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Holman Fenwick Willan

INSURANCE AND INTERNATIONAL TRADE BULLETIN

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Trade credit insurance

The use of insurance as a risk management tool is common place. Some of the insurances may be required by law and others optional but can form part of a company's risk management strategy and balance sheet protection. We have seen a significant increase in the amount of interest in trade credit insurance as a means to de-risk counterparty risk particularly in the trading of commodities; selling of product/produce; and, investment/financing facilities. The effect of de-risking transactions and investments can also lower the cost of monetary lending for example, thereby securing much needed investment for projects.

The right trade credit insurance policy has the ability of reducing a company's global trading risk and exposures. It is a product which provides protection to a company or bank (the policyholder) in respect of certain events which affect the ability of customers/counterparties to pay invoices or meet their financial commitments.

Trade credit insurance – what is it?

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Commonly trade credit policies provide cover for:

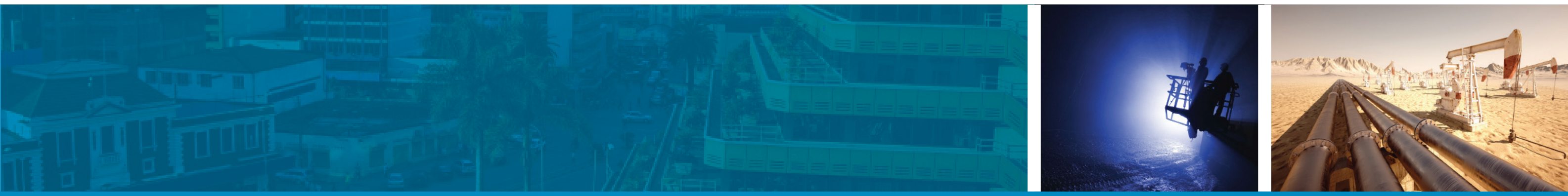
- The protracted default of a customer/counterparty: this occurs on the non-payment of all or part of an undisputed invoice. The trigger for payment will usually occur on the expiry of what is called *"the waiting period"*. This is a period of time agreed with the insurer after which the non payment triggers policy cover. The waiting period is often around 90 days from the date the invoice falls due for payment.
- The insolvency of a customer/counterparty: often insurance policies specify the scenarios that constitute "insolvency" under the policy and which will trigger cover.
- A political risk event: this is an event that prevents payment or meeting of a financial commitment by a customer/counterparty. Trade credit policies will usually define the scenarios that come within the meaning of the political risk cover provided. Scenarios can include general moratoriums decreed by a government in the customer's counterparty's country, economic difficulties in the customer's/counterparty's country, currency shortages, administrative measures or new legislation in the customer's/counterparty's country which prevents payment.

As with all insurance policies, if the right terms are obtained and the right procedures are followed by the policyholder the risk transfer can work well. However, we have been involved on a significant number of trade credit insurance disputes in relation to both national and international losses and we set out below a number of the issues that have arisen and a few thoughts on prevention procedures to minimise the risk of insurance disputes.

Pre-qualifying requirements

It is usual in trade credit policies for there to be conditions which the policyholder needs to comply with to ensure that the sale or transaction comes within the terms of the policies. These are conditions which, if not complied with, will provide an insurer with the opportunity to refuse to indemnify a loss or at least to negotiate down the amount of indemnity that should be paid to a policyholder. Pre-qualifying requirements can include the following:

- Credit limits: it is usual in trade credit insurance policies for the insurer to set credit limits for particular customers/counterparties. This effectively limits the insurance provided for transactions with a particular customer/counterparty and therefore if that credit limit is exceeded, the insurer will only provide cover up to the amount of the credit limit. Policyholders need to be aware that insurers can often withdraw or vary credit limits, usually only with prior consultation with the policyholder. However, such notice periods can be short and can catch policyholders out. As a result policyholders need to regularly review the credit limits and compare them against the amount of business being undertaken with a particular customer/counterparty to ensure there is no risk of uninsured exposures.



- Retention of title clauses: invariably there will be a requirement for the policyholder to include retention of title clauses in their contracts with their customers/counterparties. On a commercial level this can cause difficulties where a customer/counterparty is in a country in which it may be difficult to enforce such clauses. Policyholders may want to consider negotiating with insurers that this requirement is taken out of the policy completely or only for certain customers/counterparties, although such agreement may require the payment of an increased premium to reflect the heightened risk to insurers.
- Invoicing: it is not unusual for policies to require a set time by which invoices need to be rendered to customers/counterparties.
- Geographical limitations to the cover: for global businesses or businesses trading internationally there are usually limitations and exclusions in relation to providing services or the selling of goods to customers/counterparties in certain territories.

