

# COMPULSORY MARITIME INSURANCE

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## 1 INSURANCE BECOMES COMPULSORY

Before the introduction of the Civil Liability Convention in 1969 (concerning oil pollution from tank vessels), compulsory insurance or requirements for financial security for maritime liabilities was almost unheard of in international conventions. Even the conventions concerning nuclear liability, where the insurance element is pivotal, put the insurance requirement on the operator of the nuclear facility rather than on the carrier when nuclear substances are carried on board a ship. The 1971 Brussels convention relating to Civil Liability in the Field of Maritime Carriage of Nuclear Material reaffirms this approach. Although there are some provisions on compulsory insurance in a convention on nuclear ships<sup>1</sup> this is an exception from the rule that is neither practical nor far-reaching. Before 1969, insurance was an internal matter for shipowners.

After 1969, compulsory insurance has been of major importance in the development of new international law on maritime liability in the International Maritime Organization. In the 1984 and the 1992 revisions of the Civil Liability Convention, the principle was accepted as a matter of course.<sup>2</sup> And when a new liability regime for damages caused by hazardous and noxious substances was negotiated for 25 years ending up in a successful diplomatic conference in 1996, compulsory insurance was one of the principles that seemed to be taken for granted all along. (A Norwegian proposal at the 62nd session of the Legal Committee to secure in another way that claims would be paid did not even survive to lunch the first day of the session.)

At this time, provisions of compulsory insurance is discussed in International Maritime Organization both in connection with the draft conventions on liability for wreck removal, on death and injury of passengers and on bunker fuel oil oils. There have also been some preliminary discussions in connection with crew claims. Serious opposition to compulsory insurance has only arose in connection

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<sup>1</sup> Convention on Liability of Operators of Nuclear Ships and Additional Protocol, Brussels 1962, Article III.

<sup>2</sup> The 1992 revision has entered into force, while the 1984 revision never did, for other reasons than compulsory insurance.

with the wreck removal issue, and then closely linked to the question of need of the convention itself.

It is, however, notable that the 1996 protocol to the global limitation convention (LLMC) did not trigger much debate on compulsory insurance. The revision of the LLMC did not go much beyond a revision of the limitation amounts. The reason was, however, not that one did not feel a need for compulsory insurance. The argument was rather that it would be difficult to require compulsory insurance in a convention like the LLMC, where the basis of liability is not set out. At a later stage it has been considered whether a general liability convention, which would include both provisions on the basis of liability and on compulsory insurance, should be developed. However, it was felt that this would be too much of a challenge for the Legal Committee. The result has been an International Maritime Organization resolution that urges all shipowners to maintain insurance or similar security.<sup>3</sup> Although the achievement is quite modest, it certainly does emphasize that the insurance cover of shipowners is of concern to governments.

Outside the International Maritime Organization, a number of intergovernmental organizations have discussed liability relevant to maritime transport. Most of these concern environmental damages, and some of them explicitly requires compulsory insurance.

Some organizations, like the North Sea Conference and OECD, have limited themselves to point out that insurance could have some importance. The European Commission for Europe has developed a liability convention for inland transport, even on waterways, which includes provisions of compulsory insurance. Liability regimes that include insurance requirements are also being developed in connection with the Antarctic treaty system and the Basel convention on the transboundary movement of waste. Also in the context of the London Dumping Convention, there are projects that could result in liability regimes which could include compulsory insurance, and which could affect marine transport. Within the European Community (EC), however, a white paper<sup>4</sup> has recently been issued, which concludes, “the EC regime should not impose an obligation to have financial security” (*italics omitted*).

The increasing interest in compulsory insurance coincides with a new regulatory approach in the international unification of liability law. While the conventions in the first half of the century really only aimed at unification, public interests have become more and more dominant. Interests of third parties, the environment and governments themselves have become the focus of the international lawmakers. In particular this is so in the International Maritime Organization. The Comité Maritime International has ceased to play its previously so important role there. In this way, compulsory insurance is a reflection of government involvement and government interests.

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<sup>3</sup> IMO Assembly Resolution A.898(21)

<sup>4</sup> COM(2000) 66,

## 2 WHY COMPULSORY INSURANCE?

Given the fact that compulsory insurance has become an issue that is not easily ignored in connection with international maritime liability regimes, it is pertinent to ask why this is so. Certainly, it is not the result of clever lobbying of the insurance industry to enlarge its scope of business. On the contrary, this industry has generally been opposed to such schemes, referring to the limited “insurance capacity” available (see below) and to the fact that most vessels already are covered by liability insurance. The enthusiasts have been found mostly on the government side.

The rationale for compulsory insurance that has most often been expressed, is the concern that claimants will not obtain the compensation due to them after maritime incidents because of insolvency of the liable party. It does not help much to protect a third party or the weaker of the parties to a contract if they cannot recover.

Closely associated with this rationale is the concern for accessibility: The claimant must be helped to overcome the problems of pursuing a claim against a paper company in a remote jurisdiction, in particular if a judgement obtained there is not enforceable where the shipowner’s funds are located. In particular, this is important for small claimants and perhaps also government claimants, that are not very used to the smartness of international shipping. By adding a right of direct action against the insurer to a compulsory insurance regime, these problems can be overcome. The shipowner may still be unavailable, but that does not matter as long as the insurer is available, and must be available in order to stay in business. This has proved to be an efficient way to solve the accessibility problem, and much easier than trying to define and pursue the beneficial owners of a vessel that has caused damage.

