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Offshore Contracting

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The Standard Club has been providing P&I cover for offshore operators from the first days of oil exploration in the North Sea. During that time the industry has made extraordinary advances as it searches for oil in ever more challenging environments.

Each year we see new technological developments, and larger and more complex projects which stretch the resources of the oil companies to fund and develop. In step with this progression we have seen increasingly complicated networks of contracts governing the relationships between operators, joint venturers, contractors, subcontractors and service providers; contracts, moreover, involving sums that would have seemed incredible only a few years ago.

For an industry operating globally in circumstances in which the risks and rewards are higher than ever before, it is vital to negotiate appropriate contractual terms. In an ideal world, contracts should be fair and balanced, clearly and comprehensively drafted, and reflect a realistic assumption of risk and reward. Neither party should be exposed to disproportionate levels of commercial risk or potential liability. Traditionally, the industry has dealt with the apportionment of liability via the mechanism of knock-for-knock clauses, which reflect just such a fair assumption of risk. Well-drafted contracts also detail the insurance necessary to underpin each party's potential liability, a vital requirement in an environment in which a relatively small incident can lead to many millions of dollars of losses. Unfortunately, not all contracts are well-drafted, and even small amendments to standard form contracts can result in potentially large exposures for the parties concerned.

It is paramount for shipowners operating in the offshore oil industry to contract on terms that provide as much protection as possible from disproportionate liabilities. They also need to have sufficient insurance for those contractual risks that they do assume, and to be able to avoid risks that they cannot insure. But the insurance arrangements for the various parties and exposures involved in a typical offshore project can be complex and confusing, and may be affected by the terms and conditions of a particular contract.

In recognition of this, the Standard Club has produced this brief guide to the main features of P&I insurance as it relates to shipping operating in the offshore oil and gas industry and to some of the more common contractual provisions that can affect the insurability or otherwise of a contract. We hope that it will assist members and others in understanding how P&I covers the liabilities incurred by shipowners working in offshore oil and gas exploration and production – and, if we cannot provide cover, give some insight into the reasons why!

This guide will be of particular interest to owners' legal and insurance managers, as well as to their brokers and adjusters.

It will also provide a useful introduction for anyone who is interested in learning more about how P&I insurance responds to the risks incurred by shipowners operating in this most challenging and complex industry.

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The Standard Steamship Owners' Protection & Indemnity Association (Europe) Limited

The Standard Steamship Owners' Protection & Indemnity Association (Asia) Limited

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Offshore P&I Cover

Overview

A brief description of the cover offered by the International Group of P&I Clubs, the main provider of P&I insurance

P&I (Protection and Indemnity) insurance is a cover for the third party liabilities incurred by shipowners arising out of the operation of their ships. These liabilities include those in respect of personal injury to crew, passengers and others on board, cargo loss or damage, for oil pollution, for wreck removal of the ship, and arising out of collision with other ships or port facilities.

The main providers of P&I cover are the 13 P&I clubs comprising the International Group of P&I Clubs (the International Group), which between them provide P&I cover for approximately 90% of the world's ocean-going tonnage. The Standard Club is a member of the International Group. Each of the Group clubs is an independent non profit-making mutual insurance association that is controlled by its members through a member committee or board of directors.

A description of the Pooling Agreement

Each of the International Group clubs can provide P&I cover to a very high limit, currently approximately US$5.5 billion. This high limit is achieved by a claims-sharing mechanism operated by the Group clubs through the mechanism of the Pooling Agreement. The Pooling Agreement is an agreement by the clubs in the International Group to mutually reinsure one another by sharing all claims in excess of US$7 million per claim between themselves in agreed proportions.

Because all of the Group clubs share, or pool, claims amongst themselves, it is important that all of the clubs provide similar cover for poolable risks. The Pooling Agreement sets out, amongst other things, the types of claims that can be pooled, and the types of claim that are excluded from pooling.

The insurance provided by the Club is set out in the Rules, which positively express the cover available. To be covered by the Club a claim must fall within the limits of the cover set out by the Rules; it must arise out of the operation or management of an entered ship, and out of one of the risks insured against. Nevertheless, the Rules largely mirror the language of the Pooling Agreement, so a closer look at the Pooling Agreement will assist us in identifying which liabilities fall outside the mutual cover.

Normal poolable P&I cover responds to members' legal liabilities; that is, to liabilities that are imposed on members by law. This includes liabilities incurred by a member in tort, for example when he has been negligent, in law or statute, for example under the pollution or cargo conventions, or under certain contracts that are acceptable to the Club.

Cover for contractual liabilities

How the International Group covers shipowners' contractual liabilities

As a general rule, the Club will approve contractual terms that either reflect the liabilities imposed on shipowners by law, such as the Hague-Visby Rules or COGSA provisions incorporated in almost all bills of lading, or that are standard across the industry, for example compensation provisions in contracts negotiated with ITF-affiliated unions. Members should not assume responsibility under contract for any loss for which, under applicable law, they would not otherwise be liable, or in respect of which they would otherwise be entitled to exclude or limit liability. This is because of the principle of mutuality which underlies P&I insurance; poolable cover does not respond to liabilities that a member incurs voluntarily, because to do so could confer a commercial advantage on one member over another.

The Club approach to knock-for-knock contracts

In the offshore oil and energy business many contracts are negotiated on terms known as knock-for-knock. Under a knock-for-knock contract, each party assumes responsibility and indemnifies the other party for liabilities relating to the indemnifying party's own property and personnel and those of his subcontractors, regardless of negligence. These contracts have become industry standards in the offshore business, and the Club will approve knock-for-knock contracts for poolable cover, provided that they are balanced and do not expose the member to wider liabilities than those imposed on his contractual partner, and that the member has not waived his right to limit liability under applicable law.