These are only a few examples of the kinds of pre-qualifying requirements in trade credit policies to illustrate the importance of ensuring that a policyholder's practices comply globally with such requirements in order to ensure maximum cover under the policy. The requirements may vary slightly depending upon the policyholder's business and the nature of the transaction being covered but ideally risk managers and treasury departments should be aware of all the obligations.

Reporting obligations

Trade credit policies contain onerous reporting obligations. For example, in protracted default situations there is often the requirement to notify insurers that payments are overdue by a certain time-often 90 days and invariably before *"the waiting period"* expires. Whilst this may not at first appear to be a difficult process to manage, when managing the payment of invoices on a global scale across various global business units, obtaining the information in order to comply with tight notifications and reporting obligations can cause difficulties. In this respect all the business units nationally and throughout the world, if applicable, need to be complying with the policy requirements and this will often require a uniform business/systems protocol to ensure that the relevant department making the notifications and reporting to insurers has all the information available to them in good time in order to ensure that no reporting conditions of the insurance policy are breached.

Obligation to prevent the minimised loss

Invariably there will be obligations upon the policyholder to prevent and/or minimise losses. The requirement to do so is for the policyholder to take *"all reasonable steps"* and what may constitute *"reasonable"* often depends upon the country in which those steps are being taken and the availability of legal remedies against the customer. In recent years we have seen a number of disputes between insurers and policy holders regarding what is *"reasonable"*. There is case law in the English law jurisdiction (*Euler Hermes Plc v. Apple Computer BV*[1]) which supports the argument that a policyholder can take into account their commercial interests when deciding if a certain step is *"reasonable"* to prevent/minimise loss.

In addition, the policy often does provide that the insurers can contribute to the policyholder's costs in taking reasonable preventative or mitigating action. However, often such a contribution is dependent upon insurers providing their consent to the loss prevention/minimisation actions in the first place and even then is usually at the discretion of the insurer.

Care should be taken when deciding what steps to take, for example, the strategy of reissuing invoices or agreements agreeing a lesser amounts and then attempting a claim under the policy for the remaining amount. This strategy can provide insurers with the argument that the reissuing of an invoice or amending of an agreement is an acceptance by the policyholder of a price/payment reduction and there is no debt or sum due because the customer/counterparty has paid the amount stated on the reissued invoice or agreement, therefore there is no loss.

Policyholders should also stay away from accepting reduced amounts in full and final settlement of a due amount. Again, this is because a policy will often require that a policyholder preserves all subrogation rights against third parties and by agreeing to a full and final settlement a policyholder is not preserving rights against those third parties. If the intention is to agree to a full and final settlement with a customer/counterparty, this should be agreed with insurers first.

Other coverage issues

Other issues which may arise and which policyholders need to be aware of include:

- Disputed receivables: insurers will often not pay out where there is a dispute over the invoice or the services provided. The insurers will only indemnify the policyholder once the dispute is resolved.

1 [2006] EWCA Civ 375

- Collation and provision of documents to support claim: there are often deadlines within the policy by which the policyholder is required to provide documents to support their claim if requested to do so by the insurer. Policyholders need to ensure that their internal procedures are consistent nationally and, if applicable, globally to ensure that all their business units retain and correctly file relevant documentation so that it can be easily sent to the relevant department liaising with insurers.
- Insured loss: the policy will usually set out how the insured loss is calculated. This is normally by reference to a particular date by which the loss will crystallise. The date at which the losses crystallise can have marked effects on the insured loss under the policy and clauses in the policy may vary as to how recoveries are dealt with that post date the crystallisation of the loss.

Comment/practical considerations

What has been evident from the disputes we have been involved with in the last few years is that there is often a disconnect between how the policyholder and the insurer considers the policy to operate. It is essential that the policyholder understands all the clauses in the policy to ensure they know what cover they are buying, what their obligations under the policy are, and to ensure that their business units nationally and around the world are operating the same protocol and procedure to ensure that the conditions in the insurance policy can be complied with.

The effect of fronting on contract certainty

Insurance and reinsurance underpins global commerce and trade. It is an important tool to mitigate the financial risks associated with commercial transactions and ventures, particularly in jurisdictions that are perhaps developing and have more unstable economies and political regimes as well as carrying risk through hazardous geographies. From our experience, both recent and historic, there are a number of issues which all parties involved in placing insurance and reinsurance should be aware.

We have seen the exponential increase in the relevance of fronting on global programmes with captives and the use of facultative reinsurance placements where there is no, or no material, local insurance capability or retention. The main growth areas for the insurance and reinsurance industry in London, Munich and Zurich has been the LatAm, MENA, Africa and Asia Pacific regions where specialist business is written facultatively and is reliant on reinsurance markets due to limited local know how of insuring large and complex risks, particularly in the energy, property and liability sectors.

