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6th September 2005

Dear Erik

Athens Convention 2002.

Thank you for preparing the summary which you circulated on 26th July.

Since we had already asked Professor Vaughan Lowe for his opinion on the discussion which had taken place in the Correspondence Group we naturally passed to him copy of your summary and asked for his further opinion. This I am attaching for the information of the Correspondence Group. Professor Lowe's opinion speaks for itself and we do not intend to repeat the comments made there.

Before dealing with insurance issues, we have noted the recent correspondence from ICS and agree with their comments. We have stated from the very start of these discussions that the simplest and most logical conclusion would be to exempt carriers from liability under the Convention for terrorism. We believe that it is logical that, as a matter of policy, terrorism is treated in the same way as war. If, as the ICS advocate, this policy is adopted, then states and insurers will have a consistent approach to terrorism which would bring to an end the distracting discussion which has taken up so much time in the Correspondence Group.

At the Diplomatic Conference most States shared the view that Article 3.1.(b) would provide a defence for shipowners in respect of terrorism. However, it is now generally recognised that in practice the 'wholly caused' language will have the effect

of making the shipowner liable. The policy considerations should require terrorism, a supervening external force, to be regarded in the same way as an Act of War. The proposals submitted by the ICS are therefore consistent with the position as it was understood by the majority of States that spoke on the subject at the Diplomatic Conference.

Turning to insurance matters, IUMI has contacted us to express surprise that the view has been expressed on the first page of your letter that capacity is merely a question of price and that capacity is currently available. IUMI has stated that there is currently insufficient capacity and that while price is naturally an important consideration it is far from being the only factor in determining capacity. IUMI has also stated that it is not acceptable to implement a Convention on the basis of cover that may not be sustainable in the long term. We share these views.

There are a number of difficulties in making provision in the Convention regarding the shipowner's War Risk cover. The special features of the underlying risk mean that cover is very distinct from P&I cover. We have referred to these before but would summarise the main points:

(i) the limit of the cover, currently up to $600million, is much lower than potential liability under the Convention which could be over $2billion for a vessel carrying 3,600 passengers. We have previously touched on the volatility of the market in this respect and that the availability of this level of cover is dependent on the willingness of the market to accept this degree of risk. In the event of a maritime casualty being caused by an act of terrorism it is most likely that, given the fragile nature of the market, the capacity of the War Risks market at the time would be diminished very quickly.

(ii) The volatile nature of the underlying risk means that the War Risk cover, which is linked to the carrier's hull policy, is also subject to a seven-day notice of cancellation. This provision makes it impossible to provide certification on an annual basis as envisaged (though not provided) under the Convention.

(iii) War Risks cover developed at a time when liability was fault based. Insurers' exposure was limited by the fact that shipowners would not be found liable for an incident caused by an act of war. The position is different in a strict liability regime, which may add to the fragility of the cover.

None of these problems means that the cover is invalidated in any way, simply that, notwithstanding the problem of certification, the cover that might exist in the War Risks market is too volatile and uncertain to be used as a foundation for liability requirements, still less for insurance requirements, under the Convention. In order to protect themselves from liability shipowners will continue to seek whatever cover the market can provide with the consequence that the objective set out in your letter of 26th July, of utilizing whatever cover is available, would have been achieved in any event without making provision in the Convention. Even if cover for war risks (including terrorism) is unfit for use in the compulsory insurance regime, cover in some form will generally be available and will be puchased by shipowners who will wish to obtain whatever protection is available at any given time.

We set out below a form of wording in accordance with the text proposed by Professor Lowe which will apply if States accept the position advanced by ICS exempting both the carrier and the insurer, together with alternative wording which exempts the insurers alone.

Reservation to Articles 3(1), 3(2) and 4bis:
The Government of is ratifying the Protocol of 2002 to the Athens Convention Relating to the Carriage of Passengers and their Luggage by Sea, 1974, subject to the reservation that (neither carriers nor insurers shall be liable) (insurers shall not be liable) under the Convention in respect of

(a) death or personal injury resulting from acts of terrorism, or acts related to acts of terrorism, or action to prevent acts of terrorism, or
(b) *damage caused by or contributed to or arising from any chemical, biological, bio-chemical or electro-magnetic weapons, or action to prevent the use of such weapons*

Such exceptions and limitations will be clearly reflected in the certificates issued by States under Article 4bis.

The consent of the government of …to be bound by the Convention is conditional upon other States Parties making the same reservation. It will not regard the Convention as entering into force as between itself and any State that has not both ratified the Convention and made the same reservation.

