COJ: Court of Justice
- CR: Council Regulation
- CMR: Commission Regulation
- ECT: Treaty of the European Community
- TEU: Twenty-foot equivalent unit (used to describe the container capacity of container ships and container terminals)
- EEA Agreement: Agreement on the European Economic Area

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