Insurance and reinsurance

The first issue is recognition of the fact that because of local regulatory regimes, what would ordinarily be direct insurance, becomes reinsurance. Often a local fronting insurer will have little or no retention and correspondingly little expertise in specialist areas with little appetite to acquire it.

The reinsurer deals with this through the retention of claims control where possible and the insured seeks a direct relationship with reinsurers. However in some jurisdictions such a direct relationship may be unlawful, unenforceable and even criminal.

Governing law and jurisdiction

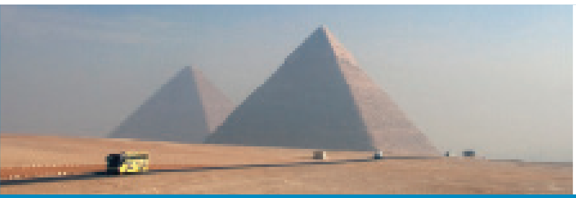
The governing law of an insurance policy can significantly impact upon the breadth of cover. Local law and jurisdictions can also dilute well known safeguards under English law contracts. For example, in some South American territories the law governing insurance contracts has emanated from banking law. This creates a significant amount of uncertainty over policy coverage where a law more suited to banking products is used to construe complex wordings.

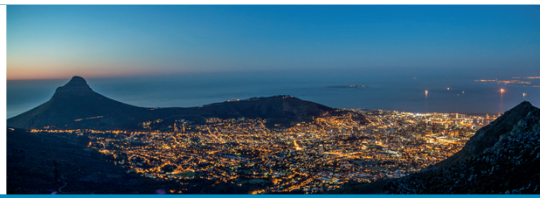
The choice of governing law can significantly affect the attempts to obtain back to back cover as between the fronting insurance and the reinsurance, particularly where the fronting policy and reinsurance have different governing law provisions, or where they are silent on the governing law. This can create a mismatch between the two contracts and cover.

Decentralisation of claims control

In jurisdictions requiring fronting, claims are likely to be dealt with locally leading to a loss of central control which can have significant implications in large and complex loss scenarios. Retaining a degree of central control of the inwards claim can be achieved by utilising “claims control” or “claims co-operation” clauses. Also, reinsurance policies should be checked for “follow the settlements” clauses to assess the obligations to a fronting insurer.

Issues can develop over the operation of claims control and claims cooperation clauses, particularly the question of who takes the lead in dealing with claims. Tensions may arise in a claims context between the





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Who decides to settle a claim can also provide tensions. The question of which reinsurer has authority to act on behalf of the others is often dealt with by way of a "follow the leader" clause where the reinsurers delegate authority to settle a claim to the "leading" reinsurer providing the fronting insurer and the policyholder (the ultimate beneficiary) with the comfort that the leader's decision to settle the reinsurance claim will bind the other, following, reinsurers.

Loss of protectionist terms and conditions

There are certain terms and conditions that are common place in English law and language policies and which are considered by (re)insurers as essential protections. These may become irrelevant when transposed into a local fronting policy either because they are unenforceable under local law or because there is no local jurisprudence to interpret them. This creates a lack of certainty.

Direct access to reinsurance

Generally, no privity of contract is enjoyed by the policyholder on a reinsurance contract but a policyholder may want the ability of claiming directly against the reinsurer in circumstances where there is an issue with the fronting insurance or perhaps the local fronting insurer becomes insolvent.

A cut-through clause allows a party that is not in privity with the reinsurer to have such rights as part of the agreement between reinsurer and fronting insurer, although careful consideration is needed of the governing law of the policy to assess the validity of such clauses.

In jurisdictions requiring fronting, often claims paid under a master or reinsurance policy cannot be ceded back to the policyholder locally without breaching laws, for which there can be significant repercussions to the policyholders. When claims monies are paid to a policyholder locally, there can be exchange issues, the transfer of money may trigger tax penalties or, more seriously, lead to investigations by local regulators as to the policyholder's compliance with insurance regulations. Careful consideration, therefore, has to be given to the local regulatory environment.

Broker conflicts

It may be that the same insurance broker is used for placing the local insurance and the reinsurance, despite the inherent risk of conflicts arising in acting for two principals with potentially competing interests.

A broker undertaking such a role should ensure it understands the risks and that the risks have been fully explained and accepted by its two principals. It should also ensure that it has internal systems in place to deal with conflict scenarios. This is particularly so with split placements.

