

**EXPLANATORY MEMORANDUM TO
THE MERCHANT SHIPPING (OIL POLLUTION) (SUPPLEMENTARY FUND
PROTOCOL) ORDER 2006**

2006 No. 1265

1. This explanatory memorandum has been prepared by the Department for Transport and is laid before Parliament by Command of Her Majesty.

2. Description

2.1 This Order in Council amends the Merchant Shipping Act 1995 ("the 1995 Act") to give the force of law in the United Kingdom to the Protocol of 2003 to the International Convention on the Establishment of an International Fund for Compensation for Oil Pollution Damage, 1992 ("the Supplementary Fund Protocol").

2.2 The Supplementary Fund Protocol significantly increases the amount of compensation available for pollution damage arising from oil tankers through the establishment of the Supplementary Fund, which is financed by oil receivers.

2.3 The main changes made by this Order in Council to the 1995 Act are the addition of new sections 176A and 176B which set out the Supplementary Fund's liability to pay compensation, plus amendments to sections 173 and 174 to require oil receivers in the United Kingdom to contribute to compensation paid by the Supplementary Fund.

3. Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None

4. Legislative Background

4.1 The purpose of this Order in Council is to implement an international treaty, the Supplementary Fund Protocol. The Order in Council will enter into force when the Supplementary Fund Protocol enters into force in the United Kingdom. The United Kingdom will accede to the Protocol once this Order in Council has been made. The Protocol (along with the Order in Council) will then enter into force 3 months later. (The date will be notified by the Secretary of State in the London, Edinburgh and Belfast Gazettes.)

4.2 This Order in Council is made under section 1 of the Merchant Shipping (Pollution) Act 2006.

4.3 The Supplementary Fund Protocol will form the third tier of the international oil pollution compensation regime which is already in force in the United Kingdom having been implemented under the 1995 Act.

4.4 Council Decision 2004/246/EC of 2 March 2004¹ authorised Member States to ratify the Supplementary Fund Protocol in the interests of the European Community “within a reasonable time and, if possible, before 30 June 2004”.

4.5 The Council Decision was placed before Parliament for scrutiny and was cleared as “not politically or legally important” by the House of Commons European Scrutiny Committee (see Report No 34 for Session 2002-2003) and cleared by the Lords Select Committee on the European Communities (Chairman’s 1157th sif of 28th October 2003).

5. Extent

5.1 This instrument extends to the United Kingdom.

6. European Convention on Human Rights

Stephen Ladyman, Minister of State for Transport, has made the following statement regarding Human Rights:

In my view the provisions of the Merchant Shipping (Oil Pollution)(Supplementary Fund Protocol) Order 2006 are compatible with the Convention rights.

7. Policy background

7.1 The International Maritime Organization adopted the Supplementary Fund Protocol in 2003 because the levels of compensation available from the existing international oil pollution compensation regime were not always sufficient.

7.2 The existing international regime is based on two Conventions, the International Convention on Civil Liability for Oil Pollution Damage 1992 (“the Liability Convention”) and the International Convention on the Establishment of an International Fund for Compensation for Oil Pollution Damage 1992 (“the Fund Convention”). The United Kingdom ratified these Conventions in 1994 and they entered into force in 1996. The implementing legislation is contained at Chapters III and IV of Part VI of the 1995 Act.

7.3 The purpose of the regime is to provide compensation for pollution damage caused by persistent mineral oil spilled from a sea-going vessel constructed or adapted to carry oil in bulk as cargo (normally a tanker). Pollution damage is defined under the Liability Convention and covers loss or damage caused outside the ship by contamination resulting from the discharge of oil from the ship. Preventive measures taken to prevent or minimise the pollution are also covered by the regime.

7.4 Under the Liability Convention the owner of such a ship has strict liability for any pollution damage caused by the oil. The shipowner can limit his liability to an amount established in accordance with the tonnage of the ship. The shipowner must maintain insurance to cover his liability.

¹ (O.J. L28 /22, 16.3.2004).

7.5 The Fund Convention established "the Fund" which provides additional compensation when the amount payable by the shipowner (and insurer) does not cover all of the damage. The Fund is financed by contributions from persons who receive more than 150,000 tonnes of crude or heavy fuel oil each year.

7.6 The shipowner's limit of liability ranges from 4.5 million SDR² to 89.8 million SDR (£3.7 million - £74 million). The maximum amount of compensation available though both the shipowner and the Fund is 203 million SDR (£166 million). 98 States have ratified the Civil Liability and Fund Conventions.

7.7 The Supplementary Fund Protocol established the Supplementary Fund which is also financed by oil receivers and increases the amount of compensation available under the regime to 750 million SDR (£614 million). The Supplementary Fund Protocol entered into force in May 2004. So far, 17 States have ratified the Supplementary Fund Protocol.

7.8 Implementation of the Protocol will considerably improve the financial security of United Kingdom victims of pollution damage from persistent oil carried as cargo by tankers. Delays in payment of compensation can arise under the existing regime, even where the overall costs of an incident do not exceed the limit available. This is because full payment of claims cannot be made until the extent of the damage is known and the final costs of an incident can be accurately assessed. Depending on the incident this process can take months or even years.