As the recent discussion has been somewhat fluid it has not been possible to consult the International Group Club Boards on this particular issue. We hope that the terrorism issue can be resolved in the near future so that Club Boards can be further consulted on the issue of whether they are prepared to provide liability cover for passenger carriers in accordance with the terms of the Athens Convention 2002. It is hoped that we will be in position to report further to the next meeting of the Legal Committee in the Spring of 2006.

In this connection we would be grateful for further comment on the suggestion put forward some two years ago that a global limit to the Athens exposure could be fixed by reference to the LLMC. In this connection I would draw attention to our letter of 22nd July 2004 (copy attached for ease of reference) and would ask whether you would be prepared to countenance the limitation on jurisdiction provisions that such an approach would seem to imply. We shall look forward to further comments on this matter as well.

Yours sincerely,

Lloyd Watkins

1. I have read Professor Røsaeg's helpful paper dated 26 July 2005. There are a few comments that I offer on it in the hope that they may help the collective effort to identify a fair and effective solution to the difficulties concerning terrorism cover.

2. My comments are confined to the question of the effective implementation of an intention to exclude or limit the liability of insurers for terrorist risks. In particular, I take no position on the likely availability of insurance cover for terrorist risks under the terms of the Athens Convention.

3. There are, as I said in my Opinion, inherent difficulties with using reservations to modify legal obligations that are established by treaty but are enforced by actions between private parties in municipal (i.e., national) courts. It is very difficult indeed –if not impossible- to eliminate the risk of divergent interpretations being adopted by courts in different States; and the possibility of forum shopping that the Athens Convention establishes means that such divergences would create much uncertainty concerning potential liabilities under the Convention.

4. That said, I understand that in the present context the use of reservations appears to be the most expedient way of limiting liability under the Athens Convention in respect of death or personal injury resulting from terrorism, etc ('terrorist risks'). Accordingly, the question is how best to frame such a reservation.

5. It may be helpful to focus these comments on the three suggestions for the text of a reservation: (1) the text of the reservation initially proposed to the Correspondence Group of the Legal Committee (the 'initial text'); (2) the text suggested in the Lowe Opinion of May 2005 (the 'May text'); and (3) the text suggested in Professor Røsaeg's paper dated 26 July 2005 (the 'July text').

6. The **initial text** read as follows:

> "The Government of … reserves its right to issue and accept insurance certificates with such exceptions and limitations as the insurance market conditions at the time of issue of the certificate necessitate, such as the biochemical clause and terrorism-related clauses, without exposing the providers of financial security to liability in disregard of the exceptions and limitations under which they have committed themselves. Such exceptions and limitations will be exercised with due regard to guidance by relevant bodies with an aim to ensuring uniformity."

7. This initial text was problematic because any national court applying it in order to limit liability under Articles 3 and 4 of the Athens Convention would have to be satisfied that the circumstances fell within the terms of the reservation. A national court might say that it needs to be convinced that market conditions necessitated the restriction of liability, for instance; and that might require both a detailed analysis of market conditions at the relevant time (the date of issue of the certificate), and also (in order to prove that the 'exceptions and limitations' to insurance cover were 'necessary'), an analysis of the different ways in which such cover as was available might have been structured so as minimise the exceptions and limitations. It would be difficult for a court to make these determinations. Determinations may vary from court to court, and vary with market conditions from week to week.

8. The initial text was also problematic because it pinned the effects of the reservation to the certificates issued by States, whereas the cause of action and liability of insurers and carriers in any claims that might be brought would depend not upon the certificate but upon national law.

9. The **May text** read as follows:

> "Reservation to Articles 3(1) and 3(2) and 4bis.
>
> The Government of ... is ratifying the PAL subject to the reservation that insurers shall not be liable under the Convention for death or personal injury resulting from acts of terrorism or acts related to acts of terrorism, or action to prevent acts of terrorism."

10. The May text sought to avoid dependence upon any such complex and subjective factors. The only question would be whether the death or personal injury in question resulted from acts of terrorism, etc. That is a judgement of the kind that commercial courts are accustomed to make without difficulty. Furthermore, the criterion ('death or personal injury resulting from acts of terrorism') is fixed and does not vary in the way that market conditions vary. It therefore enables insurers and carriers to determine their position with reasonable certainty.

