

## **NEW CHARTERPARTY INDEMNITY CLAUSE**

A new charterparty clause, known as the Oil Pollution Indemnity Clause for Penalties and Fines, has been drawn up by the International Group of P&I Clubs in consultation with BIMCO.

The text is annexed to this paper, and the background to the clause may help in appreciating its intended effect.

As the name implies, the clause is concerned with indemnities for monetary penalties imposed as a result of criminal liability being incurred for oil pollution. This may result from violation of international regulations contained in the MARPOL Convention, which is very widely in force, or in some cases from breach of other domestic laws.

International regulations relating to the prevention of oil pollution are set out in Annex I to MARPOL. Some are concerned with intentional discharges: these are permissible within strict controls as 'operational' discharges, but are otherwise a violation, and indeed are a serious offence if the controls have been deliberately flouted. Other regulations are concerned to prevent or reduce accidental pollution. The double hull rules, and other regulations affecting the design and construction of ships, fall into this category. The same applies to operational requirements such as those concerning shipboard oil pollution emergency plans.

If a discharge occurs, and it is not permitted by the MARPOL discharge controls, in principle a MARPOL violation is committed unless a) it resulted from accidental damage to the ship or its equipment, sustained without intent or recklessness on the part of the master or owner, or b) there was a failure to take reasonable measures to avoid or minimise pollution resulting from the spill. This means that there should not normally be any breach of international regulations if, for example, the pollution results from a casualty such as a collision or grounding, caused by navigational error.

If a violation occurs, and criminal proceedings are instituted, then matters of procedure and evidence, as well as the penalties to be imposed, are left on the whole to domestic law and practice. The only relevant rules of international law are firstly the requirement in MARPOL that penalties should be of sufficient severity to deter offences; and secondly the safeguard in the Law of the Sea Convention (UNCLOS) that monetary penalties only can be imposed for violations of national or international laws to prevent pollution from ships, save in the case of a wilful and serious act of pollution in the territorial sea.

Whilst these international rules require fines of at least a minimum level of severity, and restrict the imposition of non-monetary fines, they do not set any maximum financial amount. This allows scope for coastal states to legislate for fines at any maximum level they see fit, and for these to be imposed on foreign ships as well as those flying their own flag. This has led to wide variations in the level of fines typically imposed for similar offences in different contracting states, and to concerns in some cases that the amounts were out of all proportion to any culpability involved in the offence.

Coastal states have also increasingly claimed jurisdiction under UNCLOS to enact domestic laws which apply more stringent rules within their territorial seas and exclusive economic zones than international standards. Some impose criminal liability and stringent penalties for accidental pollution resulting from ordinary negligence, and in some cases even on a strict liability basis, regardless of fault. The validity of these laws has sometimes been controversial, as in the case for example of the EU Directive on Criminal Sanctions for Ship-source Pollution.

Normally the parties most affected by these laws have been the owners and masters of ships, and other ships' personnel. However another facet of growing criminalisation has been a tendency toward imposition of liability on other parties, notably charterers.

The most striking example to date of charterers incurring criminal liability for pollution is the *Erika* incident (France, 1999), in which the major oil company Total was held criminally liable under French legislation for 'imprudence' in chartering the 21-year-old single hull tanker to carry a cargo of heavy fuel oil.

Another development in the same general direction has been the introduction in Australia of federal legislation extending criminal liability for marine pollution to the charterers of ships. This legislation – contained in the Maritime Legislation Amendment Act, 2011 – now makes charterers punishable for such offences as well as owners and masters, and it also significantly increases the maximum financial penalties. These have been raised to some A\$ 2.2m (US\$ 2.3 million) for an individual, and they may be multiplied by a factor of five for a corporation, taking the maximum penalty to A\$ 11m (US\$ 11.5m).

It remains to be seen whether in practice charterers will be prosecuted or convicted only in cases where their conduct has in some way caused or contributed to the incident. In the *Laura D'Amato* incident in Sydney Harbour (1999), where a spill resulted from a valve being left open, the court convicted and fined the chief officer, who was found to have been negligent, and also the owners as his employers. Whilst technically the master was also guilty of a strict liability offence, the court decided against imposing on him any penalty as he had not been personally at fault. It is possible that the same approach may be taken in relation to charterers, but in theory the legislation enables them to be penalised on a strict liability basis.

Uncertainty about this exposure, and concern at its potential magnitude, led some charterers, such as major oil companies, to seek clauses in charterparties indemnifying them against any financial penalties incurred in this way. They were also concerned to establish that they were free of any obligation to take measures in response to an incident.

