

Offshore Energy Law

Insurance: Well Packaged?

When involved in the world of upstream offshore energy, whether on the company side or the contractor side, it goes without saying that cover for the associated risks should be properly considered. In practice, many 'package' policies are sold which combine all the elements of cover required into one convenient policy. However, the label ascribed to the policy will rarely be determinative and the make up of the policy can be a 'complete Horlicks'. Care therefore needs to be taken to review the substance of the cover so as to ensure that it has been "Well Packaged". This is especially the case where different parts of the 'package' interact with each other in order to determine coverage, and where the losses incurred could be high.

A glaring example of this is insurance for 'business interruption' ("BI") losses. Given the intended purpose of FPSOs and the potential for that business to suffer from many causes, both natural and manmade, business interruption insurance will no doubt be a common element of any suite of insurance policies in place for an FPSO.

Cover for BI losses is typically dependent upon there being physical loss of or damage to a company's offshore asset that is insured under the property section of the policy. With this in mind, whether you are an insured buying cover or insurers writing the risk, you may want to consider the following:

(a) Does the mechanism connecting the BI cover to the property damage cover work?

BI cover typically seeks to provide cover for BI loss proximately caused by physical loss of or damage to the producing asset which is covered under the property

insurance. However, we have seen policies that could arguably be said to fail in this objective.

Due to loose drafting connecting the BI cover to the property damage cover, it is not always clear whether, in order for BI cover to be triggered, the physical damage that causes the BI has to be the same physical damage that is covered under the property insurance.

So, you could have a situation whereby BI cover is arguably still triggered even though the property damage that is covered by the property insurance is totally unrelated. Put another way, what if you have a ruptured riser which causes BI and a damaged generator which does not cause BI? It turns out that the damage to the riser isn't covered under the property insurance. At first blush, you would think that there would be no BI cover. However, because the damaged generator is covered under the property insurance, even though such damage has no connection to the BI, the BI cover could still be said to be triggered.

Such an outcome cannot be what the insurers intended, but may be the bargain they have to live with if the policy is not well drafted. If cover is accepted, this would obviously be beneficial to the insured. However, to avoid disputes, it may not be worth either party overlooking such issues.

(b) Is the property damage cover "all risks" and do you know what this means?

Most property damage cover is "all risks", but it should be noted that this doesn't cover everything under the sun and that the burden is on the insured to show how the relevant damage is covered. Proper consideration needs to be given to the word 'risk'. Insurance is taken out against accidents which may happen (a fortuity), not against events which must happen (a certainty). As a result, if the damage lacks a fortuitous event, then there was never really a 'risk', and the damage is therefore not covered.

Examples may include where the loss is a known certainty to the insured (which also raises a material non-disclosure alarm bell), where the loss is deliberately caused by the insured (which also raises the fraud alarm bell), or where the loss is caused by an inherent vice, which has been defined as:

"...the risk of deterioration of the goods shipped as a result of their natural behaviour in the ordinary course of the contemplated voyage without the intervention of any fortuitous external accident or casualty" (Lord Diplock in Soya GmbH v White [1983] 1 Lloyd's Rep 122).

Although there is merit in the observation that inevitability and inherent vice are distinct concepts given that loss is not necessarily bound to occur if an inherent vice exists, it is still the default position in "all risks" policies that there is no cover for inherent vice. In the context of marine insurance, s.55(2)(c) of the Marine Insurance Act 1906 confirms this principle. However, it also confirms that cover for inherent vice can be expressly provided for.

In many cases, the hurdles of inevitability and inherent vice can be overcome. However, as is the case with all insurance, whilst cover may be given with the one hand, there is always the possibility that it is taken away with the other. It is therefore important to be equally confident of what is excluded.

(c) What is excluded under the property damage cover?

Two key exclusions that are often present are the design exclusion, and the wear and tear exclusion. This is obviously of importance to both the insured and insurers, although the burden will be on insurers to show whether or not an exclusion applies.

The Design Exclusion

This excludes the cost of repairing those parts that are faulty in design, but does not exclude physical damage arising from those parts. When reviewing this clause, things to note include:

- The importance of being clear as what does or doesn't constitute 'part'. In many package policies 'part' is left undefined without appreciating that BI cover may depend on such a distinction i.e. if the BI was caused by the defectively designed part there may be no cover for the BI loss, but if the BI was caused by physical damage resulting from the defectively designed part, there will be cover.
- That 'faulty design' loosely translates as 'not fit for purpose', meaning that there is no requirement for insurers to demonstrate negligence or personal blame (*Leeds Beckett v Travelers Insurance* [2017] EWHC 558) i.e. if the 'part' doesn't work properly in

the environment in which it has been placed, then the design is faulty regardless of whether or not it can be said to be 'state of the art' or developed within prescribed parameters.

Wear and Tear Exclusion

This excludes the cost of repairing and correcting "ordinary wear and tear". When reviewing this clause, things to note include:

- How 'ordinary wear and tear' has been defined. In *The "Cendor Mopu"* [2011] UKSC 5, Lord Mance considered it to cover "loss or damage resulting from the normal vicissitudes of use in the case of a vessel... without any fortuitous external accident or casualty". Despite subtle differences, the wear and tear exclusion is therefore really just an extension of the principle that there is no cover for inherent vice, and in the context of marine insurance, s.55(2)(c) of the Marine Insurance Act 1906 confirms this.
- The exclusion is sometimes drafted more broadly such as to drop the 'ordinary' (so that we are just left with 'wear and tear') and to include other processes such as metal fatigue, corrosion or rusting. In such cases, the exclusion could be said to depart from merely acting as an extension of the inherent vice principle, as there is less reason to suggest that should a fortuitous external accident or casualty contribute to the wear and tear, fatigue or corrosion, this would render the exclusion inapplicable.

In these circumstances, the question is then, 'what is the proximate cause of the damage/loss – the wear and tear or the fortuitous accident?' If insurers can successfully argue that the wear and tear was either the proximate cause or a proximate cause, then the exclusion will be triggered. This principle was recently confirmed in the Supreme Court case, *The "B Atlantic"* [2018] UKSC 26.

These are the main issues but there are obviously other issues to consider when reviewing whether BI cover or offshore risks more generally are "Well Packaged". For a more detailed discussion, please refer to *Offshore Construction: Law and Practice* by Beadnall and Moore (published by Routledge, 2017) or contact the author for more focused advice.



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