BIMCO standard contracts

There are a number of industry standard contracts that have been approved by the International Group. BIMCO Towcon and Towhire are approved contracts for the provision of towage services. BIMCO Supplytime 2005 is an approved supply boat charterparty. BIMCO Heavycon is an acceptable contract for carriage of cargo on a heavy-lift ship. Members should remember, when contracting under BIMCO terms, that whilst these contracts are approved by the International Group, this does not mean that all liabilities incurred under BIMCO contracts will automatically be recoverable. Claims must still fall within the P&I cover to be poolable.

Cover for non-poolable contractual liabilities

Some contracts may not be acceptable for full pool cover, perhaps because they lack comprehensive language or the owner is required to waive his right to limit. In such cases, the member may purchase a fixed-limit contractual extension to his cover under Rule 20.35. This will cover P&I liabilities assumed by him under the contract for which he would not otherwise have been liable. However, a contractual extension does not confer blanket cover for all liabilities incurred under the contract, but rather, restores the P&I cover in respect of claims for which the member would not have been liable in the absence of the contract.

Where a contractual extension is given, either as an annual cover or in respect of a specific contract, the normal provisions of P&I cover still apply; claims must arise out of the operation or management of the entered ship, and must be covered under the Rules and the Certificate of Entry. Any exclusions in the Rules or the Certificate of Entry will continue to apply unless excluded risks are specifically reinstated.

Non-poolable risks

Types of offshore work that give rise to non-poolable risks

Liabilities arising during some operations are excluded from poolable cover under Rule 19. These are risks which have been excluded from normal pool cover because they are generally considered to be so large and so different to the types of risk to which the majority of commercial ships are traditionally exposed that they are not suitable for mutual insurance.

Non-poolable risks include Specialist Operations (such as construction, installation and maintenance of offshore structures, dredging, blasting, pile-driving, well stimulation, cable or pipe-laying, core sampling, and depositing of spoil, etc), which are excluded under Rule 19.11. The pool also excludes liabilities arising out of the operation by the member of mini-submarines or Remote Operated Vehicles, and liabilities arising out of the activities of divers for which the member is responsible, both of which are excluded under Rule 19.13. Purchase of a contractual extension alone is insufficient to restore cover in respect of these operations, even if the Club has reviewed the contract, unless the member has also purchased a specific cover for the liabilities in question.

Ships that carry out oil and gas drilling and production operations are dealt with by means of a separate cover, since Rule 19.12 operates to completely exclude liabilities in respect of such ships from normal P&I cover when they are carrying out these operations. Such ships must be entered with the Club via a fixed premium entry on special conditions.

Non-poolable risks are dealt with in more detail elsewhere in this bulletin.

The Club's approach to contract review

The Club aims to proactively advise members of the effect of the contractual arrangements that they have concluded in terms of normal poolable P&I cover and of any extra extensions to cover that the contract liabilities may require, so that we can provide a level of comfort in terms of the members' cover before any potential liabilities arise. Depending on individual member's requirements, the Club reviews individual contracts, either during the negotiation process or subsequently, or may by agreement carry out a regular contract audit. When the Club has reviewed a contract, cover is granted on the basis that the liabilities therein will remain unchanged. Should any contract wording change substantively, either in the final signed version or by reason of addenda being agreed, the contract should be reviewed again by the Club.

Acceptable contractual provisions

Knock-for-knock

A knock-for-knock contract for the purposes of Club cover is defined as one containing a provision or provisions stipulating that each party shall be responsible for loss of, or damage to, or injury and/or death of, its own property and personnel, and the property and personnel of its contractors and its and their subcontractors. The contract must also stipulate that such responsibility is without recourse to the other party and arises notwithstanding any fault or neglect of that party, and that each party shall, in respect of those losses, damages and other liabilities for which it has assumed responsibility, correspondingly indemnify the other against any such loss, damage or liability that the other party may incur.

Ideally, the knock-for-knock clause should be worded to include, within the indemnity given by the member's contractual partner, liabilities arising in respect of the property and personnel of his client and of any other parties for whose benefit the work is being carried out.

Third-party liabilities

It is acceptable for third-party liabilities to lie where they fall, i.e. there need be no mutual indemnity between the member and his contractual partner in respect of those losses. If the contract does include a mutual indemnity in respect of third-party liabilities, it should be based on fault, that is, the liabilities should be at law, and the indemnity provision should be worded to make clear that it is limited to pure third-party liabilities only. This is to ensure that claims from third parties relating to loss of or damage to the property of the member's contractual partner or his client or principal will be dealt with under the knock-for-knock clause rather than the third-party liability clause.

Limitation of liability

The member should not assume liabilities beyond those for which he would otherwise be entitled to limit his liability nor waive such rights of limitation. Ideally, the member's right to limit liability against his contractual partner should be specifically preserved. Otherwise, the contractual partner may argue that the indemnities given by the member constitute an implicit waiver of the member's right to limit. The member's contractual partner may also wish to preserve his own right to limit liability. As a result of the judgement of the Court of Appeal in the case of the CMA Djakarta, English law now allows charterers in certain circumstances to limit their liability to an owner in respect of claims under a charterparty. Allowing the charterer to specifically preserve the right to limit liability may therefore prevent the member from making a full recovery under any contractual indemnity given by the charterer. In this case, it may be preferable for the contract to remain silent on the right to limit.

