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**Outline of Insurance Practices for Third Party Liability
in the field of Marine Transport**

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1 INTRODUCTION

- 1.1 British Maritime Technology Ltd (BMT) has been tasked with coordinating a programme of studies and research for the European Commission's Directorate General for Energy and Transport (DG TREN), under the title Maritime Transport Coordination Platform (MTCP). MTCP is charged with undertaking studies of DG TREN's choosing that provide background support to their development of policy in the maritime sector.
- 1.2 One such study concerns Insurance Practices for Third Party Liability Insurance in the Field of Marine Transport and that is the subject of this Report. Within this sector the Protection and Indemnity (P&I) Clubs comprise by far the largest provider of insurance. The object is essentially to document how the P&I system works in practice and how it responds to major incidents.
- 1.3 This Report was written following a joint study undertaken by BMT and DNV. Although much of what this Report contains is sourced from the relevant information to hand, it is also compiled with the cooperation of a number of key P&I providers representing different parts of the market.
- 1.4 The Report sets out to address a number of issues outlined as the Task Definition. Namely:
1. Give the general background to maritime insurance with a description of the commercial and mutual insurance markets.
 2. Define P&I Clubs, their mutual status and the insurance products provided.
 3. Illustrate case law relevant to third party liability.
 4. Review conditions of entry of ships to P&I Clubs.
 5. Review the opportunity for quality operators (exceeding normal international regulatory standards) to obtain financial benefit / incentive with regard to the cost of P&I cover.
 6. Give consideration to ships that are not insured or are insured outside the International Group context.
 7. Illustrate P&I insurance issues by way of case studies.

2 EXECUTIVE SUMMARY

- 2.1 Third party liability insurance is not compulsory, though compulsory insurance is being introduced in some regions (e.g. Japan).
- 2.2 The majority of craft will have third party liability insurance. Uninsured ships are a potential problem but one that is not considered by the insurers as likely to be significant – particularly amongst seagoing ships. However, compulsory insurance may be welcomed by the marine insurers as a tool to influence quality – though there are several caveats including the policing and enforcement issues.
- 2.3 The P&I Clubs provide the vast majority of third party liability cover in the marine sector. Of these the vast majority of ship owners are entered within a mutual P&I Club and member of the International Group of P&I Clubs; 85% to 90%+ for ocean going ship types are entered with the International Group Clubs, dependent on sector. The thirteen Clubs in the International Group provide third party liability insurance for an estimated 98% of the world's ocean going tanker fleet.
- 2.4 Other liability cover providers predominantly cater for niche clients – ship types, trades.
- 2.5 The P&I Clubs form an integral part of the marine industry.
- 2.6 The P&I Clubs provide a flexible cover suited to their Members' needs and adaptable to changes in legal and commercial framework. They have a service based ethos. The product extends beyond pure insurance cover to include claims handling, legal and technical advice through to a full-scale emergency response assistance.
- 2.7 The concept of Mutuality underpins the service ethos and is a fundamental part of the P&I Clubs' ability to provide the range and magnitude of cover, both within individual Clubs and amongst the International Group. It is their mutuality that makes the P&I Clubs fundamentally different from commercial insurers.

- 2.8 The mutual system and pooling of Club resources within the International Group permits the P&I Clubs (of the International Group) to provide cover of up to \$2 billions (maximum to the reinsurance) or an ultimate level of about \$4 billions. This cover is open to every Club within the Group and far exceeds anything provided under other forms of insurance.
- 2.9 Quality of ships and shipping operations has been a factor considered by the P&I Clubs for several years. A system of monitoring, vetting, inspecting and training has been developed in order to track and influence quality of operations. The quality of the system, and the scope of the quality assessment, varies from Club to Club, however.
- 2.10 Within certain liability categories, such as oil pollution the P&I system works as a complementary part of the international regime. For oil pollution the compensation limits have recently been raised. An optional third tier Supplementary level of compensation is likely to cover all foreseeable pollution costs in a major incident. Other lower levels may be debatable.
- 2.11 The funding of the new compensation regimes is the cause of much debate with oil producers in particular questioning the balance over the long term between themselves and insurers. The P&I insurers themselves may be willing also to see this reviewed in order to continue the perceived equitable process seen to date.

3 BACKGROUND

3.1 The shipowner requires insurance against the loss of or damage to his physical property – the ship. (He) also requires insurance against third party liabilities that may arise. To meet his needs the shipowner will normally purchase three main types of insurance: hull & machinery insurance, third party liability insurance (P&I cover predominantly) and war risks insurance, with other covers available as needed.

3.2 Hull and machinery insurance is normally provided either by commercial insurers or from Lloyd's of London market place. Third party liability insurance is overwhelmingly provided by a Protection and Indemnity (P&I) club – the majority being mutual societies. War risk insurance may be provided from commercial sources, or from specialised war risk Clubs.

Main Types of Insurance available to the shipowner:

1. Hull and Machinery
2. Third Party Liability
3. War Risks
4. Freight, Defence, Demurrage
5. Strike Liability
6. Loss of Hire

3.3 Charterers of ships have fewer third party liability risks, but these are also covered by the market place. They may be dealt with either by the shipowner based P&I Clubs (as Charterer's entry) or by a small number of dedicated P&I entities. Types of Insurance available to the Charterer:

7. P&I (Charterer's entry)
8. Hull damage (Hull as the third party)
9. Bunkers – loss / damage to
10. Loss of Freight or Hire

3.4 The organisations and market providing these insurance types are described in more detail below:

3.1 Organisations

- **Commercial insurers – insurance and reinsurance companies:** Within their **marine sections** primarily providing hull insurance to the marine market plus reinsurance leads. Internationally based, a large percentage of business is conducted in or through London. Such insurers may be part of the **International Underwriting Association (IUA)**, based in London and the largest of its type of organisation. The IUA acts as representative body for “international and wholesale insurance and reinsurance companies”, fulfilling both “trade association” and “market association” roles. The IUA hull account is approximately 1/3 the size of Lloyd’s of London. For more information about IUA, see www.iua.co.uk.
 - Commercial insurers exist to make a profit for their owners, by writing insurance against detailed policies, primarily for hull and machinery risk.

- **Lloyd’s of London** is not an insurer itself but a market place where lines of risk are underwritten by Syndicates of investors (Names), headed by a managing agent acting on the investors’ behalf. Primarily providing hull insurance (covering the hull and the machinery within) for the marine market as part of the general insurance business. There are very few specialised marine insurers. Previously unlimited liability has been capped and consequently individual private investors have tended to be replaced to a great extent by corporate bodies. Lloyd’s is in competition with the commercial insurers, though percentage lines of insurance at Lloyd’s may be taken by commercial insurers. Most insurance is underwritten by a number of Syndicates, spreading the risk. Lloyd’s accounts for about three quarters of the London based hull insurance market, itself about 25% of the global market. See www.loyds.com for more information.

The Lloyd’s investors aim to make a profit by underwriting risks including marine risks primarily against set hull and machinery policies.

- **Third Party Insurance.** Cover against liability risks for which the shipowners, or to a lesser extent the charterers, fall liable. The cover is provided overwhelmingly by the mutual P&I Clubs. Thirteen mutual P&I Clubs grouped into **the International Group of P&I Clubs** have approximately 85% by number and 90% by tonnage of the world’s shipping entered with them. Gross annual underwriting premiums in the region of 2 billions US\$. The mutual Clubs do not make profit (nor losses) per se but aim to cover the Members’ risks across the Membership. Also a number of non-mutual, fixed premium, providers exist including Syndicates at Lloyd’s (now in run-off), Lloyd’s backed Agency Underwriters and independent commercial operations. These exist to make a profit on the insurance business.

- **Brokers** handle the majority of insurance business. Some organisations, particularly the mutual P&I Clubs, may deal direct with the prospective insured, though these can also utilise P&I brokerage services. Brokers handle most Hull & Machinery business either directly placing the business or advising one of the parties.

3.2 Locations

3.2.1 Whilst other locations have grown and taken market share, the London Market at present continues to be the largest single provider of insurance, (including marine insurance). London retains approximately 25% of the world market for hull insurance, with annual premiums in the order of 600 millions US\$. Other main hull insurance centres are USA, Norway, Japan, France and Germany.

3.2.2 For third party liability, the thirteen International Group Clubs form the focus – covering about 85% of numbers and 90% of world tonnage. The International Group headquarters is in London, together with several of its Members' offices. Other member locations include Scandinavia, America and Japan. The China P&I Club has in 2004 approached the International Group for Membership.

3.2.3 An appreciation of the comparative size of the P&I market against the general insurance market can be gained from the following approximate statistics:

3.2.4 Overview of 2001 gross premiums: (All business sectors)

1. Lloyd's	\$US 16.9 billion (£9.6bn)	48% (of London Market)
2. IUA	\$US 16.4 billion (£9.4bn)	47%
3. P&I	\$US 1.76 billion (£ 1.0bn)	5%

3.2.5 Overview of 2001 gross premiums: (Marine, Aviation and Transport sectors)

1. Lloyd's	\$US 5.1 Billion (£2.9 bn)	50.9%
2. IUA	\$US 3.17 billion (£1.8 bn)	32.1%
3. P&I	\$US 1.76 Billion (£1.0 bn)	17%

3.3 Risks Covered by non Third Party Liability Insurance

3.3.1 Hull Insurance

- 3.3.1.1 Hull insurance principally covers loss of or damage to the shipowner's physical property – the ship, i.e. the insured ship's hull, machinery within and propulsion system. It also normally covers the ship's contribution to General Average (a method of sharing costs of actions taken to remedy a threat to the common interest of ship and cargo) and salvage.
- 3.3.1.2 A hull policy will include a financial value for the insured ship. This is the amount the insured would receive in the event of the ship becoming a "total loss" – i.e. either physically lost or where the cost of recovery would exceed the value of the ship ("constructive total loss" or CTL). Additional total loss cover may (restricted in some markets) be obtained at additional cost.
- 3.3.1.3 Over the years standard insurance clauses were developed by the various markets for use in their policies. English, American, Norwegian and German policy documents are in common use both within and outside their home regions. There are important differences across these policies; e.g., the Norwegian and German documents being all risks – removing from the shipowner the burden of proving that the loss is attributable to a risk specifically covered by the policy.
- 3.3.1.4 The London market developed the "International Hull Clauses", last updated in 2003. These retain a "named risks" policy. Provided principally at Lloyd's of London or by Commercial Insurers, the hull insurance policies incorporating these Clauses do not cover damage to the ship "howsoever caused" but instead list the specific risks covered.
- 3.3.1.5 Some traditional risks are covered under strict liability, i.e. without need for fault or blame: Traditionally, the principal risks covered in English policies in this way are:
1. Fire
 2. Explosion
 3. Perils of the sea. (Heavy weather, stranding, collision with other ships, but not the "ordinary action of the winds and waves").

3.3.1.6 Other named risks incorporated through time are excluded in these policies when there has been a lack of “due diligence” by the insured or their manager, including “negligence of Master or Crew or Pilots”.

3.3.1.7 A development in the 19th Century was the incorporation of cover for damage to another vessel (hull) caused by collision with the insured ship. Traditionally this cover was limited to $\frac{3}{4}$ of the cost of the damage (see next section on third party liability insurance). Today, the entire $\frac{4}{4}$ (100%) collision risk may be taken by either hull or P&I insurer. A hull policy containing a collision clause will also include a limit to the insurer’s financial exposure. Liabilities over this limit will be covered under the Owner’s P&I insurance, about which see more below.

3.3.2 Hull Policy Exclusions

3.3.2.1 Liabilities arising from war, terrorism and strikes and similar causes are almost always specifically excluded from hull policies. As well as losses caused by a war, the exclusion incorporates risks in peacetime from derelict mines and weapons, plus acts of “any terrorist” or person “acting from a political motive” as well as “strikers”. Separate insurance must be bought to cover these risks, about which see more below.

3.3.2.2 A small number of hull policies cover damage to jetties and structures, which would normally be covered under the third party insurance, described next.

4 THIRD PARTY LIABILITY INSURANCE

4.1 Lloyd's and the P&I Clubs

4.1 Whereas the main providers of hull insurance (Lloyd's of London and the commercial insurers) can best be thought of as part of the insurance industry, providers of third party liability insurance through the mutual P&I Clubs, for the most part, are an integral part of the marine industry. This has provided a fundamental difference to the outlook and operation of marine third party insurance.

4.2 History of Third Party Insurance

4.2.1 To understand the nature of the marine insurance market and in particular the third party liability market it is helpful to be familiar with at least some of its history and the driving forces that shaped its present form.

4.2.2 Maritime insurance has ancient roots, stretching back in some form over several millennia. By the end of the 17th Century, Northern Europe had become the focus for much of the world's trade and thus its insurance industry. For a fee, or premium, certain merchants would provide shipowners and cargo owners with insurance against loss during a venture. Policies were issued, detailing the insurance provided and signed underneath by the merchant backers – thus becoming known as Underwriters.

4.2.3 In London in 1680, Edward Lloyd opened a coffee house which became a focal point for conducting insurance business and eventually developed into the insurance market place which still bears his name (Lloyd's of London); the merchants becoming known as Lloyd's Underwriters. The liability covered was principally the loss of the ship (the hull).

4.2.4 Between 1719 and 1824 the providers of such insurance in England were limited by Acts of Parliament to two named companies plus individual underwriters (principally those operating at Lloyd's Coffee House).

- 4.2.5 Aggrieved at the high premiums that arose from this situation, ship owners formed Clubs as alternative insurance providers. Operating on a mutual, non-profit making basis these Mutual Hull Underwriting Associations (Hull Clubs) gave similar cover at reasonable rates, though they did so illegally until the repeal of the Act in 1824.
- 4.2.6 Until the mid 19th Century the shipowner was liable to few other insurance risks than loss of the ship (the hull) and this was consequently the principal risk covered. Cargo owners rarely claimed against the ship owner for loss or damage to their goods and there was virtually no recourse for other third parties.
- 4.2.7 The first change came in the 1830s when it was established that the policies in use did not cover the shipowner for damage to another ship (i.e. the third party hull). As a response, hull policies were modified such that hull underwriters agreed to pay $\frac{3}{4}$ of the cost of damage to another ship, caused by their insured vessel. One quarter was left uninsured, with the intention of the hull underwriters that this would act as a safeguard against complacency by the shipowners.
- 4.2.8 The response to this was for the Hull Clubs to offer cover against this uninsured $\frac{1}{4}$, thus providing the shipowner with combined $\frac{4}{4}$ or 100% cover, though from two different sources – the hull underwriter's $\frac{3}{4}$ and the mutual Club's $\frac{1}{4}$. Today $\frac{4}{4}$ cover may be obtained from one source, if arranged, though the traditional split can still be found in many cases.
- 4.2.9 A second great change came about in 1846 when the British Parliament introduced the Fatal Accidents Act (Lord Campbell's Act). This established the rights of dependents of persons killed or injured as a result of a wrongful act of others. Shipowners were thus exposed to potentially great losses, particularly in the context of the time with ever increasing numbers of emigrant passengers being carried, often in poor conditions.
- 4.2.10 The shipowners' response was to form mutual Clubs or Associations to protect, on a non-profit basis, against the new risks. The first of the new "Protecting Clubs", the Shipowner's Mutual Protection Society, (Britannia Steam Ship Insurance Association Limited of today), was created in 1855. The Britannia is celebrating its 150th anniversary in 2005.

- 4.2.11 Exclusion clauses, primarily in Bills of Lading¹, legally removed most other insurance risks from the shipowner. However, a further development came after the sinking of the “Westernhope” in 1870, when it was established that cargo owners also had right of recovery against the shipowner.
- 4.2.12 Finding that the Protecting Clubs did not cover the new risks, shipowners in Newcastle formed the Steamship Owners’ Mutual Protection and Indemnity Association in 1874 – i.e. to indemnify Members against the losses from the new risks. A number of the Protecting Associations also incorporated the indemnity cover, turning into Protection and Indemnity (P&I) Clubs.
- 4.2.13 In Norway, in response mainly to the United States Hecter Act of 1893, which again limited a shipowner’s reliance on exclusion clauses within the contracts of carriage, Skuld P&I Club was formed in Oslo in 1897. This was joined in 1907 by Gard, in Arendal.
- 4.2.14 By the turn of the 20th Century most of today’s existing major P&I Clubs had been established. The cover provided has been progressively modified in response to the increase in trade and the introduction of various national and international legislation. The decrease in size of the home based Merchant Fleets and growth of others has also been reflected in the increased international flavour of Club Membership.
- 4.2.15 A further development was the entry into pooling arrangements by various Clubs. The purpose of this is to pool or spread risks over certain financial limits between all Members within the pool. This is an extension of the mutual principal found within the individual Clubs. It culminated in 1981 with the formation of the International Group of P&I Clubs (The International Group), and its Pooling Arrangement. The International Group is described in more detail in Section 4.4.

