International Commerce

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MARINE INSURANCE BULLETIN

Welcome to the first edition of our quarterly Marine Insurance Bulletin.

This Bulletin covers topical legal issues impacting the marine insurance market. In this Bulletin we analyse how Eurozone instability may affect marine insurers. The article examines the potential consequences of a Eurozone exit and redenomination into a replacement local currency. We then turn to the new Offshore Construction Project Insurance Wording (WELCAR) and review some of the more controversial proposed changes, focussing on the potential for increased coverage disputes.

We also consider the impact of the prevalence of 6 month detainment clauses in H&M insurance in a piracy context. The article reports on how the increasing length of detentions is increasing the frequency with which deemed total loss clauses are triggered. Finally, we include our Case Update, a summary of key recent marine insurance case law, which will be a twice yearly feature.

Should you require any further information or assistance on any of the issues dealt with here, please do not hesitate to contact any of the contributors to this Bulletin, or your usual contact at HFW.

James Gosling, Partner, james.gosling@hfw.com
Jonathan Bruce, Partner, jonathan.bruce@hfw.com
Craig Neame, Partner, craig.neame@hfw.com

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Eurozone crisis

The Eurozone debt crisis has prompted parties to marine insurance contracts carefully to consider their potential exposures. Whilst it remains unlikely that the Euro would entirely cease to exist, what follows is a consideration of the issues which may arise in the event of the exit of a Eurozone state from the Euro and a redenomination into a replacement local currency.

Any withdrawing state would be likely to enact new laws making compulsory the redenomination of contractual payment obligations governed by local law into a new replacement local currency, as well as requiring payments into that state to be in the new local currency. Any such redenomination regime would be likely to be similar in some respects to the policy of "pesification" which was implemented in Argentina in 2002 and which led to contractual obligations losing their value in real terms.

The governing law and jurisdiction which applies to such contracts will be crucial in determining the impact of any such redenomination provisions. Contracts governed by express local law and jurisdiction clauses will be subject to any local laws on redenomination into any new currency, which will be difficult to avoid as they are likely to trump any currency conversion or re-denomination clauses providing for other harder currencies (e.g. Euro, GB Pounds, US Dollar). Therefore, where possible, parties should insist upon contracts being governed by English law and jurisdiction. However, even where contracts incorporate express English choice of law and jurisdiction clauses, issues may nonetheless arise because of two important conflict of laws principles.

Firstly, the internationally recognised principle of *lex monetae*, means that the choice in a contract of a particular currency is taken to imply a choice of the law of the country of that currency to determine, where necessary, what the currency of the contract is or may re-denominate into. In the current context of the risk of re-denomination into a replacement local currency (e.g. Euros back to Spanish Pesetas), issues may arise as to whether an English court, in applying this principle, should regard the choice of the Euro in a contract as a choice of the law of a particular Member State or a choice of the law of the Eurozone as a whole. To avoid such difficulties, currency fluctuation or conversion clauses, which provide either that the contract will be in Euros only or will be converted into other harder currencies such US Dollars or GB Pounds on any re-denomination, should be incorporated into potentially affected contracts. Where currency conversion clauses are utilised, parties must take great care as to the rates of exchange specified.

Secondly, there is the principle known as *lex loci solutionis*, whereby under Rome I Regulation, art 9(3), English courts may give effect to the overriding mandatory rules of the law of the place of performance of a contract (i.e. the "*lex loci solutionis*"). In doing so, courts have the discretion to render performance unlawful if payment of a claim under a contract in, for example, Euros is unlawful in the country in which payment must be made. Possible solutions here include incorporating clauses which require payment to be made to a party (e.g. a broker or other intermediary) outside of the country of the Member State which is at risk of currency re-denomination. It would be sensible to incorporate such clauses before any re-denomination takes place.

Where contracts are held to be redenominated, then issues of timing will be important. For example, insurers will want to avoid in a situation in which premium which has been contracted for in Euros becomes payable in a new, potentially devalued, currency. On the other hand, insurers who have received premium in Euros might benefit where claims become payable in the replacement currency as a result of an intervening redenomination. In a context in which contractual currencies may be redenominating, fluctuating and/or devaluing, questions of precisely when a loss under the policy has been suffered will also be crucial, as this may have a big impact on the amount of any indemnity.