11. The May text, by resting the reservation on the relatively fixed and determinate criterion of the causal link between the death or personal injury and acts of terrorism, accordingly seems to me easier

for courts, and for insurers and carriers, to implement than the initial text would be.

12. The **July text** is a composite of versions of the initial text (as paragraph one of the July text), and the May text (as paragraph two of the July text). It read as follows:

> "*Reservation to Articles 3(1) and 3(2) and 4bis.*
>
> The Government of ... is ratifying the *Protocol of 2002 to the Athens Convention Relating to the Carriage of Passengers and Their Luggage by Sea, 1974*, on the condition that it can issue and accept insurance certificates with such exceptions and limitations as the insurance marked conditions at the time of issue of the certificate necessitate, such as the bio-chemical clause and terrorism related clauses. Such exceptions and limitations will be clearly reflected in the certificate. The right retained by this reservation will be exercised with due regard to guidance by relevant bodies with an aim to ensure uniformity.
>
> The Government of ... also ratifies on the condition that insurers shall not be liable under the Convention to a greater extent than they have confirmed in the "Blue Card" to the State Party that has issued the certificate of insurance in accordance with Article 4bis of the Convention and the previous paragraph. In particular this applies to liabilities in respect of
>
> - death or personal injury resulting from acts of terrorism, or acts related to acts of terrorism, or action to prevent acts of terrorism, and
> - damage caused by or contributed to or arising from any chemical, biological, bio-chemical or electro-magnetic weapons, or action to prevent the use of such weapons."

13. The use in the first paragraph of the concept of the necessity resulting from market conditions. That would entail the uncertainties inherent in the initial text. The undertaking to have "due regard to guidance by relevant bodies with an aim to ensure uniformity" is certainly a welcome commitment; but the commitment is vague and it is difficult to see that it will actually secure uniformity.

14. The use of a variant of the May text in the second paragraph may compound the uncertainty, because of the uncertainty of the relationship between paragraphs one and two. Paragraph two appears to

permit insurers to limit or exclude liability for terrorist risks, regardless of market conditions. Paragraph one permits a State to issue or accept a certificate on the basis of limited insurance cover put forward by the carrier, if market conditions necessitate the limitations. The result would be that if insurers were unable to cover terrorist risks, carriers would seek certification on the basis of limited cover. If a certificate were granted by State A, could a court in State B hold that market conditions did not in fact necessitate limited cover? What would the legal position of the carrier and insurer be in such circumstances?

15. If a State refuses certification because it does not accept that market conditions necessitate the limited cover, the position is clearer. The carrier may not operate the ship, in so far as it falls within the jurisdiction of a State Party to the Convention.

16. The need for certificates accurately to reflect the carrier's insurance cover is evident, and the July text is helpful in spelling that out. It is not clear that the best way to achieve this is by pegging the right to <u>certify</u> to a 'market' standard. The more direct approach would be to define permissible limitations upon insurance cover and then require the certificate accurately to reflect the cover.

17. The reference to the 'Blue Card' in paragraph two may also be a weakness in the July text. 'Blue Card' is not, as far as I am aware, a term of art in international law. More significantly, by resting the question of the limitation of liability on the terms of the instrument provided by the insurer the July text permits (subject to the need for the certification if the carrier is to be able to operate the ships) a much wider and less certain limitation of liability than would be achieved if the reservation itself spelled out the extent to which liability may be limited.

18. A variation of the July text might therefore be more effective than the existing July text. The two paragraphs might be combined into one, along the following lines:

> "*Reservation to Articles 3(1) and 3(2) and 4bis.*
>
> The Government of ... is ratifying the *Protocol of 2002 to the Athens Convention Relating to the Carriage of Passengers and Their Luggage by Sea, 1974*, on the condition that [neither carriers nor] insurers shall be liable under the Convention in respect of
>
> (a) death or personal injury resulting from acts of terrorism, or acts related to

acts of terrorism, or action to prevent acts of terrorism, or

(b) damage caused by or contributed to or arising from any chemical, biological, bio-chemical or electro-magnetic weapons, or action to prevent the use of such weapons.

Such exceptions and limitations will be clearly reflected in the certificates issued by States under Article 4bis."

19. Professor Røsaeg's paper rightly points out that however a reservation is drafted it is possible that it will not be accepted by all States. If the reservation is not accepted, the provisions of the treaty to which it relates will not enter into force as between the reserving and the non-accepting State, to the extent of the reservation.