Competing dispute resolution clauses

It is not uncommon for there to be competing dispute resolution clauses as between the fronting insurance and the reinsurance contract. Where possible identical dispute resolution clauses should be agreed to ensure that disputes can be resolved in one forum, limiting the chances of inconsistent findings by different tribunals.

Local tribunal advantage

In many jurisdictions there is no distinction between sophisticated and unsophisticated insureds. This means that an insured with, say, a large, complex industrial risk will be treated in the same way as a consumer purchasing personal lines insurance. Often the result is that standard terms, conditions and exclusions are ignored by the local tribunal or interpreted in favour of the insured. This removes from insurers the protection of well drafted wordings which benefit from lessons learnt over many years.

Conclusion

In an age of contract certainty, local fronting issues in the rapidly gaining LatAm, MENA, Africa and Asia Pacific markets create contract uncertainty and should be clarified at placement to avoid uncertainty when the claims arise.

Business interruption insurance: the importance of understanding the cover

Over the last few years there have been a number of significant events that have given rise to large business interruption claims: the 2004 tsunami, hurricanes Katrina and Rita in 2005, the weather events in Queensland, Australia and South Africa in 2008, the Icelandic ash cloud, the Chilean earthquake in 2010, and the Japanese tsunami in 2011.

Business interruption insurance is often a key component of a company's business continuity plan. The insurance is designed to compensate an insured for the financial impact of the interruption/ interference to that business as a result of physical damage to insured property or other key external events, such as damage at a supplier's or customer's premises. The intention is to restore the business to the same financial position as if the loss had not occurred, subject always to the terms and conditions of the policy.

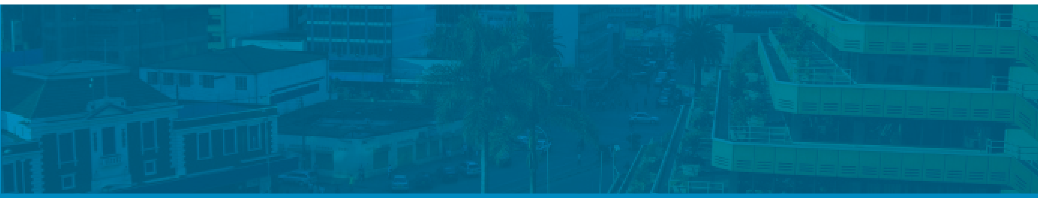
Over the last few years there have been a number of significant events that have given rise to large business interruption claims: the 2004 tsunami, hurricanes Katrina and Rita in 2005, the weather events in Queensland, Australia and South Africa in 2008, the Icelandic ash cloud, the Chilean earthquake in 2010, and the Japanese tsunami in 2011. Claims are not only triggered by weather events but also man made events such as Deepwater Horizon. Other man made events include the breakdown of major pieces of machinery or the loss of computer systems to businesses heavily reliant on the machinery or computers systems to operate. In recent years, as businesses outsource more, the focus is on business interruption as a result of the inability of these suppliers to service customers as well as other interruption of critical services. Increasingly businesses have contingent business interruption cover often triggered by non-physical damage events.

Catastrophes similar to those identified above, affect many industry sectors on a national and global scale. The industries that may be affected include:

- Mining: in South Africa in May 2014, Coal of Africa Limited announced that it had been advised by Transnet Freight Rail of a derailment of 10 wagons on the Maputo rail corridor between Tenga and Matola Gare that led to all rail traffic between Komatipoort and Maputo being suspended for a period of seven weeks. This caused its subsidiaries at the time, Limpopo Coal Company, Langcarel and NuCoal Mining to issue force majeure notices to their customers, contractors and other affected stakeholders. Due to the force majeure, Coal of Africa Limited was able to negotiate a business interruption claim for the affected time period.
- Energy (oil and gas): coal seam gas drilling in Queensland's Surat Basin was halted due to floods. This industry sector was also badly affected by, for example, Hurricane Katrina and also Deepwater Horizon.
- Port/rail operators: rail lines in Queensland have been overcome by the floods. This disrupts the transport of commodities, such as coal supplies, for export.
- Utilities: the affect of the floods in Queensland on power generation, gas, telecoms and water supply was substantial, given the property damage and effect on infrastructure.
- Leisure/travel: the effect of the floods in Queensland on the leisure and tourism industry is self evident. Similarly, the 2004 Tsunami affected high-profile tourist resorts in, for example Thailand.
- Agriculture: Australia's wheat, sugar, fruit and cotton exports have been hit by varying degrees and fertilizer makers may also be affected.
- Manufacturers/retailers: not only do they face property damage, but also logistical issues of transporting goods to shops, customers and ports.
- Aviation: both airlines and airport operators.