¹ A Bill of Lading is a document signed by the Master or Agent as a receipt for goods loaded; it evidences a contract between the carrier and the shipper for the carriage of the goods by sea; it is a document of title to the goods described thereon.

4.2.16 Another development of the third party liability market was the entry of non-mutual P&I insurers, known as “fixed cost” or “fixed premium” insurers. As the name implies they charge a fixed price for cover under a policy which closely defines the risks covered. Unlike the mutual Clubs they operate to make a profit. Three main types of providers are found within this market segment:

- A small number of Lloyd’s of London Syndicates directly underwriting the business.
- Lloyd’s backed Agency Underwriters including converted mutual P&I Clubs.
- Independent companies, many backed by a larger commercial insurance provider.

4.2.17 Following a flurry of activity in the 1990’s, the fixed premium sector has consolidated with practically all direct Lloyd’s Syndicates either ceased or in run down. The remaining sectors include a number of formerly mutual P&I Clubs, having gone private. History shows that non-mutuals often opt into the business when profits are good but in the event of big claims find that their capital providers withdraw. The sector primarily covers niche operators and ship types including coastal and brown watercraft. Charterers are also covered in this non-mutual sector.

4.2.18 Insurers from other regions have sought in the 21st Century to participate in the market either by joining the existing schemes (China P&I applying in 2004 for entry to the International Group) or providing alternative sources of cover, though these remain at present relatively small.

4.3 P&I Clubs

4.3.1 General Principles

4.3.1.1 A P&I Club is an association of shipowners who have grouped together to insure each other on a mutual, non-profit making basis against their third party liabilities. The Clubs have been described as shipowners’ cooperatives for liability insurance. Each member is both the insurer and the assured. The mutuality status is the cornerstone of marine P&I insurance.

- 4.3.1.2 To gain this type of Third Party Liability insurance cover, a shipowner must be accepted for Membership of the Club. Once accepted, the central concept is that of mutuality, i.e. all Members are equal and no shipowner or group of shipowners will subsidise any other within the group. All Members have reciprocal rights and obligations. Whilst costs of Membership vary to reflect the vessel type, crewing and trade risk profiles, this understanding remains crucial to the operation of the Association or Club.
- 4.3.1.3 The mutual P&I Clubs do not exist to make profits per se. There are no shareholders requiring profits from the operations. That said, however, it is important that they do not make a loss, and a profitable operation is needed for rainy days. The principle is for the Members (the shipowners) to pay sufficient funds to cover the claims experienced plus the cost of reinsurance and the operating costs of the P&I club management; this is achieved through a combination of Members' contributions, reserve/investment income, and reinsurance. Members' payments cover a 12-month entry period and are made in a series of "calls", discussed later.
- 4.3.1.4 Having started as unincorporated associations, most P&I Clubs have since been incorporated, enjoying separate legal status from their Members.
- 4.3.1.5 Mutuality in the P&I industry can be summarised as follows:
- Mutuality spreads the costs of large claims; a P&I Club does not get wiped out by one very large claim
 - Softer amplitudes in claims cycles
 - Share the risks with others – even with competitors
 - The P&I Club is owned by its Members seeking to protect the interests of its Members.
 - The Members are also decision makers
 - P&I Club provides insurance at costs with no proper profit or loss, but rather puts funds aside for "rainy days"
 - Mutuality requires common quality criteria/norms
 - Mutuality is about long-term benefits rather than short-term profits.

- 4.3.1.6 A number of Mutual Hull Clubs still exists, primarily in Scandinavia where they continue to play an important part of the hull insurance market. Nearly all the English mutual hull Clubs have ceased to exist, driven out by commercial competition or converting in the formative years of the industry to third party liability insurers.
- 4.3.1.7 The majority of the mutual P&I Clubs focus on ocean going tonnage as the mainstay of their business. The profile of the Membership varies between the Clubs, with some choosing to remain clear of certain main types, such as passenger vessels.
- 4.3.1.8 Niche craft may find a base within the main P&I Clubs, with one Club of the International Group in particular specialising in smaller tonnage. Alternatively these owners of smaller tonnage vessels may seek cover from one of the non-Group or non-mutual P&I providers. Amongst this segment of the market are a number dealing with specialised ship types (including fishing vessels) and smaller sea going and brown watercraft². Within these niche providers limitations normally apply including restriction on trading areas (trans Atlantic / Pacific trade excluded by some) or maximum size of vessel, particularly tankers, due to the attendant liability levels. They are discussed in more detail in a later section.

4.3.2 Structure of the Club

Control

- 4.3.2.1 A mutual P&I club is controlled by the shipowner Members. A representative number are elected for a set period onto a governing Board or Committee of non-executive Directors, normally headed by a Chair and Vice Chair, again elected for set periods.
- 4.3.2.2 The Board will meet on a number of occasions (typically three) throughout the year at different worldwide locations to reflect the Membership. They will decide such matters as general increases to levies on Members, changes to the Rules, capital expenditure, interaction with the International Group, with other bodies, and other similar matters.

² Small coastal and inland watercraft.

- 4.3.2.3 The board will typically reflect an appropriate mix of tonnage to represent the different ship types and countries making up the club Membership.
- 4.3.2.4 The Board will be provided with necessary information on the Club matters by a permanent, professional management team, the Club managers. Increasingly one or two representatives of the Club managers may also sit on the Board as Executive Directors, for their particular P&I expertise.
- 4.3.2.5 On occasions, difficult claims may go before the board – the so-called Omnibus cases – whose Members will then decide on whether or not the Member concerned is to be covered. Such concessionary claims are often on points of technicality and are usually very small in number. The ability to consider such concessionary claims is one factor which makes the mutual Clubs distinctly different from commercial insurers.

Management

- 4.3.2.6 Day to day management of the Club will be handled by a dedicated team of professional management personnel. These may be direct employees of the Club or more commonly, in the London based Clubs, may belong to an independent firm of professional managers, contracted to perform the task.
- 4.3.2.7 The management body, whether directly employed or contracted will normally have a similar organisation and function throughout the various Clubs. Lead by one or a number of club's Executive Directors the management team will be divided into a number of sections, departments or syndicates to reflect the geographic nature of the Membership and to cover the range of internal management tasks and to provide the services to the Club Members.
- 4.3.2.8 Although the day-to-day running of a Club is by the professional managers, ultimate control is with the shipowning Members and the board/committee of directors elected by the Members from their number. The Club's managers can be changed either by the board or by all the Members in general meeting. The managers' remuneration is fixed by the board or committee.

4.3.3 Services Provided

- 4.3.3.1 A P&I Club is not just a simple provider of insurance. The Members will also expect to receive a number of complimentary services. Some of these will be the subject of additional Membership subscription payments, such as Freight Demurrage and Defence (FD&D) cover which many of the Clubs will provide for their Members.
- 4.3.3.2 The Club Managers will provide a claims handling service which will include protection of the Members', and thus of the Club's, interests, both by investigation and defence of claims but also by payment as and when appropriate. The Managers will be expected to provide a full-scale emergency and incident response service, capable of dealing with the smallest through to the largest incidents from inception through to settlement of final claims. They will also be expected to provide advice and assistance to their Members in order to prevent or mitigate foreseen problems, on a real time basis. Available 24hours a day, 365 days a year both directly and via local / regional contact points the Club will be regarded as a first point of call by ship masters or owners when assistance is required for a matter with actual or potential liability issues. In the words of one Club, they encourage their Members to think of the Club as an extension to their own office and available for assistance over a wide range of matters, including informal advice.
- 4.3.3.3 A further part of their mutual ethos, the P&I Clubs have also developed loss prevention services including training and information programmes and general advice open to their Membership and promulgated throughout the industry. By their very nature, the Clubs are committed to safety and hence loss prevention in order to maintain quality amongst their Members. Because of their mutuality, the Members within a Club have an interest in maintaining the quality of each other's ships.
- 4.3.3.4 In a drive to ensure suitable standards amongst their Membership, the P&I Clubs have also developed ship inspection and vetting programmes administered by departments which generally have grown in size over the last decade.
- 4.3.3.5 The overall philosophy is one of service to the Membership, particularly amongst the mutual Clubs where the Members are the "owners". To achieve this the P&I Club Managers use a mix of their internal staff, including specialised legal and technical personnel and those of a P&I insurance background, plus external consultancy assistance.

4.3.3.6 The Clubs maintain a comprehensive network of external service providers including regional offices, correspondents, staff surveyors and external suppliers such as law firms and survey and consultancy organisations; more about this later in this Section. The ratio of internal and external expertise and the size of the management staff varies between the Clubs. This does to some extent affect interaction between individual Clubs and their Members and the exact nature of the services provided. Whilst each P&I offers the same range of basic cover the range of services and how they are provided by each club makes each club unique.

4.3.3.7 Beneath the top level of management the Club will incorporate into its structure a number of departments or sections. Varying in between the Clubs the main elements will comprise:

Underwriting

4.3.3.8 The mutual P&I Clubs maintain a staff of underwriters responsible for the entry of Members, liaising with Members and brokers and setting the levels of call income. They will also liaise with the claims and loss prevention departments concerning the Members that they oversee.

4.3.3.9 The underwriters will communicate with external brokers, where these are used, regarding prospective Members. They will also visit Members directly. The underwriters will assess each Member or prospective Member to establish that Member's requirements, the terms of entry/continued entry and the call required from the Member for the coming period. The underwriting section will base this on an assessment of the overall level of call required for the Club in the coming year. They will also look at the claims record for the Member or prospective Member plus some other defined criteria.

4.3.3.10 A weakness with the system, however, is that it is most often the underwriter doing both the underwriting work and performing a quality check of the shipowner.

4.3.3.11 The underwriting period focuses on the renewal date of 20th February. Underwriters are also actively involved in the marketing and development of the P&I Club.

Claims handling

- 4.3.3.12 The Claims handling sections will be one of or the largest sections of a Club in terms of employees. Staff will typically be organised in groups or syndicates reflecting the geography of the Membership. Claims handlers will thus get to know their Members well and be better equipped to serve their particular needs. Most day-to-day contact between the Club and its Members on matters concerning claims will be dealt with through the claims handlers. They will also assist in protecting the Member's interests by instructing lawyers or surveyors and will generally manage any claim on their Member's behalf.
- 4.3.3.13 The claims handlers will also work closely with the underwriters responsible for that Member. In this way the underwriters will themselves develop a "feel" for the Members, the nature of their business and of the extent of their liability exposure. This knowledge will be important when the annual renew comes round.

Loss Prevention

- 4.3.3.14 An example of how the P&I Clubs have responded to the challenge of loss prevention is the importance put on quality (both of the ship operator and of the ship itself) and the monitoring of quality. For more details on this, see Section 5 of this report.
- 4.3.3.15 Most Clubs have dedicated loss prevention departments consisting, partly, of ex mariners. These departments will monitor ship quality through various ship vetting incentives. They will also produce innovative methods of spreading the safety message to their Members' seafaring employees, such as through posters, cartoon calendars etc.

Ship Vetting

- 4.3.3.16 The vetting incentives will be both of the Members themselves and of their ships to be entered or in Membership. Many of the major Clubs have various levels of ship vetting. Some Clubs employ their own ship inspectors who will work under the control of that Club's ship vetting department. Ship visits by such inspectors will often comprise quite short visits to the ship, typically perhaps of three hours duration. The inspections will place emphasis on the human side of the ship, looking at systems and procedures rather than at nuts and bolts. Typically the inspectors will wear suits and ties rather than boiler suits.

- 4.3.3.17 Almost all of the Clubs will, in addition to their internal ship inspections, commission ship condition surveys which will usually be carried out by independent surveyors. These surveys will typically last one or two days and will look at the nuts and bolts as well as at the systems. Boiler suits will be worn, tanks will be entered and a certain amount of testing of equipment will be carried out. Practically all of the Clubs produce their vetting survey reports that are used by the independent surveyors. The reports usually take the form of a comprehensive check list which will guide the surveyor to look at all aspects of the ship's operations and systems. The Clubs' vetting departments will then use these check lists to assess the underwriting risks to be associated with that Member or ship. Some of the Clubs will expect the surveyor to carry out some sort of formal risk assessment based upon what he finds and his report will be on risk rather than on ship condition.
- 4.3.3.18 Almost all the Clubs will employ independent surveyors to carry out follow-up surveys. These follow-up surveys might be targeted at specific aspects highlighted in initial condition surveys. They might follow repairs or a specific incident. Follow-up surveys might be called for to clarify ambiguities or contradictions in the initial condition survey.
- 4.3.3.19 Usually, dependent upon age, ships will undergo a condition survey before or immediately after entry. They will then be subjected to further periodic condition surveys at perhaps five yearly intervals but more often if the club concerned has any reason to do so. The ship inspections are more usually a random and more frequent check on the Membership.
- 4.3.3.20 Steps are being taken within the International Group to unify the Group Clubs' ship vetting approaches. At present however, the individual Clubs have their own methods and to some extent their own priorities although the methods and priorities are generally similar within the International Group Clubs.
- 4.3.3.21 At present, there is no uniform practice across the International Group Clubs regarding the scope of surveys or the factors that trigger them. Through the International Group, the Clubs have compiled a sample condition survey report, which is expected to form the minimum basis upon which the individual Clubs will tailor their own report forms.

Ship Vetting Triggers

- 4.3.3.22 There should be a broadly similar approach between the Clubs of the International Group to ensuring that their Members' fleets are surveyed on a regular and systematic basis. Some outside factors will ensure that vessels are targeted, for example, if the vessel is out of Class or has been the attention of high Port State Control detention activity, or is beyond a certain age. However, the underlying trigger factors are very different between the Clubs. Some Clubs may automatically survey ten-year-old ships on entry but in other Clubs the automatic entry survey age may be 15 years. There is also suggestion that vessels carrying heavy and persistent fuel oils should be targeted sooner. There has been recent recommendation from within the International Group that as a minimum requirement, entry condition surveys should be set at twelve years for sea-going vessels.
- 4.3.3.23 It has been found more difficult to find consensus within the International Group members on the frequency of surveys for already entered tonnage. Age alone is a controversial factor given that some fleets made up of older tonnage and rigorously maintained to a very high standard can be favourably compared with other much younger and less well maintained fleets.

Loss prevention, training

- 4.3.3.24 Most Clubs will also have some form of educational program available to their Members, and to the wider shipping community, in the form of written advice videos, websites etc. Often this advice is based on case history and helps the experiences of the Club or its Members to be promulgated across a wider audience.
- 4.3.3.25 The form and quality that these loss prevention incentives take vary from Club to Club. Most major Clubs have regular bulletins in the form of glossy magazines distributed on a regular basis to their Membership.

Legal Advice

- 4.3.3.26 The Club managers will provide legal advice both on general matters and of particular points relating to a specific case. A number of legally qualified personnel will be employed and will provide in-house advice both to the Club staff and for the Members. External legal advice will also be used, particularly for specific cases and can range from preliminary advice, through attendance on site for major incidents, to working with a disputed case through the legal system and courts.
- 4.3.3.27 The costs of legal services will be met by the Club for covered liabilities. If a Member has in place the appropriate additional FD&D³ cover, the Club's legal services will also assist the Member in recovery costs associated with non-liability matters such as freight and demurrage disputes and in the defence of other issues in which the Member may become embroiled. Most mutual P&I Clubs have developed separate but associated FD&D Clubs and policies supported by dedicated staff for this area. They are almost invariably, known as Freight Demurrage & Defence Clubs.

Outlying Offices, Correspondents and Representatives

- 4.3.3.28 Most P&I Clubs maintain a network of regional offices to provide a global reach and contact with their Membership. The nature of the offices varies though they often hold a number of manager's staff Members to provide a liaison role, some legal advice and claims handling. Underwriting is most often conducted at the headquarters.