20. If the reservation were drafted as suggested in the penultimate paragraph, the result would in my view be that the Athens Convention provisions would not apply to liability for death or personal injury resulting from terrorism, etc, or to damage caused by chemical weapons, etc. In other words, the result would be the same exclusion of liability under the Convention as would have been achieved if the reservation had been accepted. (This may appear paradoxical, but the principle was clearly accepted in the *Anglo-French Continental* Shelf arbitration in 1977). It is much less clear what the effect of rejection of a reservation in drafted in the terms of the July text would have. It is, however, clear that there is a much greater risk of a reservation drafted in terms of the July text effectively limiting liability if it is rejected by any State party.

21. I noted in my Opinion that it would be possible to add a paragraph to the reservation that would make acceptance of the reservation a condition of the entry into force of the Athens Convention. It might read as follows:

> "The consent of the Government of ... to be bound by the Convention is conditional upon other States Parties making the same reservation. It will not regard the Convention as entering into force as between itself and any State that has not both ratified the Convention and made the same reservation."

22. I do not think that it is possible to be more specific than this and, for instance, to stipulate in the reservation that the reserving State agrees to be bound by the Convention only if all other

States actually implement the Convention in the same way.

23. A State could require other States to accept the same reservation; but how would it be determined whether the Convention was being implemented in the same way? That problem would be particularly acute if the reservation were drafted in terms that pegged the limitation of liability to market conditions or to other complex or subjective criteria.

24. I understand that there is a question whether liability for terrorist risks should be entirely excluded or only limited to the extent necessitated by market conditions. That is a policy matter on which I do not express a view, although I would observe that if 'Convention' insurance cover is limited and wider cover is indeed available on the market, additional cover can always be purchased –as travellers now may buy additional insurance to cover war and terrorist risks in circumstances where their basic insurance policies do not cover those risks.

Vaughan Lowe.

9 August 2005

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22nd July 2004

Dear Erik,

Athens Convention

Many thanks for your letter of 5th July 2004.

On the amount issue, we would like to explore further your suggestion that it might be possible to employ the global limit of LLMC by utilizing the provisions of Article 19 of the Athens Convention together with Articles 7.1 and 15.3bis of the 1996 LLMC. We would welcome the comments of the Correspondence Group on whether States would be prepared to legislate in this way, particularly those States that may already have a higher limit in force under domestic law. It would certainly be helpful in our presentation to Club Boards if we can advise them that a global limit will be available at the levels set in 1996 LLMC.

On the terrorism issue, we continue to share the view expressed by ICS that it may be worth examining once more the policy that lies behind the Athens provisions concerning war and terrorism. These provisions were carried over wholesale from other Conventions and insufficient consideration may have been given to their true intent and effect, given that circumstances have changed considerably in recent decades. We suspect that the war risk exception which is adopted in order to delineate the strict liability of most modern Conventions was originally based on the terms of hull and cargo insurance policies where it may have been assumed that cover would be available elsewhere for those excluded risks (and that States would provide backing for war risk cover). That assumption

is no longer valid and in any event, as ICS has cogently pointed out, the distinction between war and terrorism has become blurred today. We believe that this issue deserves re-examination as a matter of policy.

It has been suggested that it is not acceptable to re-open the Convention since nothing has changed since the Diplomatic Conference in 2002 when delegates agreed the Protocol despite warnings from the industry that cover was not available. This decision was taken on the assumption that cover would be available and this assumption is now generally accepted as unwarranted. This, in our view, would constitute a change in circumstance sufficient to warrant amending the Athens Convention and indeed all the other Conventions that share the same flaw.

However, the same result could perhaps be achieved in the context of the Athens Protocol by seeking the authority of the Assembly of IMO to rectify the provisions of the Protocol by including terrorism in the war risk exception. If a decision of the Assembly can be employed in order to clarify the provisions of Article 3.1.b. (Option C), why cannot the same technique be employed in order to clarify Article 3.1.a.? You suggest in your letter that "there is no way the text of the Convention can be changed by IMO resolution or otherwise." However, it seems to us that if it is possible to clarify what constitutes contributory negligence in Article 3.1.b. by resolution, it is equally possible to clarify, for example, that "hostilities" or "insurrection" include acts of terrorism in the same way. In this way it may be possible to avoid all the difficulties which are inherent in establishing absence of negligence, compliance with ISPS etc. Again, we would be interested in the detailed comments of States.