Other issues that might arise following a withdrawal and redenomination include the risk of currency controls affecting the availability of a redenominated currency, making it difficult or impossible to fulfil obligations redenominated into that currency.

The prospect of redenomination presents various uncertainties, and parties to potentially impacted contracts may wish to act now to mitigate any future impact. With a view to avoiding exposures, parties should consider revising their contracts as above so as to avoid those EU states which are perceived as higher risk.

In the case of existing contracts, this may be achievable by endorsement. In the case of new contracts, by express provision. Where necessary, standard market clauses can be modified for these purposes. They should also consider including contract continuity clauses, which maintain the validity of the contracts in the event of a Eurozone redenomination.

Whilst redenomination could impact contractual obligations, it will also of course affect counter-party and investment risks. In that context, parties must consider minimising their exposure through careful negotiation of their future and existing contracts, with a particular focus on governing law, jurisdiction, currency conversion, validity and place of performance provisions.

For further information, please contact Costas Frangeskides, Partner, on +44 (0)20 7264 8244 or costas.frangeskides@hfw.com, or Ben Atkinson, Associate, on +44 (0)20 7264 8238 or ben.atkinson@hfw.com, or your usual contact at HFW.

Revision to the offshore construction policy

Since 2009, the Joint Rig Committee (JRC) at Lloyds has been working on revisions of the standard 2001 Offshore Construction Project Insurance Wording (WELCAR). In September 2011 the new WELCAR wording was released into consultation with the market. Publication was due in January 2012 but has been delayed pending a second consultation phase.

The aim of the new wording is to reflect ten years of underwriting experience on the basis of WELCAR 2001 and to improve the quality of the wording by bringing greater clarity and consistency through the use of more contemporary language.

WELCAR 2001 - well received by insurers

Although the WELCAR 2001 wording is not a perfect policy and has often been varied or extended by agreement, it remains the principal form used in offshore construction cover. Consequently, insureds, intermediaries and the market understand what it means, which in turn provides a degree of certainty, making it a user-friendly, practical product. The form provides a breadth of coverage to meet the needs of the insureds, whilst providing built-in protection for insurers. It is also the basis on which insureds contract with their contractors and sub-contractors on offshore projects. Whilst numerous issues as to coverage have arisen under WELCAR 2001, these have usually been resolved without recourse to proceedings, which is a reflection of the sturdiness of the product.

Generally speaking, the new (latest revision) WELCAR wording, whilst seeking to clarify matters, appears more restrictive of the coverage provided to the insured, making for a more generous policy for the insurer.

We comment below on some of the proposed changes which we feel could be less welcome to insureds and which may therefore potentially lead to disputes between insurers and their insureds., assuming the wording were to be issued as per the latest draft, although we appreciate that this is unlikely and further revision will take place. This is not an exhaustive list, but includes what we think are the main changes.

Scope of insurance

The policy language has been strengthened with a new requirement that the list of activities covered under the policy must be included within “declared” values and the coverage for initial operations is no longer included in these activities. All activities will therefore need to be properly listed in order for the insured to be fully covered.

Declarations

The limitation has been introduced so that those drafting contracts with “Other Insureds” must expressly give the benefit of the insurance to them. This raises the possibility that some contractors may not be insured where an inadvertent error has occurred in not conferring the benefit or as a result of ambiguous language.

Definitions

Although “Defective Part” is defined, “Part” is not. This has been the crux of issues in respect of the aspect of coverage and remains an issue.

General conditions

“Special Conditions Applying to Other Insureds”:

Clause A is restrictive in terms of cover for contractors during the “Maintenance Period”, during which time contractors will need to be careful to have their own cover for situations that may arise, but are not covered by this policy. This is likely to be welcomed by insurers.

Clause B restricts cover for any “Other Insured” where “any act or any failure to act (whether before

or after the Period of Insurance commences) by or on behalf of the Principal Insured which prevents recovery by the Principal Insured... or would prevent recovery". Again, this is likely to be welcomed by insurers.