³ Freight Demurrage & Defence – see below

- 4.3.3.29 In addition, all Clubs maintain a world-wide network of Correspondents. These are not employed by the Club but rather act as a local agent and the first point of contact for Members' vessels in ports worldwide when they are in need of Club assistance. The correspondents will appoint local surveyors as necessary and will act as a conduit of information and advice between the vessel/Member and the Club. Correspondents are often lawyers and will advise the Club on local laws and jurisdiction and provide local knowledge.
- 4.3.3.30 External service providers will also include lawyers and law firms retained to provide additional legal advice and in certain cases assist with representation and running major incidents. Likewise, external surveyors and consultants of many fields are used both on site in incidents and to provide independent expert opinion when dealing with cases through the legal system.

Guarantor banker, cash payment

- 4.3.3.31 The P&I Clubs principally operate on the basis of indemnifying the Member against covered losses. In principle, the Member should first have settled the cost himself and then recover such costs from the Club. This is known as the 'Pay to be Paid' rule. In some jurisdictions this means that a claimant against a bankrupt ship owner is not likely to receive any payment from the P&I Club except in case of pollution by persistent oil from a tanker where the Civil Liability Convention provides for a direct action against the insurer.
- 4.3.3.32 In practice the Clubs' managers may make payments directly themselves. They may also provide letters of indemnity and/or guarantee on behalf of their Member, as appropriate. These letters will often be given to a third party as a means of preventing the Member's property (the ship) from being arrested. The Club will usually undertake to make payments in respect of third party damage if it is subsequently shown through proper legal process that the Member was liable. Thus the vessel can often be permitted to continue trading while the matter is properly dealt with in due time.

4.3.4 Competition between the Clubs

- 4.3.4.1 As mentioned, the P&I Clubs do not primarily compete on distinguishing their standard insurance products. Rather, their overall capability is considered to be their fundamental competitive advantage, together with the added value services offered in an emergency situation, in general claims handling, in predictable pricing, in technical risk advisory services, in loss prevention and similar. These added value services are important aspects for the Members.

4.3.4.2 Emergency handling is particularly important, and the main objective of the emergency response is to react quickly and effectively to an emergency, ensuring that all necessary measures are taken to protect the Members. This includes measures designed to:

- Minimise loss of life and injury
- Minimise damage to the vessel, her cargo and other property
- Minimise pollution and damage to the environment
- Co-ordinate and control the Club's response to an emergency
- Establish clear lines of communication with the Member, public authorities, on-site personnel and representatives, insurers and other interested parties
- Manage relations with the media
- The Emergency Plan provides the organisational framework to guide the personnel in responding efficiently in an emergency
- Establish cause and to protect evidence

4.3.4.3 Marine insurance matters may be extremely complex, involving legal processes dictated by national or international maritime law. When complicated situations such as arrests or major casualties arise, a Member can draw on the services of experienced, highly skilled legal teams. Also in these matters, a close working relationship between the insurance company and the Member is often of vital importance.

4.3.4.4 It is also interesting to note that the Clubs within the International Group enjoy access to each other's experience. There is a great deal of cooperation between the Clubs on matters that might affect them all in the event of big claims.

4.3.4.5 Competition between Clubs then is then not so much on the specifics of the cover that they offer, as these are mostly substantially the same. Competition is more on the way in which that cover is managed, and the support which Members enjoy. Members will often split their fleets between two or more Clubs. Different Clubs have different structures, different Member profiles, different investment histories, different claims records and different rates. Part of a split fleet might pay more for the same cover in one Club than in another Club. Shipowning Members therefore have the ability to shop around for the cover, services and rates that best suit them.

- 4.3.4.6 The P&I Club will normally carry the full risk for an entered ship, unlike most other insurers which will seek to spread the risk. They do not normally issue insurance policies, as found commercially, but have instead established Rules. The Clubs' Rule Books will define the risks covered and those excluded.
- 4.3.4.7 The P&I Clubs, within their Rules, specify a number of risks which are covered together with a number of specific exclusions. The standard risks covered by each of the International Group Clubs, and thus provided to the vast majority of tonnage, are substantially the same.
- 4.3.4.8 The central principle is that risks covered within the main section, by default of Membership, are those common to the practice of owning or operating a ship or commonly borne by shipowner. This follows the precept of mutuality. Liabilities which are thought to be particular to a certain type of ship or activity may be covered but under separate arrangement, requiring additional premiums, often on a fixed premium basis. Examples include offshore activities such as well stimulation and charter entries. However, it is not possible here to identify all the risks and liabilities covered by P&I Clubs; even the Clubs themselves do not know the full scope of cover they may need to provide. As international trade continues to develop the risks and liabilities that the shipowner faces develop in parallel and new liabilities arise which have not been previously considered. To meet this requirement the P&I Clubs incorporate an "Omnibus" clause within their Rules covering "Risks Incidental to Shipowning".
- 4.3.4.9 The Omnibus Rule permits the Member to submit a claim and for the Club to consider, despite the fact that it is not specifically covered within the Rule Book. As long as the claim did not result from a liability actually excluded under the Rules, then the Club has the ability to indemnify the Member against "liabilities, costs and expenses incidental to" their business which, in the opinion of the Directors, fall within the scope of cover afforded by the Club, but only to the extent that the Directors "in their absolute discretion may decide that the Member should recover" from the Club.

- 4.3.4.10 This Omnibus Rule provides the Club with flexibility to respond to its Members' needs and is another differentiator between P&I cover, particularly of that offered by the Mutuels, and other forms of insurance. Principal amongst the considerations will be the precept of mutuality; as long as the liability being considered does not conflict with this then it may be covered. The Club management, with ultimate decision if necessary being taken by the Board, will tend to accept liabilities they believe have arisen from mutual risks, even where the risk is a new one. They will similarly tend to reject liabilities (under general P&I cover) where the risks are peculiar to the Member concerned or not normally arising from shipowning.
- 4.3.4.11 Most P&I Clubs will also be able to provide additional cover (for instance war risk insurance, legal defence costs, strike and through transport insurance). This may be as part of a separate class of cover within the main Club or via separate Clubs established to deal with specific areas of cover. There are regional differences, with the Norwegian Clubs covering all areas as one class of insurance and the English Clubs offering separate classes and separate Clubs. E.g. Defence Clubs and War Risk Clubs associated with a main P&I mutual.
- 4.3.4.12 The lists below are examples of sections within the Rules of one of the International Group P&I Clubs; they are consistent with the contents of the other Group Clubs. The first list below identifies the main body of liabilities, covered by basic Membership. The Club will also be able to provide optional additional cover, which may be taken at additional cost and will have to be notified or agreed in writing.

Liabilities Covered as part of the *basic P&I cover*:

1. Death and personal injury of seamen, passengers and third parties
2. Liabilities in respect of stowaways and persons rescued at sea
3. Diversion Expenses
4. Life Salvage
5. Persons in Distress
6. Quarantine
7. Liabilities arising from collisions
8. Liabilities arising from groundings
9. Non-contact Damage to Ships

10. Liabilities arising from damage to fixed and floating objects
11. Liabilities arising from pollution
12. Liabilities arising from wreck removal
13. Liabilities arising from towage
14. Contracts, Indemnities and Guarantees
15. Liabilities to Cargo
16. General Average
17. Fines
18. Legal Costs, Sue & Labour
19. Risks Incidental to Shipowning⁴

Liabilities available for cover by agreement at *additional cost*, but within the main P&I framework:

20. Special Cover⁵
21. Special Cover for Salvors
22. Special Cover for Containers
23. Special Provision for Charterer's Entry
24. Freight Demurrage & Defence

⁴ The Omnibus Rule.

⁵ May extend cover to a Member for the liabilities covered by the Rules irrespective of whether the ship is entered with the club or not. Subject to express written agreement with the Managers.

- 4.3.4.13 The Member is covered for the cost of the risks plus associated costs of investigating allegations and claims against them and the legal costs of defending such claims. This only relates to such costs associated with covered risks.

Freight Demurrage & Defence

- 4.3.4.14 The legal cost of defending claims for liabilities covered by P&I insurance will be met by the P&I Club as part of the normal Membership charge, together with advice and assistance in handling the claim. In response to the growing costs to shipowners of investigating and defending claims against them on non-P&I matters a separate service was developed known as **Freight Demurrage and Defence, (FD&D)** (also freight, deadfreight). Freight and Demurrage cover has nothing to do with third party liability. On the contrary it is to assist the ship owner collecting his claims against shippers, charterers, cargo owners etc.
- 4.3.4.15 Separate from P&I insurance this cover is nevertheless offered by a number of P&I Clubs as a complementary service to shipowners, at additional cost. It provides legal cost insurance and an advisory and claims handling service similar to that offered under P&I insurance. An important difference, though, is that FD&D insurance does not cover the actual third party liability but only the legal cost of defending the Member's position – the Member will still have to pay the actual cost of the liability where they are ultimately shown liable.
- 4.3.4.16 The FD&D section may comprise a separate “Club”; the service provided by dedicated personnel normally of a legal background, though to the Member the service would be seamless and relationship on a daily basis as with the “main” P&I Club. Whilst generating additional income and covering its own costs, this type of insurance exists in order to provide the shipowner Members of the P&I Clubs with further assistance and insurance cover. Whilst separate from P&I insurance it is an extension of the service-based philosophy of the Clubs.
- 4.3.4.17 A number of mutual associations also exist solely to provide this Class of cover, particularly in Scandinavia and Germany.

Charterers

4.3.4.18 Time Charterers in particular may incur some of the liabilities of an owner. Clubs may take Charterers as Members (Charterer's entry), on specified terms. Cover will include the normal P&I cover afforded to owner Members plus additional cover for hull damage (the chartered ship is a "third party" relative to the charterer), loss of bunkers and loss of freight or hire. Cover has to be agreed in writing with club manager and liability limits may be specified below that provided to Owners, for example the lesser of 300 millions US\$ or 50 millions US\$ above any Limitation Amount.

4.3.5 Risks Excluded, Not Covered and General Exceptions

4.3.5.1 A number of risks are *not* covered or are specifically excluded from P&I insurance.

Risks Not Covered

1. Risks covered by Hull Policies
2. War Risks (unless covered by a separate War Risks Club run by the same managers)
3. Other Insurances/Double Insurance
4. Radioactive Contamination and Materials
5. Unlawful, Imprudent or Hazardous Trades

A number of other risks are specifically excluded –

1. Loss or damage to the entered ship (Hull and Machinery)
2. Loss or damage to equipment onboard
3. Cost of repairs
4. Loss of freight or hire
5. Salvage of the entered ship – other than as permitted under Life Salvage, Pollution or General Average clauses
6. Salvage by an entered ship – other than to save life at sea
7. Pollution – except as provided for within the Rules
8. Charterparty losses – cancellation of charterparty or other engagement
9. Bad / irrecoverable Debts
10. Demurrage (unless covered under the Cargo clause within the Rules).
11. Towage – other than as provided for within the Rules
12. Road Traffic Acts
13. Members' Other Interests – e.g. as owner of cargo.

- 4.3.5.2 A number of specified specialist operations and specialist ship types have limitations placed on the liabilities covered and are charged additional premiums to take account of the unique risks which may otherwise be introduced.
- 4.3.5.3 A notable example of ship types charged additional or weighted premiums are tankers carrying persistent oil to the United States. Particularly since the introduction of the Oil Pollution Act in 1990 (OPA '90) the scale of liabilities there is thought to be so large and so particular to that area and trade they are no longer fully common to shipowning. They are covered but at additional cost to the Member⁶.
- 4.3.5.4 Passenger ship premiums also merit special consideration due to non-mutual risk element involved with this type of ship. Passenger ships are considered by the wider shipowning Membership to be floating hotels rather than ships and as such they have unique liability problems which are not shared across the shipowning community. For example, if somebody is injured on a passenger ship, it is considered to be mutual risk. However if there is a loss of holiday or loss of facilities on a passenger ship (for example, the theatre out of action due to flooded carpet) this is considered to be non-mutual and no liability risk should follow. The hotel risks are therefore subject to specific cover.

4.3.6 War and Terrorism Risks

- 4.3.6.1 War and terrorism risks are excluded from the normal P&I cover, which may be withdrawn should the ship enter a war zone.
- 4.3.6.2 Under the terms of the Rules, liabilities and costs are **not covered** where they arise **from war**, civil war, revolution, rebellion, insurrection, civil strife (arising from insurrection), any act by or against a belligerent power **or of terrorism**. There is no recovery when liability is caused by mines, torpedoes, rockets, bombs, shells or explosives or similar weapons of war (unless being transported or used to avoid other liabilities that the Club would have to cover).

⁶ See 4.3.8.30

4.3.6.3 The P&I Club may, however, provide temporary normal P&I cover to a Member who finds himself in a War Zone; i.e. cover that would otherwise have been provided if the entered ship had not been in a war zone. In this instance this cover will be an excess cover, supplementing that provided under other policies, and dependant on a number of terms and conditions:

- Separate War Risk insurance will need to be in place
- Liability is limited to levels specified within the Rules
- An increased deductible will be specified
- Certain geographical areas are excluded
- Right to cancellation by either Club or Member given notice (7 days)

4.3.6.4 Such cover, if provided by the P&I Club, will be up to a **limit for owner Members of US\$400 millions** for any one incident and only to the extent that this is above any amounts recoverable by the Member under separate Hull and / or War Risks policies. Such War Risks insurance is normally capped at the value of the ship. For Charterer Members the limit of liability for damage to the hull of the Chartered vessel is set at the lesser of US\$100 millions or the amount specified in the certificate of entry.

4.3.6.5 P&I policies that are extended to cover a war situation automatically terminate on the outbreak of war between specified countries (at present the five permanent Members of the UN Security Council).

Nuclear Damage

4.3.6.6 The P&I war risk cover also excludes liabilities and losses arising from ionising radiations, nuclear fuel or waste or combustion of nuclear material, plus that arising from a component of a nuclear assembly and any weapon of war using nuclear material or similar.

Chemical, Bio-Chemical, Electromagnetic Weapons and Computer Viruses

4.3.6.7 Liabilities and costs arising from the use of the above are excluded from cover.

4.3.7 Passenger Risks

- 4.3.7.1 A number of P&I Clubs do not have Passenger ship entries as a matter of policy. The Clubs, in their Rules, cover liabilities to pay damages or compensation for death, personnel injury or illness of any passengers, together with certain liabilities to pay damages or compensation for loss of or damage to the luggage or accompanying vehicles of any passenger on any entered ship. There are exceptions in respect of individual items of high value, which are not covered.
- 4.3.7.2 The contractual relationship between the shipowners or operator and the passenger will usually be set out on the terms contained in the passenger ticket. The carriage of passengers is generally governed by the **Athens Convention 1974** (and subsequent protocols) relating to the carriage of passengers and their luggage at sea. This must be stated on the tickets.
- 4.3.7.3 In the event of injury, illness or death to passengers, liability is usually decided along the lines of the following. If the incident was caused by negligence of the carrier, or his servants, the carrier will be liable if:
- It occurred during carriage, including shore excursions
 - It occurred at a time for which the carrier may be held liable
- 4.3.7.4 The burden of proof is usually with the passengers (or their dependents) as claimants. They must prove that the incident occurred due to negligence on the part of the carrier. The only exception under the Athens Convention is in cases where the shipowner is usually deemed to be negligent (such as shipwreck, collision, stranding or defect in the ship) when it is up to the shipowner to prove that he is not negligent.
- 4.3.7.5 It is important that every crew Member on board immediately reports any passenger accident, no matter how slight, and a thorough investigation carried out.

- 4.3.7.6 The provisions relating to passenger claims under the Athens Convention are constantly changing. The 1990 Athens protocol limit is 175,000 SDR⁷ (approximately £143500, \$US 253750) per passenger. The 2002 protocol provides for a per passenger limit of 400,000 SDR (approximately £328000, \$US 580000), but for the first 250,000 SDR (approximately £205000, \$US 362500) there is a defense to any claim based wholly on war or the act of a third party done with intent. Above this and up to 400,000 SDR (approximately £328000, \$US 580000), liability is based on fault.
- 4.3.7.7 Some Clubs express the view that passenger ships should not be covered by the International Group's Pooling Agreement as they are in effect floating hotels and not ships and therefore have unique liability problems which are not shared by typical ship owning Members.

