THE

INSTITUTE TIME CLAUSES - HULLS 1/11/95

SEVERAL RESTRICTIONS TOO FAR?

DELIVERED BY

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The Institute Time Clauses Hulls are the most widely used set of clauses for the insurance of international hull business.

During the gestation period of the latest set of clauses, which are effective from the 1st of this month, the London Market has been faced with threats by The International Chamber of Shipping, the Asian Shipowners' Forum and the Greek Shipowners' Co-operation Committee to the effect that their members may be forced to find alternative markets which will not impose what in their eyes are totally unacceptable conditions. The furore has been such that it prompted an editorial in Lloyd's List which made the following points and I quote:

> "If one supplies a service to a massive and important market, the last thing that should be done is to alienate these powerful and numerous customers.

This week's polite warning by John Hadjipateras of the Greek Shipowners' Co-operation Committee of its continuing opposition to certain revisions to the Institute Time Clauses should be taken seriously by the London hull insurance market.

The Greeks have formidable purchasing powers represented by the 126m dwt they control. They are getting the distinct impression that the London market is not treating them as the valued customers they undoubtedly are, should it attempt to impose a number of unacceptable changes to the clauses.

Their objections are both practical and legal, and when they point out that the revised clauses introduce areas of uncertainty over the cover afforded by insurance policies which is to the detriment of owners, somebody ought to sit up and listen."

We are looking at what many commentators have described as a public relations disaster. How has this occurred?

BACKGROUND

The catalyst for the radical revision of the Institute Time Clauses can be traced back to the horrendous losses suffered by marine insurers during the late 1980's and 1990 when a fatal combination of suicidally low rates of premium, low deductibles, sub-standard vessels, complacent Classification Societies, second rate ship managers and poor quality adjusting led to the disappearance of many hull insurers who either simply went bust or whose senior

management decided that marine hull business was no longer for them. The underwriters remaining in the Market decided that if they were to survive long term, a radical re-think was required. Three immediate changes were put into place:

1) Rates of premium were increased substantially, with many shipowners facing hikes in their level of premiums of 100% or more.

2) Policy deductibles were increased substantially. Taking a Panamax bulk carrier as an example, which might well have been carrying a deductible as low as US$ 20,000, a figure of US$ 100,000 became the norm and for those Owners whose record showed a large number of machinery damages, the Machinery Damage Additional Deductible may also have been applied.

3) Underwriters became far more selective in their underwriting and many shipowners with a poor claims record and/or older tonnage suddenly found that they could only obtain insurance cover on restricted conditions if at all.

The above measures, coupled with other factors such as the shake-up of the International Association of Classification Societies and the number of new surveys imposed by Classification Societies, port state control and the like, caused a rapid turn-round in underwriters' results and the marine account returned to profitability. In fact, in the case of Lloyd's, marine business has been one of the most profitable classes of business for both the 1993 and 1994 policy years. However, hull underwriters were still unhappy with a situation in which they perceived themselves as still paying for many items of repair, particularly in the area of machinery damage, which they considered were attributable to poor management

and/or lack of maintenance. Another area of concern for hull underwriters was the lor g-tail which they were experiencing in the case of certain types of machinery damage which they found difficult to accept on what they had always looked upon as relatively short-tail business. It was therefore decided that a radical revision of the clauses was required.

THE JOINT HULL COMMITTEE

The revision of the Institute Time Clauses, Hulls, is the responsibility of the Joint Hull Committee which consists of underwriting representatives of Lloyd's and the Institute of London Underwriters. Under their then Chairman, Mark Brockbank, they set up a working party to undertake this task, ably assisted in the drafting by my colleague this afternoon, Julian Hill. In August 1994 the first set of draft clauses, which were in fact draft number 7, were issued on a limited circulation basis under cover of a Joint Hull Committee memorandum which gave only three weeks in which to lodge objections, failing which the clauses were to be introduced with effect from 1st January 1995.

These draft clauses represented a truly radical change in that for the first time there were two versions, the A and the B. Version A offered the wider coverage which it was intimated would only be available for blue-chip clients. Version B, which were described as the standard clauses, were the real bomb-shell because they did not cover crew negligence. Basically speaking, hull insurers had reached the point where they were fed up with paying for sub-standard crews and for lack of maintenance under the guise of crew negligence. At this time I made several speeches in which I made the point that for a shipowner, there is no difference between a deck officer making an error in navigation and placing the vesse on the

rocks and an engineer negligently closing the wrong valve and causing massive damage to the main engine; these are both accidents for which the shipowner requires insurance cover.

The publication of these draft clauses produced an extremely negative reaction, particularly from the insurance brokers who maintained that the clauses were quite simply unsaleable in the world market. Underwriters, who by this time were facing a slightly softening market, beat a hasty retreat saying that the Joint Hull memorandum had been misunderstood and that it had never been the intention to impose the restricted perils clauses upon the majority of shipowners. It was then a question of back to the drawing board with another nine drafts being produced before the clauses were published in September 1995 in their final form. During the later stages of the drafting process, input was obtained from various market organisations including Lloyd's Insurance Brokers Association and the Association of Average Adjusters. However, although changes were made in recognition of technical points of drafting, underwriters would not be swayed from the main changes in principle which they were determined to see introduced.