The third rationale for compulsory insurance is that it is believed that third party providers of financial security generally will contribute to higher standards on board (in order to keep their own costs down), and that compulsory insurance, etc., will make those mechanisms apply to all vessels.<sup>5</sup> If a ship is not seaworthy, it would not get insurance, and a compulsory insurance requirement will prevent it from sailing. Indeed, even today the vessels in the poorest condition tend to be the ones without insurance with the major insurers.<sup>6</sup>

For the shipping industry, it is also important that without an international compulsory insurance regime, national legislation may create a number of different schemes for evidence of financial responsibility. The relatively high degree of uniformity of maritime law would thus be at risk. If documentation of

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<sup>5</sup> Steven Shavell: On the Social Function and The Regulation of Liability Insurance (Harvard Law School Discussion Paper No. 278, Cambridge, MA 2000) <[http://www.law.harvard.edu/programs/olin\\_center/](http://www.law.harvard.edu/programs/olin_center/)>

<sup>6</sup> Working Paper submitted at the 76th session of the International Maritime Organization Legal Committee by Norway.

insurance first should be required, it is more convenient that the same documentation is recognized everywhere.

Finally, one has observed that competition may be somewhat distorted if irresponsible shipowners can avoid the costs associated with providing insurance; costs that responsible shipowners feel they can not avoid. In particular, such arguments must have some weight within the European Community and the European Economic Area, where the importance of a level playing field is generally emphasized.

Although it is not difficult to see a good rationale for compulsory insurance, there is also a downside. There are costs involved in establishing and enforcing the system. In particular this is so if the system shall ensure that all participating insurers really have the necessary financial strength.

### **3 THE LEGISLATIVE CHOICES**

Given that compulsory is desirable, there may be problems facing the national or international legislators that make it difficult to legislate for compulsory insurance. There are also some hard choices to be made. In the following, the main issues facing the legislators will be discussed.

#### **3.1. Insurance capacity**

##### **3.1.1. The problem**

Whichever good reasons there are for compulsory insurance, it will not be of much help if the necessary insurance is not available in the market. Indeed, the reason why the CRTD convention mentioned above has not entered into force due to lack of ratifications, is said to be that insurance is not available. The same has been the fate of the Council of Europe Convention on Civil Liability for Damage Resulting from Activities Dangerous to the Environment, 1993 (which does not apply to carriage of goods).

The marine liability market is dominated by the protection and indemnity (P&I) clubs, and in particular the clubs that participate in the pooling arrangements of the International Group of P&I Clubs.<sup>7</sup> The clubs are mutual insurers, where the premium to some extent varies with the claims made. In addition, there are a few fixed premium facilities, operating as ordinary insurance companies.

The fixed premium facilities rarely offer insurance amounts of more than USD 500 millions per ship, which may be inadequate in this context. For a 3000 passenger ship, that would leave USD 166,666 per passenger. However, the pooling agreement of the International Group provides insurance cover up to

<sup>7</sup> The pooling agreement of the International Group has largely been accepted by the European competition authorities, see Commission Decision of 12 April 1999 (OJ L 125/12).

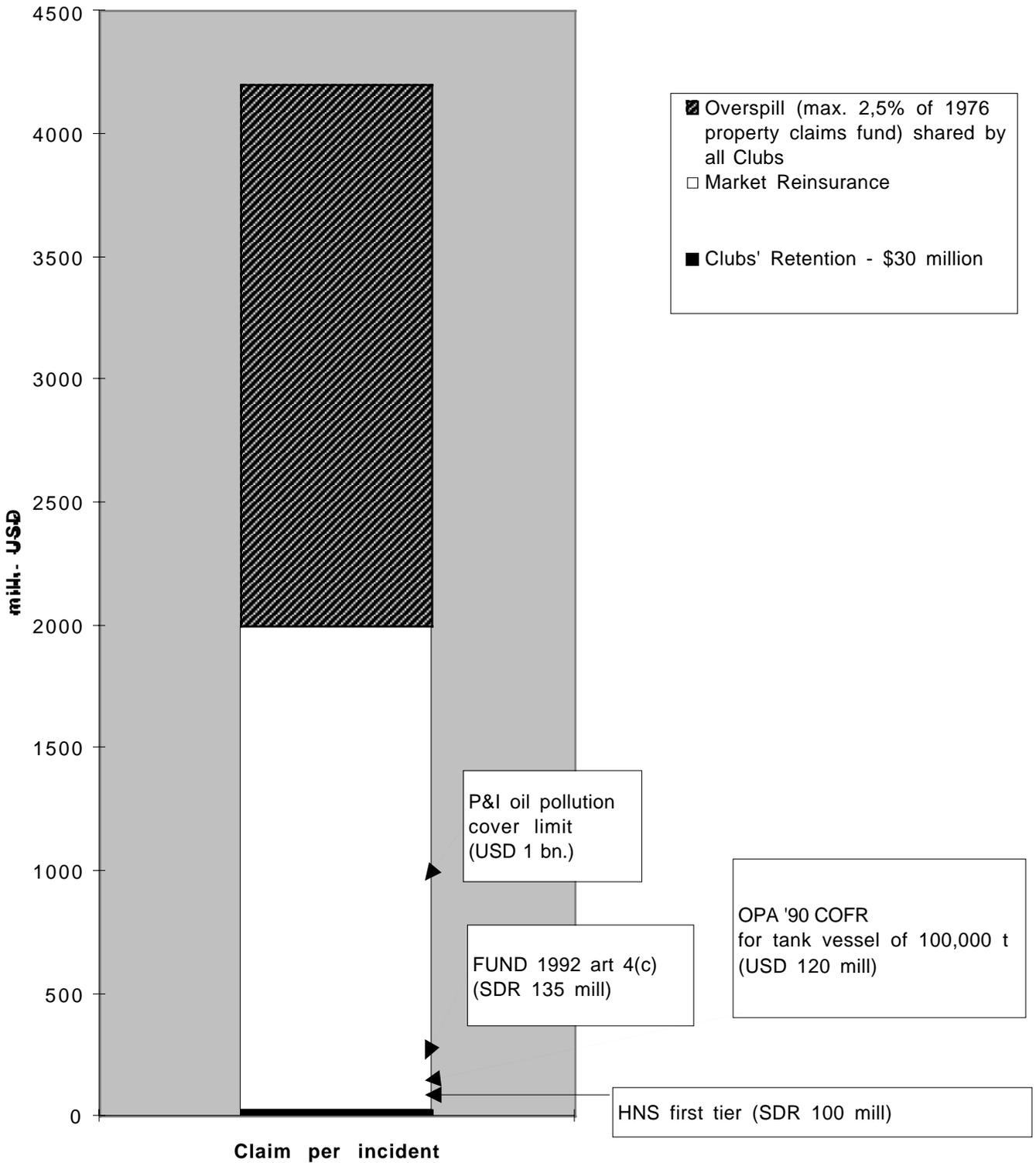
approximately USD 4,25 billions. This certainly appears to reflect adequate insurance capacity for most purposes, and should therefore be examined further.