4.3.8 Pollution Risks

- 4.3.8.1 The P&I Clubs will cover many of the shipowners' liabilities for pollution. Whilst oil pollution has been the main focus and continues to be so, the liabilities extend to many other pollutants. There has been a spate of international conventions aimed at addressing the pollution of the marine environment and compensation of the polluters. The main Conventions are:

Source of Pollution:	Convention covering Liabilities
Oil Pollution:	CLC (International Convention on Civil Liability for Oil Pollution Damage, CLC) IOPC Funds Regional legislation: OPA '90 for the United States. Prevention regime: MARPOL
Pollution from Bunkers:	International Convention on Civil Liability for Bunker Oil Pollution Damage 2001. Expected in force in 2007 ⁸ . (Tanker bunkers covered by CLC)

⁷ Currently, October 2005, currency units per SDR are ~ 0.82 (pounds Sterling) or ~ 1.45 (US dollars). The website http://www.internationalmonetaryfund.com/external/np/fin/rates/rms_five.cfm gives details of the current relationship between main currencies and the SDR. See <http://fx.sauder.ubc.ca/SDR.html> for more information on the SDR.

⁸ The limit of liability will be in line with national law or limited in line with the Convention on Limitation of Liability for Maritime Claims, 1976 (LLMC76) as amended by Protocol of 1996. The limitation fund based on that Convention will have to cover all claimants that are victims of the same incident e.g. damage on other ships and cargo or passengers on those ships.

Chemicals:	International Convention on Liability and Compensation for Damage in Connection with the Carriage of Hazardous and Noxious Substances by Sea (HNS Convention). ⁹
Cargo:	Contractual liabilities and international conventions defining liabilities.
Passengers:	Athens Convention
Seafarers:	IMO/ILO guidance

Oil Pollution Cover

4.3.8.2 In respect of oil pollution the shipowner's P&I Club will cover him for the liabilities, costs and expenses incurred as a result either of the actual pollution or taken in response to the threat of pollution (e.g. preventative measures). The liabilities covered are generally separated into the following areas:

- Damage or contamination caused by the pollution, including compensation liabilities
- Clean-up costs including the cost of the operation plus any losses suffered due the clean up action
- Preventative Measures, where there is imminent threat of discharge of any substance
- Agreements & Contracts – liabilities, cost & expenses incurred as party to an agreement relating to oil pollution – requires prior approval and possibly premium
- Salvor's expenses or Special Compensation on preventing a pollution
- Government directions, extraordinary measures e.g. "seen to be doing something"
- Fines in respect of pollution

⁹ At present, the HNS Convention has an insufficient number of contracting states to have an entry into force date although this is expected to be late 2007 or early 2008. Until this convention enters into force the LLMC76 with Protocol 96 will create the basis for all liability claims including those from the HNS victims.

Oil Pollution Prevention

- 4.3.8.3 The **International Convention for the Prevention of Pollution from Ships (MARPOL)** is the principal international Convention regarding **prevention** of ship source pollutants. The five original Annexes of MARPOL have now all been ratified covering prevention of pollution by oil, noxious liquid substances in bulk (in broad lay terms, chemicals), substances carried by sea in packaged form, sewage and garbage. A sixth section, covering prevention of air pollution, including Sulphur Oxide, Nitrogen Oxide and ozone depleting emissions enters force on 19 May 2005.
- 4.3.8.4 Due to the devastating consequences and escalating costs of oil pollution incidents an international compensation regime has developed, commencing in the 1960s. Liability for oil pollution was covered with the introduction of two complementary major international Conventions: the **International Convention on Civil Liability for Oil Pollution (CLC) 1969** and the **International Convention on the Establishment of an International Fund for Compensation for Oil Pollution Damage 1971 (the 1971 Fund Convention)**. The Fund Convention established a London-based body to manage the organisation.
- 4.3.8.5 The **CLC 1969** established rules and procedures for determining liability and awarding compensation in cases of oil pollution damage (when released from ships). The CLC Convention places strict liability on the shipowner (i.e. they would generally be liable for damage irrespective of fault), based on the “polluter pays” principle, but also enables the shipowner to limit their liability (or their insurer’s liability) as determined by the size of the ship and based on Special Drawing Rights (SDR¹⁰) of the International Monetary Fund.
- 4.3.8.6 The **IOPC Fund Convention 1971** established a supplementary compensation system or “top up” scheme which kicks in when those suffering oil pollution damage fail to obtain full compensation under the applicable CLC. Together the two funds comprise the main international oil spill compensation regime, outside the USA.

¹⁰ Currently, October 2005, currency units per SDR are ~ 0.82 (pounds Sterling) or ~ 1.45 (US dollars). The website http://www.internationalmonetaryfund.com/external/np/fin/rates/rms_five.cfm gives details of the current relationship between main currencies and the SDR.

- 4.3.8.7 In 1992 Protocols to both the CLC and IOPC Funds created a new regime, with the combined effect of increasing the compensation payable by 50.37%. The maximum payable under the combined CLC and 1992 IOPC Fund Conventions is **203 million SDR** (approximately US\$ 315 millions, GBP £166.5 millions).
- 4.3.8.8 With increasing numbers of oil importing nations joining the 1992 Fund the 1971 Fund Convention has now been wound up. Insurance was taken out to deal with any future liabilities.
- 4.3.8.9 The CLC Convention enshrined the principal that the “polluter pays” – defined as the shipowner. The Fund Convention introduced a complementary compensation regime paid for by the oil importers. The Fund Convention payments are made where the CLC payments either reach their limit or cannot be paid.
- 4.3.8.10 It should be noted though that both the 1971 & 1992 Conventions apply only to oil pollution created by tankers. (The 1992 Conventions did extend this to include bunkers on empty tankers which had previously been excluded). They also only pay for the effects of damage. Under the 1992 CLC measures taken to prevent such damage, where a real and imminent threat exists, are included.
- 4.3.8.11 There are a number of differences between the earlier and later CLC and Fund regimes:
- The 1992 Conventions broadened the definition of the term “ship” and extended the geographical limits of coverage to the exclusive economic zone (EEZ) of affected signatory States.
 - Under the 1969 CLC the shipowner was deprived of the right to limit liability if the incident happened due to the Owner’s personal fault.
 - The 1992 CLC makes it extremely difficult to break the shipowners right to limit liability by further narrowing the causes to the “shipowner’s personal act or omission, committed with the intent to cause such damage, or recklessly and with knowledge that such damage would probably result”.
 - At the same time the 1992 CLC Convention limits the persons that can be claimed against to the shipowner, prohibiting claims against servants, agents, pilot, charterer, manager, operator or persons engaged in salvage operations or taking preventative measures.

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Developments - Compensation Limits

- 4.3.8.12 Given the size of the most recent major oil spills including the “*Erika*” and “*Prestige*” as well as the earlier “*Nakhodka*” some parties remain concerned that the CLC and IOPC Funds limits are still too low.
- 4.3.8.13 The IOPC Fund must treat all claimants equally and to do so it has been necessary in the larger incidents to pro-rata payment, each approved claim being paid in equal proportions, until it is clear that the Fund limit will not be exceeded. Whilst it has normally been the case that 100% of each approved claim can be paid this will not be done until further claims are time barred, extending considerably the time frame for payments. In some cases it has also only been possible by the largest claimants (e.g. State or the liable charterer / cargo owner) undertaking to withhold their claim until the full extent of others are known.
- 4.3.8.14 The 1992 Fund Assembly adopted a draft Protocol in October 2001, introducing an optional **Supplementary Fund**. Having been adopted in 2003 by Diplomatic Conference at the IMO headquarters in London and then ratified by the required 8 States on 3 December 2004 the Protocol will enter into force on 3 March 2005. The first Supplementary Fund Assembly will be held in March 2005.
- 4.3.8.15 The Supplementary Fund will be paid for by the oil importers (i.e. levies on the oil receiving companies). It will increase the maximum payable for any one incident to **SDR 750 millions (approximately £615 million, \$US 1088 million)** including any amounts under CLC/IOPC Fund1992.
- 4.3.8.16 Any State which is party to the 1992 Fund Convention may become a party to the Supplementary Fund.

Shipowner’s Liabilities – balance of funding

- 4.3.8.17 Whereas the present CLC/ IOPC Fund regime enjoys broad support from both the shipowning and oil importing camps the Supplementary Fund has been more divisive.

- 4.3.8.18 At least one representative organisation for the oil companies contends that by having the Supplementary Fund paid for in both short and long term exclusively by levies on their Members shifts the balance of responsibility between oil companies and shipowner to an inequitable one. They believe the shipowner will be unduly shielded from the costs of pollution leading to disengagement of cause and effect and permitting sub-standard shipowners to operate with relative impunity. The contention is that this withdraws an incentive for quality operators to continue their drive to better standards of ships and operation. It is also held that P&I Clubs will be robbed of a mechanism to further control standards within their Membership.
- 4.3.8.19 It appears that this view may be held partially by the P&I Clubs, who may be willing to see amendments where the cost is more evenly spread.
- 4.3.8.20 Whilst some parties argue that costs relating to major disasters add a disproportionate amount to total claim costs, it is also argued that a high proportion of the overall claims cost arises from the large number of small claims arising from 'minor' spills. The P&I Clubs, under the International Group, have proposed a voluntary scheme to raise the limitation for smaller ships from the present 4.5 millions SDR (approximately £3.69 million, \$US 6.5 million) for a 5,000 Gross Tonne (GT) ship to 20 millions SDR (approximately £16.4 million, \$US 29 million) for a ship of 29,5000 GT.
- 4.3.8.21 There are also disagreements over the use of a sliding scale of payments under CLC, based on ship tonnage, with parties arguing for a level payment. This is still under debate.
- 4.3.8.22 The amount of compensation, the various levels and the source of funding are under debate in the industry. The IOPC Fund has implemented a Working Group to review cost of oil spills with respect to current /future liability levels.

Compensation Limits

- 4.3.8.23 The CLC and IOPC Fund Conventions work together, in Signatory areas.
- 4.3.8.24 Under the 1969 CLC the limit is the lower of 133 SDR (approximately £110, \$US 193) per ton of the ship's gross tonnage or **14 millions** SDR (approximately 11.5 millions Sterling or US\$2.3 millions). The **1971 IOPC Fund set** a maximum of 60 millions SDR (approximately £49 million, \$US 87 million) including any amounts paid by the shipowner (or the third party liability insurer) under CLC 1969.

4.3.8.25 Both the 1992 Conventions incorporate mechanisms to permit the maximum liabilities and amounts payable to be increased relatively easily, through the IMO tacit amendment procedure. The amounts have been raised and currently stand at the following:

Under the **1992 CLC** the amended limit paid by the shipowner varies along a scale dependant on the size of ship as measured by its GT:

- Ship of 5,000 GT or less, 4.51 millions SDR (approximately £3.69 million, \$US 6.5 million) (from 3 millions previously)
- Ship of 5,000 to 140,000 GT 4.51 millions SDR plus 631 SRD (approximately £517, \$US 915) for each additional unit of tonnage
- Ship of 140,000 GT or over 89.77 millions SDR (approximately £73.6million, \$US 130.2 million)

- 4.3.8.26 The 1992 IOPC Funds maximum amount payable for any one incident has similarly been raised from an original 135 millions to 203 millions SDR (approximately £111-173 million, \$US 196-294 million). This includes any sums paid by the shipowner (or their liability insurer) under the 1992 CLC.

4.3.8.27 The cost of recent incidents have highlighted the fact that the limits of CLC/IOPC Fund compensation may be exceeded at some point. If this were to occur the overspill would fall back onto the shipowner (the polluter) or his insurer. It is likely this would be the P&I Club. In the case of a P&I Club that belonged to the **International Group of P&I Clubs** this would be covered under the collective pooling or sharing arrangement and reinsurance programme for oil pollution this is **US\$ 1 billions** for any one occurrence under an Owner's entry; (for other liabilities the corresponding limit is US\$ 2 billions). The maximum limit for Charterer liabilities is **US\$ 100 millions**.

4.3.8.28 The US\$ 1 billions limit is sufficient to cater for nearly all liabilities under the limitation limits, other than possibly for the largest tankers. The reason for the relatively large US\$ 1 billions cover available to the shipowner is that his liability is only limited where the Conventions have been ratified and only under the criteria specified within the Conventions - pollution from persistent oil carried aboard oil tankers. In other areas and from other ship sources the Conventions do not apply. The shipowner under these circumstances can face potentially unlimited liabilities.

Non-CLC Countries

- 4.3.8.29 The above regime is not universal. Some regions, notably the USA, have developed their own regimes.

OPA 90

- 4.3.8.30 In response to concerns over pollution from tankers along its shores the United States of America, not a signatory to the CLC / Fund Conventions, introduced the **Oil Pollution Act 1990 (OPA '90)** and the **Comprehensive Environmental Response, Compensation and Liability Act 1990 (CERCLA)**, broadly corresponding to the CLC and IOPC Fund Conventions.

- 4.3.8.31 The Acts place strict liability on the shipowner of tankers and non-tankers. They require ships trading to the United States (not dumb barges or ships below 300 GT) to have compulsory insurance covering the maximum combined amounts liable under both Acts and evidenced onboard by a **Certificate of Financial Responsibility (COFR)**. The COFR is issued to the ship when it can prove it has insurance up to the maximum liability imposed under OPA/CERCLA.

- 4.3.8.32 For tankers over 3,000 GT the combined liabilities under OPA 90 and CERCLA would be the greater of US\$10 millions or US\$1,200 per gross ton – OPA 90 plus the greater of US\$5 millions or US\$300 per gross ton. For all but the largest levels this would fall within International Group P&I cover. However, OPA 90 also frees individual States to set their own potentially unlimited liabilities. It also removes liability limitation in cases of gross negligence, wilful misconduct or violations of Federal safety, construction or operating regulations. Several States have indeed set higher levels than those placed by the Acts themselves.

- 4.3.8.33 As one incident may potentially affect a number of States, each imposing potentially unlimited liabilities, the P&I Clubs will not normally provide the evidence required to show that the shipowner has insurance up to the maximum limits set by OPA /CERCLA. Such liabilities, when amended by individual States, could very conceivably exceed the P&I Clubs' limits. The P&I Clubs will instead provide evidence that the ship is entered and covered, up to the Club limits.

- 4.3.8.34 Additional cover can be obtained by the shipowner, assisted by the P&I Club.

- 4.3.8.35 The P&I Clubs see OPA 90 as a harsh response albeit to a real problem. Trading to the United States with a tanker is seen as introducing additional risks of potentially enormous liabilities. The Clubs therefore place an additional charge on tanker Owners engaged in this trade. Other liability providers, with often lower limits, discourage entry of tankers trading to the United States.
- 4.3.8.36 A separate view is held by some of the oil companies, who perceive OPA 90 to have had a direct and profound effect on oil pollution levels and quality of shipping (trading to the United States). They cite a reduction of the volume of oil spilled from tankers into US waters from an average 70,000 barrels (about 11,200m³) per year to an average now of 4,000 barrels (about 640m³) as attributable to a combination of OPA 90 and its rigorous, “consistent” enforcement by a trained United States Coastguard, augmented by the phasing out of single hull tankers. In this view, OPA 90 with its strict liability and very high costs placed on the Owner has discouraged low quality operators from trading to the United States.

Non-Oil Source Pollution

- 4.3.8.37 Most liability for pollution will be “strict”. Other than in a small number of circumstances the shipowner will have to pay and will also be covered by his P&I insurer.
- 4.3.8.38 The incoming or proposed Conventions covering pollution by hazardous and noxious substances (HNS) (chemicals in general terms) and bunkers both include strict liability of the ship, require compulsory insurance and provide for direct action against the insurer, whilst similarly placing limits on their liability.

Fines

- 4.3.8.39 Fines relating to a pollution incident which have arisen from the proper operation of the ship will be covered by a P&I Club. Fines, particularly ones containing a punitive element, can reach excessive proportions, particularly so in some regions.