Clause D states that the rights of "Other Insureds" can only be exercised by a "Principal Insured". This suggests that any failure on the part of the "Principal Insured" to comply with the conditions precedent could prevent cover for other insureds. This could lead to disputes between contractors and their sub-contractors, which may spill over into coverage disputes.

There is a significant change under "Due diligence" as new duties in respect of due diligence and compliance are placed on the "Principal Insured", their contractors and sub-contractors. QA/QC has been replaced by these clauses. These requirements might require contractors to increase their own cover.

"Survey Requirements" are stated to be a condition precedent to liability. A compliance obligation is placed on the "Insureds", meaning that a technical breach by an "Other Insured", for example, has the effect of removing cover for all insureds. This would leave other insureds potentially uninsured and again reduces insurers' liability.

"Notification Of An Occurrence Which May Result in A Claim" is now expressed as a condition precedent to liability and therefore breach of this will absolve insurers of liability. This is new and is a change very much in the insurer's favour.

"Waiver of Subrogation Rights" is removed where an "Other Insured" is not entitled to policy cover for an event of loss, damage, liability or expense. This waters down the hold harmless principles that are increasingly agreed between principals and contractors. As such it is likely that the market will not perceive this as a practical clause and this change will likely be rejected by insured and contractors.

Section one

"All risks" coverage has been removed from the "Insuring Clause" creating a limitation. It increases the burden of proof on "Insureds".

"Minimising Losses/Additional Work Required" replaces "Sue & Labour" language under limited cover, but the costs to be borne by insurers are only for a proportionate amount and capped at 50% of the value at the time.

The allocation of proportion across respective interests could well be problematic. This clause also provides that insurers will not pay for the cost of "imminent Physical Loss of or Physical Damage" arising from a "reasonably foreseeable" cause. Although this change appears to reduce insurers' exposure, imminent loss/damage must necessarily be reasonably foreseeable and whether something will be deemed "imminent" is a matter of fact and degree. This therefore leaves scope for disputes.

As to additional exclusions, the exclusion of costs of repairing, correcting or rectifying wear and tear, gradual deterioration, "scouring" is new. Also, the Defective Part exclusion has been broadened to include "defect in plan or defect in specification".

General

The new proposed WELCAR wording has been produced with the best of intentions, and it was time to upgrade it. Insurers are likely to welcome the broad thrust of these revisions as their exposure to claims under the new WELCAR wording would be significantly less than under WELCAR 2001. The proposed wording is particularly favourable to insurers as the inclusion of all the new conditions precedent makes it a much more onerous policy under English law, since a technical breach of any of these may result in a right for the insurer to terminate cover even where this did not cause any loss.

However, concerns have been expressed by insureds, many of whom feel that the revisions amount to a rewrite of the policy wording, propose a considerably narrower form of cover, and with more hurdles to overcome to secure cover. While the revisions are broadly favourable to insurers, insurers will want to be aware that the new

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wording (assuming it is introduced without fairly major further revision) significantly increases the scope for commercial disputes between contractors, for example where the fault of one subcontractor leads to the complete loss of insurance cover for all the others involved in the project.

There is concern that energy companies and contractors may seek broader coverage elsewhere if further amendments are not made, and uptake of the policy will be limited. Following strong criticism from some quarters we understand that the latest wording is likely to be substantially reworked before becoming a settled wording. Hopefully many of the above issues will be addressed. In any event, the above gives an idea of the current status of WELCAR 2012 and the types of issues which can actually arise whenever a new wording is introduced.

For more information, please contact Jonathan Bruce, Partner, on +44 (0)20 7264 8773 or jonathan.bruce@hfw.com, or Lizzie Gray, Associate, on +44 (0)20 7264 8752 or lizzie.gray@hfw.com, or your usual contact at HFW.