The figure USD 4,25 billions is somewhat arbitrary. Indeed, if all shipowners could expect a greater exposure than this, the international Group would certainly have to amend its rules to allow for a higher amount. After all, the club is in this respect no more than the collective interests of shipowners. Thus this limit is not really an obstacle to compulsory insurance at even a higher level.

In connection with the competition case referred to in the previous footnote, it was argued that too high a limit would force shipowners to take out higher insurance than they felt was necessary, and thus be an abuse of a dominant market position. The limit of cover was in this respect an important point. However, if compulsory insurance at a higher level first is established, it can hardly be maintained that an adjustment of the pooling agreement accordingly would imply abuse of market power.

Strangely enough, the insured amount of USD 4,25 billions is however not available for compulsory insurance purposes. This becomes apparent when one understands how the pooling agreement works.

The pooling agreement is put together of layers (tranches). For simplicity, one can say that there are three main layers, as shown in figure. These layers are the retention layer, the reinsured layer and the overspill layer.



### 3.1.2. The retention layer

The first layer, consisting of the smaller claims up to USD 30 millions, is called the retention layer. The losses are pooled within or among the clubs according to certain rules. At his level, compulsory insurance is hardly a problem.

### 3.1.3. The reinsured layer

The second layer covers the range of claims from USD 30 millions to USD 2 billions, except for oil pollution cover, where the limit is USD 1 billion. The liabilities at this level are reinsured in the market, *e.g.*, at Lloyds of London. That means that shipowners do not share this risk, except that they share the insurance premium for it. The point of the pooling agreement at this level of claims is to improve the negotiating position when buying market insurance.

As the examples in the figure shows, many compulsory insurance schemes limit liability to an amount in the lower part of this level, around USD 100 millions. Compulsory insurance at those levels does not represent a capacity problem.

In most cases, compulsory insurance at the 100 millions level would do the job. Even the 1992 FUND convention - which governs the liability of an international fund on top of compulsory insurance, is limited to SDR 135 millions. However, as the recent Erica disaster off France indicates, this level may be inadequate. The same is probably true for passenger claims, where an amount of SDR 100 millions only would yield SDR 33,333 per passenger on a 3000 passenger ship. Would it then be possible to maintain compulsory insurance at higher levels, within the reinsured layer?

Certainly, this would be a matter of price. At the request of the Norwegian delegation to the International Maritime Organization in March 2000, a London broker made an estimate of the added reinsurance cost of insurance of passenger claims, which would reach USD 2 billions for the largest ships. He indicated that the increase would be in the magnitude of USD 0.20 per passenger per day if only passenger carriers were to carry the added cost. (This corresponds to a premium increase of the reinsurance layer exceeding USD 500 millions from 2% to 5% "on line," that is, on the insured amount.) Perhaps one could even get it cheaper if the insurer had the right to get the amounts they have paid out repaid by subsequent premium increases ("finite risk insurance"). Capacity in this respect is certainly not a problem when considering making insurance compulsory.

However, even if reinsurance could be taken care of at this level, there is an important internal problem in the P&I clubs. Some shipowners not subject to compulsory insurance may feel that they are unlikely to incur liability at this level, for example due to various limitation of liability regimes in national or international law. These shipowners may find it undesirable to stay in the same P&I club, or even the same pooling agreement, as those who are more exposed. If, *e.g.*, the small minority of shipowners that carry passengers (about 4 %) would be much more exposed than others because of compulsory insurance, then they may simply be excluded from the clubs. Indeed, at least one of the clubs now avoids passenger carriers for that reason. This could be so, regardless of whether or not the added reinsurance premium is allocated only to those shipowners that are exposed at a relatively high level. After all, as long as the claims stay within the P&I system, there is at least a theoretical exposure to all participants in the system.

For governments, this cannot easily be ignored as politically biased position of the shipowners that feel less exposed, because one can hardly force shipowners to stay in the clubs and to include all others in them. And if the present P&I club and pooling structures do not survive, the insurance cover may be a lot more expensive. One would lose the benefit of good bargaining power in the reinsured layer and inexpensive insurance by pooling in the retention layer. Should this happen, and the insurance costs become prohibitive because of that, then perhaps it would not be considered viable to make insurance compulsory.

This calls for some caution when establishing new compulsory insurance schemes, so that it does not create too much of a difference between shipowners subject to compulsory insurance and those not. Arguably, this is not a real capacity problem, as the problem arises whether or not reinsurance capacity is available. It is more an organizational problem of the P&I system. Still it must be taken seriously if it is considered desirable to preserve the advantages of the P&I system.

Even this problem does not, however, in practice limit the possibilities of governments to create new compulsory insurance schemes very much. First of all, if, *e.g.*, passengers carriers pay for their own reinsurance (the 20 cents referred to above), the exposure to other shipowners would not be greater than that the P&I system could survive. And if the differences in exposure become too great, governments of course have the possibility to eliminate the differences by increasing the liability of other shipowners to regain the balance.