4.3.9 War Insurance

- 4.3.9.1 War Risks insurance is primarily Hull & Machinery insurance but may also include a P&I clause. It is discussed within this report as it compliments the P&I cover provided in other circumstances and which may be extended to pay costs where this insurance reaches its limit. Separate War Risk insurance is in any case a pre-requisite if normal P&I cover is to be extended by the P&I Club in a war setting.
- 4.3.9.2 War Risk insurance may be obtained commercially or through several of the main P&I Clubs. In line with the regional differences this may be offered under the same class as additional cover, under a separate class of insurance or by a separate War Risk club, operating on a mutual basis. There are a number of dedicated War Risk Clubs, based in the UK, associated with P&I Clubs but operated separately.
- 4.3.9.3 In the major wars of the 20th Century insurers found themselves unable to cope with the escalated scale of losses and during war times insurance was transferred either in part or full to the Government. In times of peace, the Government withdrew and normal commercial/ P&I practices returned.

- 4.3.9.4 War Risks insurance is divided into distinct areas of cover, which the owner/charterer may choose to take. The Rules within UK issued War Risk policies reflect the arrangement of transferring insurance / reinsurance to the Government, by division of the main cover for loss into “Queen’s Enemy Risks” and “non-Queens Enemy Risks”. The former being re-insured by the Government (the Secretary of State), whilst the latter may be reinsured commercially by the provider if desired.
- 4.3.9.5 The value of cover varies for each main section, but generally will not exceed the insured value, i.e. the value of the ship as a total loss, (as agreed or as insured elsewhere). If this limit is exceeded, the P&I liabilities may possibly be covered under the normal P&I insurance up to a maximum of US\$400 millions if insured with an International Group mutual P&I club. This is dependent on several factors.
- 4.3.9.6 An example of cover provided by one of the War Risk Clubs:
- I. Under Rule 2
 - a. Queen’s Enemy Risks
 - b. Insurance of Hull, Machinery etc. (Non-Queen’s Enemy Risks)
 - c. Detention or Diversion Expenses
 - d. Protection and Indemnity Risks
 - e. Sue & Labour
 - f. Discretionary Claims
 - II. Under Rule 3
 - a. Loss of Freight, disbursements and/or increased value, premiums and/or other interests.
- 4.3.9.7 The cover afforded under Queen’s Enemy Risks incorporates loss or damage to the ship together with a number of liability (i.e. third party insurance) elements.

4.3.9.8 Queen’s Enemy Risks (for UK issued policies)

Part A: Queen’s Enemy Risks
1. Loss of or Damage to the Ship
2. Detention
3. Collision Liability
4. Wreck Liability
5. Requisitioned / Chartered Ship – risks 4. above
6. Limit on sums recoverable
7. Sue and Labour

4.3.9.9 Under “Queen’s Enemy Risks” the accepted causes of losses under 1. above include:

- war or any hostile act by or against belligerent power
- capture, seizure, arrest, restraint or detainment
- Mines, torpedoes, bombs or other weapons of war, including derelict mines, torpedoes, bombs or other derelict weapons of war

4.3.9.10 Where this overlaps with protection afforded under the P&I clause, only one payment (under the Queen’s Enemy Risks) will be made.

Part B: Non-Queen’s Enemy Risks
1. Loss, including cash and wages

4.3.9.11 Under “Non-Queen’s Enemy Risks“ the accepted causes of losses under 1. above include:

- War, civil war, revolution, rebellion, insurrection, or civil strife arising there from, or any hostile act by or against a belligerent power
- Capture, seizure, arrest, restraint or detainment
- Mines, torpedoes, bombs or other weapons of war, including derelict mines, torpedoes, bombs or other derelict weapons of war
- Strikers, locked-out workmen, or persons taking part in labour disturbances, riots or civil commotions
- **Any terrorist or any person acting maliciously or from political motive**
- Piracy or violent theft
- Confiscation or expropriation

Detention or Diversion

4.3.9.12 This over includes terrorists and pirates as accepted causes. Not recoverable if already recoverable under Part A Queen's Enemy section.

Protection and Indemnity Risks

4.3.9.13 The cover in this section includes terrorism as a covered cause of the liabilities.

4.3.10 Charges to Members

4.3.10.1 When a P&I Club agrees to provide cover the shipowner becomes a Member and the ship(s) is entered into the Club. The policy year runs, for historical reasons¹¹, from noon on 20th February to noon on the following 20th February. Unless entry is for an agreed fixed period, is terminated or ceases in accordance with stipulated criteria (including transfer of the ship, total loss and ceasing to be classed), cover will continue from entry to the following 20th February and thence from year to year.

4.3.10.2 To pay for its costs, a mutual P&I Club uses a combination of annual income from their Members, reserves/investment income and a reinsurance programme, together with any recoveries from claims.

¹¹ Historically held as the first day of the year when ships could depart Newcastle and find the Baltic ice free.

4.3.10.3 The nature of third party liability means that policy years will remain open, as far as liability payments, for some time (possibly a number of years) after the end 20th February and future payments from these years have to be factored in to ongoing calculations. It should be remembered that the Clubs must seek to make neither a profit nor a loss.

4.3.10.4 The method of obtaining funds by the mutual P&I Clubs from its Members is known as a “call” system, designed to in-build the flexibility required to cater for differences between forecast costs and actual costs, within the mutual, non-profit making framework.

Call System

4.3.10.5 The Club will as accurately as possible forecast its liabilities over a coming policy year and set the level of calls to suit, notifying the Members of the **Estimated Total Call (ETC)** or premium. This will take into account any general increase decided upon by the Board. A proportion of the expected total premium (the ETC) will normally have to be paid by the Members during the policy year, probably over a number of instalments. Collectively this payment forms the **Advance Call**.

4.3.10.6 The premium actually charged to each Member will vary, dependant on the risk the Member brings to the Club. The percentage of this premium charged as Advance and Supplementary calls will be the same for every Member, though.

4.3.10.7 At the end of the policy year it will be decided how much of the remainder of the ETC it is necessary to charge and a **Supplementary** call can be made to cover this amount if this exceeds the forecast remainder of the ETC then an **Excess Supplementary** call is made. Alternatively, if it has been a better than forecast claims period it may be determined that less money is required than has already been taken and an amount returned to the Member.

4.3.10.8 A further, very rare, type of call is the **Overspill Call**. This would be made in the event of the Club having to contribute funds to pay for liabilities that exceeded the (Group) reinsurance limits. This overspill may well be in respect of a vessel covered by another Club within the International Group.

4.3.10.9 When a Member leaves the Club they will also be charged a **General Release Call**, to cover outstanding liability contributions.

- 4.3.10.10 The premiums charged to all Members thus reflect the performance of the P&I Club as a body – one of the aspects of mutuality and a differentiator over fixed premium insurers.
- 4.3.10.11 Whilst this ability of the mutual P&I Clubs to obtain additional amounts from all their Members is a necessary tool for a Member operating in a commercial environment, it adds another degree of uncertainty over their operations. Large supplementary and excess supplementary calls are very unpopular. Reserves are thus built up and combined with the call system to cater for fluctuations in liability costs, to soften the amplitude of the claim cycles.
- 4.3.10.12 **Charterer entries** will normally be made on a **fixed premium basis**, with the reduced limits set on their cover. Optional cover for specialised vessels and operations will also normally be made on a fixed premium basis, even when provided by one of the mutual Clubs. The reasoning is that the risks are thought not to be sufficiently mutual – i.e. they are particular to a certain type of craft or operation. Fixed premium entries will be set at a level to generate a profit from that entry, which will be fed into the overall pooling system and contribute in a similar manner to income from reserves/investments.
- 4.3.10.13 Optional cover for other risks may also be charged on a fixed premium basis.
- 4.3.10.14 The contributions from Members with tankers trading to the United States, whilst part of the normal mutual cover, are also weighted to account for the perceived increase in overall risk that they bring to the Club.
- 4.3.10.15 The call system thus spreads the cost amongst the entire Membership of the Club on a mutual basis. The performance of the Club overall will be reflected in the charge to every Member. Similarly, the Club pooling arrangement within the International Group spreads the costs across the entire Membership of the Group Clubs.

Deductibles

4.3.10.16 The club underwriters will agree a level of deductible with the Members at the time of renewal. The deductible is similar to the “excess” in car or household insurance. It is the amount of each claim that the insured must cover himself, before the insurance takes effect. The level of deductible is adjustable and will not necessarily be the same for different owners. Generally, the higher the deductible, the lower the premium paid by the owners. Deductibles set at a significant level will mean that small claims are not always dealt with by the Club but by the owners himself. This in turn keeps down the cost of liability insurance.

4.4 The International Group of P&I Clubs

4.4.1 Background

4.4.1.1 The International Group of P&I Clubs (“The International Group”), was formed to permit the large P&I Clubs to combine their resources via a Pooling Agreement and to spread part of the cost of potentially enormous third party liability claims. They also purchase a collective reinsurance programme to further extend the combined cover available to the individual Clubs. The present thirteen Member Clubs of the International Group account for approximately 85% of ship numbers and 90% of world tonnage. These percentages increase in certain sectors, such as ocean going tankers. The 13 Clubs are listed on, for example, www.ukpandi.com.

4.4.1.2 The International Group is an unincorporated association, without separate legal status from its Members, but regulated by a constitution. The Group Secretariat is based in London and consists of three employees: the Chief Executive Officer and two assistants. The workings of the International Group are decided by the Member Clubs.

4.4.1.3 There are about twenty sub-committees of the International Group, which follow items of the Group Pooling Agreement. The sub-Committees are made up of managing personnel from the Member P&I Clubs’ Managers; they are never Shipowner Members. The Committees report to the International Group meetings, which are held three times a year. The meetings decide on the International Group’s position to be adopted. The Member P&I Clubs conform closely to the policies agreed in the International Group forum.

- 4.4.1.4 As well as coordinating and implementing the Pooling Agreement and the reinsurance programme, the International Group also represents the Member Clubs at Governmental level and at other International bodies. The Group provides a common voice on matters of interest, enjoying, for instance, Consultative Status with the IMO. It provides a forum for information exchange and generally acts as the focal point for the Member community.
- 4.4.1.5 All that is done by the International Group is subject to ratification by the individual Member Club Boards. Decisions are consensus based and are usually unanimous. Any dissenting Club Member usually has the ability to modify proceedings until agreement is reached by all. Group proceedings are all very open and transparent within the Member Clubs. Any issues raised at International Group level are immediately circulated to all Member Clubs.
- 4.4.1.6 A new Rule introduced by the International Group as a result of the recent OECD report on sub-standard shipping is that of **Double Retention**. When Club A turns down a vessel on the basis of condition, if she is then taken on by Club B, the latter gets what is known as Double Retention. Instead of the usual US\$6 million Retention for claims to be settled locally by Club B, the latter would pay up to US\$12 million before claims in respect of that vessel's spilled over into the Pooling Agreement. The expectation is that Clubs would say "No" to rejected ships rather than to try and accommodate them.
- 4.4.1.7 Tankers thus rejected out of the International Group Membership could find that they have no cover and therefore no CLC and therefore no ability to trade. There is concern in the European Union about the possible abuse by the International Group of their dominant position with regard to Competition Law.
- 4.4.1.8 The International Group is also seeking to identify the non-mutual risks in passenger shipping with a view to taking them out of the Pooling Agreement. For example, if somebody is injured it is considered to be mutual risk. However if there is a loss of holiday or loss of facilities on a passenger ship (for example, the theatre out of action due to flooded carpet) then this is considered non-mutual and no liability risk should follow. The mutual risks are pooled. The hotel risks are out of pooling and are subject to specific, additional cover.

- 4.4.1.9 The International Group's experience of cruise shipping is that there is almost no instance of large number of lost lives. The most obvious scenario for liability against a cruise ship is collision with the ship hitting something. For this, liability would follow. It follows therefore that, on balance, the principal risk with passenger shipping are likely to be liability risks. These are to be kept mutual and to be kept in the Pooling Agreement.
- 4.4.1.10 The pooling limits are currently felt by the International Group to be “about right”. The International Group has standing instructions to Brokers to buy reinsurance cover at a sustainable figure. The level of cover is not based on any worst-case scenario; it is mainly based on the ability to pay. The feeling is that most of the ship owning Members across the International Group should be able to pay to the levels set, without bankrupting too many of them. In the worst case, if cover can be found it will be found.
- 4.4.1.11 In the past, various worst-case scenarios have been assessed to test the limits provided, and they are currently considered to be enough.
- 4.4.1.12 The International Group's focus is mainly on the small number of big cost claims. There is a split view within the Group Clubs as the large number of low cost claims can also add up to similar amounts. The cause of big claims are generally the same as the cause of small claims. It is a matter of luck whether small incidents lead to big or small claims. This is where the human element of shipping plays such an important part. Reinsurance through the Group Pooling Agreements helps to smooth out or spread the cost of big claims.
- 4.4.1.13 The International Group is conscious that uninsured ships give the shipping industry a bad reputation and that they are also bad for Members in the event of collisions. In the event of incidents involving poor quality and possibly uninsured tonnage, all of the shipping industry tends to be tarred with the same brush in the public eye.

- 4.4.1.14 The International Group supports the resolutions at the IMO that all ships should carry mandatory liability insurance. They welcome the Japanese and Indian initiatives whereby domestic shipping can only be insured through recognised companies. Sectors of uninsured ships tend to be those not engaged in international trade such as ex-Soviet fish factory ships or “Klondikers”. Nevertheless, these can be large ships and could cause considerable damage. It has proved almost impossible to provide reliable figures for the number of vessels that are uninsured¹². By their very nature, such vessels are invisible to the insurance industries. Emerging markets (such as North Korea) might have a disproportionate number of uninsured ships operating in their locality. Uninsured vessels attempting to trade internationally, however, are commercially handicapped by charter parties and vetting procedures which require liability insurance to be in place. The presence or absence of liability insurance is not currently one of the considerations of Port State Control inspections, except for tankers where the presence of a valid CLC certificate is checked. The International Group would like to ensure that Port State Control inspections do target all vessel types that are not covered from within a list of acceptable insurers.
- 4.4.1.15 Whilst the International Group would welcome some statutory legislative change to ensure that all ships were brought within the liability insurance system, it is not considered to be part of the International Group’s mission to push out sub-standard shipping. In the Group’s opinion, there is in any event some difficulty in measuring what is sub-standard. Even sub-standard ships can be properly classed and have all valid trading certificates. The International Group view is that with inclusion and education, sub-standard shipping can be supported and brought into the fold, rather than excluded. The Clubs will support the lower quartile. It is better to have ships included in the International Group Clubs and properly insured with regard to liability than some second standard. There is then some sort of control. If ships are to be thrown out of the International Group Ship Owning Membership then they should not be trading at all, not just trading under some second standard. The International Group does not have a comprehensive risk evaluation scheme available for its members so that one P&I Club can evaluate quality, or risk, in the same way as another Club (a uniform way to compare apples with apples). Also, the International Group does not have in place a system for annual auditing of its members, for example.
- 4.4.1.16 There is consequently some paradox here in rejecting Shipowner Members who are technically able to trade with all certificates intact. The Group Clubs would say these should not be rejected but should instead be encouraged to improve.

¹² Appendix 3

- 4.4.1.17 All pooled claims are scrutinised by all Member Clubs. All claims likely to hit the pooling level (over US\$6 million) would be circulated around all Member Clubs. This is for information rather than seeking a consensus to pool. All Clubs are obliged to pay under the Pooling Agreement. The Pooling Agreement evolves from time to time in response to claims.
- 4.4.1.18 Discretionary claims would normally be dealt with at the individual Club level. Once a Club Board have made a decision to pay, then the Pooling Agreement would honour the payment from the pool.
- 4.4.1.19 In the event of shipowning Members Club hopping (moving ships from Club to Club), the accepting Club is obliged to ask for the record of the claims history from the ceding Club on matters relevant to the risk. However, these are normal claims records only, not other company relevant information.
- 4.4.1.20 There is some agreement within the International Group to set up a common database such as sharing of surveys which have lead to rejection. However, the Data Protection Laws of some Member countries have to be looked at very carefully in this respect, and at the moment of this writing, no solution has been presented.
- 4.4.1.21 Unification of vetting procedures across the Member Clubs is considered to be imminent. A sub-committee is currently looking at this.
- 4.4.1.22 The International Group works well with the Funds and the ITOFF. The Funds will only pay when they are satisfied that the Shipowning Member's payments have been made.
- 4.4.1.23 It is generally considered that the International Group of P&I Clubs works well. The tools at the disposal of the International Group to influence the quality of shipping are set out in a formal response by to the OECD report on The Removal of Insurance from Substandard Shipping¹³.