7.9 Implementation of the Supplementary Fund Protocol should ensure that even in major oil spills, claims can be paid quickly and in full.

7.10 The Supplementary Fund will provide compensation only when a claim which would have been admissible under the Fund is not paid, or not paid in full, because the total claims arising from an incident exceed the amount payable by that Fund.

7.11 The Order in Council will place an additional burden on major oil companies that receive persistent oil following carriage by sea in quantities above 150,000 tonnes per year. They will be required to contribute to compensation payments required from the Supplementary Fund, and also to modest administrative costs.

7.12 The Department for Transport conducted a public consultation on the implementation and ratification of the Protocol in 2004. The Protocol will affect the major oil receivers in the UK (less than 20). There was broad agreement in the oil industry to support implementation of the Protocol as part of an overall review of the existing international oil pollution compensation system to reduce the burden on the oil industry.

7.13 The Department also hosted consultative meetings with the main industries affected by the Supplementary Fund Protocol early in 2005, prior to the introduction of the Merchant Shipping (Pollution) Bill. Those stakeholders broadly supported the Department's approach to implement the Protocol under the Bill.

7.14 In February 2006, a voluntary agreement between industry and the Supplementary Fund was been adopted under which shipowners will contribute 50%

² The International Monetary Fund's Special Drawing Right

of any payments due from the Supplementary Fund, thereby reducing the burden on the oil industry.

8. Impact

8.1 A Regulatory Impact Assessment is attached to this memorandum.

8.2 The impact on the public sector is nil. A potential cost associated with implementation of the Supplementary Fund Protocol is the administrative cost of obtaining an annual report of United Kingdom oil receipts which must be provided to the Director of the Supplementary Fund each year. However, this information is already obtained each year and provided to the Fund (which is administered by the same Secretariat and Director as the Supplementary Fund) so in practice there will be no additional burden.

9. Contact

Clare Boam at the Department for Transport Tel: 020 7944 5444 or e-mail: clare.boam@dft.gsi.gov.uk can answer any queries regarding the instrument.

**Implementation of the Protocol of 2003 to the International Convention
on the Establishment of an International Fund for Compensation for Oil
Pollution Damage 1992 ("the Supplementary Fund Protocol")**

REGULATORY IMPACT ASSESSMENT

1. TITLE

- 1.1 Regulatory Impact Assessment on implementation of the Supplementary Fund Protocol to ensure that, in the UK, the victims of pollution damage arising from spills of persistent oils¹, carried by sea, receive prompt and adequate compensation.

2. PURPOSE AND INTENDED EFFECT OF THE MEASURE

Issue

- 2.1 Several incidents have occurred world-wide in recent years that have demonstrated that the levels of compensation currently available for pollution damage arising from the carriage of oil as cargo by sea are not always sufficient to ensure prompt and adequate payment of compensation.
- 2.2 To address this concern the International Maritime Organization adopted the Supplementary Fund Protocol to significantly increase the amount of compensation available.
- 2.3 The UK, along with all EU Member States, is politically committed to becoming a Contracting State to the Supplementary Fund Protocol by virtue of EU Council Decision 2004/246/EC (2 March 2004) authorising all EU Member States to express their consent to be bound by the Protocol "*within a reasonable time and if possible before the end of June 2004.*"
- 2.4 The UK was not able to ratify the Protocol within the EU deadline because enabling powers were not available for the purpose of implementing the Protocol in UK legislation.

Objective

- 2.5 **To significantly improve the financial security of UK victims of pollution damage from persistent oil carried as cargo by tankers.**
- 2.6 The Government proposes that this will be achieved by UK accession to, and implementation of, the Supplementary Fund Protocol. It will affect major oil receivers (of quantities above 150,000 tonnes per year) but only in the event of a serious incident occurring in the jurisdiction of a Contracting State. Such

¹ The term persistent is used to describe those oils which, because of their chemical composition, are usually slow to dissipate naturally when spilled into the marine environment such as crude oil, fuel oil, heavy diesel oil and lubricating oil.