Co-assurance

If the contract requires the member's contractual partner to be named on the member's P&I cover, the wording should make clear that the cover is restricted to liabilities that are properly the responsibility of the member under the contract. In such cases, the member's contractual partner can be named as a Co-assured under Rule 8.2.2, which entitles him to "misdirected arrow" cover for claims that should fall on the member, but not to cover for liabilities that are his responsibility under the contract.

Waiver of Subrogation

If the contract requires the member's insurers to waive their rights of subrogation against the member's contractual partner or his insurers, the wording should make clear that rights of subrogation are only to be waived in respect of liabilities that are properly the responsibility of the member under the contract. Otherwise, the member's contractual partner could argue that the intention is for the member's insurers to waive rights of subrogation in respect of all of the member's liabilities covered by insurance, regardless of the contractual division of responsibility for such liabilities. This is not correct. The Club will only give waivers of subrogation in respect of those liabilities that are properly the responsibility of the member under the contract.

Towage/supply boats

Cover for towage by an entered ship

Club cover for towage by an entered ship is provided by Rule 20.16.2, which covers the liabilities, costs and expenses that a member may incur under a contract for, or arising out of, towage by an entered ship of any ship or object. The entered ship must be specially designed or converted for the purpose of towage and declared as such to the Club, and the towage contract must have been approved in writing by the Club prior to the commencement of the tow. Unless the Club has agreed in writing, the pool cover will not respond for liabilities for loss of or damage to, or wreck removal of, a towed ship or object and/or its cargo or other property on board. This essentially means that the Club provides pool cover for liability in respect of the tow and cargo or other property on board only when there is a towage contract in place that protects the member from such liability. Provided that the member has contracted out of liability in respect of the tow, the pool cover will still respond even if the contractual provisions are not upheld by a court. The International Group imposes slightly different requirements on contracts for towage in jurisdictions that will not uphold knock-for-knock contracts, which are discussed in more detail below.

Cover for towage under a supply boat charterparty

In supply boat charterparties, the wording of the knock-for-knock clause must embrace all of the property of the charterer and his subcontractors, rather than just the cargo, so that, for instance, the charterer's indemnity will cover damage to a rig if the rig is in the field where the supply boat is employed to work. If towage is to be performed by a supply boat, the language of the knock-for-knock clause must cover the property of the subcontractors, and ideally the clients, of the charterer as well as of the charterer himself. This is to ensure that the knock-for-knock provisions will apply even if the tow is not owned by the charterer. Otherwise, there must be a separate clause stating that all towage is to be carried out on knock-for-knock terms or better. Supplytime 2005 addresses these points in addition to the other points listed above.

Cover for towage by an entered ship in jurisdictions that do not uphold knock-for-knock

Since February 2007, the poolable cover requirements in respect of towing have been relaxed slightly in recognition of the fact that certain jurisdictions will not uphold a contract that allows a towing vessel to avoid liability for its own negligence and to be indemnified by the innocent tow for all losses arising from such negligence. In such jurisdictions a member may be better protected by a different form of contract than by a knock for-knock contract that is not upheld. The pool cover will now respond for a member's liability for loss of or damage to or wreck removal of a tow or property on board under a contract that does not satisfy the knock-for-knock requirements if it is subject to a jurisdiction where the concept of knock-for-knock is unenforceable in whole or in part, provided that the contract does not impose liability for negligence of the tow on the member and allows him to limit liability to the greatest extent possible. A commentary by Brian Glover on the extent of the amendment was published in the *Standard Bulletin* dated16 May 2007.

Heavylift

The heavylift cargo exclusion

Rule 19.15 excludes from poolable cover all liability for loss of or damage to or wreck removal of cargo on heavylift ships except where such cargo is carried under a contract on Heavycon or similar terms approved by the Club's Managers. Heavycon is a BIMCO contract on knock-for-knock terms in respect of the ship and cargo. This effectively means that the pool cover only responds to the owner's liability for loss of or damage to cargo on a heavylift ship when the carriage contract protects him from such liability. Provided the member has contracted on acceptable terms, the pool cover will respond even if the contractual provisions are not upheld by a court. The International Group definition of a heavylift ship is a semi-submersible heavy-lift vessel, or any other vessel designed exclusively for the carriage of heavy-lift cargo.

Specialist Operations

What are "Specialist Operations"?

Rule 19.11 excludes liabilities, costs and expenses arising out of what are termed by the International Group clubs as "Specialist Operations". These include works such as construction, installation and maintenance of offshore structures, dredging, blasting, pile-driving, well stimulation, cable or pipe-laying, core sampling, and depositing of spoil. The list is deliberately not exhaustive; it is not possible to set out a definitive list because of the rate at which technology advances and new operations are undertaken. For instance, vertical seismic profiling is now much more common than it used to be, and is considered to be a specialist operation by the International Group.

The Specialist Operations Exclusion

The exclusion does not apply to personal injury claims in respect of personnel on board the entered ship, nor to liabilities in respect of oil pollution from the entered ship or removal of the wreck of the entered ship, since these are claims that are common to all shipping and that it would be difficult for shipowners to avoid. These liabilities are therefore covered under normal poolable P&I cover even when the ship is performing Specialist Operations.

The exclusion is formulated in three parts. The first limb excludes liabilities arising out of the specialist nature of the operations. For instance, if a dredger damages a buried pipeline in the course of dredging, this would be a liability arising out of the specialist nature of the operation, because the pipeline would not have been damaged if the ship had not been dredging. An extension to cover can be purchased to cover these risks. The second limb of the exclusion relates to liabilities arising out of the member's failure to perform the Specialist Operation and the fitness for purpose or quality of his work, which is a commercial risk for the member to bear. The third limb of the exclusion relates to liabilities arising as a consequence of loss of or damage to the contract work, which will normally be covered under a Construction All Risks (CAR) insurance.