¹³ Appendix 1

4.4.2 The Pooling Agreement & Excess of Loss Reinsurance

- 4.4.2.1 The Clubs of the International Group share their liabilities via a tiered system of firstly pooling their own resources to pay for claims up to a certain level (the Group Pooling Agreement), and secondly through the purchase of a Group-wide reinsurance programme, said to be the largest in the world.
- 4.4.2.2 The Pooling Agreement permits the Clubs to pool or share the claims against them as an extension of the mutual principal. Not all P&I Clubs of the Group participate directly in the Pooling Agreement. Some Clubs are Members of the Group but not direct parties to the Pooling Agreement, instead being reinsured by the direct parties.
- 4.4.2.3 To continue the mutuality principle, risks which are held to be not commonly borne by shipowners are excluded from cover under the Pooling Agreement. For example, “hotel” liabilities on passenger ships are not generally considered as poolable.
- 4.4.2.4 To permit the Pooling Agreement to work it can be seen that the overall product provided by the Group Clubs is substantially the same, with common Rules, areas of coverage and financial limits. Amongst the Group Clubs, this is an essential feature if the Clubs are to share their risks.
- 4.4.2.5 As well as combining their resources to directly pay for liabilities, the International Group Clubs act collectively to purchase a reinsurance programme. In 2004 the thirteen shipowner based P&I Clubs of the International Group had an expected combined premium income of US\$2 billions. Their purchasing power permits the Group to obtain a massive reinsurance programme, extending to each individual Club a far higher level of cover than it would otherwise be able to provide to its Members. The reinsurance is spread across the world market, including Lloyd’s and commercial insurers.
- 4.4.2.6 **The Pooling and Excess of Loss Reinsurance Programme** has three tiers:
- I. The liable Club retains the first US\$6 millions of the claim, responsible for paying in full claims beneath this and retaining this amount of larger claims.
 - II. Secondly the International Group Clubs retain the next US\$44 million, up to a limit per claim of US\$50 millions (6 + 44), spreading payment from amongst the International Group’s members.

III. Above 50 millions, payment is met through a single collective reinsurance programme; i.e. the reinsurance policy has a US\$50 millions deductible, raised in 2004 from the previous US\$30 millions.

4.4.2.7 This third tier reinsurance programme has itself four layers:

1. US\$50 millions to US\$550 millions- First Layer (unlimited occurrences) & 25% co-insurance of 1st layer.
2. US\$550 millions to US\$1050 millions – Second Layer (unlimited occurrences)
3. US\$1050 millions to US\$1550 millions – Third Layer (unlimited occurrences)
4. US\$1550 millions to US\$2050 millions – Fourth Layer (aggregate limit)

4.4.2.8 The upper limit of cover under the reinsurance programme stood in 2004 at US\$2050 millions (i.e. US\$2.05 billions), with the contracts spread out across the international insurance markets.

4.4.2.9 Should a major disaster take a claim over the upper reinsurance limit (US\$ 2 billions) the excess would spill back down into the pooling arrangement, (unless it was related to an oil pollution incident).

4.4.2.10 The upper limit for this overspill cover from the pooling arrangement is around **US\$ 4.5 billions**. The figure fluctuates, based on the total tonnage limitation figure for all ships entered in International Group P&I Clubs and also an assessment of the maximum amount that the entire Membership (therefore most of the shipowner market) could be expected to bear without danger of total collapse. It is therefore a practical assessment of the ability of the market to pay.

4.4.2.11 If the claim relates to oil pollution, the limit within the reinsurance programme is US\$ 1 billions, not US\$ 2 billions. Any overspill would fall not back into the pooling arrangement but instead to the liable shipowner.

4.4.2.12 There are apparently mixed views on the levels of risk retention both within the Group and within individual Clubs, though it is reported that general view is that more risk should be retained – thus the increase in the reinsurance deductible to US\$ 50 millions in 2004.

4.4.3 Other forms of Club Reinsurance

4.4.3.1 A number of other forms of reinsurance are taken out by individual Clubs:

Individual Claim Reinsurance

4.4.3.2 Some Clubs reinsure on the commercial market for large individual claims up to the retention limit of pooling arrangement, e.g. claims between say US\$ 1 millions and the US\$ 5 millions where the pooling kicks in.

Aggregate Loss Reinsurance

4.4.3.3 Clubs may reinsure on the commercial market to cover the aggregate of all claims under the pool retention limit, i.e. the sum of all “smaller” claims. The facility is used to reduce uncertainty by arranging reinsurance for any aggregate amount above that which it is felt the annual call income could suitable cover.

Overspill Reinsurance

4.4.3.4 Individual Clubs may take out insurance to cover the cost of any claim that exceeds the Group reinsurance policy maximum and thus over spills back down to the Clubs.

4.5 Case Law on P&I Contracts

4.5.1 The whole framework upon which the P&I insurance system is operated is to some extent dictated by Case Law. New Case Law is being produced all the time and legal precedent is always evolving in response to claims being taken through the courts. We were unable to identify any particular instances of Case Law relevant to third party liabilities. Some of the Clubs, by way of example, handle about 3,000 cases each year. On average, every case is open for about three years before being finalised and closed. Hence, to identify any particular landmark cases which has set precedence and helped define the relationship and workings of the Club is very difficult, but also not considered as particularly interesting. The Clubs we talked to were also not able to identify any particular Case Laws relevant for this study.

4.6 Insurance as a Proportion of Running Costs

4.6.1 It will be appreciated that ship running costs vary immensely between ship types and age, crew size and nationality, trading patterns, cargo types and markets - to name but a few of the factors which will influence costs. It is not within the scope of this study to detail running costs to any great extent. More detailed breakdown of ship running costs can be obtained for a fee through Moore Stephens in the form of their OpCost Report 2004 available on their website:

www.moorestephens.co.uk/website/uk.nsf/pages/sectors.shipping.opcost.

4.6.2 Typical running costs would be those taken to keep a ship operational and would include insurance, manning, maintenance and repairs, lubricants, supplies and spares, the entire classification costs and periodical dry-docking; costs for safety and approval; fees for management services. Running costs normally exclude those derived from commercial operations such as bunkers, port charges, canal dues etc. The running costs of a typical Panamax tanker (50-80,000 DWT), by way of example, could be expected to be in the region of about 8,000 to 10,000 dollars per day. Of these running costs, it is expected that total insurance cost for all hull & machinery premiums and P&I calls would be in the region of 240 to 250,000 dollars per annum. On the basis of these broad-brush figures, it is estimated that the total insurance bill would make up about 7% to 8% of the overall running costs.

5 CONDITIONS OF ENTRY (CONDITION AND QUALITY FACTORS)

- 5.1 The rules of each Club are the framework of any contract between the Club and its Members and will govern the relationship between them. Financial premiums and charges made by the Clubs, however, are not in the rules and are confidential between the Clubs and each of their Members. The contracts between the Clubs and their individual Members would also include the correspondence made between them at the time of renewal and would refer to rules and to any amendments, as well as to the premium and any specific areas of cover required by the Member. There is therefore no set contract between a Club and its Members, everything in negotiable within the framework of the rules and the precise extent and detail of the cover will vary from club to club and from Member to Member.
- 5.2 From our meetings with the managers of P&I Clubs both within and outside the International Group, it is clear that all take seriously the matter of conditions of entry. The various Clubs' rules have a section on application and entry. The managers, through the rules reserve the right, at their discretion, and without giving any reason, to refuse any application for the entry of a ship into that Club whether or not the applicant is already a Member of that Club.
- 5.3 The standard terms of entry upon which ships will be accepted by the managers of any Club are set out in the rules of that Club. The standard risks against which a Member is insured, are also set out in the Clubs' rules. The rights of recoveries set out in the rules may be excluded, limited, modified or otherwise altered by any special terms which have been agreed in writing between the applicant and the managers. In other words, the specific terms of any Members Membership may be different from any other Member.
- 5.4 The terms of entry and the insurance provided by any club are not usually intended to confer any right or benefit on any third party under the Contracts (Rights of Third Parties) Act 1999 save to the extent provided in the club rules.
- 5.5 The managers of various Clubs may, subject to the directions of their respective boards, accept entries on terms as to contribution other than those set out in their rules. In particular an entry may sometimes be accepted on the basis that a fixed premium is to be paid instead of calls.

- 5.6 Every Member applicant shall apply for an entry in such manner and form as the Club managers may from time to time require. Applicants are required to furnish the managers with all material particulars and information; and all such additional particulars and information as the Managers may require. The particulars and information furnished shall, if the entry of the relevant ship is accepted, be deemed to form the basis of the contract of insurance between the Member or applicant and the respective club.
- 5.7 Before any application for entry is accepted by a Club managers, the managers will usually agree in writing the terms and conditions that will apply to the entry if the application is accepted, including the contribution to be paid by the Member to the Club, the date of the commencement of cover, and the terms and conditions on which the ship is to be accepted. These provisions will usually apply throughout the period of entry of the ship in the Club and the Member is usually obliged to disclose any change or changes in any material particulars relating to the entry, such as change of management, Class, the entered ship's flag, nationality of crew, tonnage, trading area and nature of trade, whether the vessel has carried fuel oil as a cargo etc.
- 5.8 Failure to comply with these obligations or to provide complete information or the provision of inaccurate information usually deprives an applicant, and any other person otherwise entitled to claim for recovery under the Club rules, of any right to recovery whether or not the omission or inaccuracy was material to the recovery in question.
- 5.9 When an application for entry of a ship for insurance in a club is accepted, the managers usually undertake to issue to the Member a Certificate of Entry as soon as practicable after acceptance. The Certificate of Entry states the date of the commencement of the period of insurance and the terms and conditions of insurance on which the vessel has been accepted for insurance, usually other than the sums payable to the Club. The Certificate of Entry becomes part of the entered ship's portfolio of trading certificates and is often viewed by many interested parties. The sums payable usually remain confidential between the Club and the Member.

Minimum Operating Standards - Managing Safety

- 5.10 Members or potential Members are screened at the time of entry. However, the scope of the screening is of varied quality, and the practice is not necessarily the same as the written screening criteria. Also, the regular follow-up is not consistent between the Clubs. Quality is assessed by reference to various underwriting procedures and criteria. At the very least, the head office of potential Members would normally be visited by the screening Club before or immediately after renewal. Most Clubs would usually try not to take on a new Member subject to a screening visit done in the heat of renewal. Most Clubs have a policy of visiting Members or potential Members on a regular basis, at least once annually, but this practice is not always followed-up. During visits, assessments are made as to the operators' quality and there is a usually a continual feedback of observations made to their respective underwriting departments.
- 5.11 A big problem, however, is that is often the same person doing the underwriting job and the quality evaluation of the new Member; providing room for some conflict of interest issues.
- 5.12 Most Clubs will try to keep good quality Membership. They are ever mindful of operators/shipmanagers who manage a pool of ships owned by small, perhaps one ship, companies. Such companies are often recognised as offering potentially higher risks, not least because Clubs like to look for long term Members who will still be Members when claims come to be defended or settled. Most Clubs will like to be aware of the exact ownership/operator link before they take ships into Membership.
- 5.13 Quality Assessment of new Members usually takes into consideration such things as (in no particular order):
- Ship's flag
 - General type of ship
 - Place and date of building
 - Major conversions
 - Current managers and length of involvement

- Current Classification Society and recent changes
- Nationality of Officers and Crew and method of sourcing
- Ratio of ships' per Superintendent
- References and reputation
- Visits to the office by managers personnel
- Operational audits
- Previous P&I condition surveys
- Port State Control Detention records
- Ship's trading pattern
- History of claims and losses
- Club's own reputation and prestige
- Ship's safety and security measures (ISPS Code)
- ISM manual and evidence of its implementation (ISM Code)
- Ship vetting
- Reputation amongst existing membership

5.14 The weighting applied to each above item, and the respective order of importance applied by the Clubs, will depend upon the individual Member and Club concerned. Ship owning companies well known to a Club and with a good track record will have newly entered ships less closely scrutinised than will a new Member, previously unknown to a Club.

5.15 An important element in the decision making of the Clubs will be the requirement for Members to have formal operating procedures for key shipboard operations. This is now a statutory requirement under SOLAS, in the form of the International Safety Management (ISM) Code.

- 5.16 The (ISM) Code entered into force for all ships on 1st July 2002. Many of the Clubs' requirements in respect of quality management are covered in the ISM Code. However, many Clubs' requirements such as those pertaining to officer and crew recruitment and employment go beyond the requirements of the Code.
- 5.17 Clubs' managers and their Members continue to discuss ship operational procedures and safety management and this is a continuously evolving area. The human element of ship management, safety culture included, is of paramount importance and emphasis will be placed on the application, rather than just the existence, of procedures for ship management, which will have an impact on P&I claims. However, the extent to which Clubs have the ability or the competency to measure the "human element" of quality shipping is an issue. Some Clubs are good in this respect, others Clubs perhaps let some Members pass through the net too easily.
- 5.18 An example of the importance placed upon quality of ship management, with emphasis on the human element, is embodied in a circular No. 1993/5 dated March 1993 of the Standard P&I Club, on the subject of Minimum Standards. It serves as a good example of a Club's requirements to its Members in this respect ¹⁴.
- 5.19 There has been increasing emphasis in recent years put upon the human element of ship safety. It is now broadly recognised that claim incidence is related to quality, but it is difficult to show a direct causative link.
- 5.20 Many Clubs hold the view that money can be saved through reducing the number of small claims by close attention to the human element. Clubs will not only stipulate the minimum standards that they expect their Members to apply; they will expect to see these minimum standards implemented in practice.
- 5.21 Club statistics show that a very large proportion of payouts are generated by a small number of very large claims. However the Clubs recognise that there is a degree of randomness to such incidents, independent of the quality of the affected Member. They also, in most instances, recognise that such large incidents will predominately be caused by an accumulation of small human errors. By concentrating on the human element and small errors it should therefore be possible to influence the incidence of both small and large claims.

¹⁴ Appendix 2

5.22 It has to be said that insured vessels are not always of the best quality. It is recognised that the Clubs' vetting procedures do not always catch the sub-standard ship. It is considered beyond the scope of this study to detail all the reasons for the continued existence of sub-standard ships. However, in the context of what can be achieved by the P&I Clubs, the following are some reasons for this:

- A potential weakness in the system is that underwriters are often conducting both the underwriting work and performing the quality checks on the shipowner. Without sufficient input from the ship vetting departments, this can lead to potential conflicts of interest.
- The current system of disparate surveys undertaken by the various bodies within the shipping industry is not transparent; the results of one body's findings are not freely available to all. This applies to transparency between the Clubs for vessels that switch Clubs.
- Not all vessels are always surveyed on entry or at sufficiently frequent intervals to detect deterioration. Some vessels are missed completely by the survey regime.
- Cost and time constraints, on the ship vetting departments, means that ships are often not as thoroughly surveyed as perhaps might be desirable. For example only a small (and not necessarily representative) selection of ballast tanks might be visited, often at the discretion of the surveyor, leaving the possibility that relevant ballast tanks are left unseen.
- There is often limited feedback between one survey and the next, leading to a lack of continuity.

6 BENEFITS AND INCENTIVES OPEN TO QUALITY OPERATORS

- 6.1 There is generally recognised to be a direct link between a shipowner's claims record and the premiums that that owner will need to pay for his P&I cover. Therefore, it follows that a good quality operator should pay lower claims but this is not necessarily the case. It is also recognised that there is little visible correlation between the level of claims and the quality of the tonnage.
- 6.2 The Clubs will generally recognise that good quality owners can have bad luck and conversely that poor quality operators need not necessarily have a poor claims records. There are also the costs of claims in different parts of the world to be taken into consideration. Premiums will reflect risk. For example, "Blue Chip" operators opting to employ US based crews will be more expensive to insure from a P&I angle than will less valuable ships with, for example, a cheaper, Far Eastern based crew. The best operators with more expensive crews will not therefore get discount for P&I premiums as the claims in respect of their crews will be very much more expensive to settle, notwithstanding that there may be less risk of claims associated with better quality crews.
- 6.3 This is something of a paradox, though: adding quality to an operation may well add additional exposure to liability. Employing good personnel can bring a higher level of liability.
- 6.4 Most Clubs are perceived to take very seriously the business of influencing their Members with regard to quality. Most Clubs genuinely hope that they are making a serious contribution to improving safety (and their own bottom-line) amongst their Members and, through the International Group, amongst world shipping in general.
- 6.5 Most will publish frequent newsletters or bulletins in which they illustrate problems by reference to more interesting case studies. These are usually done at the Clubs' own volition. They take great pains to disguise the identity of the Members concerned and consequently, cases are generally never reported in this manner until after they are closed.