In conclusion, capacity is not a problem in the reinsured layer when considering compulsory insurance schemes. A problem may, however, exist if the scheme creates too great differences between the exposure of various groups of shipowners within the P&I system.

#### **3.1.4. The overspill layer**

The overspill layer relates to claims in excess of USD 1 billion for oil pollution claims and USD 2 billions for other claims. Oil pollution claims are not covered by P&I insurance at his level, while other claims are covered, but without any market reinsurance. Covered claims are pooled between shipowners. If a claim reaches the overspill layer, then an additional premium is likely to be charged to most shipowners in the world. Such extra premiums may be significant.

On the face, this seems like plenty of insurance capacity. However, the system has not yet been tested in practice, because no claim has yet reached this level. And there are concerns that if additional calls were made, shipowners would resist them. Of course, one could attempt to legally enforce the claims. But if the enforcement would have to involve the forced sale of the majority of vessels in the world about at the same time, this would not work. Therefore, it would not be advisable to governments to rely on the overspill mechanism when considering whether there is sufficient insurance capacity to create a particular compulsory insurance scheme.

If insurance capacity beyond what is now the reinsured layer is desired, some additional reinsurance capacity is available. Three of the clubs have actually taken out market reinsurance against overspill claims. If desirable, therefore, governments could at least to some extent rely on that insurance capacity would be available simply by way of enhancing the limits of the reinsured layer. In this case one should, however, consider the problem of unbalanced exposure to different groups of shipowners that has been addressed above.

Even if reinsurance capacity is available today, there is, of course, no guarantee that it would be available tomorrow. Investors may find businesses other than underwriting more attractive. However, if premiums are sufficiently high, investors will always find it attractive to underwrite. Reinsurance capacity is therefore a question of whether insurance can be obtained at acceptable premiums. Seen in this way, insurance capacity is not likely to simply disappear.

This view on capacity is strengthened to the extent insurance is made compulsory. When insurance is compulsory for the insured, the underwriter is in a better bargaining position than if the insurance was not compulsory, because the underwriter then knows that the customer must have the product. Therefore, premiums are likely to be kept at a sufficiently high level to maintain insurance capacity when insurance is compulsory.

Altogether, insurance capacity is not likely to create an obstacle to compulsory insurance, even in the lower levels of the overspill layer.

### **3.2. Direct action**

A pivotal point of compulsory insurance is to secure that funds actually are available to compensate victims. This is generally achieved by a right of direct action: The victim can bring action against the insurer. This would generally be much more convenient than pursuing the shipowner. Although liability insurers generally tend to participate in the settlement of claims even in cases in which a direct action cannot be brought, an express clause of direct action would give the claimant a much better negotiation position. He or she cannot be given the ultimatum either to accept the offer of the insurer, or to take the challenge of pursuing the shipowner.

Much opposition to compulsory insurance schemes seems to stem from an opposition to direct action. Some of it is related to the fact that direct action does not fit well with the articles of association of P&I clubs, because they clearly are indemnity insurers. However, from a government point of view it is hardly a major concern to avoid amendments to these articles. More important, then, is the fear that direct action somehow would open a floodgate. Also this argument lacks merit. Either it is so that insurers pay out less to victims today than they should, because there is generally no direct action. In that case there would certainly be a need for such provisions. Or it is so that direct action would not increase payments by the insurers. In that case, there would be no reason not to make funds more accessible to claimants by means of direct action.

### 3.3. Policy defenses

Direct action is the mirror image of the invalidity of the “pay to be paid” clause in the various P&I club rules. This is the rule that the club shall not be liable unless the insured shipowner actually has satisfied a liability. To the extent there is direct action, this clause is invalid.

As far as other defenses arising in the relationship between the insurer and the insured are concerned, these must be addressed in connection with direct action. Such defenses include willful misconduct of the insured, non-payment of premium, unseaworthiness of the vessel and agreed deductibles.

Making insurance compulsory would be of no use if the insurer could avoid liability by all kinds of policy defenses. Therefore, limiting the policy defenses is closely linked to the concept of compulsory insurance. In the Civil Liability Convention article 7, only the policy defense of willful misconduct is expressly allowed (besides the defenses of the insured). Indirectly, also the policy defense of non-payment of premium is allowed, because the insurance may expire after a certain period of time, which may be the time for which premium is paid in advance. It is, however, conceivable that compulsory insurance schemes could allow either no policy defenses or a wide range of defenses. The element of compulsion only implies that the allowed policy defenses must be exhaustively defined.

In my view, it is difficult to find a policy defense that is so important that it should be allowed when there are reasons in the first place to protect the claimant by compulsory insurance. Even the willful misconduct defense, which traditionally has been allowed, seems harsh against a victim that may have suffered loss because of the very same misconduct (*e.g.*, negligence in keeping the vessel seaworthy). On the other hand, it is perhaps unfair to prudent shipowners that they shall have to participate in a mutual system together with substandard owners (which are the ones most likely to be guilty of willful misconduct). However, they can avoid that risk by maintaining a minimum of discipline within their own ranks, and not allow substandard shipowners to remain members of the P&I clubs. Ideally, therefore, not even the willful misconduct policy defense should be allowed when insurance is compulsory.

### 3.4. Accident insurance

If P&I clubs cannot offer insurance on the conditions governments require, one must certainly look to other sources. Personal accident insurance then seems to be a good alternative to liability insurance as far as death and personal injuries are concerned. Most passengers on board a ship has got travel insurance, which is an insurance of this kind. Insurers seem to be able to offer this without any concern about insurance capacity and, of course, without any defense relating to the misconduct of the shipowner. (This clearly illustrates the points made above that the problems of maintaining insurance is not a capacity problem, but problems relating to the working of the P&I system.)

If accident insurance policies should be issued for each individual passenger in a compulsory system, that would generate a lot of unnecessary paper work. It would then be better to require each vessel to take out an open policy, stating that all passengers on the vessel are covered. Personal accident insurance could in that way be as convenient as P&I insurance.