Some of these clauses did not preserve an owner's right to limit liability or contained other provisions imposing liability which would be uninsurable under normal terms of P&I cover.

In order to address concerns raised by the new law, the International Group has drafted, in consultation with BIMCO, a recommended clause for inclusion in charterparties. The clause is not specific to the situation in Australia and has

general application on the subject of fines and penalties for oil pollution. The text is appended to this paper.

Paragraph (a) of the Clause affirms owners' overall responsibility for responding to a pollution incident, i.e. a discharge (or threat of discharge) of oil, oily mixture or oily residue. This reflects the normal position under international laws governing incident response.

Paragraph (b) provides for owners to indemnify charterers if they incur strict liability for any penalties or fines as a result of a pollution incident caused by the act or negligence of the owner, master or crew (e.g. navigational error). It also creates a reciprocal indemnity where owners incur strict liability as a result of an incident for which the charterer is responsible (e.g. due to nomination of an unsafe berth).

These rights of indemnity are subject to two express provisos. The first reduces the amount recoverable where there is contributory fault, and the second makes the indemnity conditional on recovery of fines and penalties not being prohibited under the law governing the charterparty. These provisos are designed among other things to ensure that Club cover is not prejudiced on the grounds that liability has been contractually assumed where it would not otherwise have been incurred under the applicable law.

An indemnity under the clause may include any reasonable legal costs or other expenses which either party incurs in defending proceedings, or is ordered to pay, irrespective of whether any fine or other penalty is actually imposed.

Paragraph (c) provides that nothing in the Clause is to prejudice any defence, any right to limit liability, or any right of recourse of either party. Paragraph (d) is designed to ensure that similar rights and obligations in any other contracts in the same charterparty chain.

At the end of the day, though a variety of different scenarios can be envisaged, the Clause should not greatly alter the existing position. So far as English law is concerned, in most circumstances a fine incurred as a result of an incident for which another party was responsible should give rise to a claim in tort, or for damages for breach of contract. There may be complications where the incident resulted from more than one cause, but the fine relates specifically to fault found on the part of the party penalised. In other words, if a fine is imposed not by reason of the incident itself but to penalise some breach of duty which is personal to the accused, the indemnity may not be available. Examples would be failure by the owners to comply with some regulatory obligation, or 'imprudence' by the charterer in selecting the vessel. However, these potential complications may be encountered in practice irrespective of the Clause, and any attempt to legislate for them all in the terms of the charter is probably unrealistic.

The main benefit of the Clause is that it addresses these issues to the extent possible within the framework of available insurance cover, whilst maintaining an equitable balance between the reasonable interests of both parties. Anyone asked to accept charterparty terms which are more onerous than these should

consider carefully how they could operate in practice, and in particular whether they can count on P&I insurance covering any liability incurred.

## **OIL POLLUTION INDEMNITY CLAUSE FOR PENALTIES AND FINES**

(a) Subject to the terms of this Charterparty, as between Owners and Charterers, in the event of an oil pollution incident involving any discharge or threat of discharge of oil, oily mixture, or oily residue from the Vessel (the "Pollution Incident"), Owners shall have sole responsibility for responding to the Pollution Incident as may be required of the vessel interests by applicable law or regulation.

(b) Without prejudice to the above, as between the parties it is hereby agreed that:

i. Owners shall indemnify, defend and hold Charterers harmless in respect of any liability for criminal fine or civil penalty arising out of or in connection with a Pollution Incident, to the extent that such Pollution Incident results from a negligent act or omission, or breach of this Charterparty by Owners, their servants or agents,

ii. Charterers shall indemnify, defend and hold Owners harmless in respect of any liability for criminal fine or civil penalty arising out of or in connection with a Pollution Incident, to the extent that such Pollution Incident results from a negligent act or omission, or breach of this Charterparty by Charterers, their servants or agents,

provided always that if such fine or penalty has been imposed by reason wholly or partly of any fault of the party seeking the indemnity, the amount of the indemnity shall be limited accordingly and further provided that the law governing the Charterparty does not prohibit recovery of such fines.

iii. The rights of Owners and Charterers under this clause shall extend to and include an indemnity in respect of any reasonable legal costs and/or other expenses incurred by or awarded against them in respect of any proceedings instituted against them for the imposition of any fine or other penalty in circumstances set out in paragraph (b), irrespective of whether any fine or other penalty is actually imposed.

(c) Nothing in this clause shall prejudice any right of recourse of either party, or any defences or right to limit liability under any applicable law.

(d) Charterers shall procure that this Clause be incorporated into all sub-charters and contracts of carriage issued pursuant to this Charterparty.