- 6.6 There is no doubt that more can still be done by the Clubs in regard to improving the quality of shipping. However, they will say that there is only so much that the Clubs alone can do, without changes to the international regulatory or statutory framework. Great strides forward have already been made in recent years in improving the quality of the world fleet. Some of the incentives for this improvement have come from the Clubs, either individually or through the International Group.
- 6.7 The International Group Clubs say that if they squeeze certain sectors of the shipowning community much harder, Owners will opt out and operate without insurance or with insurance but of lesser quality than is currently provided within the Group. The Group Clubs could be accused of abusing their dominant role in their unique marketplace. Governmental support with regard to perceived anti-competitive activities would be needed, as would some move towards making third party liability insurance compulsory. If the International Group Clubs were to become yet tougher on quality by themselves, then a similar toughening stance must also be taken by the non-Group insurance providers who would otherwise gain a competitive edge.
- 6.8 The International Group Clubs have proposed a number of improvements, to be made within the Clubs themselves, in response to the OECD report on sub-standard shipping. These proposals include:
- The use of an underwriting checklist to include all information required from a prospective member, including information on whether P&I insurance has previously been declined or terminated.
 - A minimum scope of information to be included in condition survey reports.
 - The survey department of a Club to report any vessel that causes concern to the underwriting department and also to central management of the Club. This is because it is realised that there is little or no correlation between claims and condition, so that using claims alone is not an adequate indicator of condition.
 - A minimum requirement to carry out condition surveys upon application for entry of all sea-going ships aged twelve years or more.
 - Owners of sea-going vessels over ten years of age to declare annually whether that vessel has carried heavy fuel oil as a cargo in the previous year, in order to trigger a survey.
 - Establishing a central database to pool condition survey information, to be consulted by underwriters before quoting for a new member.

- Double retention as described above.
- Formal management audits of the membership of each Club.
- Consultation with other industry bodies over the setting up of unified vessel vetting procedures.

6.9 In addition, the International Group has identified measures that could be taken by other industry bodies to assist in the removal of sub-standard ships:

- To request the IMO to revive discussions regarding surveys with a view to: reducing in number and consolidating, providing a central database to ensure transparency for survey information from various sources, ensuring consistency in the performance of the Classification Societies.
- To ensure that Flag State Implementation is maintained.
- To ensure that Port State Control targets vessels from Flag States that have not accepted voluntary audit, and that it targets vessels not covered by a list of acceptable insurers.

6.10 The International Group's response to the OECD Report on sub-standard shipping is appended.

7 P&I INSURANCE ISSUES ILLUSTRATED THROUGH CASE STUDIES

7.1 Serious Marine Pollution Incident

7.1.1 We were tasked with generalising a case by reviewing claims and liability arising from events such as the Sea Empress, Erika, Prestige, Ievoli Sun etc. The following scenario is an amalgam of features from these events and other factors considered possible.

7.1.1 Scenario

7.1.1.1 Whilst transiting European waters a product tanker of carrying 35,000 tonnes of heavy fuel oil, loses all motive power during a late winter Storm. (Prior to the loss of power the ship had been experiencing a number of structural problems, with unusual readings on the remote tank gauges running with the sea/winds). The nearest available tug assistance is the coastguard standby tug permanently stationed in the region throughout the winter.

7.1.1.2 After some time the ship issues a Distress call when it is clear that the engines cannot be re-started and the ship is drifting onto a nearby lee shore.

7.1.1.3 A few hours later a salvage tug arrives at the scene and is contracted under Lloyd's Open Form to provide salvage assistance. Despite several attempts they are unable to secure a line to the tanker before it grounds on the adjacent rocky coast and breaks in two. 25,000 tonnes of persistent oil are spilt into the water immediately, with further slow leakage over several days through ruptures in the cargo tanks adjacent to the break. A small quantity remains in the intact aftermost and foremost cargo tanks plus the ship's own bunker tanks.

7.1.1.4 The salvors provide oil spill equipment, both onboard their tug and flown in as part of their mobile response equipment, though they are unable initially to use this due to the weather. Gaining access to the two sections of the ship the salvors are able to stabilise the situation. In a separate operation the remaining oil inside the two halves of the wrecked tanker is removed by salvors. A further separate contract is later agreed for the removal of the wreck itself.

- 7.1.1.5 Gradually the weather abates sufficiently for ship's crew to be rescued by helicopter. Ten persons are rescued; one crewmember was killed during the initial break up of the tanker. The rescued crew are taken to hospital suffering from hypothermia and a number of minor injuries. Once released the majority are repatriated to their homes; the Master is initially detained by the police.
- 7.1.1.6 Over the coming days the persistent oil is driven down the coastline, contaminating approximately 400 km of coastline, affecting three States.
- 7.1.1.7 The area affected is mainly one of outstanding natural beauty, lacking major industrial centres but instead dependent on thriving tourist, fishing and aquaculture industries.
- 7.1.1.8 A number of offshore and on-shore facilities comprise the aquaculture industry including fish farms, a fish processing factory, an onshore aquarium, mussel and oyster beds, and the fishing grounds themselves.
- 7.1.1.9 The fishing grounds around the area are closed for 5 months.
- 7.1.1.10 Over the winter and throughout the next year globules of oil are sporadically washed up onto the beaches after spells of heavy weather.
- 7.1.1.11 Directly from the incident 75,000 seabirds are killed – 50,000 immediately and 25,000 afterwards, approximately 75% of which had been previously cleaned up by volunteers and wildlife organisations.
- 7.1.1.12 The national emergency plan of the State (in whose waters lies the wreck) is activated. The regional (forces) command centre take charge of the response operations on land and at sea for oil recovery operations, requesting assistance from neighbouring States, primarily in the form of oil recovery vessels. With regards the wreck itself the State took an overall responsibility but monitoring role whilst the ship's insurer's co-ordinate initial salvage and site oil spill activities.

- 7.1.1.13 The ship was entered by the owners into one of mutual P&I Clubs belonging to the International Group of P&I Clubs.
- 7.1.1.14 Having been contacted directly by the Owners the Club manage matters from their headquarters office whilst also dispatching club staff, external surveyors (and legal team) to the scene. In the immediate period they are able to gain local knowledge and assistance from their Correspondents in the region, some 30 km away. The Club also handles the media response¹⁵.
- 7.1.1.15 Also in attendance within a short time are representatives of the IOPC Fund, including their external technical advisors, and technical staff of The International Tanker Owners Pollution Federation Ltd (ITOPF).
- 7.1.1.16 During the initial days the IOPC Fund and the owner's P&I Club establish a joint field office in the town adjacent the incident site. Initially the office acts as a base for the technical staff to co-ordinate activities. The IOPC Fund also liases with ITOPF staff Members over the best course of action for limitation and clean up of the oil spill contamination.
- 7.1.1.17 Over the coming months the Fund/P&I Club office acts as a focal point and liaison for anyone wishing to register a claim for payment against the effects of the oil pollution.
- 7.1.1.18 A separate oil removal contract will be entered into, removing as much of the oil remaining in the two sections as practicable. This will include engine room spaces and other non-cargo tanks. This will be covered by the CLC / Fund regime.
- 7.1.1.19 Finally, it is most probable that wreck will be removed from the shoreline. The operation will be done under separate contract from the oil removal. This will be covered under the P&I Club cover.

¹⁵ The extent of assistance and prominence of the Club would depend on the Member's own ability – a ship owning oil major taking a more prominent role to a small operator.

7.1.2 Claims Arising

7.1.2.1 The effects of the oil spill are:

- Initial salvage operation and oil pollution prevention measures undertaken by the salvors
- Operations to prevent further oil escaping from the intact sections and later recovery operations
- Life saving activity
- Constructive Total Loss of the tanker
- Eventual wreck removal operation under order from the regional authority
- Massive oil pollution along hundreds of kilometres of sensitive coastline.
- Clean up operations: volunteers, hired manpower, hired contractors and specialist advise, forces, local government.
- Assessment costs – studies undertaken to assess the impact of the pollution
- Immediate and more remote economic losses
- Death of one seaman
- Death of massive numbers of wildlife
- Unknown medium and long term effects on wildlife population
- Closure of the fishing grounds in the area
- Oil pollution damage to:
 - Coastline, sandy beaches – a massive volume of waste oil for disposal.
 - Removal of oily waste and disposal ashore (re-processing / cleaning)
Factor of up to 12 e.g. ERIKA 19,800 tonnes oil spilt, 250 000 tonnes of oily waste was collected from the shoreline.
 - Repeat pollution from emulsified tar balls from oil sunken offshore washed up on the beaches during periodic heavy seas.
 - Remote beaches in adjacent states previously unaffected are polluted as tar balls are periodically washed up.
 - Property damage including fishing vessels, pleasure boats in adjacent harbours. Also damaged fields and buildings on the adjacent coast affected by wind-blown oil and pollution control chemicals
 - Mariculture sites polluted by oil. Onshore facilities are affected by polluted seawater whilst others are affected by being unable to draw the seawater as a precautionary measure. Molluscs growing at sites with limited visible pollution are chemically tainted.
 - Power stations closing down for period – unable to draw cooling water.
- Associated Economic Losses
 - Tourism trade down – a (\$US968 million (£550 million) annual industry for the affected region)

- Costs incurred for studies
- Fishing equipment manufacturers report sales down over the coming year
- Fishermen claim lost income due restrictions and interruption of business
- Mariculture claim damages plus lost income
- Suppliers claim economic loss
- Receivers within the area claim loss of supply, e.g. fish processor, restaurants
- Receivers some 500 km distant claim economic loss through lack of supplies and no alternative providers.
- Holiday companies claim loss of earnings through lost bookings including foreign holiday companies
- Fishing grounds damaged
- Lowered saleability and lowered market prices of fish and seafood – from adjacent areas and the affected area after the ban has been lifted
- Ferry companies claim loss through reduced bookings

7.1.3 Insurance Issues & Liabilities

The main liability issues arising will be:

1. Death and injury to crew
2. Death and injuries to persons on shore
3. Hospitalisation and repatriation of foreign crew
4. Oil pollution coordination and clean-up
5. Oil pollution compensation for property moored on the water and located on adjacent shores
6. Salvage and later contracts: fire fighting, removal of bunkers, removal of cargo and wreck removal
7. Fishing vessels excluded from fishing grounds; loss of earnings and business until area is reopened. Any vessels trapped in ports along the coast by pollution – loss of earnings.
8. The constructive total loss of the ship
9. Loss of owner's business in a busy tanker spot market
10. Loss of and damage to cargo
11. Loss of personal effects to, crew and persons ashore

12. Damage to shore properties

13. Claims for Damages caused by oil pollution:

- Costs of studies commissioned because of the oil pollution incident
- Oil Pollution damage to mariculture infrastructure and fishing grounds;
- Loss of income from affected mariculture and fishing within the affected area, ban on fishing, ban on exports;
- Pure economic loss including tourism, suppliers, receivers, loss of market value for sea products for some time after the event. Includes entities within and adjacent to the affected area and those remote from it – these may not all be found covered / recoverable – see Commentary.

7.1.3.1 For the insurance perspective the above insurance issues can be grouped into the various types of claim that could most usually be made as a result of them or types of insurance policy that would normally address them. Taking matters simplistically, the issue numbers used above are tabulated against the claim/policy type as follows:

Issue	Contractual liability claim	Tortuous liability claim	Shipowner's own loss	Loss of hire insurance	Strict
1	C				
2		T			
3	C				
4	C	T			
5		T			
6	C	T			
7	C	T			
8			O		
9			O	X	
10	C				

11	C	T			
12		T			
13		T			S

7.1.4 Commentary

- 7.1.4.1 Where the incident occurs in waters of signatory States to the CLC and IOPC Fund Conventions these limits and mechanisms will apply.
- 7.1.4.2 In the case above the States are taken as signatories. The Fund and the P&I Club would co-operate as much as possible to permit the smooth running of the clean up operation and payment of compensation.
- 7.1.4.3 A joint site office will often be established for major incidents, to assist claimants who wish to make a claim for compensation for pollution damage and to receive and examine compensation claims. The office will become the focus for local attention, sometimes hostile when grievances are aired and local opinion is that payments are not being made to a suitable timescale or level.
- 7.1.4.4 Both Club and Funds will seek to make prompt payments where it is believed they are liable. In the above case the P&I Club and the IOPC Fund staff would co-operate to a great extent on site and in the initial assessment and claims payment process.
- 7.1.4.5 It is probable in our scenario that the shipowner would also have his liability limited under CLC, and hence covered by the P&I Club. In a small number of major cases the shipowner has been found to have breached the terms and lost the limitation under CLC. In this instance he would be faced with liabilities above the P&I Club amount, which would remain limited under CLC.
- 7.1.4.6 In practice the P&I Club may make such payments, where it will probably be liable, as required to keep the oil pollution clean up and prevention operation running, particularly the initial stages. Where payments are in excess of the Club's liability limit under CLC and held to fall under the IOPC Fund the Club may later make a claim against the Fund.

- 7.1.4.7 The exact role played by the Club in controlling the pollution prevention and clean up measures will depend on the mix of shipowner's capabilities and the State's action. The Club may have an observational role, monitoring actions taken and working with the Fund to assess and pay compensation. In other cases the Club would provide more direct hands on control of the operations, particularly where the Member had limited capacity and ready funds. It is probable that the local authorities would be active in the pollution clean up, involvement ranging from provision of resources to full control. They will make a claim for compensation from the Club/Fund for costs incurred.
- 7.1.4.8 It will be the IOPC Fund policy to make payments as soon as practicable, where they assess the Fund is liable. It will also be the policy to settle compensation out of court where practicable and the majority of claims are kept out of the court system.
- 7.1.4.9 In the words of the IOPC Funds: "Compensation is available to any individual, business, private organisation or public body who has suffered pollution damage as a result of the incident. Compensation is payable for expenses actually incurred and for loss or damage actually suffered as a result of the oil pollution. All claims must be properly supported by documentation."
- 7.1.4.10 Outside a Supplementary Fund signatory State, during the early stages, where further claims are anticipated, the Funds will pro-rata payments, making a percentage payment of all claims received to that date. As the full claim's picture becomes clearer the payment of approved claims will be increased, given percentage of all claims being paid up to the Fund limit, but not until claims have become time barred. If the above takes place in the waters of a State signatory to the Supplementary Fund Protocol it is most probable that 100% payments will be made from outset (the limit of 750 millions SDR (approximately £615 million, \$US 1087 million) being substantially higher than the 1992 Fund /CLC regime's 203 millions SDR (approximately £165 million, \$US 294 million)).
- 7.1.4.11 The shipowner's liabilities under the limitation Conventions will be met by the P&I Club, together with the wreck removal.
- 7.1.4.12 The IOPC Fund will apply its general criteria of admissibility when considering a claim:

- any expense / loss must actually have been incurred
- any expense must relate to measures which are deemed reasonable and justifiable
- a claimant's expenses/loss or damage is admissible only if and to the extent that it can be considered as caused by the contamination
- there must be a link of causation between the expense/loss or damage covered by the claim and the contamination caused by the spill
- a claimant is entitled to compensation only if he has suffered a quantifiable economic loss
- a claimant has to prove the amount of his loss or damage by producing appropriate documents or other evidence

7.1.4.13 Contained within the IOPC Funds Claims Manual the principal categories for claims are:

1. Clean-up operations and property damage

- Clean-up operations on shore and at sea, and property damage
- Salvage and preventative measures
- Disposal of collected material
- Property damage
- Costs of Studies
- Fixed costs

2. Consequential loss and pure economic loss

- Consequential loss and pure economic loss
- Measures to prevent pure economic loss
- Contamination

3. Environmental damage

7.1.5 Claims for Damage and Loss

- 7.1.5.1 In the above scenario the clean up costs will be met (dependent on Fund Limits) provided that the measures were reasonable, for the purpose of the Convention. A body deciding to take action would not automatically make it reasonable. Actions would have to be technically reasonable, with the situation being reappraised as the operation proceeds.
- 7.1.5.2 In the salvage operation the measures taken to prevent further oil spill from the ship sections would probably be covered by the Fund as they were taken with the prime purpose of preventing the pollution damage. The actions taken by Salvors to solely rescue the crew would not fall under this category, but would fall under the salvage Contract. Measures to save the hull would likewise not be covered, though where there is joint purpose including pollution prevention the costs would be apportioned.
- 7.1.5.3 The beach clean up will result in a far higher volume of contaminated material than oil spilt (e.g. a factor of 12:1 contaminated material: oil spilt has been experienced in recent incidents). Reasonable costs incurred disposing of this would be covered. A reasonable proportion of fixed costs (e.g. by the local Authority) would be accepted, together with reasonable additional expenses incurred solely due to the operations.
- 7.1.5.4 Similarly the cost for cleaning, repairing and if required replacing, (minus wear and tear allowance), the boats and other property including fishing gear contaminated by the oil would be admissible as a claim. Claims from adjacent farmland and adjacent buildings would be admissible if it could be shown that they had been damaged as a result of the incident.
- 7.1.5.5 As far as **Consequential Loss** the Fund may in principle accept responsibility for consequential loss of earnings suffered by the owners / users of contaminated property. The fishermen with lost income due to their nets being polluted would probably be covered.
- 7.1.5.6 Unlike the courts of many States the Fund will also consider **Pure Economic Loss**. Claims are judged against a set of main elements:
- Adequate causation, remoteness and foreseeability
 - Geographical proximity between claimant's activity and contamination

- Degree of economic dependence on the affected resource
- Extent claimant could mitigate loss
- Extent to which there were alternative sources of supply / business
- Extent to which Claimant's business formed an integral part of the economic activity within the area affected by the oil spill.

