ASSOCIATION OF
Average Adjusters

Associate Exam Module A3 (2 ½ hours) – Upstream and Offshore Energy Claims

Syllabus, Bibliography, Summaries of Law Cases and of Questions

Syllabus

Candidates will be asked to demonstrate:

- A knowledge and understanding of the different phases of exploration and production of oil and natural gas.
- A knowledge and understanding of the equipment and technology used in exploration and production of oil and natural gas
- A knowledge and understanding of the common policy wordings used in Upstream and Offshore Energy Insurance, including:

  Bespoke Wordings:
  - WELCAR 2001**
  - Energy Exploration and Development Insurance - EED8/86**
  - London Standard Platform Form JR2009/003
  - London Market Offshore Mobile Unit Form LSW678 1997**
  - Loss of Production Income (LOPI) Form JR 2005/003A**

  Incorporated Clauses:
  - Institute Clauses for Builders' Risks 1988
  - Institute Hulls - Port Risks Clauses 1987
  - Institute Cargo Clauses-A 2009
- A knowledge and understanding of the principles and practice applied to the adjustment of claims arising in Upstream and Offshore Energy Insurance,
- The ability to demonstrate this knowledge and understanding by providing solutions to practical claims questions.

Module A3 questions will be approximately 30% construction related, 30% related to control of well scenarios, 20% related to MODU's and 20% will relate to Operational and LOPI claims.

Bibliography

Candidates will find relevant material in the following texts:

- Mather, Offshore Engineering and Production (2011)
- Sharp, Upstream and Offshore Energy Insurance (2009) – (Note: Clauses marked ** in the Syllabus above are included among the Appendices to this publication).
- Goodacre, Marine Insurance Claims (5th Edition, 1996)
- Chalmers, Marine Insurance Act 1906 (10th Edition, 1993)
- Hodges, Cases and Material on Marine Insurance Law (1999)

Summaries of relevant Law Cases (kindly provided by Clyde & Co.)

Campbell v Conoco (UK) Ltd [2002] EWCA Civ 704
(Indemnity clause and sub-contractors)

The owner and operator of an oil rig in the North Sea entered into a contract for the hook-up and commissioning of a platform. The contractor then immediately entered into a subcontract with another party to carry out fireproofing. This subcontract was expressly stated as being 'back to back' with the main contract.

An employee of the subcontractor was injured when he was hit by a jet of compressed air from a diesel line whilst working below the deck carrying out fireproofing. This escape of compressed air was not related to the subcontractors' fireproofing work. The employee brought proceedings against the operator of the rig, who then brought action against the contractor under the clause indemnifying them in respect of liability for injuries. The contractor then proceeded to bring proceedings against the subcontractor under the indemnity clause in the subcontract. The subcontractor denied liability to indemnify the contractor.

Both contracts contained a clause whereby the contractor and subcontractor would indemnify the other party for any injury 'in connection with' the contract.

It was held (and confirmed on appeal) that that clause was applicable in these circumstances, even where there was no causal link between the accident and the performance of the subcontract. The wording of *'in connection with'* was interpreted as having a wide application, requiring merely a connection of some kind rather than some causal connection. The fact that the employee was on the rig for the sole purpose of the subcontracted work was sufficient, regardless of what he was doing at the time of injury.

It was further held that the subcontractor's indemnity covered contractual liability as well as tortious. It was argued that the difference in the subcontract's wording covering a '*claim arising in respect of any injury'* and the main contracts' indemnity that covered *'all liabilities and all claims*' meant the subcontract would not cover contractual claims. However, it was stated by the Judge that in a situation involving back to back indemnities down a contractual chain it would be surprising if the indemnity clauses did not extend to contractual claims as well as direct tortious liability.

Therefore the contractor was entitled to the indemnity from the subcontractor.

Sealion Shipping v Valiant Insurance *(The Toisa Pisces)* [2013] Lloyds Rep IR 122
(Definition of due diligence)

This case addressed the open question as to the meaning of "*due diligence*" in the context of the policy wording's proviso and in particular whether, it was enough for insurers to show

Law Cases (continued)

that negligence on the part of the assured, owners or managers played a causal role in the loss or whether a more culpable failing (equating to recklessness) was required.

The insurer in the Toisa Pisces argued that the due diligence proviso would apply if the damage in question resulted from negligence on the part of the assured's technical manager. The assured said that the proviso would only apply if the technical manager had been reckless. Essentially Insurers alleged that if Owners had exercised due diligence after discovering the design fault in the engines, further modification works would have been executed and the relevant breakdown avoided.
In his judgement Blair J noted that "*want of due diligence*" referred to a lack of reasonable care (that is, negligence) by the assured itself and not recklessness. However, no negligence was found on the facts. On appeal, want of due diligence was not in issue.

This case involved a specialist well-drilling vessel ("*The Toisa Pisces"*), propelled by two thrusters that allowed its position to be precisely controlled. These thrusters were driven by electric motors, one of

which broke down and caused the vessel to be dry-docked for repairs. The ship owner took advantage of the removal of the motor to carry out maintenance work for which there would otherwise have been no easy access, which resulted in a subsequent hydraulics failure.

During these works, the owner also opted to do an Intermediate General Survey and other works that had been scheduled for some time later in the year. Once the vessel left port the second motor broke down, requiring further repairs and reinstallation. The vessel was only able to return to service 82 days after the original breakdown. The vessel was covered under a loss of hire marine insurance policy. The sum insured under the policy was $70 000 per day with a 30 day limit and 21 day excess in respect of a machinery claim.

