Contracting issues in the heavylift sector

Rupert Banks and **Ian Billington**, at the Standard Club, consider the increasing risks for heavylift operators

As project cargos, particularly in the offshore oil and gas sector, become physically larger and of higher value, heavylift operators are facing increasingly onerous contractual liability regimes. This article highlights current trends in heavylift contracting: in particular, the fact that it is increasingly common for heavylift operators to be required under contract to assume all liability for cargo, irrespective of fault. This is a worrying trend for heavylift operators; as such burdensome terms bear no correlation with their risk-reward ratios.

Poolable cover

The members of the International Group (IG) of P&I clubs, of which the Standard Club is one, insure more than 90% of the world's shipping fleet by tonnage for their third party operational liabilities. By "pooling" claims and arranging a shared reinsurance facility, the IG clubs can provide the high limits of cover their members need to trade.

Pooling is regulated by the pooling agreement (PA) which ensures a level playing field between the participating clubs and defines the risks that can be pooled and how losses are to be shared. Normal poolable P&I cover responds to an operator's legal liabilities, ie liabilities imposed upon them by law. This includes liabilities incurred by an operator in tort, under statute, or under a contract that is acceptable pursuant to the terms of the PA.

Through the Standard Club's offshore contract review service, we see a range of heavylift contracts, from project cargos for petrochemical or power plants through to complex transport and installation (T&I) contracts for large-scale offshore energy developments.

A requirement of poolable cover is that an operator must endeavour to avail themselves of the benefits and defences afforded to their trade under applicable international conventions. Furthermore, certain activities and operations which have been identified as too different from those undertaken by mainstream shipping cannot be accepted under the pooling arrangement for cover or are subject to additional restrictions. Semi-submersible heavy-lift vessels with their colossal cargos fall into this latter category, such that poolable cover for cargo liabilities is denied "save to the extent that such cargo is being carried under the terms of a contract on Heavycon terms or any other terms approved by the Association." [Cl.27 of Appendix V of the PA.]

Increasingly onerous liabilities

While the BIMCO HEAVYCON charterparty, where liabilities are apportioned on a knock-for-knock basis, continues to be the industry standard for the carriage of super-heavylift cargos, it is in transport and installation (T&I) contracts for offshore energy projects that we are seeing increasingly onerous liabilities being placed upon operators involved in the heavylift sector.

Heavylift operators that carry and install high-value topsides, modules and other components for oil companies and engineering procurement installation and commissioning contractors have generally always been expected by their clients to bear some exposure, ie have some "skin in the game" regarding the loss of or damage to the objects that they are carrying and installing offshore. Pure knock-for-knock contracts, while representing the benchmark, have traditionally been relatively rare for such operations and certain narrow carve-outs under the liability regime are customary. It is not uncommon, for example, to see heavylift operators being exposed under T&I contracts to liability for loss of or damage to and/or the wreck removal of the cargo arising out of their negligence up to a specified limit (usually between US$250,000 and $1m) which generally corresponds to the deductible that their client bears under their construction all risks (CAR) policy. The client then provides the operator with an indemnity under their contract for any liability in excess of this. In such a scenario, heavylift operators bear some potential exposure to a claim but they can take measures to adequately manage this risk.

"Gross negligence"

Recently, it has become increasingly frequent for heavylift operators to be required under contract to assume all liability for the cargo, irrespective of whether there is any negligence on their part, up to higher and higher limits (commonly up to around $10m to $20m, but with some reaching values of $250m). Furthermore, while they will generally still have the benefit of a contractual indemnity from their client for liability in excess of this cap, we are increasingly seeing this indemnity being eroded under the allocation of liability by exceptions for "gross negligence" or "wilful misconduct" and the right to limit their liability under applicable law being waived. This exposure is further compounded when mutual indemnities for consequential losses are also made subject to the same exceptions.