3. RISK ASSESSMENT

- 3.1 The UK has one of the longest coastlines in the EU and the English Channel is the world's second busiest international straight. In the event of pollution damage arising from a serious incident in UK waters involving the carriage of oil as cargo by sea, victims may not be able to obtain full compensation for pollution damage incurred. Even when full compensation is available, claims may be subject to lengthy delays before they are settled.
- 3.2 When claims exceed the amount of compensation available under the 1992 regime, payments are made at a reduced level to ensure that the maximum amount payable by the IOPC Fund is not exceeded. Such payments are made on a *pro-rata* basis to ensure that all claimants are treated equally. Claims continue to be paid on this basis until it is clear that sufficient funds exist to pay all claims in full. If, after all claims are assessed (claims are rejected if they do not meet the criteria of the IOPC Fund), the amount of compensation available is still not sufficient to pay all claims in full, claimants will only receive payment for a proportion of their claim.
- 3.3 The UK's experiences of the *Braer* (1993) and the *Sea Empress* (1996) incidents, and recent oil spills in Japan (*Nadhodka*, 1997), France (*Erika*, 1999) and Spain (*Prestige*, 2002) all demonstrate the difficulties that can face victims of oil pollution.
- 3.4 There were considerable delays in full settlement of claims for both the *Braer* and *Sea Empress* incidents because of low compensation limits at the time. Implementation of the Supplementary Fund Protocol will overcome this because of the significantly higher limit.
- 3.5 The most recent major incident, the *Prestige*, resulted in unprecedented costs. The tanker broke in two and sank off the coast of Spain in 2002. It had been carrying 77,000 tonnes of heavy fuel oil, of which an unknown but substantial quantity was spilled. The spilled oil reached the coastlines of France and Portugal as well as Spain. Clean up costs, as well losses in fishing, tourism and related industries were incurred in Spain, France and Portugal. An expensive salvage operation was undertaken to remove some 13,000 tonnes of oil from the sunken wreck to prevent any further pollution. The total costs of the claims submitted to date, based on information provided by the Spanish, Portuguese and French governments, is around £716 million. In view of these figures, initial payments for compensation by the IOPC Fund were set at 15% of the loss or damage suffered by claimants. This figure has still not been increased more than two years after the incident occurred.
- 3.6 In 1995, a risk analysis of tanker oil spills was prepared for the Marine Pollution Control Unit of the UK Maritime and Coastguard Agency. The study suggests that an oil spill in excess of 14,000 tonnes should be expected somewhere in UK waters once every 4 years, with a greater than 50% probability that the spill will occur in the open waters of the English Channel. A

spill of less than 14,000 tonnes should be expected somewhere in UK waters once every 16 months.

- 3.7 The Supplementary Fund is to be financed solely by the oil industry. This may distort the balance of the financial sharing of the compensation system between the shipping and oil industries. The UK oil industry has accepted that they alone will finance the Supplementary Fund and supported its development as part of an on-going review of the system by Member States and industry representatives. The UK is taking an active role in this review, in particular to address the sharing of the financial burden of the system between the shipowner and oil receivers. We are also seeking other key reforms which should simplify the operation of the regime, especially to ease the settlement of compensation.

4. OPTIONS

- 4.1 Two options have been identified:

Option 1

- 4.2 To continue to apply the legislation that currently governs liability and compensation from oil spills from ships in UK waters (the 1992 Civil Liability Convention and the 1992 Fund Convention).
- 4.3 This would impose no extra burden, financial or administrative, on UK receivers of persistent oil following carriage by sea. Such receivers would still be required to pay financial contributions under the 1992 Fund Convention for incidents involving the carriage of oil by sea in a 1992 Fund Contracting State. They would not be required to pay financial contributions for an incident in a Contracting State to the Supplementary Fund Protocol where the Supplementary Fund is engaged.
- 4.4 The cost of doing nothing may affect individuals and sectors of industry that have in the past suffered consequences of pollution damage from tankers in UK waters. In particular the fishing and tourism industries have been subjected to the economic difficulties following serious pollution damage from an oil tanker in UK waters. These difficulties will be exacerbated in the event of a serious oil tanker incident in UK waters if the levels of compensation contained in the existing international compensation regime are exceeded
- 4.5 The cost of doing nothing may also result in long-lasting damage caused to the environment, due to a lack of financial resources to pay for restoration measures to help reinstate the environment back to its original condition, in the event of a serious incident. There could be strong pressure for public expenditure to meet any shortfalls in compensation and the failure to fulfil the EU Council Decision would lead to calls for regional compensation arrangements, weakening the international regime and probably being detrimental to UK industry interests.

Option 2

- 4.6 UK accession to, and implementation of, the Supplementary Fund Protocol, within the EU Council Decision timescale, if possible. This will ensure that the victims of damage arising from an oil pollution incident involving the carriage of persistent oil by sea in UK waters receive prompt and adequate compensation.
- 4.7 Following very serious oil spills, this option would impose additional costs on the individual UK oil and energy companies that already contribute financially to the 1992 Fund Convention.
- 4.8 13 UK companies exceeded the threshold in 2003 for contributions to be paid to the 1992 Fund.
- 4.9 Such contributors will only be levied in the event of an incident on a scale that requires cover by the Supplementary Fund and to cover the modest administrative costs of the Fund.
- 4.10 Membership of the Supplementary Fund is voluntary. There will not, therefore, necessarily be the same number of Contracting States as for the 1992 Fund, which means financial contributions, whilst still spread globally, would be met by a smaller number of contributors. At present there are 85 Member States to the 1992 Fund.

5. COSTS AND BENEFITS TO BUSINESS, CHARITIES AND VOLUNTARY ORGANISATIONS

Business sectors affected

- 5.1 UK oil, and energy, industries (who already contribute financially to the 1992 Fund).
- 5.2 The UK shipping industry should remain unaffected by the introduction of any UK legislation. Charities and voluntary organisations would not be affected.

6. Benefits

Economic

- 6.1 The economic benefit of continuing to apply the existing legislation (option 1) is that the oil industry will not be exposed to additional financial liability. However this should be weighed up against the potential economic costs associated with this option.
- 6.2 The economic benefits of implementation of the Supplementary Fund Protocol (option 2) will be far reaching. The Protocol will considerably improve the

financial security of UK victims of pollution damage from oil carried as cargo by tankers. Both the *Braer* (1993) and *Sea Empress* (1996) incidents, referred to in the risk assessment section, highlight the difficulties that victims can face in obtaining full compensation.