7.1.5.7 In the above scenario, claims for losses in income due to the exclusion zone and ban on fishing within the area may be permitted.

7.1.5.8 Losses due to the contamination of fisheries and mariculture may claim for the destruction of contaminated produce – but must be able to show that it was reasonable on scientific grounds. Instances where local authorities have instructed destruction of produce have not been upheld to be on a scientific basis and as such not paid by the Funds.

7.1.5.9 **Tourism** related losses could be very high. The above tests would be applied, for admissibility and in general a distinction drawn between those directly serving the tourists and those further down the supply chain.

7.1.6 Proportion of Costs

7.1.6.1 In one major oil spill the break down of costs incurred was:

- 11% clean up and property damage
- 51% fishing and mariculture
- 38% tourism

7.1.7 Types of Insurance Cover

7.1.7.1 For the P&I Club the different issues can be grouped into similar types as follows:

Group 1 (1, 3 and 10) Contractual liability claims. These would be made under any contract the injured party had with the owners of the tanker. Contractual claims in this type of instance would normally be dealt with under the shipowner's P&I cover.

Group 2 (5, 12 and 13) Tortuous liability claims. These would be made against the owners of the tanker for an injury or wrong suffered by a third party, irrespective of any contract between them. Tortuous claims in this type of instance would normally be dealt with under the shipowner's P&I cover.

Group 3 (4, 6, 7 and 11) Possibly a combination of contractual or tortuous claims, dependent upon any contracts which third parties had with the shipowner (such as port authorities, etc.). Claims in this type of instance would normally be dealt with under the shipowner's the P&I cover.

Group 4 (8 and 9) Claims that would normally fall outside P&I as not being third party issues. The loss of the ship and or loss of earnings would both be the shipowner's own loss normally covered under his Hull & Machinery or Loss of Hire policies.

Group 5 (13) Dealt with under the P&I cover and by IOPC Funds' Compensation Regime where this applied. Liability is strict under CLC, admissibility is dependent upon set criteria.

7.1.7.2 The above commentary is intended only as a broad guide to the way in which the P&I and Fund insurances typically interlink. Much will depend upon the specific policies and contracts made between the insured and the insurers. There will also be a great deal of interpretation both within the Club, the IOPC Funds and legally, to be made before a definitive settlement is reached. Wherever possible the Clubs and IOPC Funds will settle claims without recourse to legal action. It is probable that a number of claimants will take recourse to civil action.

7.2 Terrorist Attack in EU Port

7.2.1 Scenario

7.2.1.1 Ocean going passenger ferry upon entering a south coast harbour of and EU Member State from a northern port of another Member State on a sunny summer afternoon, suffers a catastrophic explosion in the lower car deck resulting in her partial sinking, capsizing and taking fire.

7.2.1.2 The immediate effects of the explosion are:

- Large numbers of casualties amongst the passengers and crew on the ferry
- A number of casualties on shore caused by the effects of the explosion
- The vessel abandoned and a large scale rescue operation carried out by naval and coastguard units
- A salvage fire fighting operation. The fire was confined to the vessel
- The loss of the private and commercial vehicles carried as cargo
- Loss of freight cargo
- The constructive total loss of the ferry
- The wreck being a hazard to navigation causing substantial blocking of the entrance to the harbour, a busy commercial and naval port.
- Blast damage to domestic and commercial properties adjacent to the harbour entrance
- Damage to cars parked on the road adjacent to the harbour entrance
- Damage to yachts moored adjacent
- Pollution of the harbour resulting from leaking bunker tanks
- Damage to submarine cabling crossing the harbour
- A wreck removal order is made against the ferry owners by the port authorities

7.2.1.3 The cause of the explosion is traced to a van packed with conventional explosives, which was parked on lowest car deck adjacent to the starboard side shell plating, immediately above the engine room, fuel and ballast tanks. A recognised terrorist group subsequently claims responsibility for the bombing, stating that they were acting from a political motive. The van was stolen. It was recorded on CCTV footage during loading as it passed security and boarded the vessel without being scrutinised. CCTV footage also revealed that the driver of the van disembarked from the vessel prior to it sailing from the departure port.

7.2.2 Insurance Issues

In no particular order:

1. Death and injury to passengers
2. Death and injury to crew
3. Death and injuries to persons on shore including customers in the garden of a public house located adjacent to the harbour entrance and to passers by on the road adjacent
4. Hospitalisation and repatriation of foreign passengers and crew
5. Oil pollution coordination and clean-up
6. Oil pollution compensation for property moored on the water and located on adjacent shores
7. Savage: fire fighting, removal of bunkers, removal of cargo vehicles and wreck removal
8. Commercial and naval vessels trapped in port; loss of earnings and business until port is reopened
9. Diversion of other vessels to other ports
10. The constructive total loss of the ferry
11. Loss of owner's business in a busy summer ferry schedule
12. Damage to vehicles and freight cargoes
13. Loss of personal effects to passengers, crew and persons ashore

14. Damage to shore properties and cars parked on or passing along road alongside the entrance

7.2.2.1 The above insurance issues can be grouped into the various types of claim that could most usually be made as a result of them or types of insurance policy that would normally address them. Taking matters simplistically, the issue numbers used above are tabulated against the claim/policy type as follows:

Issue	Contractual liability claim	Tortuous liability claim	Shipowner's own loss	War Risks policy and P&I	War Risks policy	Loss of hire insurance
1	C			WR/P&I		
2	C			WR/P&I		
3		T		WR/P&I		
4	C			WR/P&I		
5	C	T		WR/P&I		
6		T		WR/P&I		
7	C	T		WR/P&I		
8	C	T		WR/P&I		
9		T		WR/P&I		
10			O		WR	
11			O			X
12	C			WR/P&I		
13	C	T		WR/P&I		
14		T		WR/P&I		

7.2.3 Commentary

- 7.2.3.1 This commentary deals only with the shipowner's liability and insurances. It does not deal with any personal insurance that individuals may have, nor any insurance that other organisations may have, such as the owners of the port, the truck owners, other affected property owners etc.

The different issues can be grouped into similar types as follows:

Group 1 (1, 2, 4 and 12) Contractual liability claims. These would be made under any contract the injured party had with the owners of the ferry. Contractual claims in this type of instance would normally be dealt with under the shipowner's War Risks policy, up to its limit (usually an amount equal to the ship value) and then by the P&I club under the club's excess war and terrorism risks coverage, excess of ship value and with a limit of \$400m excess of ship value.

Group 2 (3, 6, 9 and 14) Tortuous liability claims. These would be made against the owners of the ferry for an injury or wrong suffered by a third party, irrespective of any contract between them. Tortuous claims in this type of instance would normally be dealt with under the shipowner's War Risks policy up to its limit (usually an amount equal to the ship value) and then by the P&I club under the club's excess war and terrorism risks coverage, excess of ship value and with a limit of \$400m excess of ship value.

Group 3 (5, 7, 8 and 13) Possibly a combination of contractual or tortuous claims, dependent upon any contracts which third parties had with the shipowner (such as port authorities, road hauliers etc.). Claims in this type of instance would normally be dealt with under the shipowner's War Risks policy up to its limit (usually an amount equal to the ship value) and then by the P&I club under the club's excess war and terrorism risks coverage, excess of ship value and with a limit of \$400m excess of ship value.

Group 4 (10 and 11) Claims that would normally fall outside P&I as not being third party issues. The loss of the ship and or loss of earnings would both be the shipowner's own loss unless specifically covered under his War Risks or Loss of Hire policies respectively.

- 7.2.3.2 In this scenario, responsibility for the bomb has been claimed by a terrorist group. However, such a claim is not necessarily needed to invoke the War Risks insurance. The question is of evidence as to what was the most likely cause of the explosion. If, on the available evidence it was a bomb, then the event would be handled as a war/terrorism risk. If on the balance of probabilities, however, it was not a bomb, for example an explosion for some non-terrorism reason, then the P&I club cover and hull and machinery covers would normally respond as appropriate. There would be need for cooperation between the various underwriters. The P&I club would likely take the lead on liabilities in any event, and would seek agreement from the war risk underwriters that they would in turn honour their cover if it transpired that the event was one of war/terrorism. Even if it was found early on to be a terrorism event, the P&I Club might well handle the claim on behalf of the war/terrorism underwriters in any event. This is apparently what happened in the LIMBURG case where a French Flag vessel was attacked by terrorists on 6th October 2002 off Yemen.
- 7.2.3.3 The above commentary is intended only as a broad guide to the way in which the P&I and War Risks insurances typically interlink. Much will depend upon the specific policies and contracts made between the insured and the insurers. There will also be a great deal of legal interpretation to be made before a definitive settlement is reached. The above commentary also needs to be seen in conjunction with the following Notes:

Note 1: A shipowner typically buys 3 main types of insurance cover:

- first, hull and machinery insurance, bought from the commercial market, which covers loss and damage to the ship up to an agreed limit, usually the value of the ship;
- second, war risks insurance, which is normally bought from the commercial market but which can be bought from a specialist war risks club, which typically covers both hull and machinery and P&I risks when caused by war or terrorism, and this again is normally limited in each case to the value of the ship;
- third, P&I club cover which covers liabilities to third parties up to a limit of an undefined amount but roughly \$4.5bn – this cover excludes war and terrorism liabilities but the club also gives an extension to cover war and terrorism risks excess of ship value, for a limit of \$400m.

Note 2: The third party liabilities will only be covered by the shipowner's insurances if the shipowner is legally liable for the claims in the first place. As the cause was a terrorist act, the shipowner may well not in fact be liable, unless negligence of some sort on his part can be proved. This is the case for any tortious claims where the claimant will have to prove the shipowner's negligence.

Note 3: For contractual claims, the contract terms will determine liability, and without knowing what the specific contract terms are in this example, it cannot be known if the shipowner would be liable. However, for contractual passenger and crew claims, see below.

Note 4: For the passenger claims, where there will be a contract evidenced by the passenger ticket, the Athens Convention is likely to apply. The Convention applies to personal injury or death of passengers caused by the fault or neglect of the carrier or his servants or agents. Such fault is presumed if an explosion causes the injury, although of course the carrier can disprove that presumption, which he might well be able to do here.

7.2.3.4 The 1990 Athens protocol limit is 175,000 SDR (approximately £143500, \$US 253750) per passenger. The 2002 protocol provides for a per passenger limit of 400,000 SDR (approximately £328000, \$US 580000), but for the first 250,000 SDR (approximately £205000, \$US 362500) there is a defense to any claim based wholly on war or the act of a third party done with intent, which looks like the case here. Above this and up to 400,000 SDR (approximately £328000, \$US 580000), liability is based on fault, which may not be provable in this case.

Note 5: For crew claims, the crew contract will determine if the shipowner is liable to pay compensation; in all probability, he will be, possibly up to limits set out in the contract, or under employer's liability, or at common law depending on the jurisdiction.

7.2.3.5 The Athens Convention liability limits outlined above are per passenger. The insurance coverage limits discussed above are for the sum of all claims arising out of the occurrence.

8 CONCLUSION

8.1 By far the largest providers of Third Party Liability Insurance in the Marine Field are the Protection and Indemnity Clubs (P&I Clubs), the majority of which are Members of the International Group of P&I Clubs. The P&I Clubs are an integral part of the shipping industry. They are mutual insurance associations, owned by the shipowners who are also their insured Members. The Clubs exist solely to provide these shipowner Members with liability cover and attendant services. The Clubs have been described as shipowners' co-operatives for liability insurance.

8.2 The mutuality status is the cornerstone of marine P&I insurance, but as a business model, it is relatively rare in today's commercial world. Mutuality in the P&I industry can be summarised as following:

- Mutuality spreads the costs of large claims; a P&I Club does not get wiped out by one very large claim
- Mutuality gives softer amplitudes (in claims) in cycles
- Mutuality shares the risks with other, similar organisations – even with competitors
- P&I Clubs are owned by their Members seeking to protect the interests of their Members. The Members are also the ultimate decision makers
- P&I Clubs provide insurance at costs – making no proper profits or losses, but rather giving funds for rainy days
- Mutuality requires common quality criteria and norms
- Mutuality is about long-term benefits rather than short-term profits
- Each Member of a Mutual Club has a close interest in maintenance of quality.

8.3 Three important aspects of the Mutual P&I Clubs, as providers of Third Party Liability insurance, separate them from commercial insurance providers:

- The Omnibus Clause which gives the Clubs the flexibility to cover their Members for claims which are incidental to shipowning – even if such claims are not specifically mentioned elsewhere as covered. This is a great benefit of the P&I system.
- The Mutual Clubs, through the spread of Membership available through the International Group, can offer a breadth and depth of practically unlimited (nominally US\$4 billion) cover. No one commercial insurer could offer this extent of cover, as it would prove far too expensive.
- The Mutual Clubs provide a flexible cover suited to the Members' needs through a service based ethos

8.4 The Mutual P&I system for Third Party Liability Insurance is an integral and important part of the whole shipping industry. A litmus to the continued success of the Mutual P&I system is the only limited success of the fixed premium market for large seagoing vessels. The continued and successful existence of the non-mutual fixed premium market is in niche client groups and trades.

9 APPENDIX I: INTERNATIONAL GROUP'S RESPONSE TO 2004 OECD REPORT

The Response of the International Group of P&I Clubs to the Organisation for Economic Co-operation and Development's report on '*Maritime Insurance Study: Policy Overview and Future Actions*', DSTI/DOT/MTC (2004) 4, May 2004

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10 APPENDIX II: STANDARD P&I CLUB'S MINIMUM STANDARD CIRCULAR

Minimum Standards, Circular No. 1993/5 March 1993 extract from the Protection and Indemnity Class Rules and Defence Class Rules for the 2004/05 policy year of The Standard Steamship Owners' Protection and Indemnity Association (Bermuda) Limited and The Standard Steamship Owners' Protection and Indemnity Association (Europe) Limited.

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11 APPENDIX III: BRITISH MARITIME LAW ASSOCIATION REPORT

British Maritime Law Association report on the Role of Cargo Owners / Shipper and Marine Insurers in the Quality Shipping Campaign.

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