Turning to the Options set out in your letter of 20th May, we have the following comments:

Option A.
As we have explained on previous occasions, war risks (including terrorism) are excluded from Club cover and covered by separate war risk underwriters. However, the Clubs' reinsuring underwriters have nonetheless agreed, for the time being at least, to continue to provide reinsurance for the exposure of Clubs under the CLC certificate even though the substantive risk is covered by a different set of underwriters. Although this arrangement will work in the short term, it is plainly not satisfactory in the long term. Even if it were possible it would be unwise to attempt to extend this arrangement to cover risks arising under Athens, HNS and Bunkers. Moreover, it is extremely unlikely in the context of a new liability under a new convention that a reinsuring underwriter would be prepared to stand behind a certificate when the substantive cover is placed elsewhere. This is particularly the case where, as under Athens, the amounts at stake are considerably higher than the amounts under CLC. It is also

unlikely that the threat to withdraw a licence, even if administratively achievable, would have much effect on underwriters in their assessment of the risk.

Option B.
Any pool of shipowners would have to be capable of bearing at least one claim of SDR750million. Even if set up by government, this would be impossible without reinsurance, and reinsurance is simply not available.

As mentioned in Hakan Lundquist's letter of 2nd July, the Clubs did try to develop this idea and mutualize the existing exposure under the bio-chem exclusion but even on this limited basis it proved impossible without reinsurance to provide cover in excess of $20million and then only for crew claims and legal costs, as it was not possible to obtain support for the cover of passengers or other P&I risks. We see no prospect of extending this arrangement to cover the much wider liabilities thrown up by the Conventions which are not yet in force.

Option C.
We suggested in our letter of 24th June that Option C may provide a way forward. However, on further reflection we doubt whether this option is practicable: just as a Club is unable to certify that cover is in place in respect of wilful misconduct of the owner, so the Club is equally unable to certify that cover is in place where the member does not have an ISPS certificate in place. However, the analogy with wilful misconduct is not precise: in the absence of wilful misconduct, cover under the Rules may be available whereas cover is simply not available in relation to terrorism whether or not an ISPS certificate is in place. Standard cover of general P&I risks may have been granted on the basis of compliance with ISPS but if the certificate is withdrawn for whatever reason (or was never obtained) then cover of those general risks will cease to exist and in any event that cover would not extend to liabilities arising from acts of terrorism because of their exclusion from the standard cover. The stumbling block therefore is that if ISPS certification is withdrawn or never obtained, the consequence, so far as concerns any COFR guarantee which might have been given by a Club, is that the Club would then be on risk for terrorist and/bio-chem liabilities, the very risks that Clubs cannot insure or guarantee up to the Protocol levels. These liabilities are not covered or only covered within a band or up to limits ($400m.excess of Hull value for terrorism risks, $20m. for restricted bio-chem risks) which do not fulfil the requirements of the Protocol. It is therefore not possible for Clubs to certify that cover is in place in those circumstances. Taken together with the objections outlined by Sweden we feel that Option C as presently understood is probably unworkable. Moreover, as we suggest above, we feel that the mechanism suggested in relation to Option C would probably be better employed to provide a more comprehensive answer by clarifying Article 3.1.a.

Option D.
In our view this option would run up against the same problem as Option B, namely that reinsurance is simply not available. In order to operate satisfactorily a government reinsurance scheme would have to be capable of meeting a claim of SDR750million. It is very unlikely that any finance ministry would be prepared to set aside sufficient funds to make this possible. Reinsurance cover would therefore be sought but would not be available.

Option E.
Although we have no precise knowledge of the amounts currently held on deposit by the IOPC Fund we doubt whether they would be sufficient to meet the obligations under the Athens Convention. Therefore resort would again have to be made to reinsurance, which is simply not available.

Bio-chem Exclusion.
As we mentioned in our letter of 24th June, present indications are that our underwriters will not be in a position to change their stance on this issue at the 2005 renewal. We share your view that in logic the bio-chem exclusion was intended to deal only with war and terrorism. However, the language is plainly wider in effect and this gives rise to a gap in our cover. As indicated above we have tried to put together mutual protection in this respect but can provide no more than the restricted $20million cover mentioned above, which is obviously inadequate in the context of the Athens Convention.

Like you, we shall look forward to the comments of other members of the Correspondence Group and in the meantime confirm that we are ready to assist in every possible way to bring the Convention into force at an early date. In particular we should perhaps clarify that we wish to be in a position to report fully to Clubs as soon as it appears that a workable solution may be found on the terrorism issues.

Yours sincerely,

Lloyd Watkins