In addition, natural catastrophes affect domestic buildings and state municipal property and operations.

Business interruption insurance and reinsurance claims can therefore be particularly difficult to navigate through and this article focuses on the issues that often arise on business interruption claims.



Material damage/property damage

Business interruption claims are normally linked to material damage/property damage. One of the first issues is whether there is a valid occurrence which triggers the policy cover. The issues that may arise include:

- Whether the insurance is triggered, for example whether the weather event/flooding has triggered cover; or whether the damage occurred during the policy period.
- Was the property damaged excluded under the policy?
- Was the cause of the damage excluded under the policy?
- Are there multiple events or occurrences and if so how will the loss be allocated between them? The problem can be exacerbated where there are complex multilayer programmes where the interests of different layers might diverge.

Business interruption

Business interruption insurance claims are often the claims that can lead to the largest, most complex and contentious claims. This is due to the many factors that impact upon the calculation of loss. Policies often contain sub-limits, which can have an important impact on coverage. Examples of issues that arise include:

- Collecting and tracking information for the purposes of preparing or scrutinising a claim: if a business is affected by a flood, fire or explosion, the premises and offices where the necessary documentation is kept may be ruined/destroyed. This can make it difficult for an insured to support parts of their business interruption claim and raises issues with not only the insured proving their loss, but also at the insurance and reinsurance level, because often in the absence of documentation, certain assumptions are incorporated into the loss calculation which may be contentious. In terms of the larger corporations, often their financial data and manufacturing documentation is kept in more sophisticated electronic systems and often in different geographical locations, so this issue may not be such a problem.
- Basis of indemnification: the policy will set out the basis upon which the business interruption claim is to be calculated. Often this is limited to the 'Loss of Gross Profit', due to the reduction in turnover. However, there may be the option of presenting a claim on an output alternative or loss of production income basis. The basis on which the claim is presented can impact significantly upon the resources and skill sets required for the calculation of the loss, as well as the amount of the loss. Often the starting point of the calculation will be to look at the financial year immediately before the date of damage in order to assess standard turnover or output.
- Increased cost of working/additional increased cost of working claims: the policy may incorporate this cover. This is additional expenditure reasonably and necessarily incurred by the insured for the sole purpose of avoiding or diminishing the loss in turnover or output experienced as a consequence of the damage. Issues may arise as to whether the additional expenditure incurred was for the sole purpose of reducing the loss. There may be an extension to the policy which provides an indemnity for the costs incurred by the insured which are in excess of the limits provided under the policy of the increased cost of working. This is known as the additional increased cost of working. A key issue in respect of claims involving these elements is documentation of the decision making process and costs, often omitted in the haste to get back to business.
- Analysis of the causation of lost production/selling lost production: other factors which may influence the rate of production will need to be taken into account and an insured will need to show what is claimed as lost production was due to the property damage or other business interruption trigger. Similarly, the ability to sell the lost production "but for" the damage can be a significant issue. There may be a number of reasons why the business may not have proceeded along the course it had done in the previous financial year. For example, when the general financial crisis hit in 2008, this may have had a detrimental impact upon customers' and clients' appetite or requirement for a particular service or product, which cannot be shown to be caused by the property damage.
- Indemnity period: the insurance will not provide an unlimited period of cover. Normally, the indemnity provided will be limited to a particular length of time, which is known as the "indemnity period". The indemnity period is usually defined in the policy as the period beginning at the date of the occurrence of the damage and ending when the results on the business cease to be affected by the property damage. This is usually limited to a maximum indemnity period, commonly 24 months.

- Extensions to cover: in addition to the additional increase in the cost of working extension, further extensions that the insured may have negotiated and purchased include denial of access, where accessibility of the property due to the property damage impacts upon the business. A further extension which can also be a stand alone cover is contingent business interruption insurance.

- Other/special circumstances clause: this allows the parties to take into account other circumstances which may impact upon turnover/production and the calculation of the business interruption. Its aim is to ensure that the amount indemnified is as true as possible to the actual amount lost by the insured as a result of the damage. For example, if the company affected is a commodity producer, for example wheat or coal, where the damage is so extensive and affects a number of companies in the same industry sector it can create a price spike for that particular commodity globally as a result of the disruption in production and supply. An insured may have benefited from the increased commodity prices in another geographical location or once its business has got back on track. Issues as to whether this should be taken into account or not and how this is included in the loss calculation can create significant discussions and debate at the insured, insurance and reinsurance levels.

- Deductibles/occurrences: the number of deductibles applicable to a loss can be a cause of contention. This is particularly the case where there are potentially multiple causes of the property damage and business interruption.