- 6.3 When the *Braer* ran on to the rocks of the Shetland Isles, fully laden with 84,700 tonnes of crude oil and 1,600 tonnes of heavy fuel oil, only approximately £50 million was available for compensation through the international system. At the time the 1992 Civil Liability and Fund Conventions were not in force, and liability and compensation was governed by the preceding international compensation regime, namely the 1969 Civil Liability and 1971 Fund Conventions. The limit of compensation available was less than the 1992 regimes.
- 6.4 The incident caused substantial damage to the whole area and resulted in claims having to be pro rated. The 1971 Fund was still not in a position to pay claims in full. This subsequently caused delays and court actions resulting in claims for compensation still being settled 9 years after the incident occurred. Although the compensation available has increased significantly over the last 10 years, the cost of oil spill incidents has also risen.
- 6.5 The most recent major incident, the *Prestige* (Spain, 2002), resulted in unprecedented costs, see section on risk assessment.
- 6.6 Primarily, the benefit will take the form of improved financial security for victims of pollution damage arising from the carriage of oil in cargo by sea, through guaranteed prompt and adequate compensation.

Environmental

- 6.7 There are no additional environmental benefits associated with the existing legislation (option 1). Compensation will continue to be available to a limit of £165 million,
- 6.8 The benefits of implementing the Supplementary Fund Protocol will impact on the environment. The existing Fund and the Supplementary Fund will provide compensation for clean-up costs and for costs arising from the contamination of fisheries and aquaculture produce. In addition, the Funds will meet the costs of certain measures to reinstate the environment, where such measures are likely to accelerate significantly the natural process of recovery. The increased amount of compensation available through the Protocol therefore provides a clear environmental benefit.

Social

- 6.9 The existing legislation provides no additional social benefits. Compensation will be available to the victims of oil pollution but only to the limit of £165million.

- 6.10 Small businesses have in the past been those most likely to suffer the consequences of an oil spill. Both the tourism and fishing industries, which are mainly comprised of small businesses, have been subjected to the economic difficulties arising from delays in full settlement of compensation following serious incidents in UK waters in the past.
- 6.11 Introduction of the Supplementary Fund Protocol (option 2) will significantly help to prevent these vulnerable groups from suffering financial hardship in the event of a major oil spill.

7. Costs

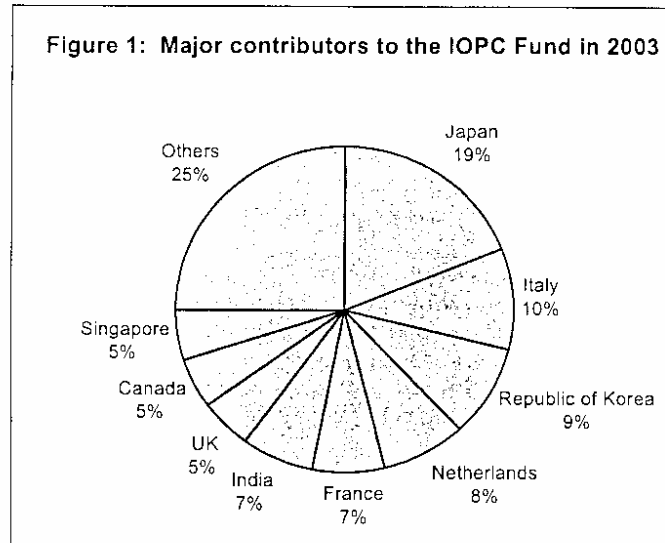
Economic

- 7.1 There are no additional costs associated with continuing to apply the current legislation. The UK oil industry has contributed to the existing IOPC Fund since 1979. In major incidents payments are likely to be limited until the full cost of the claim is established, and will only be paid in full if the total cost does not exceed £165 million. If such an incident occurs in UK waters and also affects France or Ireland, UK victims may be paid at a slower rate than those in the other States and may not be paid in full whereas victims in France or Ireland could expect full, prompt compensation under the Supplementary Fund Protocol.
- 7.2 If this option is followed then there are potential costs which may arise as a result of not acceding to the Supplementary Fund Protocol.
- 7.3 The European Commission has taken the view that the existing international oil pollution compensation regime established under the 1992 Protocols to the Civil Liability Convention (CLC) and the IOPC Fund needed improvement ever since the *Erika* incident in France in December 1999. The Commission proposed to establish the COPE Fund, which would provide top-up compensation for claimants in European waters subject to a ceiling of €1,000 million European oil receivers, using procedures parallel to those of the International Oil Pollution Compensation (IOPC) Fund would finance the COPE Fund. The Commission has 'parked' this proposal pending the establishment of the Supplementary Fund Protocol, it is clear however that they stand ready to reintroduce the proposal if EU Member States fail to implement the Supplementary Fund Protocol. The implications of this are considerable. Not only would such a measure be damaging to the status of the international regime but it would be costly to industry. The limit proposed for the COPE Fund of €1,000 million (approximately £860 million) means that industry would be liable to contribute £249 million more than they would under option 2 - implementation of the Supplementary Fund Protocol. This is compounded by the fact that such contributions would be met by EU oil receivers only. Under the current international regime, 5 of the top 10 contributors (accounting for 44% of all compensation payments) are not EU Member States. Japan is currently liable for 20% of contributions that may arise in respect of the Supplementary Fund.