In the Legal Committee of the International Maritime Organization, shipowners have argued that accident insurance should not be considered due fulfillment of any insurance obligations. The concern was expressed to be that accident insurance would set the standard too high, and eventually force all shipowners to arrange for insurance without a willful misconduct defense.<sup>8</sup> Luckily, it is now settled that shipowners (carriers) will be free to use this kind of insurance to fulfill the prospective insurance requirement in respect of passenger claims.<sup>9</sup> Accident insurance must, however, comply with the same requirements as liability insurance. Thus, the traditional tables of invalidity used to calculate loss in accident insurance would have to be replaced by a calculation based on the facts of each case.

If accident insurance had been excluded in the passenger regime, serious problems would have arisen in respect of the European Community legislation and the corresponding provisions within the European Economic Area. Even in compulsory insurance, it is not for the individual member states to exclude one type of insurers for the benefit of another.<sup>10</sup> This has nothing to do with competition and abuse of dominant marked positions, but is a part of the implementation of the four basic freedoms of the community. Insurance services should be exchanged without restrictions, just as other services.

In my view, the debate on accident insurance in the International Maritime Organization was not very helpful. Also the other compulsory insurance regimes would allow other kinds of insurance to substitute liability insurance; indeed all kinds of financial security might be utilized. However, during the debate, other insurers than the P&I clubs became interested and involved. This may open the way for some competition between insurers, and may make it possible for governments to rely on other insurers than the P&I clubs if necessary to implement compulsory insurance. It is true that no insurer outside the clubs can offer a USD 4,25 billions limit for the insurance cover. But, as has been explained above, not even the clubs maintain that this capacity is available for compulsory insurance purposes. Therefore, the debate on accident insurance may have opened the way for other insurers as reliable alternatives to P&I insurers in respect of compulsory insurance.

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<sup>8</sup> IMO document LEG 79/4/7, page 1.

<sup>9</sup> IMO document LEG 81/5/1, paragraph 5.

<sup>10</sup> See further Commission Interpretative Communication - Freedom to provide services and the general good in the insurance sector (2000/C 43/03).

### 3.5. Channeling

A concept that has been associated with compulsory insurance for a long time is channeling. In its simpler form as in the 1969 Civil Liability Convention article 3, the legislators chose one person (*e.g.*, the registered shipowner) to be liable and to take out insurance for his own liability. The stronger form is found in the 1984 Civil Liability Convention article 3, paragraph 4, and corresponding provisions in later conventions: Not only is one person made responsible, but in addition a number of other persons is excluded from liability.<sup>11</sup>

The idea of simple channeling would be that it suffices to make one person liable when his liability is backed by compulsory insurance. The point of the stronger form of channeling would be to avoid that more than one person would have to take out insurance, at least not with full cover. The idea is not to avoid recourse actions, as this is to a large extent permitted and expected.

During the last sessions of the International Maritime Organization Legal Committee, there has been a significant shift away from the idea of channeling. Thus in the draft bunkers convention, a group of persons has been made liable. However, only one of them has to take out insurance, and then only for his or her own liability. Similar moves have been seen in connection with the discussions on a new passenger regime.<sup>12</sup>

The rationale for the new approach to channeling is that only one liable party would not always do. In particular this is so when the vessel is so small that there is no insurance requirement, or one of the persons involved has caused the damage in a way that makes it desirable that just he can be targeted. The reason why still only one person has to maintain insurance, is simply that nothing is added if the same liability is insured several times. Also, the clubs signaled that they felt it difficult to extend the insurance cover of their members to cover the liability of non-members, even if that liability would be identical to that of their members.

In my view, channeling is after this no longer an indispensable part of compulsory insurance schemes.

### 3.6. Certificate bureaucracy

Apart from capacity concerns, it has sometimes been argued that compulsory insurance involves quite a lot of bureaucracy.

This is obviously true as far as the procedure used in the Civil Liability Convention is concerned. In that system, each vessel needs a paper certificate on board, which must be renewed regularly. Each renewal involves the P&I club, that issue a so-called blue card, the governments, that issue or authorize the

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<sup>11</sup> Even in the 1969 CLC, servants and agents of the owner were exempted from liability.

<sup>12</sup> See LEG 81/WP.2, paragraphs 24 *et seq.* and 127.

certificate and scrutinizes the insurer, and finally a logistics problem in getting the certificate on board the vessel in time.

This seems very cumbersome. I have been told that the major P&I clubs employ one person each only to deal with these procedures. Still, it is said, most vessels that are detained for lack of Civil Liability Convention certificates really have got insurance cover, but have problems with the documentation. It does not seem unlikely that this is true, and if so, compulsory insurance may represent a bureaucracy problem.

There are, however, solutions also to this problem. Thus, in the draft convention on pollution from bunker fuel oil, provisions for the issue of electronic insurance certificates have been included. Furthermore, there are provisions that would allow delegation of the issue of certificates to recognized P&I clubs, dispensing for government involvement in the issue of each certificate.<sup>13</sup>

In the future, therefore, the necessary information on whether a compulsory insurance requirement has been fulfilled could be found on databases containing other information about the vessel, such as SIRENAC or EQUASIS. These are databases used by maritime safety authorities when determining whether or not to inspect a foreign vessel calling at their ports. If desirable, the databases could be updated directly from the insurers.

The use of such database does not imply that safety inspectors also must check insurance certificates. Indeed, insurance certificates in the form of a computer record could be checked from any government office.

When such procedures are implemented, the generation of bureaucracy can hardly be an obstacle to compulsory insurance.