Six month detainment clauses: the unexpected consequence of piracy

The past 12 months have seen a clear reduction in the number of successful attacks attributable to Somali piracy. In the period January to June 2012 there were 44 attacks attributable to Somali piracy resulting in 13 hijackings[1]. In the same period in 2011, there were 125 attacks resulting in 21 hijackings[2]. The ICC International Maritime Bureau attribute this to *"the efforts and actions of the naval forces and preventative measures used by the merchant vessels including the use of citadels and employment of Privately Contracted Armed Security Personnel".*

However those unfortunate vessels which are captured are destined to be held for increasing periods of time. The duration of captivity for vessels hijacked by Somali pirates has steadily increased from 1/2 months in 2008 to in excess of six months in 2011. The humanitarian consequences of these long periods spent in captivity are all too apparent.

However there is an unexpected consequence of the increasing periods that Somali pirates are holding vessels, in particular the impact on Owners' War policies that can also prove commercially very important.

Under many of the standard sets of H&M terms there is provision for what happens in the event of a detention of the insured vessel. For example, Clause 84.1.6 German DTV-ADS 2009 provides as follows:

"If the vessel is seized by pirates for a period of more than 12 months, the Insured may request payment of the sum insured."

Likewise, section 15-11 of the 2007 Version of the 1996 Norwegian Plan provides as follows:

"If the ship has been captured by pirates or taken away from the assured by similar unlawful interventions, for which the insurer is liable under section 2-0, the assured may claim for a total loss if the ship has not been recovered within twelve months from the day the interception took place."

Some polices take this provision even further by making the detainment of the vessel for a specified period of time a deemed total loss. For example clause 3 of the Institute War and Strikes Clauses Hulls 1/10/83 provides as follows:

"In the event that the Vessel shall have been the subject of capture seizure arrest restraint detainment confiscation or expropriation, and the Assured shall thereby have lost the free use and disposal of the Vessel for a continuous period of 12 months then for the purpose of ascertaining whether the Vessel is a constructive total loss the Assured shall be deemed to have been deprived of the possession of the Vessel without any likelihood of recovery."

In the early days, these clauses were of no consequence in a Somali hijacking and for several years attracted no attention. However, as the length of the detention period by the pirates has increased they have come under closer scrutiny. For historical reasons these detention clauses have frequently been amended from the standard position

"The market practice of amending detention clauses to apply after a period of six months is likely to come under increasing scrutiny."

1. ICC International Maritime Bureau, Piracy and Armed Robbery Against Ships Report for the Period of 1 January - 30 June 2012, page 21.
2. ICC International Maritime Bureau, Piracy and Armed Robbery Against Ships Report for the Period of 1 January - 30 June 2011, page 21.

of 12 months to six months. Prior to the upsurge in piracy this reduction was seen as an uncontentious concession by underwriters. Given the gradual increase in the duration of Somali hijackings the likelihood of a vessel falling within the provisions of one of these amended detention clauses is more and more likely. We are aware of several cases where Owners are seeking to make claims under their War policy for a total loss where the vessel has been detained by pirates for more than six months.

Where a six month deadline has been inserted, as this deadline approaches with the ship still held it can give rise to tensions between owners and underwriters as to the status of the vessel after the deadline passes and how this might impact on the hostage negotiations, bearing in mind that the welfare of the crew should be of paramount importance to all parties.

While hijackings are clearly reducing, piracy continues to be a major risk for the shipping industry and detentions are generally lasting longer. The market practice of amending detention clauses to apply after a period of six months is likely to come under increasing scrutiny as underwriters respond to the increased risk that such clauses will be triggered if a vessel is hijacked.

For more information, please contact Alex Kemp, Associate, on +44 (0)20 7264 8432 or alex.kemp@hfw.com, or your usual contact at HFW.

Case Update January - June 2012

Welcome to the first of our HFW Marine Insurance Case Updates, which will be produced on a six-monthly basis. The Update will provide a regular summary of English court cases relevant to the law of marine insurance, including hull, war and cargo risks. The Update will form the basis of a series of presentations we will make to the marine insurance market. If you are interested in receiving further details about any of the cases highlighted here, or think a presentation of the cases would be useful for your organisation, please contact Toby Stephens on toby.stephens@hfw.com, or Alex Kemp alex.kemp@hfw.com, or Kate Buzzard on kate.buzzard@hfw.com.