  Taking the example of flood, wind or storm, the policy would normally define whether flood, wind or storm constitutes one occurrence, and therefore one deductible is payable by the insured, by reference to a temporal limit, for example 72 hours. Multiple occurrences would impact the number of deductibles and affect the amount paid by the insured, insurer or reinsurer. On the particularly large losses, where there are excess layers on both insurance and reinsurance levels, this can create significant issues due to the varying interests involved.

The Ebola virus that has gripped West Africa has seen a significant amount of speculation as to its insurance impact. A business interruption could be anything from the loss of key employees to sickness, to the quarantine of an airliner or cruise ship used by a suspected patient suffering from Ebola or another serious infectious disease. Usually property and business interruption policies are triggered only by direct physical damage to property and so would not be triggered by the Ebola outbreak. Physical damage, however, can include contamination. Moreover, some policies, particularly those written for policyholders in the hospitality industry, expressly provide coverage for losses stemming from infectious diseases without requiring other physical damage to property. Further, many property policies include civil authority coverage, triggered when authorities limit access to an area in which a business is located even, in some cases, if there is no physical damage to the policyholder's premises. Since the outbreak a number of the insurers have been writing express exclusions in relation to Ebola linked claims.

Contingent liability

This is a business interruption insurance where the insurance is triggered by property damage at the premises of a supplier or customer, or other trigger such as loss of utility, denial of access or the act of a local authority/government/regulating authority. There are certain industry sectors, such as agriculture and mining, that are heavily reliant on utilities providers (water, gas and electricity) and, in the case of the agricultural sector, upon external contractors to provide large machinery often needed such as at harvest time. Port operators are likewise reliant upon manufacturers, commodity producers, logistics and rail companies for the continuous flow of products to the ports for shipment. For example, there were significant problems with gas supplies in Western Australian following the Varanus Island explosion in 2008 and uncertainties over the continuity of supply in South Africa due to the weather events in 2008. While policies vary, there is often extended cover

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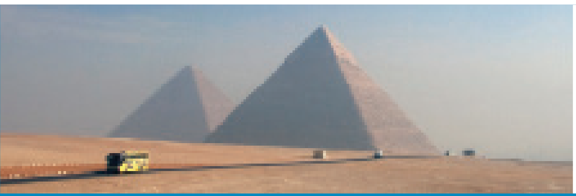

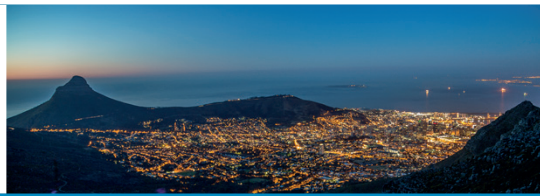

for named suppliers and loss of utility supply. With the deregulation of utility supplies, the identity of the contractual supplier can often differ from the source of supply, raising issues of whether or not the policy responds to business interruption as a result of damage at source.

Any business which is heavily dependent upon other industries for its business should consider contingent business interruption insurance cover and must include appropriate triggers in the policy. For example, many airport operators and airlines discovered that, although heavily reliant on the provision of airspace to generate revenue, when this was lost in 2001 (after the 9/11 attacks) and in 2010 (Icelandic ash cloud), the contingent business interruption trigger language in their policies was not broad enough to respond.

Reinsurance and retrocession

Inevitably payment at the reinsurance level is key to drive the payment of the insurance claims. As a result, it is important to identify issues facing reinsurers. Reinsurers will often be concerned that the claims at the insurance level are being handled effectively and efficiently. They may, in this respect, insist on control of the insurance claim (where there is a claims control clause in the reinsurance policy) or otherwise seek to participate in the investigation, adjustment and settlement of loss(es). Other issues might include:

- Triggers, aggregation and excess/attachment points.
- Where there is a captive or fronting agreement, whether the insurance or reinsurance should be back to back and the extent to which the captive/front should pay in claim investigation and negotiation.

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- Reinstatement.
- Payments on account and how these should be managed, particularly where there is a reinsurance programme with multiple layers and potentially non-aligned interests.

Business interruption insurance claims can involve considerable numbers of parties in addition to the principals such as loss adjusters, experts, accountants and lawyers, as well as documentation. What is important is that the claims process is correctly project managed and that there is no polarisation of the respective parties' positions. To successfully resolve an insurance claim without recourse to expensive dispute resolution requires a degree of cooperation by the insured, insurers and reinsurers throughout the process. That is not to say there are no disagreements and differences in approach as to how a policy should respond to a claim. In claims with multiple and extensive issues, the parties should look to agree those issues that can be agreed at an early stage, thereby allowing them to focus energy, time and resources to resolve the remaining contentious issues.