It was argued that the initial breakdown of the motor (an insured risk under the policy) had been overtaken by the second breakdown resulting from the hydraulics failure which broke the chain of causation. It was also contended that three breakdowns meant that three excess periods of 21 days ought to be applied, and that in any event there was no loss of hire in relation to the hydraulics failure as the party undertook their own work and survey at the same time, saving time and earning capacity at a later date.

However, it was held that the fact-sensitive question of causation was not broken by the breakdown of the hydraulics on the basis that the work resulting in the hydraulics failure was reasonably related to mitigation efforts. The second motor breakdown was also part of the claimant's mitigation efforts and therefore the 3 breakdowns would be treated as one period and therefore only one excess was due to be paid.

On that basis, the insured was entitled to a full indemnity under the policy in respect of the loss, less the excess and subject to the policy limits.

It was also held that under the policy wording there was liability if they were prevented from earning hire for the time in question on a simple chronological basis, with no provision for exploring ultimate net loss or grounds for reading such a provision in. Without such a provision, they were entitled to indemnity under the loss of hire marine insurance policy.

JL Lloyd Instrument Ltd v Northern Star Insurance Co Ltd *(The Miss Jay Jay)* [1985] 1 Lloyd's Rep 264
(Causation)

This case concerns a yacht which was badly damaged whilst navigating choppy seas with waves up to three metres high. It was later found as fact by the trial judge that the yacht was ill designed and poorly constructed.

The vessel was insured against loss caused by *'accidental external means'*. Loss caused by the unseaworthy condition of the vessel in consequence of its design and construction was not a peril expressly excluded by the terms of the policy, nor was seaworthiness warranted.

It was held that the damage was caused by frequent and violent impacts of a badly designed and constructed hull on an adverse sea, which falls within the definition of 'external'. It was also 'accidental' in that the vessel should not in the ordinary course of events to have suffered the damage that it did. Therefore, the poor quality of the vessel and the adverse sea conditions were two concurrent causes of the damage.

The court of appeal affirmed the trial judge's finding that the adverse sea conditions were a proximate cause of the damage to the vessel. Both the adverse sea and unseaworthiness of the vessel were taken as proximate causes.

Therefore, on the basis that one of the proximate causes was expressly insured against and the other was not excluded, it was held that the insurer was bound to indemnify the claimant.

Lamb Head Shipping Co Ltd v Jennings (The Marel) [1994] 1 Lloyd's Rep 624
(Causation and unascertained 'perils of the sea')

There is a species of loss known as '*unascertainable*' or '*unspecified*' perils of the seas described in this case and is a form of loss which is proved by the drawing of inferences when a shipowner is unable to pinpoint an event or accident showing the loss was accidental or fortuitous. In these circumstances, the courts would allow an inference to be drawn where the loss is unexplained or where the ship is missing, that the ship was lost by reason of an unascertainable peril of the sea.

This case involves a vessel, which suffered a 'bump' during adverse weather conditions. Large volumes of seawater immediately began to flood the engine room, causing loss of forward propulsion and electricity. The crew abandoned the vessel and it sank within 7 hours of the 'bump'. The plaintiffs claimed under their marine hull insurance that the vessel was lost due to 'perils of the sea', an insured peril under the marine policy.

It was held that the burden of proof lay on the owners to prove that the vessel was lost due to perils of the sea – merely showing a flooding of seawater was not sufficient. The owners failed to discharge the burden of proof as the argument submitted, that the vessel had collided with a floating container causing the bump and fracture to the vessel's shell plating, was viewed on expert evidence to be so improbable as to be judged impossible.

It was also held that the presumption of 'perils of the sea' being the cause of an unknown sinking when a ship had been seaworthy when she set out was not applicable on the facts as that presumption only applies when a ship is lost with all hands and no trace, which was not the case at present.

Finally, it was also rejected that the loss was caused by unspecified perils of the sea as inferred by all other causes. This argument was held as insufficient to discharge the burden of proof. The argument that perils of the sea was the only possible explanation for the damage suffered was rejected.

The claim failed and insurers did not have to pay out for the claim under the marine policy.

Red Sea Tankers Ltd v Papachristidis (The Hellespont Ardent) [1997] 2 Lloyd's Rep 547
(*Gross negligence– NY*)

Red Sea Tankers Ltd, a shipping investment fund specialising in the refitting of tankers, contracted with the defendant, Papachristidis, to provide expert technical and commercial advice on a shipping investment. The contract, subject to New York law, excluded all liability of the defendant except for bad faith, gross negligence or wilful misconduct.

As part of their advising activities, the defendant failed to arrange for the adequate inspection of a vessel that they recommended the claimant to acquire and made no inspection of the ballast tank.

It was ultimately revealed that substantial steelworks were required for the vessel, which would have been revealed upon an inspection and on discovery of such, would have led to the vessel being of no interest to the claimant. It argued that failure to insist on such an inspection went to the heart of the Papachristidis' contractual role as adviser and, as a result of that inadequate inspection, the price paid for the vessel was far greater than ought to have been, regardless of the rising market.

The claimant sued the defendant for gross negligence and wilful misconduct in failing to arrange an adequate inspection of a vessel that they advised the claimant to acquire.

However, it was held that failure to pursue records or estimates closely did not amount to gross negligence sufficient to overcome the contractual exclusion clauses in favour of the defendant. Whilst this case revealed the defendant's misjudgements and shortcomings, it did not amount to such great negligence so as to fall out with the intended sphere of immunity under the contract.