- 7.4 Information on the potential costs of implementing the Supplementary Fund Protocol (option 2) has been estimated from the data available from the IOPC Fund.
- 7.5 It is impossible to predict with certainty the levies that will be charged to UK oil companies following implementation of the Supplementary Fund Protocol. Several factors will determine the cost of levies, as follows:
- a) the number of Contracting States to the regime;
 - b) the total contributing cargo in each Contracting State in the year preceding the incident;
 - c) the frequency of incidents exceeding the limit set down in the IOPC Fund, and
 - d) the total costs of each incident exceeding the limit established under the IOPC Fund, and
 - e) the exchange rate between the SDR and the pound sterling.
 - f) The number of years it takes to establish and settle all claims arising from any one incident, depending on the severity (this has ranged from 3 - 8 years).
- 7.6 It is unlikely that all Contracting States to the 1992 Fund will join the Supplementary Fund. However, all EU Member States will ratify, or accede to, the Supplementary Fund Protocol by virtue of the European Council Decision. France, Ireland, Finland, Denmark, Germany, Spain and Norway are already Contracting States, along with Japan. Portugal has recently acceded to the Protocol and it will come into effect there in May 2005. Other EU Member States including the Netherlands, Poland, Greece and Sweden have previously indicated that they will become Contracting States. Japan, Netherlands, UK, Spain and France are in the top 10 financial contributors to the 1992 Fund, based on the contributing oil received in those States in the calendar year 2002.
- 7.7 The Protocol entered into force on 3 March 2005 after 8 States, with a total annual quantity of 450 million tonnes of contributing oil had expressed their consent to be bound by the regime.
- 7.8 The Director and Assembly of the Supplementary Fund (consisting of the Contracting States) will decide on the amount of contributions to be levied and also the date on which payments should be made. The Secretariat of the Supplementary Fund will then determine the amount of contributions required from each company based on exact quantities of contributing cargo received in the year preceding the incident.
- 7.9 If an incident occurs and the existing 1992 Fund is required to make payments, levies are raised on the major oil receivers in all Contracting States to the 1992 Fund Convention.

Existing UK contributions to the 1992 Fund

- 7.10 The UK currently contributes about 5% of all annual industry payments to the IOPC Fund. This equates to 70.5 million annual tonnes of contributing oil from 13 UK companies, from an overall total of 1.3 billion annual tonnes of contributing oil from all the States that were parties to the 1992 Fund in 2002.
- 7.11 Figure 1 shows the breakdown of the main contributors to the 1992 IOPC Fund in 2002.



- 7.12 The proportion contributed by UK industry has decreased steadily since the IOPC Fund came into force, from an initial figure of 12%. This is due to the increase in the number of States becoming party to the IOPC Fund. This proportion is expected to become lower still as States continue to join.
- 7.13 The following table shows the actual contributions that have been levied on contributors in all contracting States since the present regime entered into force in May 1996. The figures are for illustrative purposes. In most cases the levy includes payments in respect of more than one incident. Oil receivers are only required to contribute if their receipts exceeded the contribution threshold in the year preceding the incident. The figures below show the maximum levy any one contributor would be required to pay if they were liable to contribute in respect of all incidents requiring payment each year.

Annual contributions	Date due	Total contribution	Contribution per tonne of contributing oil
1996	01.02.1997	4 000 000	0.0110440
	01.09.1997	10 000 000	0.0188066
1997	01.02.1998	9 500 000	0.0114295
	Maximum deferred levy	30 000 000	No deferred levy made
1998	01.02.1999	28 200 000	0.0400684
	01.09.1999	9 000 000	0.0134974
1999	Credit: 01.03.2000	- 3 700 000	-0.0056367
	01.09.2000	53 000 000	0.0552651
2000	01.03.2001	49 500 000	0.0545770
	Maximum deferred levy	43 000 000	No deferred levy made
2001	01.03.2002	41 000 000	0.0428439
	Maximum deferred levy	21 000 000	No deferred levy made
2002	01.03.2003	31 000 000	0.0274518
2003	01.03.2004	82 000 000	0.0052994
	Credit: 01.03.2004	-37 700 000	-0.0568302
	Maximum deferred levy	40 500 000	

7.14 Since the original regime began in 1974, the highest total amount of compensation ever paid out in one year was in 1993 when £78 million was levied. At the time the UK contributed around 8% of the costs (approximately £6.3 million) which would have equated to an approximate levy of £0.08 per tonne. The high costs were due to several incidents occurring around the same time, the most costly of which was the Braer on 5 January 1993. As stated elsewhere in this RIA, the Braer occurred on the Scottish coast and has been one of the most expensive incidents in the history of the regime. Of the £78 million levied in 1993, £35 million was to provide compensation for the Braer incident. This levy was of course spread across oil receivers throughout the world, with the UK oil industry contributing around 8% or approximately £2.8 million.