Protection of financiers' interests

Introduction

Increasingly, financiers are utilising insurance policies as a means of protecting loans and/or underlying assets as well as, if possible, addressing unfunded Capital Risk Mitigation (CRM) issues. As will be seen, where the borrower has been required to take out the policy, certain issues may materialise which could well prevent the borrower and/or the financier recovering under the policy. Where the financier takes the policy out as the principal named insured these issues do not arise, although clearly we would advise that the policy is scrutinised for the purpose of ensuring that the underlying risk maps into the policy wording and that policy defences are neutralised where possible (e.g. removal of conditions precedent or, at the very least, the dilution of their impact).

It has often been the case that where insurance was required as part of the lending package (until the last decade), little attention was paid to the robustness or otherwise of an insurance policy. However, increasingly, financiers scrutinise the insurance policies provided to ensure they give the necessary protection and security in the event of the failure of the borrower to repay any loans or the failure to realise the underlying security.

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When considering a policy there are five basic steps which should be kept in mind:

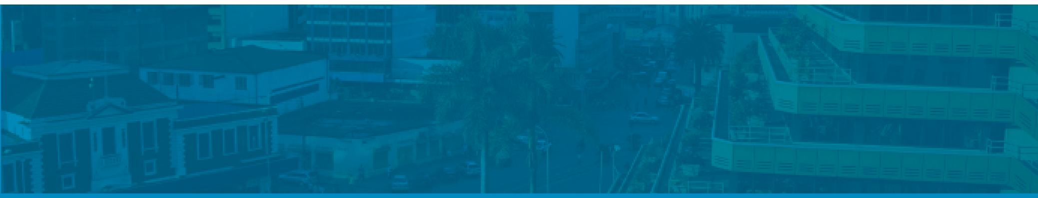
1. Unless there are compelling reasons to do otherwise, we would advise financiers to be co-insureds under the relevant policies. The principal requirements for protecting the financiers' interests are (a) for the financier to be a named or additional insured under the policy and (b) to ensure that the policy is a composite policy. The normal means of effecting this outcome is to note that the financier is an insured together with other insured entities *"in respect of their respective rights and interests"*. The latter wording ensures that the policy will be viewed as a composite policy. We would recommand that it should be noted, for the avoidance of doubt, that the issued policy should be regarded as composite.

2. It follows in the usual course of events that if the financier is an insured under the policy it is required to disclose material information to the insurer (or, possibly, complete a proposal form). The solution to this is to expressly state that the financier has no duty of disclosure. Given that it is often the borrower which is required to obtain the policy and complete the proposal form, it is the borrower which has the relevant information. We would add that if there are instances where disclosure is required of the financier the impact of non-disclosure can be addressed by innocent non-disclosure clauses as well as limiting disclosure to specified individuals or departments.

3. Following on from points 1. and 2., if there is by the borrower (a) a non-disclosure or misrepresentation which would entitle the insurer to avoid the policy, (b) a breach of warranty which would terminate the policy from the date of the breach (irrespective of the relationship of the breach to the loss which has occurred) or (c) a failure to comply with a condition precedent, then such event will only impact the borrower which has effected the breach. Any remaining insured will remain covered as a result of the policy being stated to be a composite policy and an express non vitiation provision (i.e. avoidance acts of one insured will only entitle insurers to avoid against that insured and not other, innocent, coinsureds).

4. Provision should be made with regard to the administration of the policy e.g. the payment of premium, destination of proceeds, notification to the financiers of material changes and cancellation and non renewal of the policy.

5. We would not recommend that financiers are simply noted as loss payees under the policy. The reason for this is that if the borrower is the sole insured under the policy and a defence arises due to non-disclosure or mis-representation, the financier would be in no better position than the borrower given that the policy would be avoided *ab initio*.



Sanctions

The current EU and US sanctions against Russia create a host of different issues for international oil and gas companies. While the rules are highly complex, and include a number of overlapping restrictions, they do not amount to a full embargo on trade with Russia, and businesses will be rightly keen to ensure they do not exclude lawful opportunities, given challenging conditions elsewhere. On the other hand, because the restrictions are so complex and dynamic, with over 20 EU Regulations issued in less than a year, and because the penalties for breaching sanctions can be so severe, there are very real challenges for the unwary. This article will summarise the key restrictions, and set out some practical steps to ensure compliance.

The current EU sanctions comprise four broad components, namely (i) the asset freeze, (ii) the ban on most EU trade with Crimea and Sevastopol, (iii) the restrictions on supply of oil and gas equipment to Russia and (iv) the restrictions on certain Russian companies access to EU debt, equity and capital markets. While the detail of the US restrictions is outside the scope of this article, the US measures are broadly aligned with those imposed by the EU.