The Contract Work exclusion and CAR cover

The Club defines "Contract Work" as including materials, components, parts, machinery, fixtures, equipment and other property that is or is destined to become a part of the project on which the entered ship is working or to be used up or consumed in the completion of the project. The definition is designed to dovetail with the CAR policy wording most commonly used in the London market to cover builder's risks for big offshore projects, since this will be the insurance that will cover the risk of loss or damage to these items, listed in the CAR policy as project property. As with the Specialist Operations exclusion, the description of "Contract Work" is deliberately not exhaustive to take account of the fact that each project will involve slightly different project property.

Cover for liabilities arising out of Specialist Operations

A limited extension is available to reinstate cover for claims excluded by the first limb of the Specialist Operations exclusion (Rule 19.11(i)). This extension gives cover for claims arising out of the specialist nature of the operation. It does not give a blanket cover, and to be paid, claims must still fall within the P&I Rules. Even if an extension has been purchased, the other two limbs of the Specialist Operations exclusion will still apply. As a general rule, it is difficult economically to buy extensions reinstating the exclusions in respect of failure to perform or fitness for the purpose of the member's work and loss of or damage to contract work (Rules 19.11(ii) and (iii)). Liabilities in respect of failure to perform and contract works therefore remain excluded under a Specialist Operations extension.

Most Specialist Operations work is performed under contract. If a contract for Specialist Operations work exposes a member to wider than acceptable liabilities, cover for these wider contractual liabilities must also be specifically agreed with the Club in addition to any Specialist Operations cover.

Divers, mini-submarines and ROVs

The ROV exclusion and cover for liabilities arising out of ROV operations

Pool cover excludes liabilities arising out of the operation by the member of submarines, mini-submarines and diving bells, which includes Remote Operated Vehicles (ROVs) and other underwater vehicles (Rule 19.13 (ii)). The exclusion will only apply if it is the member who is carrying out or is responsible for the ROV operations. When the entered ship has been chartered out as a platform for ROV operations and the underwater vehicle is being operated from the ship by another party, the exclusion will not apply.

The exclusion will apply when the member is using his own equipment or is otherwise responsible for the operation of the ROV, and liabilities arising out of the operations will not be covered. It is possible to purchase a limited extension of cover in respect of the excluded liabilities. The extension will only cover third-party liabilities arising out of the operation of the underwater vehicle; it will not cover damage to or loss of or wreck removal or recovery of the vehicle itself.

The Divers exclusion and cover for liabilities arising out of the operations of divers

Pool cover excludes liabilities arising out of the activities of professional or commercial divers where the member is responsible for those activities (Rule 19.13 (iii)). When the member is not responsible for the activities of the divers, for instance in circumstances in which the entered ship has been chartered out as a dive platform and the charterer or another party is responsible for the engagement of the divers, the exclusion will not apply. It is possible to purchase an extension of cover for third party liabilities arising out of diving activities, but this does not usually cover death of or injury to the divers themselves.

FPSO's, FSU's and Drilling Units

Cover for units involved in offshore oil and gas drilling and production

Poolable cover excludes all liabilities arising in respect of ships or units involved in oil and gas drilling and production operations whilst those units are working (Rule 19.12). This includes FPSOs (Floating Production, Storage and Offloading Units), FPUs (Floating Production Units), MOPUs (Mobile Offshore Production Units), drilling rigs and drill ships. In contrast to the Specialist Operations Exclusions, there is no cover for liabilities such as personal injury, wreck removal or pollution from the ship or unit whilst it is working. This means that, in practice, from the time such units arrive on the field and commence operations, they have no poolable P&I cover at all. They therefore purchase fixed premium P&I cover through the Club which gives similar coverage to the normal International Group cover, but to a lower limit. The cover is given by the Club and reinsured in the commercial market.

FPSOs, drill ships and other drilling and production units can be entered within the International Group pool for normal P&I cover until they commence operations, for instance while they are navigating or under tow to the field, since the risks they run during these operations are similar to those incurred by many commercial ships. If P&I cover is given for a unit that is being towed, the normal restrictions regarding cover for towage of an entered ship will apply.

Floating Storage Units (FSUs) can be covered within the International Group Pool because they are not involved in production operations, and the risks they run are not greatly different to those incurred by a trading tanker. For this reason no extensions of cover are required for FSUs.

Special Covers

The Standard Club Non-pool Reinsurance Programme

The Standard Club has been providing cover to offshore operators from the first days of oil exploration in the North Sea in the early 1970s. We are able to provide tailored extensions to allow members to buy back cover for many of the risks excluded from normal poolable P&I cover such as Specialist Operations and drilling or production operations. These extended covers are reinsured through the Standard Club's non-pool reinsurance programme, which is sufficiently flexible to allow the Club's underwriters to offer a wide range of terms and limits to best suit individual members' needs. The Club can provide cover to limits up to US$1 billion any one accident reinsured with security rated A and above by Standard and Poors.

We have produced a number of insurance products specifically designed for shipowners operating in the offshore oil and gas industry which are intended to give these owners comprehensive cover set out in clear and unified wordings. The wordings of all of the products mentioned below can be found on the offshore section of the Club's website.

The Standard Offshore Conditions

These offer P&I cover for production units such as FPSOs whilst they are operating and therefore excluded from pool cover. The wording allows a short certificate to be issued which states that cover is on the Standard Offshore Conditions and includes the applicable limit. The cover and exclusions together with necessary definitions are contained in the Conditions themselves. Excess war risks P&I cover for drilling and production units is normally purchased at the same time and provided under the Standard Offshore Conditions P&I War Risks Clause.

