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Athens protocol pressure places a heavy burden on cruise industry

Owners, insurers and banks are struggling with the concept of sky-high passenger liability limits as ratification is stepped up, writes Sandra Speares

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POLITICAL pressure by governments to implement the 2002 Athens protocol covering passenger liability at an early stage will leave owners, insurers and banks with difficult problems to solve.

One of these is whether the insurance market can provide the cover not only for a one-off event but on a sustainable basis, according to Ian Gaunt, senior vice-president, international, of cruise giant Carnival.

Speaking at a London Shipping Law Centre seminar to discuss the current legal issues facing the cruise industry, Mr Gaunt said that the Athens protocol meant P&I clubs would be unable the invoke the ‘pay to be paid’ rule and could face direct action from claimants in the event of an accident.

Cruiseship operators will be required to carry certificates proving they are covered for the full amount of a potential claim and cover will need to remain in place even if the market declines to provide further cover following an incident.

According to Nigel Carden, deputy chairman of Thomas Miller, which manages the UK Club, among exclusions in club rules and the pooling agreement, “one particular headache” relates to war risks including terrorism.

The club excludes for terrorism even in cases where the owner has some negligence on his part.

“In contrast, a defence to liability based on terrorism is generally only available under international shipping instruments if the liability is caused wholly by a third party terrorist, without any contributory negligence of the shipowner.”

International Group clubs will provide war risk cover up to a limit of $400m excess of the proper value of the ship, deemed not to exceed $100m or whatever greater amount is recovered from any other insurance.

“However, reflecting a general market exclusion, the group’s P&I war risks cover does not respond in respect of ‘biochem’ risks. A small pooling facility for these risks, limited to $30m, is restricted to crew claims and legal expense claims. Passenger risk of this kind cannot be insured,” Mr Carden said.

Insurance requirements under the Athens protocol would mean insurers would have to certify the provision of cover for some risks that could not be insured, even on a “one-shot basis”, he warned delegates.

The protocol includes replacing the fault-based liability system with a strict liability system for shipping incidents.

The carrier will have to take out compulsory insurance of not less than SDR250,000 ($379,535) per passenger on each distinct occasion.

Limits of liability are capped at SDR400,000 per passenger unless a signatory decides to opt out and fix a higher limit.

The combination of higher limits, direct action, the opt - out provisions and the almost strict liability regime consituted a “rich mix”, Mr Gaunt said.

The fact that provisions under Athens did not fit with exclusions from cover in insurance contracts meant that until the issue was dealt with the protocol would be “difficult to implement”.

While he said governments thought that the market would “find a way” there needed to be a distinct exclusion for terrorism.

Solutions might include amending the protocol, implementing a ‘blue card’ system for cruiseships similar to that used under the Civil Liability Convention by which potential liabilities not covered by the blue card were covered by a pool of carriers serving a certain state or region.

The downside of this was that the pool might be small, exposing carriers to great uninsured risk.

Graham Barnes, director of BankServe Insurance Services, said: “The whole issue of Athens is a complete re-run of OPA90.”

He said that with OPA, clubs said they could not fulfill the requirements for insuring ships visiting the US, but a way was found

There are serious issues arising from the Athens protocol, he believed. He stressed the determination of governments to push ahead with it, particularly in the light of high profile casualties like the Herald of Free Enterprise, the Estonia and the Express Samina. If one examined losses from cruises, they were “very slight”, he said.

The US Coast Guard is saying that the record of the cruise industry is fairly good, he said, “but qualified with a lot of goddam luck”.

Taking the Express Samina as an example, under the current Athens passenger liability owners had to pay $4.7m. If the 2002 protocol had been in force at the time of the accident they would have had to pay $25.4m with a maximum passenger liability of $40.4m.

The risk of ferry casualties is what has motivated states to demand far higher passenger liability limits, Mr Barnes said. In the case of a 3,600-passenger ship, liability limits at current SDR rates could breach $2bn.

The EU wants member states to ratify the protocol by the end of this year. Six states are already signed up.

This issue is not only a very serious one for cruise and ferry companies but also for the banks, he told delegates. Banks can be operating on an unsecured basis although more often on the basis of ship mortgages.

“They have a big problem,” he warned, as one casualty at $2bn would “make a very big hole”.

He agreed that the limits on terrorism were too high and that terrorism should be “absolutely excluded”. He also concurred with the view of the P&I clubs that there was insufficient capacity in the reinsurance markets to cover terrorism to the limits required and that risks from biochemical weapons must be excluded.

P&I clubs have turned their back on the passenger industry and passengerships only represent a small proportion of international group liability.

The question, he said, was how to cover cruise vessels and higher risk ferries and ring-fence the rest of the club membership from catastrophe calls.

The clubs are only reinsured up to $2bn and while there had never been an overspill, the risk of this would be much greater under the protocol. One alternative might to strip out passenger liability from the P&I reinsurance pool and those who needed would pay separately for that reinsurance, he said.

The ‘pay to be paid’ rule, he believed, was getting a bit outdated.

On the issue of providing guarantees, the international group clubs were talking about setting up a captive insurer named Hydra Insurance Co, based in Bermuda, he said, and if that was the case they could be the guarantor.

Levels of current financing on passengerships amount to approximately $22bn for cruiseships and $3bn for ferries outstanding and committed, he said.

Lending risks for financial institutions caught up in an accident include the fact that in jurisdictions like the US, outstanding payments to plaintiffs come ahead of the mortgagee.

Where there is no ship mortgage at all, virtually every creditor of the cruise line would come ahead of the corporate financier. “Leasing is even worse” as the bank lessor has the liability, Mr Barnes said. In the event of a sudden accident it could be an extremely high risk.

Another issue is that consolidation among cruise lines has made second values for cruiseships “extremely uncertain”.

Struan Robertson of Stephenson Harwood said that restructuring in the face of financial difficulty for cruise companies made sense for both the company and its financiers.

“Firstly and most obviously, unless there is bad faith, fraud or at the least incompetence involved, by far and away the best and most cost- effective solution is for the management of the cruise line to work out their restructuring with their existing financiers in co-operation as opposed to contention.”

In addition, setting up cruise itineraries is very time consuming and “if that itinerary is lost due to arrest or other interference then it cannot be replaced overnight as would be the case of a panamax dry bulker where the market is liquid and immedediate replacement employment can usually be found”.