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The effect of the first component (ie the EU asset freeze) is that it is prohibited to make funds or economic resources available, directly or indirectly, to/or for the benefit of the named individuals or entities. The EU currently publishes two lists, under the titles “Misappropriation and Human Rights” and “Sovereignty and Territorial Integrity”.

The first list comprises 22 individuals who have been designated because they are *“subject to investigation in Ukraine for involvement in crimes in connection with the embezzlement of Ukrainian State funds and their illegal transfer outside Ukraine”*.

The second list comprises 151 individuals and 37 entities which have been designated for *“undermining or threatening the territorial integrity, sovereignty and independence of Ukraine”*, and includes the likes of Arkady Rotenberg, Feodosia, Kerch Commercial Sea Port and Russian National Commercial Bank.

The EU sanctions include a defence where the person who would otherwise have breached the sanctions can show that they did not know or have reasonable cause to suspect that their actions would infringe the sanctions. Businesses need to conduct due diligence on their counterparties and other entities they engage with, to ensure they are not dealing directly or indirectly with prohibited persons.

The second component (ie the ban on trade between the EU and Crimea/Sevastopol has a number of key elements), but the most relevant restrictions are likely to be the bans on (i) importing any goods originating in Crimea or Sevastopol into the EU and (ii) supplying key equipment, technology and construction/engineering services for the following sectors of the economy in Crimea or Sevastopol: transport, telecommunications, energy and exploitation of oil, gas and mineral reserves.

The third component (the restrictions on the supply of oil and gas equipment to Russia) will affect any supply of listed equipment to a Russian company or for use in Russia. A licence is needed for that supply (whatever the project and whichever Russian or non-Russian entity is involved) and no licences will be granted for new Russian deep water, arctic or shale oil projects. There are associated bans on the provision of technical assistance, brokering, financial assistance and certain services for deep water, arctic and shale oil projects. Businesses engaged in the supply or transport of goods, services or equipment to Russia’s energy sector should carefully consider the nature (and use) of the goods, services or equipment which is being supplied, to ensure compliance with these restrictions.

The fourth and final component (the restrictions on certain Russian entities' access to debt and capital markets) will only restrict certain activity with certain Russian entities. The first point to stress is that this measure is not a comprehensive ban on all Russian entities' access to debt and capital markets – non-listed Russian entities can continue to access EU debt and capital markets. The second point to stress is that this measure is also not a comprehensive ban on all trade – only certain activity with the relevant entities is prohibited, but businesses are otherwise free to continue dealing with them. As such, while the entities which are subject to these restrictions (which include Sberbank, VTB Bank, Rosneft, Transneft and Gazprom Neft) are listed in the EU Regulations, this listing needs to be distinguished from a listing as an asset freeze target.

The restrictions prevent the listed entities (as well as any non-EU entities which they own 50% or more of) from accessing EU debt and capital markets, and also from accessing certain loans and credit (there is a specific carve out which permits particular trade finance and emergency funding).

Businesses need to be aware of any transactions which they have with these Russian entities, so that they can ensure that they do not fall foul of these complex restrictions.

As well as taking the above measures to ensure that they comply with the restrictions affecting trade with Russia, Crimea and Sevastopol, businesses which are operating in these areas need to ensure that they contract on suitable terms so that, in the event the sanctions change, their position is protected. They should also consider obtaining suitable warranties from counterparties, to support their own due diligence, and maintaining careful records of the due diligence which they carry out.

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With over 475 lawyers operating in 13 offices across 11 countries, we provide a global and seamless service 24 hours a day. We are dynamic, entrepreneurial and leaders in our specialist areas. Many of our partners are recognised experts.

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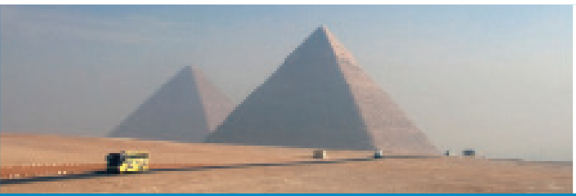

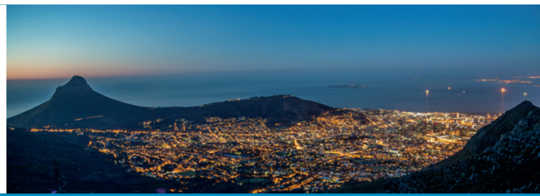

Should you require any further information or assistance on any of the issues dealt with here, please do not hesitate to contact any of the contributors to this Bulletin, or your usual contact at HFW.

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