The Standard Offshore Extension

This is intended for ships involved in operations offshore such as cable and pipelaying or construction and maintenance, diving or ROV work, or that carry out towage or salvage operations. The extension sits within the member's P&I certificate of entry and is designed to dovetail with the poolable P&I cover to provide cover for risks such as those arising out of Specialist Operations that would otherwise be excluded. The cover given is flexible; the wording is set out in various sections so that members can choose those relevant to their operations, and different limits can be purchased for different risks.

Offshore Contract Review

Introduction

Each year the Club reviews a large number of contracts for members, ranging from relatively straightforward supply boat charterparties to complex, high-value EPIC contracts for large offshore projects. The Club aims to proactively advise members of the effect of the contractual arrangements they have concluded in terms of normal poolable P&I cover and to draw attention to any extra extensions to cover that the contract provisions may require, so that we can provide a level of comfort in terms of the member's insurance position before any potential liabilities arise.

In the course of this contract review process we see a number of pitfalls repeated again and again, some of which are discussed below. For ease of reference, we have referred throughout to the member's contractual partner as the charterer, although we also review contracts other than charterparties and the comments apply equally to these. The comments below are concerned only with drafting pitfalls – members may also incur non-poolable liabilities under a contract for other reasons, perhaps because the work that the member is carrying out qualifies as a specialist operation or the entered ship is involved in drilling and production operations. If members are in any doubt as to whether the liabilities incurred under a specific contract are poolable, they should contact the Club for advice.

Whilst these comments are largely intended for those members who have poolable cover, they are in many cases equally relevant for members operating units such as FPSOs and drill ships that are insured wholly outside the Pool. The Club will in most cases still wish to review the relevant contracts for these units.

Knock-for-knock provisions

The International Group definition of knock-for-knock

There are numerous ways in which these clauses can be eroded or otherwise made defective so as to place the member outside poolable P&I cover. The starting point for any consideration as to whether a knock-for-knock contract is poolable must be the definition of knock-for-knock in the Pooling Agreement. This reads as follows:

"Knock for Knock" - a provision or provisions stipulating that

> *i) each party to a contract shall be similarly responsible for loss of or damage to, and/or death of or injury to, any of its own property or personnel, and/or the property or personnel of its contractors and/or of its and their sub-contractors and/or of other third parties, and that*
>
> *ii) such responsibility shall be without recourse to the other party and arise notwithstanding any fault or neglect of any party and that*
>
> *iii) each party shall, in respect of those losses, damages or other liabilities for which it has assumed responsibility, correspondingly indemnify the other against any liability that that party shall incur in relation thereto*

Note that the language of the definition requires the liability and indemnity provisions to be balanced and co-extensive in order to be poolable. In other words, if the member takes liability for his own property and personnel and that of his own contractors and subcontractors, the other party must also take liability and give an equally wide indemnity in respect of its own contractors and subcontractors. If, on the other hand, the charterer is only liable and indemnifies the member for his own personnel, the contract will still be poolable if the member's own liability and indemnity obligations are limited to the member's own personnel. To the extent that any contractual allocation of risk is not reciprocal, the member may consider buying a contractual extension to cover those liabilities that would not be poolable.

Cover for unbalanced knock-for-knock contracts

Unfortunately, we see a large number of contracts in which the liability and indemnity provisions are unbalanced, in that the member is required to take responsibility for the property and personnel of his contractors and subcontractors, but the charterer's indemnity is limited only to his own property and personnel and does not extend to his other contractors and subcontractors. In this case, because the provisions are not co-extensive, the contract will not be considered poolable in respect of any liabilities to which the member would not have been exposed in the absence of the contract and which are not balanced by a similar assumption of liability by the charterer in respect of his contractors and subcontractors. In practice, the non-poolable exposure will often be limited to any non-negligence-based liability for the personnel (and property, if covered by the Club) of the member's contractors and subcontractors, if any, for which the member is obliged to indemnify the charterer. This is likely to be more of a problem in contracts for offshore or subsea construction or maintenance work where the member may employ subcontractors, than in straightforward supply boat charterparties. (Note that different considerations apply to contracts for towage by an entered ship, and these are dealt with in more detail elsewhere in this bulletin).

Mutual Hold Harmless (MHH) Agreements

How MHH Agreements operate

It is not uncommon, in contracts in which the charterer's indemnity is limited only to his own property and personnel, for liability for the property and personnel of his other contractors and subcontractors to be dealt with by a mutual hold harmless scheme. Such schemes are intended to govern the relationships between various parties who are working simultaneously on an offshore project but who have not contracted directly with one another. Each party signs an identically worded liability and indemnity agreement (also known as a mutual hold harmless agreement, or MHH), which provides that the signatory will indemnify any other signatory of the agreement for liability in respect of the first party's own property and personnel, regardless of fault or negligence. This creates an acceptable knock-for-knock scheme between the various parties who have signed up to it. Provided that signature of

the mutual hold harmless agreement is compulsory for all of the charterer's other contractors and subcontractors, these schemes are a reasonable substitute for a comprehensive contractual knock-for-knock regime encompassing the charterer's other contractors and subcontractors. The disadvantage is that the member must look to the charterer's other contractors to abide by the mutual hold harmless and to indemnify him in respect of any claims, which can be a drawback since the member may not be in a position to check those parties' financial strength and insurance position.

Pitfalls of MHH Agreements

A problem arises when the charterer does not undertake to ensure that all of its other contractors and subcontractors sign up to the mutual hold harmless scheme. Contracts frequently provide that the charterer will use his best endeavours, or some such wording, to persuade his other contractors and subcontractors to sign up. In such cases the member has no guarantee that they will sign, and no recourse if they do not. Such wordings would create a poolable contractual matrix only if the charterer undertook to remain liable and indemnify the member for claims in respect of the property and personnel of any of the charterers' other contractors and subcontractors not party to the mutual hold harmless scheme.