Therefore, the defendant advisers were not liable under the contract.

Wayne Tank and Pump Co. Ltd v Employers Liability Assurance Corp Ltd [1974] QB 57
(Proximate cause)

Wayne Tank designed and installed equipment for transporting and storing liquid wax in a plasticine factory. An employee of the company switched this equipment on and left it unattended overnight before it had been tested, leading to it catching fire and ultimately burning down the factory. The owners of the plasticine company successfully sued for unsuitability of the pipes provided and negligence of the employee. Wayne Tank then sought to recover the damages paid from their insurers.

The insurance policy covered liability for damage to property as a result of accidents, but excluded liability for damage caused by the nature or condition of goods sold or supplied by the insured. It was held that goods installed in a purchaser's factory are 'supplied', even though property may not have passed or the contract concluded.

The Court also held that of the two proximate causes, the dominate cause was the dangerously defective nature of the installation on the basis that no other loss would have occurred without it. Accordingly, where there are two causes of damage, one within the general terms of the policy and one within an exclusion, the insurer is entitled to rely on the exclusion (under both marine insurance law and common law).

Therefore, the insured was not able to recover the amount paid out from the insurers.

Aspen Insurance UK Limited and Others v Pectel Limited [2008] EWHC 2804 (Comm)
(Condition Precedent)

A deep-level tunnel facility owned by BT caught fire on the 29 March 2004. Upon investigation it was found that Pectel, the subcontractor of the engineering services supplier, was using materials that had failed the relevant British Standards ignitability requirements. A letter was sent to Pectel informing them of BT's intention to make a claim against the contractor on 12 January 2007, and advising Pectel to inform their insurers. In March 2007 the contractors sent a letter to Pectel from BT alleging that the contractors, by reason of Pectel's actions, were liable for the fire. Pectel gave this to their insurer after two weeks.

The insurance policy contained an 'immediate written notice' requirement upon 'any occurrence which may give rise to an indemnity under the policy'. It was a condition within the policy that liability of the insurer was conditional on Pectel observing the terms and conditions of the insurance.

The Court held the fire was an occurrence any reasonable man would consider as *'an occurrence which may give rise to an indemnity*', thus it was not fanciful to consider that the work of Pectel's employees had some connection to the fire and there would be a real possibility that if a claim was brought against the contractor, they would seek an indemnity from Pectel.

Therefore Pectel failed to give immediate notice to the insurer by not informing them after the fire in 2004. The Court also noted that in the event that notice had not been required at that stage, the receipt of the letter from the contractors in January 2007 would definitely have given rise to the requirement for immediate notice to insurers to be given.

It was also held that the notice clause and condition taken together was a condition precedent to liability. This was both on a common sense approach to the wording of the two clauses and also the commercial purpose underlying the immediate notice clause, which was to allow the insurer to investigate claims at the earliest opportunity.

Therefore, insurers were not liable to pay.

Canada Steamship Lines v The King [1952] AC 192
(Exclusions clauses and interpretation of unfair terms contra proferentem)

In November 2014 Canada Steamship Lines entered into a crown lease for a 12 year term and became the tenant of a certain dock property on which a freight shed was situated. Under the terms of

the lease, the Crown undertook to keep the shed in repair. While trying to keep the shed in repair, it caught fire due to a servant of the Crown negligently using an oxy-acetylene cutting torch, which destroyed the shed and all its contents.

Clause 7 of the lease contained the wording: *'the lessee shall not have any claim or demand against the lessor for damage to the shed or to any goods at any time being in the said shed'*.
Clause 17 also stated that: *'the lessees shall at all times indemnify the lessor from and against all claims and demands, loss, costs, damages, actions, suits, or other proceedings brought in any manner based upon, occasioned by or attributable to the execution of the presents, or any action taken or things done'*.

Canada Steamship Lines brought action against the Crown for the loss of the shed and contents. The Crown denied any liability by virtue of Clause 7, and also brought action against the Canada Steamship Lines under Clause 17 in respect of the claims made against it by the other parties whose goods were lost in the fire.

It was held that a clause expressly exempting a party from the consequence of negligence of its own servants must be given effect to. However, if there was no express reference to negligence in the exclusion clause, then the Court must consider if the wording used is wide enough to cover negligence on the part of servants.

It also established that the duty of the Court in approaching clauses which purport to exempt one party from liability is to construe it *contra proferentem*, meaning it would be interpreted against the party in whose favour it had been made.

It was held that the Crown had failed to limit its liability in respect of negligence in clear terms under Clause 7 and Clause 17, therefore the clause was to be construed as being related to liability not based on negligence. Furthermore the Crown could have easily included negligence expressly in the contract wording if it had intended to. Therefore, the Crown was not protected from the liability for the loss and was liable to the appellant in damages and for costs, as well as in respect to the third party claims.

Burt & Harvey Ltd v Vulcan Boiler and General Insurance Co [1966] 1 Lloyd's Rep. 161
(Exclusion clauses, corrosion)

This case involved a new chemical plant, which was covered by a policy of insurance against loss from breakdown. This policy covered "*sudden and accidental damage by any fortuitous cause*" but excluded loss and damage from "*wear and tear, corrosion, erosion . . . deterioration or gradually developing flaws or defects.*"

After a few days of operating, the plant had to be shut down due to a build-up of high pressure within it. The insured claimed under the policy on the grounds that the breakdown was due to a crack in a tube in the heat exchanger which allowed water to mix with the chemical being produced and thereby forming a highly corrosive acid which caused the damage. Insurers argued that the split in the tube was a pre-existing defect (excluded from the insurance), alternatively that it was due to corrosion, or, alternatively that it was a gradually developing flaw or defect.

