

Non-collectable contributions to the separate LNG account of the HNS Convention

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I The problem

The HNS Convention¹ will, when in force, provide compensation from an international fund for victims of accidents caused by hazardous and noxious substances (HNS) carried by sea. This compensation will be financed by contributions from cargoes received in States Parties.

Recently, concerns have been raised that it will not be possible to collect a high proportion of these contributions in respect of LNG cargoes, placing a greater financial burden on others. This is because contributions in respect of LNG are payable by the last title holder before the discharge of the cargo,² and this person may not be subject to the jurisdiction of a State Party to the Convention. Therefore it may not be possible to collect the levy at this point, as the HNS claim may not be recognised as enforceable, for example if it is considered to be of a public law nature. The cause of this problem, the designation of the liable person, is specific to LNG and was incorporated in the Convention at the request of the LNG industry.³ However, much in the industry has changed since the Convention was adopted in 1996.

The situation is aggravated because the Convention incorporates a special arrangement for LNG (a separate account), which was created after intense lobbying by the LNG industry.⁴ This means that the LNG industry will not make contributions to finance damage caused by other HNS cargoes. In return, all damage caused by LNG which can be compensated under the Convention is to be financed by levies on LNG cargoes. As a result of this arrangement, it is feared that any loss in respect of LNG resulting from contributions which cannot be collected will have to be covered by the other LNG contributors alone.

This article discusses possible responses to these concerns and the relevant provisions of the HNS Convention.

¹ International Convention on Liability and Compensation for Damage in Connection with the Carriage of Hazardous and Noxious Substances by Sea, 1996 (HNS Convention).

² Pursuant to HNS Convention art 19 para 1(b) the contribution in respect of an LNG cargo shall be made by the person who 'immediately prior to its discharge, held title to an LNG cargo discharged in a port or terminal'.

³ See IMO Document LEG 71/3/4 paras 127–8. In the original Japanese proposal, the only explanation offered is that 'Cargo title holder necessary and practical because of long-term contractual relationships within LNG industry' (IMO Document LEG 68/4/4, Annex, fn 1 to art 13(e)(iv)).

⁴ HNS Convention (n 1) art 16 para 2(b), art 17 para 3 and the provisions on contribution referred to below.

2 The obvious solution

The obvious solution to the problem is to make sure that contributions in respect of LNG can be collected. The LNG industry, which insisted on this particular system, should be responsible for ensuring that this is the case.

In many cases, the receiving terminals in States Parties are controlled by entities which could potentially be exposed to the problems outlined above. These entities could require the person liable to contribute in respect of LNG to provide security for the levy as a condition of discharge, thus making the contributions easier to collect.

Alternatively, the government at the receiving end may require security⁵ to ensure the smooth working of the Convention. States Parties are obliged to provide this if the collection of contributions really turns out to be a problem:

Each State Party shall ensure that any obligation arising under this Convention is fulfilled and shall take appropriate measures under its law including the imposing of sanctions as it may deem necessary, with a view to the effective execution of any such obligation.⁶

There is no doubt that the obligation to take the necessary steps to make the Convention workable extends to requiring security, even if this security has to be demanded from the receiver of the cargo. Unlike the corresponding provision in the 1992 Fund Convention⁷ and the Japanese draft for an LNG separate account,⁸ there is no proviso that the enforcement 'measures shall only be directed against those persons who are under an obligation to contribute to the Fund'.

A requirement to post security could be made part of any EU implementation measures. If this simple step were followed, the problem would be resolved.

3 How the HNS Convention deals with non-collectable contributions

3.1 Overview

Any arrears in contributions are irrelevant in respect of the duty of the HNS fund to compensate victims.⁹ However, arrears are an internal problem for the fund and its contributors. The Convention has two mechanisms that can be applied in such cases:

- The non-collectable contributions may be written off.¹⁰ The Convention is not clear whether the loss caused thereby should be borne by the separate account or as an administrative expense of the fund, financed by LNG and other contributors on the same footing. This question is discussed in section 3.2.

⁵ For example the Norwegian proposal for implementation legislation s 223 <http://folk.uio.no/erikro/WWW/HNS/NorwayDraft.doc>.

⁶ HNS Convention (n 1) art 6. The receiving state has in any event an obligation to identify the contributors, art 21 paras 1 and 2.

⁷ International Convention on the Establishment of an International Fund for Compensation for Oil Pollution Damage, 1992, art 13 para 2 (the provision quoted below).

⁸ IMO Document LEG 68/4/4 Annex art 16 if. Indeed, the Japanese draft seems to presuppose that only LNG owners within a State Party should contribute at all, arts 18 para 8 and 39(e).

⁹ HNS Convention (n 1) art 14, which is unconditional in this respect.

¹⁰ *ibid* art 22 para 2: 'Where a person who is liable to pay contributions in accordance with articles 18, 19, 20 or article 21, paragraph 5 does not fulfil the obligations in respect of any such contribution or any part thereof and is in arrears, the Director shall take all appropriate action, including court action, against such a person on behalf of the HNS Fund with a view to the recovery of the amount due. However, where the defaulting contributor is manifestly insolvent or the circumstances otherwise so warrant, the Assembly may, upon recommendation of the Director, decide that no action shall be taken or continued against the contributor.'