Supply boat charters involving MHH agreements with drill rig operators

A variation on the mutual hold harmless scheme occurs sometimes in charterparties between the owners of offshore supply boats and oil companies for services to a third-party drilling rig that has been separately contracted-in by the oil company. Rig owners have recently become less willing to enter into agreements that require them to indemnify supply boat owners for liability for loss of or damage to the rig. This is partly due to the current high market rates for drilling rigs, which means that large sums are lost by rig owners if their units have to go off-hire to repair. The result is that the indemnities in the charterparty between the supply boat owner and the oil company are often limited to the oil company's own property and personnel and may specifically exclude the drilling rig. This leaves the supply boat owner to reach a separate agreement with the rig owner, who will often provide a full mutual indemnity only in excess of a set amount, below which each party will be liable for damage he does to the other's property. Under such side agreements with rig owners, the supply boat owner can sometimes be liable for amounts up to US$50 million, and whilst claims that fall below this will in many circumstances be poolable provided they arise from the member's negligence, claims arising during towage of the rig may not be poolable. In such cases the shipowner will need to purchase an extension to cover his liability to the rig owner up to the amount at which the mutual indemnity applies.

Contract works exposures

Cover for shipowner's exposure to contract works/project property liabilities

A similar issue exposing members to additional liability arises relatively frequently in contracts relating to offshore construction projects, which often include a provision that the member will take liability for a tranche of any damage caused as a result of his negligence to the work that is the subject of the contract, despite the fact that, since this is the property of the charterer, the charterer should be liable for such damage regardless of cause. The member's share may be quite low, perhaps US$250,000 or US$1 million, representing the deductible on the CAR policy, but he should bear in mind that it may not be possible for him to insure this exposure if the ship is involved in any installation, construction or maintenance work. This is because such work constitutes a Specialist Operation, and while it is possible to buy an extension for the member's liability arising out of Specialist Operations, the extension cover will not cover claims in respect of loss of or damage to work that is the subject of the contract (Contract Works). Cover for Contract Works liabilities is limited and extremely expensive to buy as an extension to P&I cover because such risks should normally be covered in the CAR market, which is rated very differently.

Contractual indemnities

Knock-for-knock provisions must incorporate indemnities

The knock-for-knock definition in the Pooling Agreement requires the division of liability to be regardless of fault or negligence, and for each party to indemnify the other. It is not uncommon to see contracts that are defective in that they lack indemnities, or do not include language that requires the parties to take liability regardless of fault. The indemnity provisions are important because they protect the member if he is sued by a party who is not bound by the contract. For instance, he may be sued directly by one of the charterer's employees or other contractors if they suffer injury or damage as a result of the member's negligence. The provisions in the charterparty will not be binding on other parties so as to prevent them suing the member. However, without an indemnity the member will not be able to recover his liability to any other parties from the charterer, since the division of liability in the contract may be held to refer only to claims between the two parties to the contract. It is therefore essential for the parties to agree to fully indemnify and hold one another harmless in respect of claims for which they are liable under the contract, to avoid the contractual division of liability being undermined by third-party claims.

Knock-for-knock provisions must apply regardless of fault

It is also important that the contract states clearly that the division of liability and the provision of indemnities shall be regardless of fault or negligence. In many jurisdictions, including England, clear language is required before a court will uphold provisions allowing a party to avoid the consequences of its own negligence. Therefore, a simple division of liability between the parties without such language will only be effective in cases where the claim is not due to the fault of either party.

Gross negligence/wilful misconduct

Exceptions from the knock-for-knock regime for gross negligence/wilful misconduct – no cover for owner's wilful misconduct

An increasingly common feature in amended knock-for-knock contracts is an exception within the liability and indemnity clause for claims arising out of one party's (usually the shipowner's) gross negligence or wilful misconduct. These usually take the form of a wording providing that one party need not indemnify the other for claims arising out of the indemnified party's gross negligence or wilful misconduct. These clauses are inadvisable for various reasons. Firstly, the Marine Insurance Act provides that insurers will not be liable for losses arising out of the assured's own wilful misconduct. In the unlikely event that a court finds that, because of his wilful misconduct, a member cannot recover under a contract liabilities which should be for his contractual partner under the indemnity provisions, he will therefore be liable for losses for which *prima facie* he is uninsured.

Gross negligence/wilful misconduct exceptions undermine the knock-for-knock regime

Apart from this, gross negligence/wilful misconduct exceptions can still be problematic. There is a general assumption that gross negligence must relate to something more severe than ordinary negligence, whilst wilful misconduct involves a conscious element of wrongdoing, but there is often no definition of either term in the contract. Even where there is a definition, it may be rather widely drafted. For instance, many definitions refer to "senior supervisory personnel", presumably intending to limit the exceptions to cases where the gross negligence or wilful misconduct has occurred at such a senior level that it is tantamount to conduct by the guiding mind of the company. However, in the absence of further detail "senior supervisory personnel" is a sufficiently vague wording to possibly encompass the master and officers on board the ship, which would be a much less severe test.