It was held that the proximate cause of the damage was the splitting of the tube, which was caused by sudden and accidental damage by a fortuitous cause that fell within the policy. The exclusion of "*corrosion*" only applied to corrosion where it occurs in the ordinary course of production and not where it is consequential on another failure. The split was not a gradually developing flaw but a sudden breakdown in the course of manufacture.

The purpose of the exclusion clause was to limit liability for such wear and tear over the expected 20 year life span of the factory, not immediately upon beginning operations.
Therefore, the insured was entitled to recover under the policy.

A Turtle Offshore SA v Superior Trading Inc. [2008] 2 C.L.C 953
(Exemption clause ("knock for knock") and best endeavours)

The claimants were the owners of a semi-submersible drilling platform ("*A Turtle"*) and claimed damages in the sum of US $20 million from the defendant tug-owners for the loss of the rig and the associated wreck removal expenses. The tug had transported the drilling platform from Brazil to Singapore via Cape Town. Contracting under a standard form towage contract – TOWCON – the tug nearly ran out of fuel in the South Atlantic due to the tug owner's failure to exercise due diligence in preparing the tug for the voyage and released the towage connection causing the rig to drift away. This was after reaching an average speed of 2.5 knots as opposed to the 3-4 knots factored into the fuelling calculations. The rig was subsequently found on the rocky shores of Tristan da Cunha and, after a failed salvage attempt, was removed and dumped at sea.

The exemption clause of the Tow Contract allocated risk on a no-fault basis and provided that the tug owner would be liable for loss or damage to the tug and the rig owner would be liable for loss or damage to the rig. The owners of the rig argued that this wording was too wide and that the defendants' breach of duty was extreme enough to fall outside its scope, and that the breach of warranty of seaworthiness by the tug was sufficiently serious so that this indemnity did not apply.

The Court held that the defendant had breached their duty of best endeavours by failing to exercise the due diligence in not adequately planning how much fuel would be required to reach Cape Town. Further, they breached their duty of best endeavours by not returning to South America upon realising there was not enough fuel to reach Cape Town as well as making inadequate arrangements for another tug, to take over the tow on realising they would not be able to complete the journey.

However, despite breach of their duty, it was held that the Defendant was protected from liability by virtue of the mutual exemption clause. The commercial purpose of this clause was to clearly allocate the risk of specified types of loss and damage between the parties. The exclusion clause allocated risk on a no-fault basis and provided that the tug owner would be liable for loss or damage to the tug and the rig owner would be liable for loss or damage to the rig *"… whether or not the same is due to breach of contract, negligence or any other fault*."

The Court held that on the facts, even though it was unseaworthy, the tug was still performing its contractual obligations albeit not to the required standard and that this was the type of behaviour knock-for-knock clauses were intended to cover, and accordingly, the tug's breach of duties was not sufficiently serious to override the contractual knock-for-knock indemnity.

The rig owner therefore had to bear the loss for damage to their rig.

Promet Engineering (Singapore) Pte Ltd v Sturge & Others ("The Nukila") [1997] C.L.C. 966
(Latent Defect)

This was an appeal in relation to The Nukila, a mobile self-elevating accommodation and work platform. The unit was insured by policies incorporating the Institute Time Clauses Hulls 1.1.83 plus the Additional Perils Clauses. The policy therefore covered damage caused by the latent defect but excluded the cost of repairing or replacing any part found to be defective as a result of fault or error in design or construction which had not caused loss of or damage to the vessel.

The latent defect was the defective circumferential welds securing spudcans to the three legs of the platform. The Court of First Instance found there was no consequential damage to the vessel and thus there was no coverage.

This decision was appealed and overturned. The Court of Appeal found that at the beginning of the period of cover, the latent defect was in the welds joining the spudcans to the external surface of the leg. During the period of cover the defects caused extensive fractures in the full thickness of the leg and throughout the spudcans. Accordingly, the Appeal Judge found that on any ordinary use of language, damage had been caused to the subject matter insured, the hull of *The Nukila*, and the claim should therefore succeed.

On Appeal, the Court held it was vital to establish what constitutes the latent defect. In these circumstances, it was held that the defect was minute fatigue cracks in the welds. By the time they were discovered, the cracks had become much larger ("serious cracks in the top plates of all three of the spud cans"). Consequently, The Appeal Court found there was damage to vessel's hull caused by a latent defect.

Global Process Systems Inc and another (Respondents) v Syarikat Takaful Malaysia Berhad (Appellant) ("*The Cendor MOPU*") [2011] UKSC 5
(Causation and 'Perils of the Sea')

A jack-up rig, the "*Cendor MOPU*", was transported from Texas to Malaysia under a policy of insurance which contained a clause excluding loss, damage or expense caused by inherent vice. During the voyage the legs fractured, fell into the sea and were lost. The fractures were the result of progressive stress fatigue fractures.

The Court of First Instance held that the proximate cause of loss was the fact that the legs were not capable of withstanding the conditions of the insured voyage. This meant the cause of loss was inherent vice and was therefore excluded by the policy.

The Court of Appeal took a different view as it concluded that the proximate cause of loss was a "leg breaking wave" which was an insured peril and thus covered by the policy. This decision was appealed by the insurers. Discussion centred around the definition of inherent vice and perils of the sea. It was held that inevitability is not the test of inherent vice but rather an inherent inability of the goods to withstand the ordinary incidents of the voyage. Accordingly, whether the loss of the legs was due to the peril of the sea or the inherent characteristic of the cargo or both needed to be determined.