- The separate account may be suspended because of non-payment of contributions.¹¹ The contributions will then be calculated by a points system,¹² which levies contributions according to the damage caused by the different industry sectors. This system is described in more detail in section 3.3, with a view to understanding whether it represents a special risk for LNG contributors. (If so, this would be a risk indirectly triggered by the non-collectable contributions.)

Both these mechanisms carry an inherent political risk, as some crucial decisions are made by the Assembly of the HNS fund. These political risks are discussed in section 3.3.

3.2 *Redistribution of the loss caused by write-off*

The problem to be discussed here is whether LNG contributors will be more exposed than other contributors under the HNS Convention if a claim for a contribution in respect of LNG has to be written off as non-collectable. The situation may typically arise because the person liable to contribute is not subject to the jurisdiction of a State Party (see section 1 above).

Contributors under the LNG separate account only contribute to cover their share of any eventual LNG damage.¹³ Deficits – including those incurred by non-payment of contributions – are treated like administrative costs.¹⁴ It is then left to the discretion of the Assembly to distribute such costs between the different accounts.¹⁵

The 1992 Fund Convention, on which the HNS Convention is modelled, has no separate accounts and therefore no previous practice that can provide direct guidance. However, a somewhat similar problem may arise in connection with the claims funds set up to organise contributions following major incidents. The fund secretariat has informed me that if a contribution to a major claims fund is written off, the loss is distributed between the other contributors to it, and not between contributors to the fund in general.¹⁶ This could indicate that LNG contributors alone would have to cover losses incurred through non-collectable contributions in respect of LNG. There is, however, no clear practice, as such losses are rare.

A possible scenario could be that the majority of the Assembly will distribute all arrears in respect of the LNG account between LNG contributors. This represents a political risk, discussed in section 3.4.

¹¹ *ibid* art 19 para 4: 'The Assembly may suspend the operation of a separate account ... (b) when six months have elapsed from the date when the contributions were due, the total unpaid contributions to that account exceed ten per cent of the most recent levy to that account in accordance with paragraph 1.'

¹² *ibid* art 19 para 6: 'Any person who would be liable to pay contributions to a separate account the operation of which has been postponed in accordance with paragraph 3 or suspended in accordance with paragraph 4, shall pay into the general account the contributions due by that person in respect of that separate account. For the purpose of calculating future contributions, the postponed or suspended separate account shall form a new sector in the general account and shall be subject to the HNS points system defined in Annex II.'

¹³ *ibid* art 17 para 3: '... For each separate account, the fixed sum per unit of contributing cargo referred to above shall be calculated by dividing the total annual contribution to be levied to that account by the total quantity of cargo contributing to that account'. See also art 16 para 4: '... a separate account shall be available to compensate damage caused by a hazardous and noxious substance covered by that account'.

¹⁴ *ibid* art 15(b)(i): '... costs and expenses of the administration of the HNS Fund in the relevant year and any deficit from operations in the preceding years'.

¹⁵ *ibid* art 17 para 4: 'The Assembly may also levy annual contributions for administrative costs and decide on the distribution of such costs between the sectors of the general account and the separate accounts.' A rule of joint and several liability of the contributors to a separate account, at least after its suspension, was envisaged in IMO Document LEG 71/3/4 <http://folk.uio.no/erikro/WWW/HNS/docs/IMO2.pdf> paras 122–23, but was never made a part of the Convention.

¹⁶ Email 28 February 2007.

3.3 The HNS points system

The purpose of this discussion is to understand whether suspension of the separate account, caused, for example, by arrears in contributions, would represent a threat to LNG contributors.

If the LNG separate account were to be suspended, LNG damages would still be covered by the HNS Convention, and the contributors to the fund in respect of LNG would remain the same. The rules for covering written-off contributions would be exactly the same.¹⁷ However, contributions would be calculated a little differently.¹⁸ The risks would be shared by all types of HNS (unless they were in another separate account that has not been suspended). This would open the way for cross-subsidising, but the LNG contributor would also be less exposed to fluctuations in annual contributions.

The HNS points system¹⁹ is designed for postponed separate accounts,²⁰ and will be applicable to suspended separate accounts only if the Assembly so decides.²¹ The decision of the Assembly is a political risk which will be discussed below in 3.4. At this stage, it will be assumed that the rules for postponed accounts will be applied also to separate accounts.

When separate accounts are suspended, the starting point is that all expenses in a given year are shared equally per ton of cargo, so that the contributions are calculated as a fixed amount per ton.²² However, the level of contribution for the different types (sectors) of cargo will be somewhat adjusted to reflect the claims history of each, with a particular view to ensuring that high volume/low hazard cargoes, such as LNG, do not have to pay an unreasonably high share. This is what the HNS points system does.