## **4 THE ADMINISTRATION OF THE RULES**

When compulsory insurance has been implemented in national legislation, several questions arise for the executive branch. Could an application for an insurance certificate be refused on the basis that there is a foreign insurer? And must certificates from other states be recognized, even if the insurer is not trustworthy? In the following, this will be discussed on the basis of the certificate clauses of the HNS convention, which is the most recent of the International Maritime Organization compulsory insurance conventions. It is notable that even if these clauses seem somewhat inadequate and ambiguous, the Legal Committee insists on modeling new conventions closely on these clauses.

HNS convention article 12, paragraphs 1 and 10, require that certain ships registered in a State Party shall “maintain insurance or other financial security, such as the guarantee of a bank or similar financial institution” of a specified amount of money. Paragraph 11 of the same article extends the requirement to ships entering or leaving a port or other specified areas of a State Party. All these

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<sup>13</sup> See LEG 81/WP.2, paragraphs 33 *et seq.*

paragraphs must be read in conjunction to establish the main rule, that all ships in a State Party need an insurance certificate. The drafting could be improved.

The dominant form of security under the Civil Liability Convention is a so-called blue card issued by a P&I Club, but other kinds of insurance or security may also be utilized. It is often said that such other kinds of insurance will be more common under HNS convention than under Civil Liability Convention. The security will in the following for simplicity in any event be referred to as the blue card.

#### **4.1. Recognition of insurance certificates**

When a foreign vessel presents an insurance certificate, the question arises whether the port state can refuse to recognize the certificate, *e.g.*, on the basis that the insurer is financially unsound.

The point of departure in article 12 of the HNS convention is that it is for any of the States Parties to determine whether the blue card represents the necessary level of security, and in case issue a certificate to that effect (paragraph 2).<sup>14</sup> Such decisions shall be considered final by the other States Parties (paragraph 7). However, the wording of paragraph 7<sup>15</sup> indicates that a State Party is not obliged to accept certificates issued by other States Parties to a greater extent than it would accept its own certificates. A state that may revoke its own certificates before expiry, *e.g.*, if the issues of the blue card runs into financial difficulties, may therefore also refuse to accept certificates issued by other States Parties under the same circumstances. The rationale is obviously that a State Party shall not be forced to put those ships to which it itself has issued certificates at a disadvantage.

The last sentence of paragraph 7 gives a State Party a right of consultation with another State Party that has issued a certificate if it believes that the insurer or guarantor is financially unsound.<sup>16</sup> As I read it (see the previous paragraph), this remedy is not necessarily the only remedy in such situations.

It may be that paragraph 6 of article 12 extends the duty of States Parties to accept certificates if issued in respect of ships registered in the State Party that issued the certificate. When it, pursuant to this paragraph, is for the state of registry to determine the conditions of issue of certificates, it arguably follows that it also is for that state to determine whether or not those conditions are fulfilled at any given time. Therefore, a State Party arguably must accept these certificates even to a greater extent than certificates issued by itself, contrary to the main rule of paragraph 7. However, it seems difficult to establish a convincing rationale for such a rule. For my part, I believe that the intention of paragraph 6 only is to

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<sup>14</sup> A State Party shall however not issue a certificate in respect of ships registered in another State Party without the consent of that State Party (paragraph 6).

<sup>15</sup> HNSC article 12(7): "... and shall be regarded ... as having the same force as ... certificates issued ... by them."

<sup>16</sup> See also the similar rule in the EC/EEA law; Council Directive 92/49/EEC article 40.

prevent that States Parties issue certificates in respect of a ship registered in another State Party.

In conclusion, it seems like states often can object to foreign insurance certificates. However, this is hardly seen in practice.

## **4.2. The acceptance or non-acceptance of insurers**

When a blue card is presented with a request to a State Party to issue an insurance certificate, could it refuse to issue a certificate for whatever reasons? Particular problems arise if an insurer or other financial institution in a foreign country has issued the blue card. Then, there may be a problem not only to ascertain the level of security to require, but also to actually ascertain the financial standing of the issuer of the blue card. Below, some points of view that may be helpful in the shaping of national law in this respect shall be offered.

### **4.2.1. The rules of the convention**

The HNS convention provides little guidance as to the criteria for recognition or non-recognition of insurers.<sup>17</sup> There are, however, some clues in article 12:

- It follows from paragraph 1 that “other financial security” must be as good as a bank guarantee, and this arguably also applies to insurance.
- Paragraph 7 gives a right of consultation if a State Party believes that a “insurer or guarantor named in the compulsory insurance certificate is not financially capable of meeting the obligations imposed by this Convention.” Implicitly, therefore, the issuer of a certificate should ascertain that the issuer of the blue card is financially capable of meeting the obligations of the convention at the time of issue of the certificate, and, arguably, during the certificate period. Thus a blue card from an insurer with unknown financial standing should not form basis for issue of an HNS certificate.

This indicates that there is a duty to evaluate the soundness of the financial security, but it is not clear which criteria should be used.

Again, paragraph 6 may be read as a special rule in respect of vessels registered in a State Party. In these cases, it is for the state of registry to “determine the conditions of issue ... of the ... certificate.” Seemingly, therefore, a State Party may, in respect of its vessels registered in that state, accept blue cards issued by insurers of questionable financial standing. That was hardly the intention of the draftsmen. Thus also in these cases, the blue card must be scrutinized.

Even when the financial soundness of an insurer is clear, it can hardly be maintained that States Parties has a duty to issue a certificate. It follows from

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<sup>17</sup> Article 12; paragraph 5 gives some rules relating to the time period of the blue card and the certificates.

article 12(6) that there is no such obligation in respect of vessels registered in the state that is about to issue the certificate. Furthermore, a vessel registered in a non-contracting state could hardly invoke any such obligation under the convention, simply because it is only for States Parties to enforce the convention.<sup>18</sup> In the remainder of the cases, the certificate will be issued by the State Party where the vessel is registered, and article 12(6) applies. Thus, the HNS convention does not hinder additional national requirements for issuing certificates.<sup>19</sup>

When the convention is silent, national law must determine the criteria for evaluation of blue cards. No clear state practice has formed under the Civil Liability Convention, because, as already mentioned, almost only P&I Clubs are providers of financial security under this convention.