Maximum deferred levy

7.15 The Assembly of the IOPC Funds operates a system of deferred invoicing whereby the Assembly fixes the total amount to be levied in contributions for a given calendar year but may decide that only a specific lower amount is levied in March of the following year, with the remaining amount or part thereof to be invoiced later in the year if necessary. This system helps to strike a balance between ensuring that sufficient funds will be readily available if further compensation is required to pay victims claims as they are assessed throughout the year but without unnecessarily or prematurely invoicing industry for contributions. If the additional money is not required, no levy is made, however if further contributions are necessary, industry has been forewarned and able to take this into consideration in their accounting processes.

Credits

- 7.16 The credit payments in the table above show the instances where contributions have been refunded to the oil industry. This normally occurs where the IOPC Fund has taken successful recourse action in respect of an oil spill. Following an incident, claimants are quickly compensated through the IOPC Fund but if, at a later date a liable party is identified, the Fund's policy is to recover costs and redistribute them to the original contributors, wherever possible.

Supplementary Fund levies

- 7.17 The number of incidents where the Supplementary Fund would have been engaged had it been in existence is small. Only [three] cases in the past 25 years have exceeded the limits of compensation available through the 1992 Fund. Whilst the amount of compensation available through the Supplementary Fund is considerably higher than that available through the 1992 Fund, it is not expected that the full amount of the Supplementary Fund will be required. The high limit was set in part to ensure that the instrument will maintain its value in future years.
- 7.18 It is expected that the Supplementary Fund will rarely be engaged. Its main benefit is that it will allow full compensation to be paid under the 1992 Fund, without the need to make reduced payments for fear of exceeding the overall limit of the 1992 Fund.
- 7.19 When the Supplementary Fund is engaged it is expected that payments will only be required to "supplement" those made under the 1992 Fund. That is, the bulk of the payments will be made through the 1992 Fund and payments made under the Supplementary Fund would not normally be expected to exceed the amounts paid under the 1992 Fund.

Capping provision

- 7.20 Under the Supplementary Fund Protocol, no State will contribute more than 20% of the total amount of contributions payable under the Supplementary Fund in any one year. Where a State's contributions as calculated on the amount of oil received would exceed 20% of the total contributions, that State will pay 20% and the deficit will be made up through increased contributions from other States on a *pro rata* basis.
- 7.21 This is a transitional provision and will cease to apply once the total contributing cargo reaches 1,000 million tonnes or when the protocol has been in force for 10 years, whichever occurs first.
- 7.22 This means that in the worst case scenario where the total £445.8 million available from the Supplementary Fund is required to meet claims arising from a single incident, no State would ever pay more than £89.1 million for a single incident and such a payment would be spread over several years.

Potential cost to UK industry

- 7.23 As stated earlier it is impossible to say what the actual annual costs to industry will be but we can predict the administrative costs that industry will be required to meet once the UK has ratified the Protocol.
- 7.24 It has been proposed by the Director of the IOPC Funds that for the year 2005, the Supplementary Fund should pay a management fee of £125,000 to the 1992 Fund to cover the administrative costs associated with the Supplementary Fund. The following table shows the amount that the UK would be required to contribute assuming that the proportion paid remains the same as would apply for payments in respect of an incident (i.e. the capping effect has been included so no State contributes more than 20%).

	Current States party and UK	Current States party and other EU Member States including UK
Total UK contribution for administrative costs	£23250	£11625
Approximate levy per tonne for administrative costs	£0.0003	£0.0002

- 7.25 These figures are estimates based on oil receipts reported to the IOPC Fund in 2002. The administrative costs may rise as the Supplementary Fund becomes established; however as the number of States party to the Protocol increases, such costs will be spread across a greater number of contributors.

Maximum Potential UK contribution to the Supplementary Fund

- 7.26 Given the uncertainty over potential costs to industry, we have analysed the "worst case scenario" where an unprecedented incident occurs requiring the total amount of compensation payable under the Supplementary Fund. We have looked at this from two situations; that which would apply if the UK was the tenth State to ratify the Protocol, and the situation where the UK, along with all other coastal EU Member States, has ratified the Protocol. It must be emphasised that these figures are illustrative, based on the oil receipts reported by those States to the IOPC Funds in respect of 2002⁵.

⁵ In fact some States will report higher quantities to the Supplementary Fund because they will not be able to pass on liability for oil which is transported to a second State not yet a party to the Supplementary Fund Protocol, the effect of this is that potential UK contributions should be lower than those illustrated above. However, this data is not yet publicly available so the figures in this RIA have been calculated on the oil reports submitted to the IOPC Fund in 2002.