It was held that the Court of First Instance's definition of "*perils of the sea*" was too narrow and that of inherent vice was too wide. All goods are capable of being lost or damaged from the fortuities of the weather, but this does not mean the loss or damage necessarily arose from the nature of the goods.

Accordingly, it was held the failure of the legs was due to the effect of the height and direction of the waves on the pitching and rolling motion of the barge and therefore on the steel legs. It was known from the outset that the legs of the rig were at risk of fatigue cracks during the voyage. The weather experienced was within the range of weather which could have been reasonably expected. In that light, the breaking of the legs occurred due to the influence of a leg breaking wave of a direction and strength which caught the legs at just the right moment.

The failure was very probable but not inevitable, and even though the failure occurred in the ordinary course of the voyage the way in which it occurred was fortuitous. It was concluded that the proximate cause was therefore the result of a fortuity, namely the perils of the sea and not the susceptibility of the legs to crack as a result of metal fatigue or inherent vice. The loss was therefore covered by the policy and the appeal was dismissed.

Shell UK Ltd v CLM Engineering Ltd, Field Enterprises Construction (UK) Limited and 37 others [2000] 1 All E.R. (Comm) 940
(Latent Defect and Interpretation)

The defendants were contractors who designed, constructed and installed pipelines for the claimant who was carrying out business developing and exploiting oil and gas resources in the North Sea. The contract between the claimants and the defendants was to design and construct sub-sea carrier pipes. The contract specified certain minimum well-fluid arrival temperatures and the pipeline cavities were therefore filled with a gel insulation medium.

The claimant argued that on reception of oil and gas, the temperature was lower than agreed. Whilst this was disputed by the defendant, the claimant claimed the insulating gel split into hard gel and liquid monoethylene glycol and that this was due to a fault in design of the gel or faulty construction or workmanship.

The claimants had insurance placed with the defendant underwriters and Judgment centred on the construction of the relevant clauses. It was the claimant's case that a particular clause provided insurance cover for the costs incurred by the claimant in repairing or replacing any party of the property insured which was defective by reason of faulty design, construction or materials irrespective of whether physical loss or damage had been sustained.

The defendant underwriters however claimed that there was only an indemnity against the cost of repair or replacement of the defective part *if* the insured property had suffered physical loss or damage as a result of the defect. The underwriters argued that on the claimant's construction, the policy was no less than a guarantee of the contractor's performance.

It was held that the claimant's construction of the policy involved considerable straining of language and the judge agreed with the underwriters that implying the words "*giving rise to physical loss of and/or physical damage*" was both obvious and necessary to give the remainder of the paragraph its ordinary and natural meaning.

The judge continued by discussing section 55 of the Marine Insurance Act 1906 and its guidelines on inherent vice if the policy is silent. The policy in this case did "otherwise provide" in regard to inherent vice, but it was held that such provisions must be clear and unambiguous since the presumption must be that the policy only responded to casualties. Further, the judge stated if the latent defect was present at the inception of the risk (which, by definition, latent defects must be) then he was unable to accept that there was a fortuity if the defect was subsequently discovered. For the above reasons, the Court held that the underwriters' construction of the relevant clauses was appropriate and the claim was therefore dismissed.

Clark (Inspector of Taxes) v Perks [2001] EWCA Civ 1228
(Tax status of drilling rig employees, what is a ship)

This case related to the tax status of people employed on jack-up drilling rigs operating in the North Sea. The *Income and Corporation Taxes Act* 1988 (the " 1988 Act") gives exemptions from income tax for work performed abroad which includes employment as a seafarer. Employment as a seafarer is defined as employment consisting of the performance of duties on a ship. A ship is not defined by the 1988 Act, but initially before the Commissioner and then on appeal in front of a judge, reliance was placed on the definition of a ship in the *Merchant Shipping Act* 1894. The 1894 Act defines a ship to include every description of vessel used in navigation not propelled by oars.

The Commissioner originally held that rigs were ships and the taxpayers were accordingly seafarers. The reasoning behind the Commissioner's finding was that the jack-up rig was capable of navigation despite having none of its own propulsion or engine. The Commissioner found the rig was capable of navigation with the motive power being the engines of the towing tugs with all navigation being controlled from the rig itself.

There was a subsequent appeal on a point of law only. The Judge set out that the meaning of the word *'ship'* was a matter of law rather than fact. Upon evaluating the relevant case law the Court concluded that the primary function of a jack-up drilling rig was to be positioned at a point on the surface of the earth and drilling. Its ability to float (not even under its own power) was incidental to its static, non-floating primary function. He therefore held that rigs did not have the necessary characteristics to be defined as a ship.

On appeal the Court of Appeal overturned the first Judge's interpretation. Defining the test for what constitutes a ship was a matter of law, but the determination of whether this specific jack-up rig was a ship was a matter of fact and the sitting Judge should not therefore have substituted his own views for those of the Commissioners. The Court found that the rigs in question did constitute a ship and the appeal was therefore allowed.

King v Brandywine Reinsurance Company [2005] EWCA Civ 235
(Sue and Labour)

Approximately 11 million gallons of oil were spilled after the *Exxon Valdez* ran aground. Exxon, the owner of the ship and the cargo on board proceeded to take steps to contain the spill which spread

approximately 470 miles. Exxon were also the subject of a number of claims against them including claims from the Federal Government of the United States of America and the State of Alaska.