#### **4.2.2. Jurisdiction**

A possible area for national law is provisions on jurisdiction

When a direct action is brought against a provider of financial security under HNS convention article 12, paragraph 8, it must usually be brought in the court of a specified State Party (HNS convention article 38). A problem may then arise if the provider of financial security has no assets in that state or in a state that will enforce the judgement pursuant to HNS convention article 40 or other national or international rules. It is therefore submitted that the location of the assets of the provider of financial security must be taken into consideration when the blue card is evaluated, and that the blue card may be turned down if the insurance funds may prove to be inaccessible.

#### **4.2.3. Burden of proof**

Nothing in the convention prevents that national law puts on the ship (the applicant) the burden of proving that the issuer of the blue card is financially sound and will remain financially sound. Therefore, blue cards issued by unknown or foreign financial institutions should not form a problem for the issuers of the certificates. State Parties may provide in their national law that certificates shall not be issued until the financial well being of the provider of financial security has been established by the applicant.<sup>20</sup>

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<sup>18</sup> If the owners of the vessel are citizens of a State Party, but have registered their vessel in a non-contracting state, the State Party where the owner has his or her citizenship hardly can demand that another State Party shall issue an HNS Certificate rather than itself.

<sup>19</sup> Such additional requirements may however be prohibited by other rules, *e.g.*, in the EC/EEA law (see below in 4.2.5.3).

<sup>20</sup> See however below in 4.2.5.3 on the EC/EEA system.

#### 4.2.4. Reliance on the supervision of other states

It is likely that a State Party that shall evaluate a blue card from a foreign provider of financial security often relies on that the provider is properly monitored in its principal place of business. There is much wisdom in this, as the best place to monitor a financial institution is at its principal place of business.<sup>21</sup> However, it is hardly in conformity with the convention if a State Party replaces its own views of what is the required financial standing of the provider of financial security for those of another state, in particular if that other state is not a party to the convention. Arguably, therefore, a State Party has a duty to ascertain the quality of the local supervision system it would like to rely on.<sup>22</sup> National law should implement corresponding rules of caution.

In the draft bunker convention, there is a special clause that allows reliance on external sources when evaluating the blue cards.<sup>23</sup>

#### 4.2.5. Duties under international law

While the HNS convention leaves some discretionary power to the States Parties in respect of accepting a blue card for the purpose of HNS certificates, other commitments of the States Parties may limit this discretionary power. These rules may restrict the freedom of national law to provide for recognition or non-recognition of blue cards. Here three sets of rules relevant to many European states shall be discussed.

##### 4.2.5.1. WTO rules on free trade

There has been some concern that the rules of the World Trade Organization require that any foreign provider of financial security shall be accepted on an equal footing as national providers, so that some blue card must be accepted that would otherwise not be accepted. However, the main rule on “domestic regulation” in GATS article VI reads (all italics in the following are added by me):

“1. In sectors where specific commitments are undertaken, each Member shall ensure that all measures of general application affecting trade in services are *administered in a reasonable, objective and impartial manner* ...”

Paragraphs 4 and 5 of article VI clarify this in some respects. In these provisions, it is pointed out that requirements shall

- be “based on *objective and transparent criteria*, such as competence and the ability to supply the service”
- *not be “more burdensome than necessary to ensure the quality of the service”*

<sup>21</sup> This is also the choice in the EC/EEA law; see below in 4.2.5.3.

<sup>22</sup> The EC/EEA law gives such an assurance, see below in 4.2.5.3.

<sup>23</sup> See LEG 81/WP.2, paragraphs 33 *et seq.*

- “in the case of licensing procedures, *not in themselves [be] a restriction on the supply of the service*”

It seems, therefore, that GATS does not prevent that each provider of blue cards, foreign or not, is evaluated individually. Paragraph 5(b) even states that “account shall be taken of international standards of relevant international organizations applied by that Member” (footnote omitted), which I believe could include International Maritime Organization and such international funds as the International Oil Pollution Fund.

The GATS annex on financial services does not change this, but expressly states (in article 2(a)) that:

“Notwithstanding any other provisions of the Agreement, a Member shall not be prevented from *taking measures for prudential reasons*, including for the protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed by a financial service supplier, or to ensure the integrity and stability of the financial system. Where such measures do not conform with the provisions of the Agreement, they shall not be used as a means of avoiding the Member’s commitments or obligations under the agreement.”

The “*measures for prudential reasons*,” referred to in this paragraph are exactly what is desirable and required under the HNS convention. One may, therefore, safely conclude that the GATS does not represent a problem in connection with issuance of HNS certificates of insurance. However, protectionism is prohibited.

#### 4.2.5.2. OECD rules on liberalization

Also the OECD “Code of Liberalisation of Current Invisible Operations”<sup>24</sup> may influence the operation of the HNS convention by giving priority to the principle of liberalization to the extent that blue cards must be accepted that would otherwise not be accepted.

The code includes insurance services among the current invisible operations (Annex A(D)). The main rules of the code are that “members shall grant any authorization required for a current invisible operation” (article 2) and deal with applications for authorization in an “as liberal manner as possible” (article 1(b)) and on a non-discriminatory basis (article 9). However, the member states are permitted to “take any measures required to prevent evasion of their laws and regulations” (article 5(1)). In my view, this last clause provides the necessary basis to ensure that the blue cards represent real and valuable financial security. If the blue card had to be accepted even if it did not represent such real and

<sup>24</sup> Published by OECD (Paris 1997). The Code was adopted by the OECD Council 12 December 1961 (OECD/C(61)95), and has been amended several times. Its legal basis is article 5(a) of the Convention in the Organization for Economic Co-operation and Development 14 December 1960, which empowers the organization to “take decisions, which, except as otherwise provided, shall be binding on all the Members”.

valuable security, the compulsory insurance requirement of HNS convention would be evaded.