The claims history is expressed in recognised claims per ton of cargo for that specific sector.²³ The claims history over the last 10 years is taken into account,²⁴ and recent years carry more weight than previous years.²⁵

In this system, the division of sectors is important. The sectors were established as requested by the industry at the time of the diplomatic conference. Substances that are not granted a separate account are split into two sectors: one for low danger, high volume bulk substances and one for the rest.²⁶ When separate accounts are suspended, the account will constitute a new sector in this 'general account'.²⁷

Until the HNS Convention has operated for 10 years, there will not be sufficient claims history for these rules to operate. The Convention therefore supplies a fictional claims history to be

¹⁷ See n 15.

¹⁸ HNS Convention (n 1) art 17 para 6: 'Any person who would be liable to pay contributions to a separate account the operation of which has been postponed in accordance with paragraph 3 or suspended in accordance with paragraph 4, shall pay into the general account the contributions due by that person in respect of that separate account. For the purpose of calculating future contributions, the postponed or suspended separate account shall form a new sector in the general account and shall be subject to the HNS points system defined in Annex II.'

¹⁹ *ibid* Annex II.

²⁰ *ibid* art 19 para 3: postponement means that the entry into force of the separate account is delayed due to small quantities of cargo.

²¹ *ibid* Annex II reg 2 para 8: 'If the operation of a separate account has been suspended, the relevant sector factor shall be calculated in accordance with those provisions of this regulation which the Assembly shall consider appropriate.'

²² *ibid* art 17 para 3.

²³ *ibid* Annex II reg 2 paras 1–3 and 5. The Regulations make use of special terms such as sector factor, but it is not necessary to use these terms for the purposes here.

²⁴ *ibid* Annex II reg 2 para 4.

²⁵ *ibid* Annex II reg 2 para 7. The spreadsheet <http://folk.uio.no/erikro/WWW/HNS/HNSpointsSystem.xls> illustrates how this works.

²⁶ *ibid* Annex II reg 1 para 2(a) and (e).

²⁷ *ibid* Annex II reg 1 para 2(b)–(d).

used in the meantime.²⁸ This fictional claims history has been drawn up in such a way that LNG contributors will not cover any part of the loss unless there has actually been an LNG incident.²⁹

The points system means the Convention can be operated even if one or more separate accounts cannot operate, for example due to non-collectable levies. It does not, however, resolve problems caused by contributions which cannot be collected. On the other hand, it does not create additional risks for LNG contributors.

3.4 Political risks

The decision to write off contributions and suspend an account (if the conditions are met³⁰) is made by a two-thirds majority of the Assembly.³¹ By a simple majority,³² the Assembly also determines the extent to which the HNS points system should apply to suspended separate accounts,³³ and whether arrears in respect of LNG contributions should be covered by all contributors or only LNG contributors.³⁴ In the Assembly, each State Party has one vote.³⁵ The possibility must therefore be considered that, as most states have no interest in LNG, they are likely to make decisions that are unfavourable to LNG interests. This is referred to as the political risk.

The two first situations clearly would not create a political problem.

- If a debt is not written off, the loss is down to the fund in general, which compensates the victims. There is no particular reason to levy this loss from the other LNG contributors. Indeed, refusal to write off the debt means that attempts to collect it should continue. Thus, non-LNG states would have nothing to gain from refusing to write off non-collectable contributions.
- If the LNG separate account is not suspended, LNG contributors would continue not to contribute to damage caused by other classes of cargo, without incurring greater obligations. It is therefore most unlikely that the majority of the Assembly will refuse to suspend the separate account.

Also, the political risk relating to the application of the HNS points system to suspended separate accounts is marginal. The starting point is clearly that the contributions 'shall be calculated in accordance with those provisions of this regulation'.³⁶ The Assembly has discretion merely to make minor adjustments to deal with any specific situation resulting from the handling of the separate account before its suspension.

However, there is a substantial political risk that the Assembly will decide that arrears in respect of LNG contributions should be paid by the other LNG contributors. The majority of the State Parties may well be inclined through self-interest to make such a decision, and will also see the problem as internal to the LNG industry and, rightly or wrongly, believe the industry to be more or less affiliated worldwide. One must therefore assume that non-collectable LNG contributions will have to be paid by the other LNG contributors.

²⁸ *ibid* Annex II reg 2 para 6.

²⁹ *ibid* Annex II reg 2 para 6 (c): the fictional claims history is set to 0.

³⁰ *ibid* art 19 para 4.

³¹ *ibid* art 34.

³² *ibid* art 33.

³³ *ibid* Annex II reg 2 para 8.

³⁴ See text s 3.2.

³⁵ HNS Convention (n 1) art 33.

³⁶ *ibid* Annex II reg 2 para 8.

4 Conclusion

The problem of possible non-payment of contributions to the HNS fund in respect of LNG could be dealt with easily and efficiently by demanding security from the contributors as a condition of discharge. If this does not happen, the losses caused by non-collectable contributions will have to be covered either by all HNS contributors or by LNG contributors only, at the discretion of the HNS Fund Assembly. Payment arrears in respect of LNG may also cause the separate account to be suspended. However, this would not imply a significant additional risk, as the HNS points system would keep the contributions at a proportionate level.

The solution would seem to be to use all possible means to make contributions in respect of HNS collectable.