"Requiring T&I heavylift operators to assume all risk in respect of cargo up to exceptionally high limits of liability does not incentivise them in any way"

Gross negligence and wilful misconduct have no common legal meaning across jurisdictions and are usually defined terms in the contract. Our particular concern is these terms are often expressed in T&I contracts to specifically include conduct on the part of shipboard personnel. This will increase the risk of litigation as, in the event of a casualty, it is likely an operator's client will argue it was caused by the gross negligence or wilful misconduct of their personnel.

Unbalanced risk and reward

Most of the property destined to be transported and installed for offshore oil and gas projects is insured under a CAR policy, typically WELCAR. The form is designed to be available to all contributors to a project so that:

- there is consistency of cover;
- disputes on how a loss arose are minimised because all component parts wherever manufactured and handled are covered under the same policy; and

• costs are minimised through the purchasing power of centralised buying and avoidance of duplication of cover.

However, often, the heavylift operator is at the opposite end of a contracting chain from the party who has purchased the CAR policy. In this relationship it is often unclear what rights he has under the insurance policy or what the terms of cover are, so the real prospect of a non-covered claim still exists. Furthermore, access to cover under the CAR policy is very often subject to the indemnity regime in the contract, meaning that if a heavylift operator has assumed liability for loss of or damage to and/or wreck removal of the cargo under the contract (either up to a specified cap or otherwise), then they may not be afforded the benefit of cover under the CAR policy to the extent of their indemnity obligations under the contract.

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Even where the terms of cover and the extent of access to it are known, potential problems remain. In an attempt to impose standards of quality throughout the community of contributors to a construction project, special conditions are often applied, which in the worst case scenario can see cover denied. This may make sense for the manufacturers of component parts where the revenue they earn incorporates all costs of labour and parts that go into their manufacturing process and has a direct relationship to the value of the item they have produced. Therefore, if a manufacturer of a single part is particularly sloppy in their work the downside is 100% of the revenue they were due to earn.

On the flip side, the heavylift operator earns a day rate linked solely to delivery services, which are performed at the time all constituent parts have been assembled to create a single highly valued product. If the operator has any exposure to the full value of the cargo, no matter how slight, his risk to reward ratio is completely disproportionate.

It is not always possible to discuss the issues highlighted above with the ultimate customer because their relationship with the carrier is often too far removed. As an example, an EPIC contractor may be employed by the customer and it is this party that subcontracts through the heavylift operations. For understandable reasons, a company contracted to construct topsides for a platform including delivery to site may face quality based qualifications to their access to CAR insurance. However, when these are passed through to the heavylift operator in a back-to-back subcontract the potential consequences for them is far more severe, but the company is unlikely to dilute their own negotiating position with the end customer by pleading special measures for the carrier. This is unfortunate because we are not convinced the resulting position is always intended. Indeed, when opportunities have existed to contribute to discussions, we have witnessed improvements in terms once the position has been fully appreciated by the customer.

It is clear users of heavylift services want and need to deal with responsible and diligent operators. Yet often those carriers are put in a position where they would need to add the cost of full value insurance cover in addition to the customer's CAR policy to behave completely prudently. However, with the value of cargos involved, in the majority of cases this course of action is not viable. Operators are therefore left with the options of either taking a risk or walking away.

Concluding thoughts

This is a worrying trend for heavylift operators as such onerous liability regimes bear no correlation with their risk-reward ratios. While these recent contracting trends reflect a desire to ensure high standards are maintained in the carriage and installation of such high-value cargos, this can be adequately achieved by selecting only high calibre operators who frequently perform such operations as part of their core business and who therefore have strong incentives to maintain the high standards already implemented.

If an operators' client is not willing to contract on pure knock-for-knock terms for T&I services then, at most, negligence based exposures in respect of the cargo, up to manageable limits that provide sufficient motivation to maintain high standards, should be more than sufficient to allay any quality concerns from clients. Requiring T&I heavylift operators to assume all risk in respect of cargo, irrespective of fault, up to exceptionally high limits of liability does not incentivise them in any way. It merely drives up insurance costs unnecessarily in an environment where adequate, effective and efficient insurance arrangements are usually already in place. These increased insurance costs ultimately lead to higher lump sum prices or day rates charged to clients for T&I services. *MRI*

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