The OECD code thus does not represent a problem in relation to the HNS convention. However, the code prohibits protectionism.

### 4.2.5.3. EC/EEA rules

#### 4.2.5.3.1. *The freedom to provide insurance services*

In the European Community (EC), the Treaty establishing the European Community articles 49 *et seq.* (ex articles 59 *et seq.*) provide freedom to render insurance services, which is also extended to the European Economic Area (EEA) by the EEA Agreement articles 36 *et seq.* Thus an insurer licensed<sup>25</sup> by an EC or EEA State may, by virtue of this single license, offer insurance services within the EC/EEA:

“Authorization [of providers of insurance] shall be valid for the entire Community. It shall permit an undertaking to carry on business there, under either the right of establishment or the freedom to provide services.”<sup>26</sup>

This also applies to compulsory insurance.<sup>27</sup> Because of this, a state within the EC or the EEA must accept a provider of blue cards licensed by another EC or EEA State. Blue cards issued by insurers not licensed in EC/EEA can however be evaluated on an individual basis.<sup>28</sup>

Within the EC/EEA, governments must, because of this, rely on the supervision system of other EC/EEA states where insurers are licensed.<sup>29</sup> This should create

<sup>25</sup> Each state must have a licensing system; Council Directive 73/239/EEC article 6, as amended by Council Directive 92/49/EEC article 4.

<sup>26</sup> Council Directive 73/239/EEC article 7(1), as amended by Council Directive 92/49/EEC article 5. See also Council Directive 73/240/EEC abolishing restrictions on freedom of establishment in the business of direct insurance other than life insurance and Commission Interpretative Communication - Freedom to provide services and the general good in the insurance sector (2000/C 43/03).

<sup>27</sup> Council Directive 88/357/EEC article 8(1).

<sup>28</sup> Such insurers may however benefit from other rules, such as the OECD and WTO rules discussed above. The licensing requirement for non-EC/EEA insurers of Council Directive 73/239/EEC article 23 does not imply that a non-licensed insurer cannot provide financial security.

<sup>29</sup> Supervision should be the “sole responsibility of the home Member State;” Council Directive 73/239/EEC article 13 (as amended by Council Directive 92/49/EEC article 9). The home Member State is in most cases where the head office is located. Member states shall require that the head offices of insurance undertakings be situated in the same Member State as their registered offices.

no problem in connection with the HNS convention, as each state must ensure that insurers they have licensed comply with certain standards.<sup>30</sup>

#### **4.2.5.3.2. Rules on prior approval of policy conditions**

In order that the principle of free movement of services shall work, the states cannot require prior approval of policy conditions:

“Member States shall not, however, adopt provisions requiring the prior approval or systematic notification of general and special policy conditions, scales of premiums and forms and other printed documents which an undertaking intends to use in its dealings with policyholders.”<sup>31</sup>

However, national law may require prior notification of the insurance terms in case of compulsory insurance:

“Notwithstanding any provision to the contrary, a Member State which makes insurance compulsory may require that the general and special conditions of the compulsory insurance be communicated to its competent authority before being circulated.”<sup>32</sup>

The EC/EEA law thus allows that national law might require prior notification of insurance policy forms intended to serve as a basis for issue of blue cards. To my knowledge, there has been no question of utilizing this freedom, *e.g.*, in the context of Civil Liability Convention.

#### **4.2.5.3.3. Rules limiting the discretion on respect of blue cards**

Under the system of the HNS convention, the main checkpoint for whether or not the blue card complies with the requirements of the convention is the issue of the certificate under HNS convention article 12. But also at this stage, there seems to be little leeway for the national authorities, because the conditions for acceptance or non-acceptance shall be generally stated and published in a specific manner:

“(a) Each Member State shall communicate to the Commission the risks against which insurance is compulsory under its legislation, stating:

– the specific legal provisions relating to that insurance,

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<sup>30</sup> See; *inter alia*, Council Directive 88/357/EEC article 16 (as amended by Council Directive 92/49/EEC article 35), Council Directive 92/49/EEC articles 21 *et seq.* and Council Directive 91/674/EEC.

<sup>31</sup> From Council Directive 73/239/EEC article 8(3), as amended by Council Directive 92/49/EEC article 6. See also Council Directive 92/49/EEC articles 29 and 39.

<sup>32</sup> Council Directive 92/49/EEC article 30(2). At one stage, national requirements could even be extended to rules of *approval* if these requirements predated Council Directive 88/357/EEC, see its article 8(4)(b). This provision has however now been deleted by Council Directive 92/49/EEC article 30(1).

- the particulars which must be given in the certificate which an insurer must issue to an insured person where that State requires proof that the obligation to take out insurance has been complied with.

A Member State may require that those particulars include a declaration by the insurer to the effect that the contract complies with the specific provisions relating to that insurance.

- (b) The Commission shall publish the particulars referred to in subparagraph (a) in the Official Journal of the European Communities.
- (c) A Member State shall accept, as proof that the insurance obligation has been fulfilled, a certificate, the content of which is in conformity with the second indent of subparagraph (a).<sup>33</sup>

These rules are not fully enforced. No particulars have been published in the Official Journal pursuant to article 8(5)(b). Neither the European Commission nor the EFTA Surveillance Authority seems to maintain lists of current compulsory insurance regimes, although a questionnaire was circulated in 1990. Still, a reasonable reading seems to be that a blue card from any community insurer referring generally to the obligations under the HNS convention must be accepted pursuant to paragraph (5)(c) of the quoted article.

The EC/EEA rules are somewhat complicated. However, if the proper formalities are complied with, the EC/EEA insurance law allows national requirements for issuance of HNS certificates to the same extent the HNS convention does.

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<sup>33</sup> Council Directive 88/357/EEC article 8(5).