In any case, the decision as to exactly what constitutes gross negligence or wilful misconduct may be a subjective one, since in many instances the decision will be a matter of degree and judgement and will involve consideration of the state of mind of the individuals concerned. This means the loss of the certainty and clarity in the allocation of liabilities which is the great advantage of knock-for-knock regimes. Clearly, if a contract includes a gross negligence or wilful misconduct exception there will also be a temptation on the indemnifying party to attempt to bring claims within the exception and thus avoid liability. If the parties themselves cannot reach agreement on the interpretation of the facts of a particular incident, they will be reliant on the courts or arbitration tribunals in the relevant jurisdiction to decide exactly what constitutes either gross negligence or wilful misconduct. This therefore means that such exceptions are more likely to lead to litigation, undermining the other advantage of knock-for-knock regimes, namely, the avoidance of time-consuming and costly disputes.

Third-party liabilities

Third-party liability at law is acceptable, but should not encompass charterer's other contractors or towed property

Provisions in respect of third-party liabilities feature in many contracts, and these can cause further problems. Such provisions can expose the member to non-poolable liability if the indemnities given by the charterer are not wide enough to extend to his other contractors or subcontractors. This is a particular problem if towage of property owned by a party other than the charterer is involved, since in many cases the member may not be able to pool claims in respect of loss of or damage to or wreck removal of a towed object, even if his liability arises out of negligence. "Pure" third-party claims, ie those that do not involve any towed property or other contractors or subcontractors of the charterer, can be pooled provided that the contractual language imposes no wider liability upon the member than he would have at law.

Member's liability for third-party claims must be subject to his negligence

Unfortunately, many of these provisions use language that exposes the member to wider liability than he would otherwise have. The wording may simply provide that the member will be liable and indemnify the charterer for all third-party claims without reference to negligence or the position at law, or may even go so far as to provide that the member will be liable for third-party claims regardless of the negligence of the charterer or his other contractors and subcontractors. Poolable cover will not respond if the member is liable under a contract for third-party claims arising out of the charterer's or any other party's negligence.

Members should also be wary of third-party liability provisions that are widely worded or unclear, such as, for instance, those that provide that the member will be liable for all claims "caused by" him or his ship. Without a specific reference to negligence, the member could be held liable for claims regardless of whether he is negligent or not; for instance, if the ship drops an anchor on a pipeline because the charterer has given the member incorrect information. Claims arising under such provisions will not be poolable if they expose the member to claims wider than those for which he would be liable in the absence of the contract.

We also see contracts that require the member to take liability for third-party claims "arising out of all work to be carried out under this charterparty" and similar wordings. These are even wider in their potential effect, since there is no actual link between causation and the member's activities, so it is open for the charterer to argue in the event of a claim that the intention of the clause is for the member to be liable even when the claim is caused by the charterer or someone for whom he is responsible. Members should remember that the normal P&I cover is limited to claims arising out of the management or operation of the entered ship, so wordings such as this could potentially expose them to claims that may be outside cover even where they have bought a contractual extension.

Towage by an entered ship

Pool cover for towage in jurisdictions that uphold knock-for-knock

There are particular provisions in the Pooling Agreement applying to towage by entered ships. The recent amendments relax requirements for towage contracts where the concept of knock-for-knock is unenforceable in whole or in part in a particular jurisdiction, provided that towage contracts do not impose liability on the member for negligence of the tow and allow him to limit liability to the greatest extent possible. From members' point of view, this means that contracts for towage in jurisdictions that uphold knock-for-knock contracts, such as England, must still be on terms that exempt them from liability for loss of or damage to or wreck removal of towed objects. Detailed comments on the position in jurisdictions that do not uphold knock-for-knock are set out elsewhere in this bulletin.

Poolable cover for towage under supply boat charterparties

The Pooling Agreement provisions in respect of towage also apply to supply boat charterparties and other offshore contracts involving towage; the contract must protect the member from liability in respect of the towed object. Members will need to be particularly careful in fixing such contracts to ensure that the language of the liability and indemnity provisions gives them proper protection in respect of towage. For instance, if the charterer is an oil company fixing a ship to support a well-drilling programme, it is unlikely that the drilling rig will be owned by the oil company, and therefore knock-for-knock provisions that refer only to the property of the charterer will not be sufficient to protect the member. The wording should ideally provide that the owner will not be liable and the charterer will hold him harmless for liabilities in respect of loss of or damage to or wreck removal of anything towed by the ship, but in the absence of such clear language a provision extending the charterer's liability and indemnity provision to the property and personnel of his other contractors and subcontractors will generally be acceptable. Some contracts specifically exempt the drilling rig from the liability and indemnity provisions in the contract; in such cases the member must have a comprehensive Hold Harmless and Indemnity Agreement with the owner of the rig. Otherwise, any liability the member may have for loss of or damage to or wreck removal of the rig arising out of towage will not be poolable.

Pollution and wreck removal

Pool cover for contractual liabilities for pollution

Members should carefully examine clauses in respect of pollution clean-up and removal of wreckage or debris, since if not carefully worded these can also expose them to non-poolable liability. Member's normal P&I cover will respond to loss or damage caused by pollution from the entered ship and the costs of cleaning up such pollution, regardless of fault, provided that the member has not waived his right to limit liability. Clauses that allow the charterer to conduct the clean-up and bill the member for the cost and for any claims arising from the pollution may cause difficulty if the contract does not otherwise preserve the owner's right to limit. The charterer may not be able to rely on the same limitation of liability as a shipowner, or may be unwilling to do so, but the additional exposure may not be poolable since a member should not take on contractual liability greater than he would have had in the absence of the contract. Apart from limitation issues, members should normally endeavour to retain control of costs that will ultimately be billed to them.

No cover for blowout, control of well expenses and pollution from reservoir

Members who are operating FPSOs or other drilling or production units will see exclusions in their Club cover for risks such as blowout, seepage and pollution from reservoir, and control of well expenditure. The Club does not provide any cover for these risks, which are normally covered under specialist insurances written in the commercial market and rated very differently. The contract should provide for these exposures to be borne regardless of negligence by the oil company for whom the member is working, since they can more appropriately be insured under the oil company's Operator's Extra Expense (OEE) or Energy Exploration and Development (EED) programme.