Exxon's Global Corporate Excess (GCE) policy contained sue and labour provisions stating that they were entitled to recover *"all sums which the Insured pays or incurs as costs or expenses on account of…removal of or attempted removal of debris or wreck of property and/or residual structure"* under which Exxon claimed the costs of its attempted clear up of the oil spillage.

The Judge at First Instance found the governing law of the GCE was English law and thus there was no cover under the sue and labour clause as it did not extent to pollution clean-up.
The respondent, Brandywine Reinsurance Company, argued that the words "*removal of debris*" do not naturally describe the clean operations of Exxon, as "*debris*" does not naturally describe "*oil*", and "*removal*" does not naturally describe the clean-up activities undertaken. It was therefore outside the intention of the parties for "*debris*" to include oil spills. The appellant submitted that the ordinary definition of "*debris*" is "*something broken down or destroyed*". The oil spill had rendered the oil useless and destroyed it and the oil should therefore be classed as debris in the context of the policy.

On appeal, the judge upheld the decision of Court of First Instance. It was held that neither under New York or English law would the words "*removal of debris*" cover the clean-up costs of an oil spillage.

Suez Fortune Investments Ltd v Talbot Underwriting Ltd (*The Brillante Virtuoso*) [2015] EWHC 42 (Comm)
(Salvage and sue and labour clauses)

The vessel, *The Brillante Virtuoso*, was insured against loss or damage caused by piracy under a war policy issued by the insurers. Whilst on voyage and waiting off Aden, pirates boarded the ship and started a fire causing extensive damage. The vessel's owner subsequently entered into a salvage contract and salvage operations were carried out redelivering the vessel by the salvors to the owner. The vessel remained a dead ship anchored in international waters and the owner subsequently hired two tugs to stand by her until delivery to the buyers to whom she was sold for scrap.

Following redelivery of the ship, the owner's surveyor inspected her and concluded that the cost of repair exceeded the insured value. Accordingly, in December 2011 (prior delivery of the vessel to the buyers to whom she had been sold for scrap) the owner tendered a Notice of Abandonment ("NOA") to the insurers, declaring the ship a Constructive Total Loss ("CTL"). The insurers rejected the NOA.

The claimants claimed an indemnity for (i) a CTL, alternatively (ii) if the vessel was not a CTL, a partial loss and loss of hire and (iii) sue and labour expenses incurred. For the purposes of the sue and labour claim, the claimants sought an indemnity against their liability to the salvors as well as in respect of the standby tugs costs and related agency fees incurred.

The insurers' primary defence was that the claimants were not entitled to cover under the policy as they were in breach of warranty, however the claimants denied said breach. The insurers disputed that the vessel was a CTL and took issue with the claimants on their calculation of the alternative partial damage claim and as to their entitlement to loss of hire cover. The insurers also disputed the amount and the period for the sue and labour expenses claimed.

Salvage expenses were claimed under Clause 11 (General Average and Salvage) of the Institute Time Clauses (Hulls), or alternatively as sue and labour expenses under Clause 13 (Sue and Labour). The Court however considered that the claimants were clearly entitled to an indemnity in respect of the liability to the salvors.

As for the standby tugs and agency fees costs, the claimants sought to recover those under the sue and labour clause and/or under section 78 of the *Marine Insurance Act* 1906. The insurers argued that the cost of hire of the standby tugs had been incurred for the benefit of the owners, not for the benefit of insurers.

Insurers submitted that once the vessel had been redelivered by the salvors, any insured peril which had been operating ceased to operate. The claimants argued that the vessel was a dead ship and the

causative influence of the original peril was still in effect, therefore the claimants had acted reasonably to prevent a loss or at least the risk of a loss (which would otherwise fall on the insurers) by hiring the standby tugs. The Court considered that, even after redelivery by the salvors in October 2011, the vessel (being a dead and disabled ship anchored in international waters) remained in the grip of the original peril.

On the basis that the vessel remained in the grip of the peril, the Court also considered that the cost of the standby tugs and the associated agency expenses were incurred not only for the benefit of the owners, but for the benefit of the insurers, so that they should be recoverable as sue and labour expenses.

Furthermore, the Court also found that the claimants' entitlement to claim for sue and labour expenses ceased when the claim form was issued on 8 February 2012
In conclusion, it was held that that: (i) the overall cost of repairs was such that the ship was a CTL; (ii) the claimants had not lost the right to claim for a CTL by the ship's sale (because the insurers were aware that the owner was proposing to sell the ship and they did not object); (iii) the claimants were entitled to an indemnity in respect of the liability to the salvors as well as to an indemnity in respect of standby tugs costs and agents' fees until the date of issue of the claim form.

Linelevel Ltd v Powszechny Zaklad Ubezpieczen SA (*The Nore Challenger*) [2005] EWHC 421 (Comm)
(Sue and labour clauses)

The claimants were the owners of the tug *Nore Challenger* and its sister vessel, both insured under the same insurance policy. The policy incorporated the Institute Time Clauses (Hulls) 1983. On 29 September 1999 the *Nore Challenger* was chartered to NM Shipping, a tug operating company named as the assured under the Policy. The policy covered loss of or damage to the tug caused by perils of the seas and negligence of the crew and also covered loss of hire.

As the bareboat charterer of the tug, NM Shipping had an insurable interest and would be entitled to recover under the Policy in respect of damage to the tug. NM Shipping would also be entitled to claim for loss of hire in consequence of any damage to the tug incurred during the period of insurance, if such damage prevented the tug from earning hire for a period in excess of 5 days.

