Limits on cover

The current cover limits for owners, charterers and for specific risk types were maintained for the forthcoming policy year.

Release calls

The boards have set an initial release call margin percentage of 10% of ETP for the forthcoming policy year, which will be reviewed as the year progresses in the light of risk factors relating to claims and other developments. An explanation of the release call methodology will be contained in this year's annual report.

Certification

The club is now providing blue cards for those members who need them to comply with the EU PLR. The club sees provision of this type of documentation as a core service to the membership.

Solvency II

Although the timescale for the implementation of Solvency II by the European regulatory authorities continues to slip, there is no doubt that much of the content of the Solvency II directive is now in any event considered to be best practice for insurance company operations in the EU. Accordingly, the club continues to develop its corporate governance, financial, risk management and internal control disciplines in order to be Solvency II compliant.

P&I and CAR insurance

Robert Dorey, Offshore Director

+44 20 3320 8831
robert.dorey@ctplc.com

Introduction

The *offshore forums* in London and Singapore sought to raise awareness of the contracting pitfalls and potential gaps between offshore Construction All Risks (CAR) cover and P&I entry. This article summarises these discussions with the aim of identifying some of the gaps that may attract risk to a member's balance sheet.

Offshore marine activity in 2012 was marked by an upturn which the club noted in the *Standard Bulletin Offshore Special Edition*. The surge coincided with the aftermath of *Deepwater Horizon* and the considerable exposure absorbed by the oil companies to upstream losses. However, the after-effects of this loss have also been felt in offshore construction risks and associated contracting.

Although individual experiences varied from member to member, there was a widely shared view expressed at both forums that the current indemnity regimes employed in the offshore construction sector can be inefficient and uncertain.

Offshore construction operations

From the club's perspective, offshore construction operations typically fall into three categories:

A. Fixed platform construction and associated subsea field development (including float-over, lift-on, pipe- or cable-lay operations, subsea installation and windfarm construction).
B. FPSO navigation from yard to field (whether under own steam, wet tow or dry tow), including hook-up, installation and pre-production testing up to point of delivery to the ultimate client.
C. Maintenance or servicing of oil field infrastructure (including maintenance, subsea and ROV operations).

Construction All Risks cover

In scenarios A and B, the client or the principal contractor will have taken out a CAR policy to cover the items insured. Usually this is under a WELCAR 2001 form. The limits of cover will depend on the value of the sums insured, but for significant offshore field developments this may exceed and stretch energy insurance market capacity.

The WELCAR form is designed to provide coverage from the commencement of construction operations, including the initial design phase, through the period of onshore fabrication, including installation offshore and finally completion. The policy provides coverage in respect of first-party property for all risks in relation to loss or damage of the '*contract works*' as defined. Such policies also provide an element of liability coverage in respect of third-party liabilities arising out of the construction activity.

WELCAR was designed to meet the community of interest of all parties (contractors and subcontractors) associated with construction projects. As such, the most efficient way to insure the contract works was to have a combined single limit with access to that limit available to all parties contracted to the project. Access to cover is granted to the principal assureds and to the interests of other assureds with an associated waiver of subrogation by the CAR underwriters. It is not however necessary to specifically name the other assureds.

Limitations of CAR cover from a marine contractor's perspective for fixed or subsea construction operations

Watercraft exclusion

The CAR policy specifically excludes watercraft liabilities. These risks are required to be insured under a P&I entry. However, P&I policies exclude liabilities arising out of specialist operations (for example construction) where those liabilities are bought back under the club's Offshore Liability Extension, they only respond to certain liabilities, up to the applicable limit.

P&I specialist operations and contract works

The Offshore Liability Extension does not reinstate cover for loss or damage to the contract works. Therefore, liabilities in respect of contract works remain excluded. The exclusion is in place because CAR policies specifically cover such risks. That policy will be the subject of a detailed risk assessment and rated in accordance with energy risk practice.