Pool cover for contractual liabilities in respect of wreck removal

Similarly, poolable P&I cover extends to the costs of removing the wreck of an entered ship and cargo on board when required by a competent authority or because the wreck is a danger to navigation. Many contracts include clauses whereby the member also agrees to pay for the cost of removing the wreck of the ship if it interferes with the charterer's operations. If there is no wreck removal order and the wreck is not causing any danger to navigation such liability goes beyond poolable P&I cover and therefore will only be covered under an extension.

Members should also remember that the poolable P&I cover only responds for the costs of cleaning up wreckage of the entered ship or cargo thereon. For this reason members should avoid clauses that make reference to a general requirement for the member to clean up any wreckage or debris that is not limited to the wreck of the ship itself and its cargo, since these clauses may expose him to liability that will not be covered unless he has bought a specific extension. This will be particularly relevant in cases when underwater vehicles are being operated from the entered ship since the Club will not normally cover loss of or damage to such vehicles or claims consequent thereon, which would include liability for removal of the wreck of such vehicles.

Insurance provisions

Insurance provisions must underpin liability and indemnity provisions

The insurance provisions in a contract should always be reviewed to ensure that they underpin and support the liability and indemnity provisions. This is particularly important since courts will often look at the insurance provisions of a contract to assist them in interpreting the liability and indemnity provisions if the latter are not clear. In cases where the insurance and liability provisions conflict, the courts may even "follow the

money" and allocate liability to the party who ostensibly has the obligation to insure the risk concerned, even if the result conflicts with the liability provisions on a straightforward interpretation.

Waivers of subrogation

Waivers of subrogation should be limited to the owner's contractual liabilities

There are various insurance provisions in offshore contracts that can present problems. The most obvious example is the waiver of subrogation clause, as discussed elsewhere in this bulletin. When a clause simply requires the member's insurers to waive their rights of subrogation in respect of the charterer or other parties without further qualification, this can allow the charterer to argue that the waiver is intended to cover all claims covered by the member's insurers, and is therefore not limited only to claims that fall to the member under the contractual knock-for-knock provisions. This interpretation could severely compromise the knock-for-knock provisions, and therefore the wording of any waiver of subrogation clause should make clear that such waivers are limited to those liabilities that are to be borne by the member under the terms of the relevant contract, and are not given in respect of those liabilities that are to be borne by the charterer.

Co-assurance

Charterer entitled to misdirected arrow cover for the owner's contractual liabilities only

Most contracts require the charterer to be named as a "co-assured" on the member's P&I insurance; the contract may also refer to a "co-insured" or an "additional assured". The meaning is generally the same, namely, that the charterer shall be named on the member's P&I cover as a Co-assured, which is a term defined in the Pooling Agreement. A Co-assured, as defined in the Pooling Agreement, is a party who will be permitted to access the member's P&I cover in respect of liabilities that would have been recoverable by the member from the Club if the claim in question had been brought against the member rather than the Co-assured. In the case of a party that has entered into a contract or charterparty with the member, this means that poolable co-assurance will extend to liabilities that are to be borne by the member under the terms of the contract or charterparty, provided that the contract is on acceptable knock-for-knock terms. If the contract is not knock-for-knock, the poolable cover will only cover the Co-assured charterer for those liabilities for which the cover would have responded if the claim were brought against the member.

Cross Liability clauses and "As Owner" provisions

Cross Liability and "As Owner" provisions can prejudice cover

Charterparties concluded in the US often include provisions requiring the member's insurers to insert a Cross Liability (also known as Severability of Interest) clause in the policy wording and to delete any "As Owner" language. These particular provisions are problematic and should be deleted insofar as they apply to P&I insurance, because they impose requirements on the member with which it will be difficult for the Club to comply, and additionally, may expose the member to liability that he would otherwise avoid.

Cross Liability clauses cannot be included in P&I policies

A Cross Liability clause essentially requires an insurance that covers several different parties, such as a public liability policy, to behave as if each party has his own cover with a separate policy issued to each insured. This is perfectly appropriate when the policy is intended to cover each insured party in his own right. However, charterers named as Co-assureds on a member's poolable P&I cover do not have cover in their own right, but rather have the benefit of the member's cover for claims properly the responsibility of the member, which in the context of an offshore charter would mean claims for which the member is liable under the charterparty. The Co-assured does not have cover in his own right, so a Cross Liability clause in this context is inappropriate.

The Club cannot delete provisions in the Rules restricting cover to owners' liabilities only

"As Owner" language in insurance policies refers to policy provisions which only allow cover to a shipowner or another party acting in that capacity. Similar language is found in the Club's Rules, which provide that a member shall not be covered by the Club for any liabilities incurred by him in a capacity other than the capacity in which he is insured by the Club. This means that the member is covered only for liabilities that he incurs as an owner, which under a charterparty will mean his liabilities under the liability and indemnity clause. A Co-assured charterer may claim on the member's cover if he has to pay for liabilities that are the responsibility of the member under the charterparty, but, since the charterer is not claiming on his own insurance but accessing the member's cover to pay for claims that are properly the responsibility of the member as the owner under the charterparty, there is no need to amend the Club's Rules.

We hope you have found the information contained in this bulletin helpful. Please remember that the information provided is intended to be used as a guide only and should not be relied upon as a substitute for specific legal advice. The Club will be happy to provide further advice to members on the terms of particular contracts if required.

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