1. Atlasnavios-Navegacao v Navigators Insurance Company Limited [2012] EWHC 802 (Comm)
   Preliminary issue regarding a claim under a war risks insurance policy for constructive total loss and the exclusion at Clause 4.1.5 of the Institute War Clauses.

2. (1) Sealion Shipping Limited and (2) Toisa Horizon Inc vs Valliant Insurance Company [2012] EWHC 50 (Comm)
   Claim under marine loss of hire policy arising out of the breakdown of a propulsion motor. Whether Underwriters entitled to avoid the policy on the grounds of material non-disclosure and or misrepresentation.

3. European Group Ltd and others v Chartis Insurance UK Ltd (formerly known as AIG (UK) Ltd and AIG Europe (UK) Ltd) [2012] EWHC 1245 (Comm)
   Determination of whether the Erection All Risks, Public Liability and Delay in Start Up Insurance Policy or the Primary Marine Cargo/Delay in Start Up Insurance Policy were to cover losses arising from fatigue stress cracking to tubes in an economiser block.

4. Clothing Management Technology Limited and Beazley Solutions Limited trading at Beazley Marine UK [2012] EWHC 727
   Claim under a marine policy incorporating Institute Cargo Clauses A 1982 and the Institute Strike Clauses 1982. Whether the Claimants had suffered an ATL or CTL.

5. Elafonissos Fishing & Shipping Company v Aigaion Insurance Company SA [2012] EWHC 892
   Application by Underwriters for permission to re-amend defence & counterclaim submissions in respect of the meaning of “laid up”.

6. Metall Market OOO v Vitorio Shipping Ltd (The “Leman Timber”) [2012] EWHC 844 (Comm)
   Appeal from an Arbitration Award regarding the exercise by Owners of a general average lien over cargo.

7. (1) Albert John Martin Abela, (2) Albert J.M. Abela SRL and (3) Albert J.M. Abela Catering and Interactive Systems v Ahmed Baadarani [2011] EWHC 116 (Ch)
   Appeal to the Court of Appeal regarding the correct method for service out of the jurisdiction when the time period for service of the Claim Form has expired.

8. Robert Lawrence Weston v (1) Kenneth William Bates (2) Leeds United Football Club Ltd [2012] EWHC 590 (QB)
   Appeal from the judgment of Master McCloud concerning service of a Claim Form outside the jurisdiction.

9. BNP Paribas SA v (1) OJSC "Russian Machines", (2) OJC Management Company "Ingosstrakh-Investments" and others [2012] EWHC 1023 (Comm)
   Retrospective validation of service of a claim form in the context of CPR 6.15(2).

10. Global 5000 Limited v Mr Sarang Wadhawan [2012] EWHC Civ 13
    Challenge to the jurisdiction of the High Court. Whether there was a serious issue to be tried.

11. Star Reefers Pool Inc v JFC Group Co. Ltd. [2012] EWCA Civ. 14
    Appeal from the High Court to the Court of Appeal in respect of granting an anti-suit injunction of proceedings in Russia.

Conferences & Events

Maritime International Congress
Brazil
(4-7 November 2012)
Jonathan Bruce

Marine Insurance Forum
Melbourne
(16 November 2012)
Andrew Dunn and Richard Jowett

HFW Marine Insurance Seminar
HFW London office
(19 November 2012)
Jonathan Bruce, James Gosling, Craig Neame, Julian Pierce, Toby Stephens, Nigel Wick and Matthew Wilmshurst

Time & Voyage Charterparties
Dubai
(9-10 December 2012)
Simon Cartwright, Sam Wakerley, Yaman Al Hawamdeh and Nejat Tahsin

Salvage Law & Practice
London
(10-11 December 2012)
Toby Stephens

Salvage & Wreck Removal Conference
London
(12-13 December 2012)
Andrew Chamberlain

Bills of Lading
Dubai
(12-13 December 2012)
Simon Cartwright, Sam Wakerley, Yaman Al Hawamdeh and Nejat Tahsin

Lawyers for international commerce

HOLMAN FENWICK WILLAN LLP
Friary Court, 65 Crutched Friars
London EC3N 2AE
T: +44 (0)20 7264 8000
F: +44 (0)20 7264 8888

hfw.com