The tug underwent a survey and the surveyor identified an oil leak and recommended a thorough inspection of the tug be carried out in dry-dock. The tug subsequently entered dry dock and, on inspection, damage to part of the propulsion unit of the tug was discovered. On examination of the damage, marine surveyors opined that the damage could reasonably be attributed to contact with the river bottom whilst the tug was sailing or manoeuvring in muddy and shallow waters, leading to leakage and ingress of seawater into the unit. The claimant owners thus alleged that a grounding had occurred between 4 September 2000 and 28 September 2000 and referred to a specific incident on 12 September 2000. However, there was no record of such incident. The charterers denied that any grounding occurred and argued there had been a latent defect arising from an incident prior to the charter which was the cause of the problem.

The Court found that the surveyors had been correct in attributing the damage caused to the tug to an incident when the unit came into contact with the river bottom or something similar. Accepting expert evidence, the Court found that the incident causing the damage was likely to have taken place between 4 September 2000 and 28 September 2000 (when the unit failed completely). The Court also considered that NM Shipping had to have been aware of the incident but was likely to have chosen to keep quiet about it.

The Court determined the proximate cause of the damage was a peril of the sea (the grounding), thus covered under 6.1.1.of the Institute Time Clauses, and as such the exception of damage resulting from want of due diligence (by the assured, owners or managers) did not apply.

In light of the findings that there had to have been a grounding post 4 September, the Court also found that the duty under Clause 13 of the Policy and section 78(4) of the *Marine Insurance Act* 1906 required the assured to take such measures as may be reasonable for the purpose of averting or minimising loss and accordingly, there was a duty by the assured to sue and labour. Regardless of

the lack of evidential certainty as to when the incident took place, once it did, it had to have become immediately apparent to NM Shipping. At that point, NM as the controlling co-assured should have immediately dry- docked and inspected the tug.

The Court found that the owner was entitled to be indemnified for the loss. In so finding the Court may have taken into consideration the owners' argument that, though there might have been a failure by the BB Charterers to sue and labour following the grounding, such failure had no financial impact since the damaged items would have required repair/renewal in any event.

Atlasnavios Navegacao Lda (formerly Bnavios Navegacao Lda) v Navigators Insurance Co Ltd B Atlantic, The [2014] EWHC 4133 (Comm)
(Sue and Labour expenses)

The Court of Appeal did not address the sue and labour issue so the High Court judgement in this regard, as summarised below, is still referable.

This case concerned drug smugglers who had strapped drugs to the hull of a ship without the knowledge of the ship-owner leading to the ship's detention and constructive total loss. The relevant policy was written on Institute War and Strikes Clauses 1/10/83 with additional perils.

Regarding sue and labour expenses, it was held that first, the owners could recover, as sue and labour, any expenses incurred after the date of the notice of abandonment until the date of issue of proceedings, where the underwriter declined the notice but scratched the “writ clause” on the notice.

Second, where legal fees are incurred both for the purpose of extricating the vessel from the insured peril and for some other purpose which is not sue and labour (here the defence of the crew), then

they are to be regarded as sue and labour expenses, *unless* insurers could demonstrate that the relevant expenditure was incurred solely for the other purpose. In these circumstances, it was impossible to do so as the defence of the crew was inextricably bound up with the release of the vessel.

Third, the costs of manning the vessel and providing for its technical management during the period of detention were recoverable as sue and labour expenses and were not excluded by the "*wages and maintenance*" or "*agency commission*" provisions under the policy which only deal with partial loss or particular average cases. These costs were not incurred due to contractual commitment (which would have rendered them unrecoverable as sue and labour) but incurred because the owners wanted to be ready to sail as and when the opportunity arose.

Fourth, it was held reasonable to put in a team of investigators more than a year after the incident to investigate who committed the offence, as a part of an overall attempt to secure the release of the vessel so should be recoverable as a sue and labour expense.

Royal Boskalis Westminster BV v Mountain [1997] LRLR 523
(Sue and labour)

Underwriters appealed a preliminary judgement on liability under the sue and labour clause of a war risks policy. The Iraqi Government had lodged a deposit in a Dutch Bank as security for payment on a contract for Royal Boskalis Westminster ("RBW") to dredge a port. However, following the Iraqi invasion of Kuwait, sanctions were imposed which prevented the Dutch Bank from making any payment to Iraq.

Under a Finalisation Agreement, RBW illegally returned what remained of the deposit and waived a claim for an extra 84million Dutch Guilders in return for release of the dredging fleet and the 479 employees held. RBW then claimed for the latter under their insurance policy as '*sue and labour*' expenses.

It was held that although the Finalisation Agreement was not void under Iraqi law, the illegal clauses relating to the transfer of the funds to Iraq would be severed as a matter of public policy. Therefore,

the waiver it contained was unenforceable and RBW suffered no loss for which they could claim for. A ransom cannot be recovered under a sue and labour clause.

AIG Europe (Ireland) Ltd v Faraday Capital [2007] Lloyd's Rep IR 267
(Claims co-operation clause)

The reinsured insured a US company against third party liability of the company and its directors. The company's shares had lost a third of their value after it announced its intention to re-state the previous three years' accounts. Shareholders of the company instituted proceedings claiming that the value of the shares had been artificially inflated as a result of the accounts before restatement.

The company gave notice to its insurer, but the insurer failed to pass on the notice of claim to reinsurers. When the claim settled, the insurer gave notice within 30 days as required under the claims co-operation clause. Reinsurers denied liability on the basis of the claims co-operation clause notification requirement, arguing they should have been notified within 30 days of the claim being issued, rather than as of the date of settlement.