Table showing maximum potential UK contribution to the Supplementary Fund:

	Current States party and UK	Current States party and other EU Member States including UK
Maximum UK contribution respect of an incident requiring full compensation from the Supplementary Fund	£82.7million	£41.4 million
Approximate levy per tonne	£1.44	£0.72

- 7.27 In this illustration we have only included EU Member States because they are all required to ratify the Protocol by virtue of the Council Decision of 2 march 2004 (2004/246/EC). However it is expected that other non-EU Member States will also ratify the Supplementary Fund Protocol - this will lower the potential contribution.
- 7.28 This is not an indication of the maximum potential annual cost to industry. As explained elsewhere in this document, payments are spread over a number of years. When past spills have generated high costs, payments have been spread over 5-6 years so the theoretical cost per year, based on the worst-case scenarios above ranges from £6.9 million to £16.5 million.
- 7.29 Experience has shown that claims for responding to the pollution and for any physical damage are the first to be submitted and will usually tail off during the second year after the incident. Damages for economic losses (mainly fishing, aquaculture and tourism) on the other hand tend to be ongoing. Some incidents have resulted in payments being levied over a number of years, though the majority of claims tend to be settled within 3 - 4 years.
- 7.30 It should also be noted here that in 1974 when the UK first considered joining the original IOPC Fund, the potential cost to UK contributors was predicted at £1.66 per tonne. In fact the highest levy ever raised was in 1993 as a result of three major incidents (one of which was in UK waters). £78 million was levied that year, which corresponded to an approximate levy per tonne of £0.073.
- 7.31 These figures are intended to give an idea of the theoretical maximum exposure faced by UK industry in the event of a serious incident reaching the maximum level of the Supplementary Fund. This is not a predicted annual cost.
- 7.32 These figures are also based on the contributing cargo of the current 9 Contracting States along with the coastal EU Member States. It is expected that more States join the Supplementary Fund further reducing the potential costs.

Effect of additional levies

- 7.33 There is not expected to be any knock-on effect on the price of oil in the UK. The price of oil fluctuates due to many factors; the relatively small levies are not expected to affect oil prices. Previous levies, including the £0.078 per tonne resulting from the *Braer*, have not impacted on the cost of oil and we do not expect this to change.

Environmental

- 7.34 Under the existing legislation (option 1) just £165 million is available for compensation instead of a further £445 million, which as mentioned earlier, can be used for clean-up costs, costs arising from the contamination of fisheries and aquaculture produce and to meet the costs of certain measures to reinstate the environment following damage by oil pollution.
- 7.35 There are no environmental costs associated with the implementation of the Supplementary Fund Protocol (option 2).

Social

- 7.36 The social costs associated with applying the existing legislation are again that potential compensation of £445 million will not be available to help meet the claims of victims of oil pollution. These will often be small, coastal businesses in the fishing and tourist industries.
- 7.37 There are no social costs associated with the implementation of the Supplementary Fund Protocol (option 2).

8. EQUITY AND FAIRNESS

- 8.1 The existing system comprising the Civil Liability Convention and the Fund Convention was created to share the costs of oil spills between the oil and shipping industries, although the Fund Convention was intended to ensure that the economic consequences of oil pollution damage should be borne by the oil industry in part, only.
- 8.2 The Supplementary Fund is to be financed solely by the oil industry, which may distort the balance of sharing between the shipping and oil industries. The International Oil Pollution Compensation Fund recently published a study of the costs of oil spills in relation to past, current and future limitation amounts of the 1992 Conventions. When the costs of all incidents governed by the study (5,800) were inflated to 2002 levels the oil cargo interests and the shipping industry would have contributed 57% and 43% of the total costs respectively. If the anticipated costs of the *Prestige* (and *Erika*, France (1999)) incidents were taken into account these figures would become 64% (oil industry) and 36% (shipping) respectively.

- 8.3 The oil industry has accepted that they alone will finance the Supplementary Fund and supported its development as part of the on-going review of the current regime.
- 8.4 The UK is continuing to progress proposals in the Working Group of the IOPC Fund to review the current regime, in particular through the development of proposals for consideration by the Working Group to address the sharing of the financial burden between the oil and shipping industries.

Race equality impact

- 8.5 There are no race equality impacts associated with either option contained in this RIA.

9. SMALL FIRMS' IMPACT TEST

- 9.1 Accession to the Supplementary Fund will have no negative impact on small businesses in the UK. The threshold establishing those liable to pay levies in the draft Supplementary Fund Protocol is 150,000 tonnes of contributing cargo. None of the 13 contributors based in the UK are classified as small businesses, indeed all are large companies with over 250 employees.

10. COMPETITION ASSESSMENT

- 10.1 Implementation of, and accession to, the Supplementary Fund Protocol in the UK will affect the 13 large oil, and energy, production companies that already contribute to the 1992 Fund.
- 10.2 If an incident occurs that requires payment from the Supplementary Fund, these companies, and all the companies based in Contracting States to the Supplementary Fund that are already contributors to the 1992 Fund, will be levied an amount that is proportionate to the quantity of oil they import. Therefore, whilst some companies will be affected to a greater extent than others because they may import greater amounts of contributing oil, this will be in proportion with their share of the market.
- 10.3 We have applied the competition filter test in accordance with the Office of Fair Trading's guidelines for competition assessment and we do not expect that the costs arising from the levy will impact disproportionately on these businesses or have a significant effect on competition.
- 10.4 The EU Council Decision will ensure that all EU Member States become Contracting States to the Supplementary Fund. This will ensure that UK oil receivers will not be placed at a disadvantage within Europe. The costs section provides information on States that have indicated their intention to proceed to ratification of the Supplementary Fund Protocol.

- 10.5 It should be noted that whilst the United States is not a Contracting State to the existing international regime, they have in a place a domestic arrangement with limits of compensation in line with the level of compensation available under the Supplementary Fund. These are not funded by the oil industry however, but through financial security of the shipowner.