Waiver of subrogation of other assureds

The CAR cover requires that claims are brought against the policy by the principal assured. Therefore, there is no marine subcontractor right to claim directly against the policy. The waiver of subrogation provides other assured with limited protection. However, this may not prevent the ultimate client from bringing a claim against such other assured, depending on the terms of the cover.

Access to making a claim under the CAR

If a marine contractor is the Engineering Procurement and Installation (EPI) contractor who is a principal assured under CAR then they may have direct access to bring a claim thereunder.

However, the EPI contractor or their subcontractors are 'other insureds' or if a subcontractor to the EPI contractor is an 'other insured', there are some practical issues that may impede access to CAR cover, namely:

1. The principal insured to accept a claim because of an ongoing dispute with the marine subcontractor.
2. The terms of the CAR may have been amended to exclude coverage for subcontractors and the policy may not have been disclosed to any member of the tiers within the contractor group.
3. The client of the offshore construction project generally pays significant premiums for CAR cover. Therefore, they are naturally concerned that the actions of any party to the construction project could prejudice their cover. There is a considerable commercial pressure by such clients to make contractors liable for their negligence, gross negligence and/or wilful misconduct.
4. Clients may also encourage contractors participation and exposure by requiring the EPI contractor to bear the first loss under the cover, for example, up to $10m. Typically, this cascades down through the contracting chain to the marine contractor. The marine contractor is left with few options – either bear an uninsured risk or insure at inefficient cost.
5. It is also generally assumed that the client will take out CAR insurance. However, there may be projects where the client elects to self-insure. Again, the marine subcontractor needs to establish the extent of credit risk and decide whether insurance is an efficient solution for their own risk appetite.
6. There are due diligence obligations under the CAR, namely quality assurance and quality control 'QA/QC' provisions which must be adhered to by the contractors ('other assureds') as a condition precedent. Marine contractors should consider whether their procedures adopt the prescribed standards. Practically, the Marine Warranty Surveyor should approve the construction activities for the benefit of the underwriters. However, clients may be keen to lessen the chances of a breach of the condition precedent as this may compromise their own ability to recover under the CAR. The QA/QC provisions may therefore be deleted on a case-by-case basis.

Limitations of CAR cover from a marine contractor's perspective for FPSO units

The CAR does anticipate that contract works may include floating units, for example, FPSO/MOPU/FPU during any navigation from the yard to the offshore field. Section II of the CAR policy typically has a sublimit for third-party liabilities or coverage terms that may not be adequate compared to P&I policies, albeit section II cover can be arranged to sit in excess of P&I.

It is common for FPSOs to have a P&I entry for delivery voyages. This has the additional benefit of freeing up capacity under CAR section I for increased value of the unit relevant. There are practical issues for continuity and risk pricing for short duration exposures; risks that offer continuity and/or which are of short duration are more attractive.

Maintenance operations where there is no CAR cover

Once an offshore installation is in production, there will be maintenance obligations on the operator of the facility. Inevitably, these maintenance operations will involve marine contractors with an appropriate marine spread.

However, the existence of any CAR cover almost certainly will have ceased and/or there will be no equivalent insurance under which the marine contractor may be covered. The marine contractor's operations would constitute a specialist operation, and damage to the items being maintained would be treated as damage to contract works and therefore would be excluded under the P&I entry of that marine contractor.

Conclusion

In all three scenarios, it is apparent that marine contractors either may have no or limited access to the CAR cover for damage to the contract works. The options available for the marine contractor are stark – avoid the exposure through contracting; mitigate the exposure to the balance sheet by insuring the risk or bear the financial risk uninsured. Although at both forums there was no clear consensus on all issues, it was clear that inefficient insurance purchase is not in any party's interest. WELCAR 2001 was designed to address the offshore construction industry's competing requirements of limit, efficiency and certainty. The trend of contracting does not give any comfort to the club – there appears to be a significant pressure to turn the principal insured's property risk into a liability risk for the contractors and to avoid the community of interest. Unquestionably, this leads to uncertainty and inefficient use of limited insurance market capacity.