It was held that the sharp fall in a company's share price was a "*loss which may give rise to a claim*" within the meaning of a claims co-operation clause in a reinsurance policy. Therefore, the insurer did know of a "*loss which may give rise to a claim*" for more than 30 days before notifying reinsurers. Accordingly, the claim was not covered under the respective policy.

Colour Quest Ltd v Total Downstream UK [2009] EWHC 540 appealed to [2010] EWCA Civ 180
(Indemnity clauses and vicarious liability)

In this case, Total had control of tank filling operations at an oil storage depot where an explosion occurred. The explosion caused serious damage to the nearby houses, as well as to the property of other oil companies (tanks and pipelines), and claims for compensation were brought both against Total and the Joint Venture Company ("JVC"). Total submitted that, under the relevant joint venture agreement, it was the JVC who was to operate the site, direct the employees there and retain ultimate responsibility for directing and controlling the manner of tank filling operations.

It was held that the question of who is vicariously liable is a question of fact, and in these circumstances, it was Total who was vicariously liable for the careless tank filling activities carried out by their employees and for failing to promulgate an adequate system to prevent overfilling of the tank.

On appeal, Total accepted liability for the damage to the property but argued that they had a contractual right to an indemnity against the JVC, even when they had been negligent, as this had been expressly agreed between the parties.

The appeal was dismissed and the right to an indemnity for Total was denied. The Court held that the clauses were not intended to indemnify a party in respect of its own negligence. This finding falls in line with the principles of *Canada Steamship Lines Ltd v The King*, which set out that where such an indemnity does not expressly exclude negligence, it is viewed to be an inherent improbability that the parties would agree to indemnify one another for negligent conduct. There was no other material relating to the parties' presumed intentions that was sufficient to set aside this presumption. Furthermore, where a contract is drafted whereby one clause covers negligence and another does not, it is presumed to have been an intentional omission.

Summary of Questions

This module contains one "mini-practical" question (carrying the most marks and designed to be completed in around 45 minutes) plus a variable number of standard short-form questions.

"Mini-Practical" Question

Corrosion damage occurs to production risers at an offshore platform during construction period and before First Oil. Problems with weld process during fabrication of replacement risers using surplus project material. Claim presented under a standard WELCAR wording.

Candidates are expected to demonstrate their understanding of fortuity and consider the application of exclusions under an All Risks policy. They shall also demonstrate their understanding of the practical application of: principles of indemnity, intervening cause and reasonable cost of repairs, presenting their answer in a tabular "Adjustment" and providing a recommendation for settlement of the total net claim.

Edited Examples of Short-Form Questions on Wordings

WELCAR 2001

1) Under "Scope of Insurance" in a standard WELCAR 2001 wording, the covered activities include [the question mentions one covered activity]. Give a brief example to illustrate your understanding of this term, as used in this context.

2) During drilling activities connected with an offshore development Project, the senior onsite representative of the drilling Contractor ("DrillCo") observes and reports that 2 recently installed BOP's appear to be underrated for their respective anticipated well pressures. [Scenario asking Candidates how the concept of "due diligence" would apply in practice].

EED 8/86

1) Briefly summarise the terms of Clause [X] of the Declarations

2) Clause 2a of Section A of the EED 8/86 wording sets out the definitions and the criteria which are applicable to the determination of whether or not a well may be considered to be "Out of Control".

   Identify…[the question asks Candidates to identify specific aspects of the definition].

LONDON STANDARD PLATFORM FORM JR2009/003

1) To what extent are additional limits available?

2) Summarise the Insuring Agreement covering [X] which is set out at Section [X] of the Form.

3) How would you summarise the definition of [X]?

4) Outline the Measure of Recovery which is applicable to [X].

5) Summarise the provisions of the Policy Condition relating to [X].

6) Summarise any 6 of the 17 exclusions set out under Section A of the Exclusions Clause 5.

LOPI JR 2005/003A

1) Under Section 1. A (Insuring Clauses - Coverage) summarise [the Candidate is asked to outline aspects of the cover afforded]

2) Under Section 2 (Definitions), describe the definition of [X].

3) Summarise any [X] of the Exclusions set out under Section 3.

4) Under Section 4 (Conditions) what is meant by the term [X]?

LONDON MARKET OFFSHORE MOBILE UNIT FORM LSW678 1997

1) Under Section 1 (Coverage) of the Insuring Agreements, the coverage for [X] is restricted according to a formula. Summarise the application of that formula and illustrate your answer with a simple example.

2) Describe the principal provisions of the following general Conditions set out under Section VI of the Form: [XXX].

3) With regard to Section III of the Form, summarise the Limit of Liability which applies to [X].

INCORPORATED CLAUSES

It is expected that Candidates will have acquired familiarity with the principal relevant features of the following standard forms:

- Institute Clauses for Builders' Risks 1988
- Institute Hulls - Port Risks Clauses 1987
- Institute Cargo Clauses-A 2009

However, they will not be tested on their ability to quote accurately or provide "chapter and verse" references to these texts.

Examples of Questions on General Principles requiring a knowledge of Case Law

1) Summarise and explain the principal points arising from the decisions in the following law cases: [X]

2) An insurance manager asks you if you think that a jack-up rig is a ship. Draft a response, referring to any relevant law cases.

3) In the *Brillante Virtuoso* what guidance did the Court of Appeal provided guidance in respect of [X]?