11. ENFORCEMENT AND SANCTIONS

- 11.1 UK oil receivers who contribute to the 1992 IOPC Fund currently submit annual reports to the Downstream Oil Branch of the Department for Trade and Industry (DTI), detailing the quantities of oil imported by sea each year. The DTI then reports this information to the Fund Secretariat, who invoice contributors based on the information contained in these reports. This system will continue to apply for the Supplementary Fund Protocol, and the same reports will be considered as reports for the Supplementary Fund as well. This will ensure that there will be no double reporting and that there will be no additional administrative burden on either the existing contributors or DTI officials.
- 11.2 The Supplementary Fund will also be administered by the same Secretariat as the 1992 Fund.
- 11.3 Contravention of the requirement to report annual reports of oil receipts where requested within a specified time frame is currently subject to a fine not exceeding level 5 on the standard scale for statutory fines. This will continue to apply for the Supplementary Fund because the reports submitted to the 1992 Fund will also be considered as reports to the Supplementary Fund.

12 MONITORING AND REVIEW

- 12.1 The Government will monitor and review the implementation of the Supplementary Fund Protocol through existing consultative arrangements. From time to time the IOPC Fund reviews aspects of the operation of the oil compensation regime by means of an international Working Group consisting of all states that are parties to the regime and the Supplementary Fund would be subjected as needed to the same process.
- 12.2 The Supplementary Fund is not expected to be engaged very often but the implementing legislation will be reviewed once the Supplementary Fund has operated in practice, this may not be for several years. We will continue to work closely with the oil industry involved in this process.

13 CONSULTATION

- i) Within government
- 13.1 Both the European Policy Committee and the Domestic Affairs Committee have previously been consulted regarding the ratification and implementation of the Supplementary Fund Protocol. The Devolved Administrations have also been informed of our proposals in this respect.

ii) Public Consultation

- 13.2 The Department published a public consultation document, with a Partial Regulatory Impact Assessment, on implementation and ratification of the Protocol on 22 March 2004.
- 13.3 All individual UK contributors to the 1992 Fund were consulted. The responses received to the consultation indicate that the UK oil industry supports implementation of the Protocol as an interim step towards a more comprehensive revision of the existing international oil pollution compensation system.
- 13.4 The review of the system is on-going and the UK is taking an active part, as above. This has included on-going informal consultations with key industry representatives who have indicated that implementation of the Supplementary Fund Protocol is preferable to the implementation of a regional regime.

14. SUMMARY AND RECOMMENDATION

14.1 Summary of costs and benefits of each option

Option	Total cost per annum	Total benefit per annum
1 Continue to apply existing legislation.	<p><u>Economic:</u> no additional costs unless major oil spill occurs in which case UK victims of oil pollution will be unable to access an additional £445 million in compensation available to States Party to the Supplementary Fund Protocol. The Government will be expected to provide supplementary compensation.</p> <p>Possibility that the Commission will resurrect their proposal for a regional solution which could be far more costly to UK industry than the Supplementary Fund Protocol (option 2).</p> <p><u>Environmental:</u> Claims for clean-up costs, damage to fisheries and</p>	<p><u>Economic:</u> no additional cost to industry.</p> <p><u>Environmental:</u> No additional benefit.</p> <p><u>Social:</u> No additional benefit.</p>

	<p>aquaculture, and environmental restoration may be subject to lengthy delays and may not be paid in full.</p> <p><u>Social:</u> Potential hardship for victims of oil pollution whose claims for compensation are subject to delay and may not be paid in full.</p>	
2. Ratify and implement the Supplementary Fund Protocol	<p><u>Economic:</u> Industry will be required to contribute towards the administrative costs of the Supplementary Fund (predicted cost for 2005 is £11,625 - £23,250 which would be spread across all major oil receivers in the UK). In the event of a major oil spill in a State Party to the Protocol, all major oil receivers in States Parties will be required to contribute to the costs of providing compensation. Such incidents rarely occur. In a theoretical worst case scenario where maximum contributions are required, UK industry would not be expected to contribute more than £16.5 million in any one year.</p> <p><u>Environmental:</u> No environmental costs</p> <p><u>Social:</u> No social costs</p>	<p><u>Economic:</u> An additional £445 million will be available to meet the costs of compensation.</p> <p><u>Environmental:</u> Claims for clean-up costs, damage to fisheries and aquaculture, and environmental restoration should be paid promptly and in full.</p> <p><u>Social:</u> Victims of oil pollution should be fully and promptly compensated.</p>

14.2 Recommendation


The objective is to improve the financial security of UK victims of pollution damage from oil carried as cargo by tankers. To achieve this objective it is recommended that Option 2 is adopted, namely UK accession to, and implementation of, the Supplementary Fund Protocol.

The social, economic and environmental benefits in the event of serious pollution damage arising from the carriage of oil as cargo by tankers will be substantial.

15 **MINISTERIAL DECLARATION**

I have read the Regulatory Impact Assessment and am satisfied that the benefits justify the costs.

Signed by the responsible Minister:


.....

Dr Stephen Ladyman MP

Date:..... 17.5.5

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