So what are the major changes?

The Navigation Clause (Clause 1) has had two new sections incorporated, both of which have been the subject of brokers' add-on clauses for many years and have as a consequence been a feature of most Owners' existing covers. Clause 1.2 recognises the fact of life that Owners are frequently forced to enter into pilotage and routine towage contracts with liability limitation or exemption clauses and provided that this is done in accordance with established local law or practice it will not prejudice the insurance. Similarly, Clause 1.3 acknowledges

that nowadays personnel. supplies and equipment are frequently transported to and/or from vessels by helicopter and once again this will not prejudice the insurance.

The Continuation Clause (Clause 2) had been abused in that in a hardening market the clause had been used to obtain an extended period of cover at the lower prevailing rate and/or to give a longer period in which to shop around for cheaper alternative markets. The clause can now only be invoked if at the expiry of the policy the vessel is at sea and in distress or missing and then cover will only be continued while the vessel is in danger.

Clause 4 Classification is a new clause for the I.T.C. It imposes upon Assureds, Owners and Managers, two very clear duties which must be strictly adhered to and the consequences of non-compliance are set out in 4.2. In effect, Underwriters are treating 4.1.1 and 4.1.2 as warranties, breach of which will entitle them to avoid the policy as from the date of any breach (or arrival at next port thereafter). Underwriters have publicly stated that, in the case of fleet policies, 4.2 will be construed as applying only to the vessel in respect of which there has been a breach, provided that the policy stipulates that each vessel be deemed a separate insurance. An important point for our insurance broker friends to note.

Underwriters have confirmed that Clause 4.3, although having the character of a warranty, will not be construed as such, although any apparent non-compliance would be noted and possibly used as a factor in future renewal negotiations.

Clause 4.1.1 is the basic Class Maintained Warranty which has been a standard feature of most covers for years. Please note that it must be a Classification Society agreed by the Underwriters.

Clause 4.1.2

This warranty relates only to Class recommendations requirements or restrictions relating to the seaworthiness of the vessel. One question which arises is what are the due dates within the terms of the clause: the date when the item was first due for survey, or the later date(s) given after extension(s) have been agreed by the Classification Society? I would submit that it is the latter.

Clause 4.3 imposes the duty upon the Assured, Owners and Managers to ensure that any incident condition or damage in respect of which the vessel's Classification Society might make recommendations as to repairs or other action . . . must be promptly reported to the Classification Society. The necessity for this clause arose primarily from the tendency of some ship operators to avoid complicating their lives by the simple expedient of neglecting to report any accidents or defects in their vessels to the Classification Society. When reviewing this clause, I would urge underwriters to refer to the case of the "BUENA TRADER" (1978 2 Lloyd's Re.325) and in particular the expert evidence adduced therein. One section is particularly relevant:

> "So far as the practice is concerned, there seems to be a considerable divergence between what in theory an Owner ought to do, and what Owners do in fact. Captain Bryson agreed in cross-examination that if an Owner was aware of any defect which affected class, it ought to be communicated to the Classification Surveyor, but when asked whether it is the practice of Owners to make a list of defects for Lloyd's Surveyor, or to draw his attention to defects, replied

"Certainly not. It doesn't happen". Mr. Casebourne accepted that it was the duty of the Owners to inform the Classification Society Surveyor of all but trivial defects in class items, and conceded that it was within "the spirit of the rules" that defects affecting class should be brought to the attention of Lloyd's Register, but he said "The practice to inform Lloyd's of defects is not a very widespread practice; in practice, the Lloyd's Surveyor goes round and makes his own decisions . . . it would not be held against an Owner that he didn't report defects". My conclusion is that vis-à-vis his Classification Society there is an unwritten duty on an Owner to inform the Classification Surveyor of any serious defect which affects a class item, but that in practice, when a classification surveyor comes on board, Owners do not go out of their way to point out defects which they have no intention of repairing."

We must ensure that we do not have conditions in insurance policies which fail to recognise the pragmatic practicalities of ship operations; to ignore this rule is to enter a veritable minefield. This reporting requirement is extremely wide and strictly speaking would require every bump, scrape and minor incident to be reported, on the ground that the Classification Society might make it the subject of a recommendation.

Clause 4.4

There are no points of difficulty in the construction of this wording, which simply requires the Assured to provide the necessary authorisation should Underwriters wish to examine the Classification Society's records: a very useful facility on occasions.

Clause 5 Termination has been extended to include any of the Classification Society's periodic surveys becoming overdue, without an extension having been agreed, as one of the circumstances which will automatically terminate the insurance.

Clause 6 Perils has been subject to some tinkering and re-numbering but the most important change and the one which has met with the most resistance from shipowners is the extension of the due diligence proviso to include superintendents or onshore management. I am noticing an increasing and worrying trend in the attitude of certain underwriters in that where there is an accident they appear to be adopting the attitude that it should not have occurred and the fact that it has must be prima facie evidence that the shipowners' management was at fault and they should not be liable. This ignores the facts of life which are that most accidents, when investigated in depth, prove to have been the result of a catalogue of human failings, breakdowns in communication etc., etc., which would not have occurred in a perfect world. However, underwriters would be well advised to remember that in a perfect world there would be no need for insurance.

In an earlier published draft, this clause was worded to place the onus upon the assured to show that due diligence had been exercised. Fortunately this was strangled at birth. I know that Julian will be giving a detailed commentary on the drafting process which led to the final wording and he is far better qualified than me to comment on the legal interpretation of the words adopted. However, the extension of the due diligence proviso to include superintendents and onshore management does have important practical implications for those engaged in the claims process. Who, for example, is to instigate an investigation into whether due diligence has been exercised? Is it to be The Salvage Association surveyor at the time of the survey or will it become part of the Average Adjusters' responsibilities. Let

me give as an example, the case of extensive damage to the vessel's main engine which is discovered during a routine Classification Society survey and is attributed to operation over a considerable period with poor quality lubricating oil. The extent of the investigation which could be instigated is almost limitless and could include, inter alia, the following:

1) Copies of all reports covering visits to the vessel by Owners' superintendents during the relevant period.

2) All lub oil analyses during the relevant period.

3) Details of when such analyses were sent to the Owners' office.

4) Information as to who monitored the analyses in the Owners' office.

5) Details as to the procedures in place to enable the onshore management to monitor lub oil analyses, lub oil supplies, performance of the main engine and so on ad nauseam.

It would also need to be remembered that we could be dealing here with a gross claim of say US$ 500,000 which, after application of the policy deductible and machinery damage additional deductible, might result in a potential net claim of say US$ 250,000. Still a relatively large claim, but if one really went to town on the above-mentioned exercise a good proportion of this figure could easily be spent in expenses of the claim investigation. As Chairman of the London Market's Marine Claims Committee, which has representatives of most of the main players in the London marine insurance market, I raised this question at last month's meeting. The Salvage Association advised that at the time of survey their surveyors

frequently do not know the terms of the insurance and The Salvage Association remain firmly of the view, as I do for that matter, that this is how it should remain, as it is not their surveyor's role to become involved in insurance related questions. The Salvage Association have therefore simply advised their surveyors of the change in the Institute Time Clauses but to date have not given any specific instructions in this regard. It really is going to be a question of waiting to see whether in practice underwriters are going to use the extended due diligence proviso as a defence to claims. I fear that in practice the experience may be extremely mixed and the uncertainty generated is not going to assist the claims process.

The increased number of situations in which the underwriters may be able to deny coverage under the new clauses will be of concern not only to shipowners but also to mortgagees and serious consideration will have to be given as to the effect on mortgagees' interest insurances.

Hull underwriters have become firmer in their resolve to see that as property insurers they do not pay for pollution liabilities and they have taken the opportunity of this revision to tighten up the wording of the Collision Liability (Clause 8) General Average and Salvage (Clause 10) and Sue and Labour (Clause 11).

Notice of Claim and Tenders (Clause 13).

The obligation to notify underwriters of a potential claim now arises at the time the Assured, Owners or Managers become or should have become aware of the loss or damage giving rise to the claim. In the words of one of the underwriters who was a member of the working party "If a shipowner is not aware of a claim twelve months after the event, I would question

what kind of operator it is". This clause introduces a new subjective test i.e. at what point should the Assured, Owners or Managers have realised that there was loss or damage?

Failure to give notice within 12 months of that date will discharge underwriters from liability for the loss or damage in respect of which timely notice was not given. The practical effect of this new provision is that, in order to avoid the possibility of late notification, notice may need to be given of any incident, however trivial it may seem at the time, on the basis that it might eventually give rise to a claim.

The requirement to give notice to the local Lloyd's Agent, if the vessel is abroad, no longer applies.

Returns for lay-up and Cancellation (Clause 23)

As previously, the clause makes provision for a return of premium when vessels are laid up either under or not under repair. A new sub clause has been added to exclude from the term 'under repair' periods when work is undertaken in respect of wear and tear or to comply with the rules of the vessel's Classification Society. The concession previously given by underwriters which enabled vessels to obtain a partial return whenever the vessel was at an approved port or area but spent part of the time in a non-approved area has been removed.

The future.

Stephen Redmond, current Chairman of the Joint Hull Committee, in refuting allegations about the alleged lack of consultation during the drafting process, made the point that at the end of the day these are underwriters' clauses.

Trevor Hart who is a leading Lloyd's Underwriter and who was a member of the I.T.C. working party "believes the good owner will have nothing at all to fear from the changes we are promulgating".

As to whether Trevor Hart's prognosis proves to be correct will depend in my opinion upon how his claims practitioners construe the new provisions in practice. If they take a hard line I think that we could well be looking at a Lawyers' paradise.

On that note I will close. Thank you for your attention Ladies and Gentlemen.